MEMORANDUM

Date: August 20, 2020

To: The Ohio Manufacturers' Association

From: John Seryak, PE, and Peter Worley (RunnerStone, LLC)

RE: H.B. 6 Decoupling Provision - $355 Million for FirstEnergy through 2024, Possibly Millions More

Amended Substitute House Bill No. 6 (H.B. 6) was signed into Ohio law in 2019. H.B. 6 significantly reworks Ohio's electricity policy in a way that substantially affects manufacturers. H.B. 6 is again open for debate and examination. Governor DeWine has called for H.B. 6 to be repealed and replaced, saying that a $61 million bribery and corruption scheme used to pass the bill has "forever tainted the bill and now the law itself."[1]

H.B. 6 has well-documented provisions that affect Ohio's nuclear power plants, coal power plants, select solar power plants, and energy efficiency requirements. Less well documented, let alone understood, is a confusing decoupling provision in the bill. This provision is written opaquely even for an industry professional, and its meaning is almost certainly incomprehensible to the public. Fortunately, FirstEnergy's CEO put the effect of the provision in plain language for its investors:

> "essentially it takes about one-third of our company and I think makes it somewhat recession-proof"[2]

As a result of this decoupling provision, FirstEnergy could collect about $355 million in unearned revenue through 2024. Ratepayers will incur higher electricity costs with no associated benefits. Moreover, a unilateral ruling from the PUCO could extend FirstEnergy's decoupling at the utility's discretion. This could, for example, cost FirstEnergy customers an additional $400 million if extended from 2025 through 2030.

Decoupling via H.B. 6

H.B. 6 enacted decoupling to specifically benefit FirstEnergy, not to benefit ratepayers or achieve other state policy goals. The decoupling provision is complicated electric policy:

> "For an electric distribution utility that applies for a decoupling mechanism under this section, the base distribution rates for residential and commercial customers shall be decoupled to the base distribution revenue and revenue resulting from implementation of section 4928.66 of the Revised Code, excluding program costs and shared savings, and

[1] https://www.dispatch.com/news/20200723/gov-mike-dewine-calls-for-quick-repeal-and-replacement-of-hb-6

[2] https://www.utilitydive.com/news/firstenergy-nears-proposal-to-decouple-ohio-utility-revenues-electricity-c/566610/

> recovered pursuant to an approved electric security plan under section 4928.143 of the Revised Code, as of the twelve-month period ending on December 31, 2018."[3]

FirstEnergy CEO Chuck Jones has referenced customer energy efficiency to justify this decoupling provision, saying it "allows us to continue to promote energy efficiency with our customers so that they can get the benefit of that without impacting our base revenues."[4] However, this is a misleading statement. H.B. 6 ended the requirement for FirstEnergy – and Ohio's other investor-owned distribution utilities – to achieve energy efficiency savings as of December 31, 2020. And, FirstEnergy proactively suspended the bulk of its energy-efficiency programs early, in January 2020. FirstEnergy also has taken no steps to offer non-mandated efficiency programs in 2021. Thus, it's clear that FirstEnergy is not using the H.B. 6 decoupling provision to further promote customer energy efficiency.

The H.B. 6 decoupling provision allowed FirstEnergy to tie its annual base distribution revenue to 2018 collections. Notably, 2018 was *not* a representative year of distribution electricity sales for FirstEnergy; it is the highest electricity sales year in a 10-year span. H.B. 6 decoupling did not include a revenue cap on the base year amount. It did not include any adjustments to total base distribution revenue for weather or economic downturn.

H.B. 6 did, however, include some curious eligibility constraints to the decoupling provision that apply to the efficiency program lost revenue recovery, requiring that this revenue recovery be "recovered pursuant to an approved electric security plan under section 4928.143 of the Revised Code, as of the twelve-month period ending on December 31, 2018." As it happens, only FirstEnergy has implemented a decoupling mechanism and is receiving decoupling revenues based on the H.B. 6 provision. AEP Ohio, Duke, and DP&L have not successfully implemented an H.B. 6 decoupling mechanism (although AEP Ohio has tried).

