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MEMORANDUM

TO: Ohio Manufacturers' Association Energy Group

FROM: Kim Bojko, Carpenter Lipps & Leland LLP

DATE: August 12, 2020

SUBJECT: Impact of 2019 FirstEnergy SEET Amendment

In the as-passed version of HB 166,¹ which established the State of Ohio's fiscal year 2020-2021 operating budget, FirstEnergy was successful in including a provision that would allow it to retain "significantly excessive profits" if the three Ohio operating utilities collectively did not significantly excessively earn, instead of requiring customer refunds if one or more of the utilities over earned.

Prior to enactment of the new law, the PUCO applied the significantly excessive earnings test (SEET) on a utility-by-utility basis to annually evaluate whether individual utilities have over earned from their electric security plans (ESPs) pursuant to R.C. 4928.143. If it is determined that a utility has significantly excessive earnings under the SEET, the utility must refund the excess earnings to its customers.

HB 166 amended the PUCO governing statute (R.C. 4928.143) to require the PUCO to consider the total earned return on equity (ROE) of all affiliated distribution utilities operating under a joint ESP when administering the SEET. Under the HB 166 amendment, a utility that is over-earning is able to offset that amount by the earnings of an affiliated distribution utility that is not as profitable. For example, FirstEnergy will be able to shield one of its over-earning distribution utilities by including the ROE of its less profitable affiliated distribution utility in the SEET calculation. As a result, FirstEnergy is able to retain significantly excessive profits that it otherwise would be required to refund to customers.

Learn more about the SEET provision by [reading this memo](#) from the OMA's energy consultant RunnerStone.

¹ The new law became effective October 17, 2019.



MEMORANDUM

Date: August 20, 2020
To: The Ohio Manufacturers' Association
From: John Seryak, PE, and Peter Worley (RunnerStone, LLC)
RE: FirstEnergy's 2019 "Significantly Excessive Profits" Amendment – Preventing Potentially \$50 Million in Customer Refunds from 2017-2019

A 2019 Ohio law change, House Bill (HB) 166, created favorable new conditions for FirstEnergy to retain "significantly excessive profits" and avoid customer refunds. A separate legal analysis has been provided by OMA energy counsel Kim Bojko on the issue¹. As stated in that memo, the law change allows FirstEnergy to "shield one of its over earning distribution utilities" from customer refunds.

How much will this shielding cost manufacturers and other customers? Unfortunately, the law also is being used to obfuscate the financial earnings of FirstEnergy's distribution utilities, and we do not yet know the exact current or future cost of this new provision. However, in this memo we show how this law change could prevent tens of millions of dollars in customer refunds, and that this could be exacerbated by the so-called "decoupling mechanism" included in HB 6.

The Significant Excessive Earnings Test (SEET) Law Change

FirstEnergy owns three electric distribution operating companies in Ohio: Ohio Edison, Cleveland Electric Illuminating, and Toledo Edison. It is important to remember that these are three separate public utilities regulated by the Public Utilities Commission of Ohio (PUCO), albeit owned by the same parent corporation. Consider in contrast that AEP formerly merged its two distribution operating companies, Columbus Southern Power and Ohio Power, into one regulated public utility, AEP Ohio. FirstEnergy has not taken this corporate merger step with its Ohio distribution companies. There are important legal, tax, and other financial implications of this difference. When evaluating the policy and financial impacts of the SEET law change, manufacturers and policymakers should consider that FirstEnergy has again modified Ohio law to receive a unique benefit that its peers do not. The SEET law change is part of a clear trend: FirstEnergy regularly seeks to modify Ohio's laws for its own benefit to avoid prior laws enacted to protect customers.

Cost Impact of Significant Excessive Earnings Test (SEET) Law Change

Distribution public utilities in Ohio do not earn a profit in competitive markets. Instead, they receive a government regulated profit via a return on equity (ROE) that is administered by state regulators

¹ Impact of 2019 FirstEnergy SEET Amendment, Memorandum to the Ohio Manufacturers' Association Energy Group, <http://www.ohiomfg.com/wp-content/uploads/OMA-Memo-2019-FE-SEET-Amendment-CLL-FINAL-August-2020.pdf>



and paid for by customers. In Ohio, the PUCO determines the ROE that the regulated public utilities receive. Ohio law allows regulated electric distribution public utilities operating under an electric security plan to retain profit earnings, even if it is “excessive”. It is not until the profit is deemed to be “significantly excessive” that the PUCO can require the electric utility to issue a refund to customers. While typical electric distribution utility ROEs are around 9.7%,² the PUCO determined that 200 basis points above the mean of the comparable utility risk group recognized by the PUCO should establish a safe harbor ROE.³ Utilizing this standard, in a recent PUCO proceeding, the PUCO established FirstEnergy’s SEET threshold ROE at 17.22%⁴. Given the high safe harbor calculation, the SEET threshold is rarely triggered in Ohio. For example, Table 1 shows the 2017 common equity, earnings, and ROE for each of FirstEnergy’s distribution corporations.

