IN THE SUPREME COURT OF OHIO

OHIO ENVIRONMENTAL COUNCIL, ENVIRONMENTAL DEFENSE FUND, and ENVIRONMENTAL LAW AND POLICY CENTER, Appellants, v. THE PUBLIC UTILITIES COMMISSION OF OHIO, Appellee.	))))))))))))))	CASE NOS. 2017-1444, 2017-1664 Appeal from the Public Utilities Commission of Ohio *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Provide for a Standard Service Offer in the Form of an Electric Security Plan.* Case No. 14-1297-EL-SSO

MERITS BRIEF FOR APPELLANTS OHIO ENVIRONMENTAL COUNCIL, ENVIRONMENTAL DEFENSE FUND, AND ENVIRONMENTAL LAW AND POLICY CENTER

RACHEL BLOOMEKATZ (0091376)
Counsel of Record
GUPTA WESSLER PLLC
1148 Neil Avenue,
Columbus, OH 43201
(202) 888-1741
(202) 888-7792 (fax)
rachel@guptawessler.com

JOHN FINNIGAN
ENVIRONMENTAL DEFENSE FUND
6795 Hidden Hills Drive
Cincinnati, Ohio 45230
(513) 226-9558
jfinnigan@edf.org

(Continued on the next page)

MICHAEL DEWINE (0009181)
Attorney General of Ohio
WILLIAM L. WRIGHT (0018010)
Section Chief
THOMAS W. MCNAMEE (0017352)
THOMAS G. LINDGREN (0039210)
STEVEN L. BEELER (0078076)
Assistant Attorneys General

PUBLIC UTILITIES COMMISSION OF OHIO
180 East Broad Street, 6th Floor
Columbus, OH 43215-3793
(614) 644-8698
(614) 644-8764 (fax)
william.wright@ohioattorneygeneral.gov
thomas.mcnamee@ohioattomeygeneral.gov
thomas.lindgren@ohioattomeygeneral.gov
steven.beeler@ohioattomeygeneral.gov

Counsel for Appellee Public Utilities Commission of Ohio

TRENT DOUGHERTY (0079817)
MIRANDA LEPPLA (0086351)
OHIO ENVIRONMENTAL COUNCIL
1145 Chesapeake Ave., Suite I
Columbus, OH 43212
(614) 487-7506
(614) 487-7510 (fax)
tdougherty@theoec.org
mleppla@theoec.org

MADELINE FLEISHER (0091862)
ENVIRONMENTAL LAW & POLICY CENTER
21 W. Broad St., 8th Floor
Columbus, OH 43215
(614) 569-3827
mfleisher@elpc.org

Counsel for Appellants, Ohio Environmental Council, Environmental Defense Fund, and Environmental Law & Policy Center

BRUCE WESTON (0016973)
MAUREEN R WILLIS (0020847)
Counsel of Record,
Senior Regulatory Counsel
WILLIAM MICHAEL (0070921)
Assistant Consumers' Counsel

OFFICE OF THE OHIO CONSUMERS' COUNSEL
65 East State Street, 7th Floor
Columbus, OH 43215-4213
(614) 466-9567
(614) 466 9475 (fax)
maureen.willis@occ.ohio.gov
william.michael@occ.ohio.gov

Attorneys for Appellant, Office of the Ohio Consumers' Counsel

JAMES F. LANG (0059668)
Counsel of Record
N. TREVOR ALEXANDER (0080713)
CALFEE, HALTER & GRISWOLD LLP
1405 East Sixth Street
Cleveland, OH 44114
(216) 622-8200
(216) 241-0816 (fax)
jlang@calfee.com
talexander@calfee.com

YVETTE MCGEE BROWN (0030642)
JONES DAY
325 John H. McConnell Blvd., Suite 600
Columbus, OH 43215-5017
(614) 281-3867
(614) 461-4198 (fax)
ymcgeebrown@jonesday.com

CARRIE M. DUNN-LUCCO (0076952)
FIRSTENERGY SERVICE COMPANY
76 King James Way
Akron, OH 44308
(330) 761-2352
(330) 384-3875 (fax)
cdunn@firstenergycorp.com

Attorneys for Movants to Intervene as Intervening Appellees, Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company

MICHAEL L KURTZ, ESQ. (0033350)
JODY KYLER COHN, ESQ. (0085402)
BOEHM, KURTZ & LOWRY
36 E. Seventh Street, Suite 1510
Cincinnati, OH 45202
(513) 421-2255
(513) 421-2255 (fax)
mkurtz@BKLlawfirm.com
jkylercohn@BKLlawfirm.com