These decoupling costs will be charged to the residential and General Service Secondary rate classes. General Service Secondary includes many manufacturers.

Impacts to Ratepayers from Decoupled Base Distribution

Based on its 2018 base revenue, , FirstEnergy can continue to collect approximately $978 million for base distribution revenue for each year through 2024 as a result of the H.B. 6 decoupling mechanism, no matter its electricity sales (demand), its actual costs, or Ohio's economic environment. FirstEnergy submitted supporting paperwork at the PUCO documenting these base distribution costs for 2018. We total these costs in Table 1.

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[3] Ohio Revised Code, Section 4928.471 (B)

[4] https://www.utilitydive.com/news/firstenergy-nears-proposal-to-decouple-ohio-utility-revenues-electricity-c/566610/

	Residential		General Service Secondary		Total (with tax)
Ohio Edison	$	353,312,299	$	122,247,953	$ 476,799,932
CEI	$	200,556,856	$	143,676,179	$ 345,130,374
Toledo Edison	$	106,504,639	$	48,763,226	$ 155,672,614
Total	**$**	**660,373,794**	**$**	**314,687,358**	**$ 977,602,920**

Table 1. Summary of FirstEnergy 2018 Base Distribution Cost Recovery[5]

Decoupling essentially allows the utility to recover the difference between its 2018 base distribution revenue (approximately $978 million) and what is collected in a future calendar year through a rider, guaranteeing it a stable revenue of approximately $978 million. FirstEnergy duplicitously named its decoupling rider "Rider CSR" which stands for "Conservation Support Rider."

FirstEnergy expects 2018 to be the highest distribution energy delivery year in a decade, which is shown in Table 2. For example, according to FirstEnergy's filing, its 2019 base distribution costs were $956 million, which is approximately $22 million less than in 2018. FirstEnergy will be able to collect the difference (approximately $22 million) in 2020 because of the H.B. 6 decoupling provision. While the estimates in Table 2 will not perfectly correlate to distribution revenue, we can use it to gauge what future base distribution revenue differences might look like, which are also illustrated. This allows a reasonable estimate of the total cost of the H.B. 6 base distribution decoupling mechanism. H.B. 6's decoupling provision may apply through 2024, when FirstEnergy's current distribution rate freeze ends and FirstEnergy is authorized to file its next distribution rate case, which would reset its base distribution revenue requirements. However, note that due to a recent PUCO decision, FirstEnergy is no longer required to file its next base distribution rate case in 2024;[6] therefore, the H.B. 6 decoupling mechanism, if favorable to FirstEnergy, could last in perpetuity.

5 In the Matter of Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company For Approval of a Decoupling Mechanism, Case No. 19-2080, http://dis.puc.state.oh.us/TiffToPDf/A1001001A19K21B65741G03457.pdf

6 *In the Matter of the Application of Ohio Edison Company, the Cleveland Electric Illuminating Company, and the Toledo Edison Company for an extension of the Distribution Modernization Rider*, Case No. 19-361-EL-RDR, Entry at ¶ 17 (November 21, 2019)

Year	FirstEnergy Ohio Energy Deliveries	Energy Deliveries, Percent off Peak Year	Additional Base Distribution Revenue Resulting from Decoupling
2015	62,351,282	1.6%	
2016	62,966,774	0.7%	
2017	60,973,484	3.8%	
2018	63,392,963	0.0%	
2019	61,094,619	3.6%	$ 21,916,065
2020	61,263,393	3.4%	$ *20,306,705*
2021	61,725,825	2.6%	$ *15,897,144*
2022	62,030,096	2.1%	$ *12,995,740*
2023	62,110,144	2.0%	$ *12,232,435*
2024	62,324,025	1.7%	$ *10,192,954*
Average			**$ 15,590,174**
Total			**$ 93,541,043**

