OHIO LEGISLATIVE SERVICE COMMISSION

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Office of Research and Drafting

Legislative Budget Office

H.B. 740
133rd General Assembly

Fiscal Note & Local Impact Statement

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Version: As Introduced

Primary Sponsors: Reps. Skindell and Denson

Local Impact Statement Procedure Required: No

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Highlights

- The bill requires that the Public Utilities Commission of Ohio (PUCO) separately evaluate affiliated electric distribution utilities when determining whether the utility earned significantly excessive profits.
- The bill may yield utility refunds for customers, including state agencies and political subdivisions, served by the Ohio Edison Company, but the outcome depends on numerous other circumstances that are not influenced by the bill. Two utilities affiliated with Ohio Edison would also be affected by the bill.

Detailed Analysis

The bill repeals a provision enacted in H.B. 166 of the 133rd General Assembly that affected electric distribution utilities (EDUs) and how the Public Utilities Commission of Ohio (PUCO) administers the significantly excessive earnings test (SEET). H.B. 740 restores the previous law that requires 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 singular 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 electric security plan (ESP) – Cleveland Electric Illuminating Company, Ohio Edison Company, and Toledo Edison Company.

SEET methodology

R.C. 4928.143(F) 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 R.C. 4928.143(F), 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.[1]

> 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

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

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 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.[2]

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