Counsel for Movants to Intervene as Intervening Appellee, The Ohio Energy Group

GLENN S. KRASSEN (0007610)
Counsel of Record
BRICKER & ECKLER LLP
1001 Lakeside Avenue, Suite 1350
Cleveland, OH 44114
(216) 523-5405
(216) 523-7071 (fax)
gkrassen@bricker.com

DANE STINSON (0019101)
BRICKER & ECKLER LLP
1001 South Third Street
Columbus, OH 43215-4291
(614) 227-2300
(614) 22-2390 (fax)
dstinson@bricker.com

Counsel for Appellant, Northeast Ohio Public Energy Council

THOMAS R. HAYS (0054062)
Counsel of Record
COUNSEL FOR LUCAS COUNTY AND NOAC
8355 Island Lane
Maineville, Ohio 45039
(419) 410-7069

LESLIE KOVACIK (0070157)
Assistant Law Director
CITY OF TOLEDO
420 Madison Avenue
Toledo, OH 43604
(419) 245-1893
(419) 245-1090 (fax)
leslie.kovacik@toledo.oh.gov

JOHN BORELL (0016461)
Assistant Prosecutor
OFFICE OF THE LUCAS COUNTY PROSECUTOR
700 Adams Street, Suite 250
Toledo, OH 43604
(419) 213-2001
jaborell@co.lucas.oh.us

Attorneys for Appellants, NOAC and the individual NOAC Communities

KIMBERLY W. BOJKO (0069402)
CARPENTER LIPPS & LELAND LLP
280 North High Street, Suite 1300
Columbus, Ohio 43215
(614) 365-4100
(614) 365-9145 (fax)
bojko@carpenterlipps.com

Counsel for Appellant, The Ohio Manufacturers' Association Energy Group

MARK I. WALLACH (0010948)
Counsel of Record
THACKER ROBINSON ZINZ LPA
2330 One Cleveland Center
1375 E. 9th Street Cleveland,
OH 44114
(216) 456-3848
(216) 456-3878 (fax)
mwallach@trzlaw.com

SHANNON FISK (pro hac vice)
EARTHJUSTICE
1617 John F. Kennedy Blvd., Suite 1130
Philadelphia, PA 19103
(215) 717-4522
sfisk@earthjustice.org

Counsel for Appellant, Sierra Club

TABLE OF CONTENTS

Table of authorities iii

Glossary of terms and abbreviations viii

Introduction 1

Statutory background 3

1. For decades, Ohio employed a traditional model of utility regulation. 4
2. The Ohio Legislature deregulates the generation component of the electricity market. 5
3. The Ohio Legislature provides support for a growing free market for electricity generation. 7

Statement of the facts and case 9

1. The three FirstEnergy entities in this case. 9
2. Regulators reject FirstEnergy's initial efforts to prop up its struggling generation affiliate. 12
3. After rejecting FirstEnergy's proposal, the Commission proposes its own bailout—a distribution modernization rider. 13
4. The Commission approves Rider DMR in its Fifth Entry on Rehearing, rejecting challenges that it is unlawful and unreasonable. 14
5. The Commission reaffirms Rider DMR in its Eighth Entry on Rehearing. 18

Standard of review 18

Argument 19

<u>Proposition of Law 1</u>: R.C. 4928.143(B)(2)(h) does not permit distribution modernization riders that fail to require any grid modernization or other distribution investments. 19

A. The Commission exceeded its statutory authority in creating and approving Rider DMR under R.C. 4928.143(B)(2)(h) because it does not require any distribution investments, and hence does not "regard[] distribution service." 19

B. Rider DMR cannot be considered an "incentive" to modernize the grid. 24

C. Rider DMR cannot be approved under R.C. 4928.143(B)(2)(h) because it is not based on the utility's costs incurred in providing services, in violation of the statute and the Commission's own longstanding precedent. 25

Proposition of Law 2: Awarding a distribution utility a rider to compensate for debt accumulated by its poor performing market-based generation affiliate constitutes unlawful transition revenue or "any equivalent revenues" under R.C. 4928.38. 31

Proposition of Law 3: The Commission's approval of the modified DMR is unreasonable because, contrary to the Commission's established standards, it does not provide for safeguards to ensure that the revenues be used for grid modernization. 37

Proposition of Law 4: It is unreasonable and contravenes R.C. 4928.66(D) for the Commission to allow a utility to recover lost distribution revenues stemming from independent customer decisions that improve energy efficiency rather than any affirmative efficiency program sponsored by the companies. 41

Conclusion 46

Appendix	App. Page
Notice of appeal	1
Fifth entry on rehearing (Oct. 12, 2016)	10
Eighth entry on rehearing (Aug. 16, 2017)	202
Application for rehearing	292
Ohio Revised Codes	327