Table 2. FirstEnergy's Recorded and Expected Energy Deliveries in Ohio, 2015-2024[7,8]

It is important to note that base distribution costs were already established for FirstEnergy based on its own forecast of electricity sales, and system costs, prior to the establishment of the decoupling provision in H.B. 6. In other words, FirstEnergy was already made whole through its base distribution costs and had agreed in a rate case at the PUCO to its distribution rates. A good base distribution rate design should essentially average revenue out over time to match utility costs. Meaning, in some years the utility should collect somewhat higher distribution revenue, and others somewhat lower, due to changes in weather, business activity, etc. By tying revenue collection to its peak distribution revenue year – 2018 – FirstEnergy is thereby setting itself up to over-collect on base distribution revenue for years to come.

FirstEnergy is thus using the decoupling provision for the purpose of creating unearned bottom-line profit to the company.

This is the first way FirstEnergy earns revenue from the H.B. 6 decoupling.

Impact to Ratepayers from Decoupled Energy Efficiency Program Revenue

H.B. 6's decoupling provision applies to more than just base distribution costs. It also applies to energy efficiency program implementation revenue incurred in 2018. The electric distribution companies collect revenue for energy efficiency program implementation in three ways: the actual program costs (administration, staffing, rebates), profit (called "shared savings" in regulatory proceedings), and lost distribution revenue. H.B. 6 allows a utility implementing a decoupling

[7] 2020 Electric Long-Term Forecast Report to the Public Utilities Commission of Ohio, Case No. 20-657, http://dis.puc.state.oh.us/TiffToPDf/A1001001A20D15B63247C02407.pdf

[8] We estimated future year costs of base distribution decoupling by prorating 2019's cost. For example, the cost of decoupling for the 2020 year was calculated as $21,916,065 x 3.4% / 3.6% = $20,306,705.

mechanism to also collect revenue associated with implementing R.C. 4928.66 "excluding program costs and shared savings".[9] Thus, H.B. 6 allows FirstEnergy to continue to collect, for years to come, the lost revenue associated with implementing energy-efficiency programs that it collected in 2018. In fact, FirstEnergy is doing just this, by including its 2018 energy efficiency program lost distribution revenue cost as part of its decoupling filing at the PUCO. As it happens, FirstEnergy collected nearly $66.5 million for energy efficiency program lost revenue in 2018, as shown in Table 3.

	Residential	Commercial	Total (with tax)
Ohio Edison	$ 24,780,874	$ 4,295,483	$ 29,152,153
CEI	$ 19,616,798	$ 5,129,473	$ 24,810,779
Toledo Edison	$ 10,914,024	$ 1,585,707	$ 12,532,315
Total	**$ 55,311,696**	**$ 11,010,663**	**$ 66,495,247**

Table 3. Summary of FirstEnergy 2018 Lost Revenue Cost Recovery[10]

H.B. 6 effectively allows FirstEnergy to calculate the difference of the $66,495,247 collected in 2018, and the amount of lost revenue recovered in FirstEnergy's energy-efficiency rider (called Rider DSE2) in a given year and recover this difference in Rider CSR. In 2019, the difference will be a credit that is applied through Rider CSR to customers in 2020. However, at the end of 2020, the efficiency programs will officially end, and FirstEnergy's Rider DSE2 will cease. As a result, for the 2021 revenue differential the full $66.5 million difference would flow into Rider CSR. Table 4 shows how the H.B. 6's decoupling provision provides an additional $261 million in revenue to FirstEnergy through 2024 from "the implementation of section 4928.66".