Corporation	Common Equity	Earnings	ROE
Ohio Edison	\$ 1,033,641,759	\$ 126,320,235	12.2%
Cleveland Electric Illuminating	\$ 1,463,357,709	\$ 58,142,960	4.0%
Toledo Edison	\$ 529,304,805	\$ 34,110,490	6.4%
FirstEnergy Owned Corporation Total	\$ 3,026,304,273	\$ 218,573,685	7.2%

Table 1. 2017 Common Equity, Earnings, ROE for FirstEnergy Owned Ohio Electric Distribution Utilities⁵

At first blush, it appears that all of FirstEnergy’s separate utilities are well under the SEET threshold of 17.22%. However, if an appeal of the PUCO’s decision is successful, an above-market charge that FirstEnergy’s utilities received in 2017 called the distribution modernization rider (DMR) will be added to the earnings shown in Table 1. If these DMR revenues are included, Ohio Edison’s earnings are estimated to result in a 17.39% ROE, which is above the SEET threshold, and would thus trigger a refund of about \$1.8 million to its ratepayers⁶.

The DMR earnings were not actually spent on distribution modernization. Instead, it was a straight cash infusion to these utilities. The DMR was recently ruled an unlawful charge by the Supreme Court of Ohio. Unfortunately, Ohio law also prevents customer refunds of unlawful charges. As a result, customers only hope of receiving any of their money back is through the refunds allowed by

² https://www.spglobal.com/marketintelligence/en/news-insights/trending/aln1bkurulx_2hqjihmxeg

³ *In re Significantly Excessive Earnings Test*, Case No. 09-786-EL-UNC, Finding and Order (June 30, 2010).

⁴ *In the Matter of the Determination of the Existence of Significantly Excessive Earnings for 2017 Under the Electric Security Plans of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company*, Case No. 18-857-EL-UNC, Opinion and Order at ¶ 29 (March 20, 2019).

⁵ *In the Matter of the Determination of the Existence of Significantly Excessive Earnings for 2017 Under the Electric Security Plans of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company*, Case No. 18-857-EL-UNC, Direct Testimony of Jason S. Petrik at 8-9 (May 15, 2018).

⁶ $(\$126,320,235 \text{ earnings} + \$58,479,765 \text{ DMR earnings}) - (0.1722 \text{ SEET} \times \$1,062,702,154 \text{ modified common equity}) = \$1,841,277 \text{ refund}$

See testimony by the Office of the Ohio Consumers’ Counsel

<http://dis.puc.state.oh.us/TiffToPDF/A1001001A18J16B54335H02196.pdf> (Page 14 of pdf)



SEET. As noted above, the question of whether the DMR should be considered as earnings is currently before the Supreme Court of Ohio.⁷

The stakes increase when evaluating the FirstEnergy companies' earnings in 2018, shown in Table 2. Ohio Edison's earnings and ROE increased significantly in 2018. Thus, the DMR collections by Ohio Edison in 2018 of about \$58.5 million push Ohio Edison further across the SEET threshold than in 2017. Ohio Edison would need to be required to refund \$18.1 million to its customers for 2018 if the DMR is determined to be earnings for SEET calculation purposes.⁸

Corporation	Common Equity	Earnings	ROE
Ohio Edison	\$ 1,066,489,590	\$ 148,242,053	13.9%
Cleveland Electric Illuminating	\$ 1,486,548,741	\$ 86,219,827	5.8%
Toledo Edison	\$ 477,684,058	\$ 32,960,200	6.9%
FirstEnergy Owned Corporation Total	\$ 3,038,887,273	\$ 267,422,080	8.8%

Table 2. 2018 Common Equity, Earnings, ROE for FirstEnergy Owned Ohio Electric Distribution Utilities⁹

The stakes in 2019 increase yet again. Table 3 shows FirstEnergy's earning information made available by FirstEnergy in its 2019 SEET application on an aggregate basis. As one can see, we no longer can evaluate Ohio Edison's earnings. This reduction in transparency is a direct result of the SEET law change. FirstEnergy has used the SEET law change to avoid customer refunds and also to obfuscate what Ohio Edison's earnings are, so that interested parties, regulators, and policymakers cannot determine how much excessive profit they are keeping. However, we can see that collective earnings have increased significantly again, as has the aggregate ROE.

Corporation	Common Equity	Earnings	ROE
FirstEnergy Owned Corporation Total	\$ 2,805,618,220	\$ 305,812,386	10.9%

Table 3. 2019 Aggregate Common Equity, Earnings, ROE for FirstEnergy Owned Ohio Electric Distribution Utilities¹⁰

Absent transparent data on what the FirstEnergy distribution utilities separate earnings were, we will have to make an educated estimate of what customer refunds should be in 2019. Table 4 shows this educated estimate, assuming the increase in earnings is evenly distributed across the three corporate entities. In this scenario, Ohio Edison has further increased earnings and ROE compared to previous years. Thus, the DMR collections by Ohio Edison in 2019 push them further across the

⁷ Ohio Supreme Court Case 2019-0961 <http://www.supremecourt.ohio.gov/Clerk/ecms/#/caseinfo/2019/0961>

⁸ (\$148,242,053 earnings + \$58,518,353 DMR earnings) – (0.1722 SEET x \$1,095,549,985 modified common equity) = \$18,106,699 refund; We adjusted common equity to account for DMR revenue per method in OCC's testimony referenced earlier

⁹ *In the Matter of the Determination of the Existence of Significantly Excessive Earnings for 2018 Under the Electric Security Plan of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company*, Case No. 19-1338-EL-UNC, Direct Testimony of Tracy M. Ashton at 7 (July 15, 2019).