Year	(A) 2018 Lost Revenue Recovery	(B) Lost Distribution Revenue Recovered in EE Rider (Rider DSE2)	(A - B) Difference in Lost Distribution Revenue Collected in Decoupling Rider (Rider CSR)
2019	$ 66,495,247	$ 71,290,905	$ *(4,795,659)*
2020	$ 66,495,247	$ *66,495,247*	$ -
2021	$ 66,495,247	$ -	$ 66,495,247
2022	$ 66,495,247	$ -	$ 66,495,247
2023	$ 66,495,247	$ -	$ 66,495,247
2024	$ 66,495,247	$ -	$ 66,495,247
Total			**$ 261,185,328**

Table 4. Location and Amount of Lost Revenue Cost Recovery[11]

[9] . The provision states that base distribution shall be decoupled to base distribution revenue "…*and* revenue resulting from implementation of section 4928.66 of the Revised Code, excluding program costs and shared savings… as of the twelve-month period ending on December 31, 2018." Section 4928.66 of the Revised Code is the section of Ohio law which enabled the electric distribution utilities to operate energy-efficiency programs.

[10] In the Matter of Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company For Approval of a Decoupling Mechanism, Case No. 19-2080, http://dis.puc.state.oh.us/TiffToPDf/A1001001A19K21B65741G03457.pdf

[11] We estimated FirstEnergy's 2020 lost revenue recovery in the DSE2 rider as exactly equal to the 2018 amount for

Impacts to Ratepayers - Summary

The total cost of FirstEnergy's decoupling, accounting for base distribution and energy efficiency program implementation lost distribution revenue, is thus about $355 million in total through 2024.

$93,541,043 (Base Distribution Decoupling through 2024) + $261,185,328 ("implementation of 4928.66" through 2024 costs) = $354,726,371

There is additional risk to ratepayers. As stated by FirstEnergy's CEO, decoupling makes FirstEnergy "somewhat recession proof." The estimated $355 million in additional revenue does not account for additional costs of decoupling should FirstEnergy's electricity sales in Ohio decline. While the severity of an economic downturn may have been in doubt when H.B. 6 was passed, COVID-19 has made this scenario a near certainty. As a result, decoupling costs during the pandemic could increase as utility sales decrease.

PUCO Implementation of H.B. 6 – Risk of Millions of Dollars More in Customer Charges Benefitting FirstEnergy

Unfortunately, the tens of millions of dollars per year in decoupling that are collected from customers for FirstEnergy may not end in 2024. H.B. 6's decoupling provision provides an expiration event for the decoupling,

> "The decoupling mechanism shall remain in effect until the next time that the electric distribution utility applies for and the commission approves base distribution rates for the utility under section 4909.19 of the Revised Code."[12]

At the time of H.B. 6's passage, FirstEnergy was expected to file a distribution rate case in 2024, for implementation in approximately 2025. However, in an unrelated case ruling in November 2019 the PUCO unilaterally created the possibility for FirstEnergy to extend its distribution rates – and thus also its decoupling – in perpetuity. Specifically, the PUCO ordered that,

> "… we find that it is no longer necessary or appropriate for the Companies to be required to file a new distribution rate case at the conclusion of the Companies' current ESP."[13]

Importantly, the PUCO's unilateral ruling did not provide the typical evidentiary hearing to offer supporting or opposing evidence from customers and other stakeholders. While FirstEnergy's Long-

illustrative purposes. The actual lost revenue recovery through DSE2 in 2020 could be lower than normal due to the impact of COVID-19. If so, 2021 would have additional costs in Rider CSR due to a true-up. Thus, the estimates of total cost of lost revenue decoupling we present here are conservative.

Note also that the cost differential from 2019 will be collected in calendar year 2020 as a true-up.

[12] Section 4928.471 (C) of the Ohio Revised Code

[13] In the Matter of Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company For Approval of a Decoupling Mechanism, Case No. 19-2080, http://dis.puc.state.oh.us/TiffToPDf/A1001001A19K21B65741G03457.pdf

Term Load Forecast shows higher electricity demand starting in 2025, this is far from certain. And, any decoupling credit over-collection in base distribution revenue in future years would likely be offset by the continuing $66.5 million revenue potential from the lost distribution revenue resulting from "implementation of 4928.66", which would amount to $398 million from 2025 through 2030.