¹⁰ *In the Matter of the Determination of the Existence of Significantly Excessive Earnings for 2019 Under the Electric Security Plan of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company*. Direct Testimony of Tracy M. Ashton at 7 (May 15, 2020).



SEET threshold. Its DMR collections and in 2019 would likely do this, amounting to \$29.2 million for Ohio Edison before the Supreme Court of Ohio halted its unlawful collection. A decoupling provision included in H.B. 6 will result in an additional \$4.7 million in distribution revenue for Ohio Edison from 2019¹¹. Assuming a comparable SEET threshold is established to that established in the 2017 case, this would result in \$30 million in customer refunds, now lost to customers because of H.B. 166.¹²

Corporation	Common Equity	Earnings	ROE
Ohio Edison	\$ 1,066,489,590	\$ 169,523,234	15.9%
Cleveland Electric Illuminating	\$ 1,486,548,741	\$ 98,597,285	6.6%
Toledo Edison	\$ 477,684,058	\$ 37,691,867	7.9%
FirstEnergy Owned Corporation Total	\$ 2,805,618,220	\$ 305,812,386	10.9%

Table 4. Estimates - 2019 Common Equity, Earnings, ROE for FirstEnergy Owned Ohio Electric Distribution Utilities

Therefore, considering the above assumptions, the total refund that will be lost to Ohio Edison customers from 2017-2019 due to the enactment of the HB 166 change in law is about \$50 million.

Year	Potential Ohio Edison Refund (Millions)
2017	\$ 1.8
2018	\$ 18.1
2019	\$ 30.0
Total	\$ 49.9

Table 5. Potential Customer Refunds Lost for Ohio Edison Customers

There is risk of additional losses of customer refunds under the new SEET law. The decoupling provision of H.B. 6 will result in higher than normal base distribution earnings for FirstEnergy’s distribution utilities for years to come. Additionally, the common equity of the distribution utilities could decrease in future years. New costs and riders, such as grid modernization riders, could increase earnings for the utilities. These are all ways in which FirstEnergy’s distribution utilities could achieve significantly excessive earnings and exceed a SEET threshold, and would otherwise be required to issue customer refunds were it not for the recent law change in HB 166.

¹¹ 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>. It is not clear how the decoupling revenue collection for prior years will be handled with earnings accounting, if it will be attributed to the 2019 year in which it is based, or the 2020 year in which it is collected. Here we assume that decoupling revenue for 2019 will be accounted for the 2019 fiscal year.

¹² (\$169,523,234 earnings + \$29,200,000 DMR earnings + \$4,704,328 decoupling earnings) – (0.1722 SEET x \$1,004,229,203 modified common equity) = \$30,499,293 refund; We adjusted common equity to account for DMR revenue per method in OCC’s testimony referenced earlier, and also new decoupling revenue



SEET Law Change – Targeting, Timing, and Transparency Issues

Manufacturers and policymakers should carefully consider several other controversial issues with the SEET law change. First, this law change was specifically targeted to benefit FirstEnergy, at the expense of its customers. No other utility benefits from this law change. There is no policy goal advanced by this law change. The SEET law change does not improve electric service, does not lower customers' costs, does not save or create jobs, does not improve reliability, and does not reduce carbon emissions. The SEET law change allows FirstEnergy to keep significantly excessive earnings for their own shareholders.

Second, transparency issues abound with the SEET law change. This law change creates significant costs for customers, but FirstEnergy is not providing any supporting, transparent reasoning for why it needs this money, or how much money it stands to gain. Moreover, it is now considerably more difficult for FirstEnergy to be held accountable at the PUCO, as its three electric distribution operating utilities, separate corporate entities, are not disclosing their individual earnings.

Third, the timing of the SEET law change is conspicuous. The SEET law change was included in HB 166, which was the budget bill for Ohio's 2020-2021 fiscal year. This bill passed in the summer of 2019, approximately the same time as the controversial HB 6 was passed. It would seem that the SEET law change, being a utility-specific law change, would have been included in HB 6, which was a major rework of Ohio's electricity law, but, instead, it was included in the state budget bill. If HB 6 had included the SEET law change for FirstEnergy's benefit, HB 6 would have been demonstrated to be even more costly to customers.

Lastly, the SEET threshold determined by the PUCO of 17.22% is concerningly high. Our refund estimates use the PUCO selected SEET value. In contrast, the Office of the Ohio's Consumers' Council provides arguments for a threshold of 14.91%.¹³ Using the OCC suggested SEET threshold would have resulted in customer refunds of \$135 million.

¹³ <http://dis.puc.state.oh.us/TiffToPdf/A1001001A18J16B54335H02196.pdf> (Page 7 of pdf)