TABLE OF AUTHORITIES

Cases

Bark v. USFS,
37 F. Supp. 3d 41 (D.D.C. 2014) 36

Broad Street Energy v. Endeavor Ohio, LLC,
975 F. Supp. 2d 878 (S.D.Ohio 2013) 36, 37

California Div. of Labor Stds. Enforcement v. Dillingham Constr., N.A., Inc.,
519 U.S. 316, 117 S.Ct. 832, 136 L.Ed.2d 791 (1997) 20

Discount Cellular, Inc. v. Pub. Util. Comm.,
112 Ohio St.3d 360, 2007-Ohio-53, 859 N.E.2d 957 19

EPSA v. FirstEnergy,
155 FERC ¶ 61,101, No. EL16-34-000 (April 27, 2016) 13

Heckler v. Chaney,
470 U.S. 821, 105 S.Ct. 1649, 84 L.Ed.2d 714 (1985) 36

In re AEP Request for Approval of Its Program Portfolio Plan,
Pub. Util. Comm. No. 09-1089-EL-POR, Opinion and Order (May 13, 2010),
available at https://perma.cc/LZE7-ELR6 43

In re App. of the Dayton Power and Light Company for Approval of Its ESP,
Pub. Util. Comm. No. 16-0395-EL-SSO, available at
https://perma.cc/3G5F-UBMY 29

In re Application of Columbus S. Power Co.,
128 Ohio St. 3d 512, 2011-Ohio-1788, 947 N.E.2d 655 .... 7, 8, 19, 23

In re Application of Columbus S. Power Co.,
138 Ohio St.3d 448, 2014-Ohio-462, 8 N.E.3d 863 28

In re Application of Columbus S. Power Co.,
147 Ohio St.3d 439, 2016-Ohio-1608, 67 N.E.3d 734 .... 3, 8, 32

In re Application of Columbus S. Power Co.,
Pub. Util. Comm. Nos. 08-917-EL-SSO, 08-918- EL-SSO (Mar. 18, 2009),
available at https://perma.cc/W7ZP-P8G6 28

In re Application of Dayton Power & Light Co.,
147 Ohio St.3d 166, 2016-Ohio-3490, 62 N.E.3d. 179 32

In re Ohio Edison Co., The Cleveland Electric Illuminating Co., Toledo Edison Co., Pub. Util. Comm. No. 08-935-EL-SSO, Opinion and Order (Dec. 19, 2008), available at https://perma.cc/JH35-X59P 28, 38

In re Rev. of Alternative Energy Rider Contained in Tariffs of Ohio Edison Co., Slip Opinion No. 2018-Ohio-229 .... 22, 39, 40

In the Matter of Aligning Electric Distribution Utility Rate Structure With Ohio's Public Policies to Promote Competition, Energy Efficiency, and Distributed Generation, Pub. Util. Comm. No. 10-3126-EL-UNC, Entry (Dec. 29, 2010), available at https://perma.cc/G3L6-8Y4K 43

In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Approval of Ohio Site Deployment of the Smart Grid Modernization Initiative, Pub. Util. Comm. Nos. 09-1820-EL-ATA *et al.*, Finding and Order (June 30, 2010), available at https://perma.cc/UC2K-MFBJ 43

In the Matter of the Application of The Cleveland Electric Illuminating Company, Ohio Edison Company, and The Toledo Edison Company for Approval of Their EE/PDR Program Portfolio Plans for 2010 through 2012, Pub. Util. Comm. Nos. 09-1947-EL-POR *et al.*, Opinion and Order (Mar. 23, 2011), available at https://perma.cc/7VBG-GT9N 44

In the Matter of the Application seeking Approval of Ohio Power Co.'s Proposal to Enter Into an Affiliate Power Purchase Agreement for Inclusion in the Power Purchase Agreement Rider, Pub. Util. Comm. Nos. 14-1693-EL-RDR, 14-1694-EL-AAM, available at https://perma.cc/6YTG-L3KA 29

Monongahela Power Co. v. Pub. Util. Comm., 104 Ohio St.3d 571, 2004-Ohio-6896, 820 N.E.2d 921 18

New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co., 514 U.S. 645, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995) 20

NLRB v. SW General, ___ U.S. ___, 137 S.Ct. 929, 197 L.Ed.2d 263 (2017) 36

Ohio Consumers Counsel v. Pub. Util. Comm. Of Ohio, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269 .... 5, 6, 37

Ohio Edison Co. v. Pub. 868 Util. Comm., 78 Ohio St.3d 466, 678 N.E.2d 922 (1997) 18

Ottery v. Bland,
42 Ohio App.3d 85, 536 N.E.2d 651 (10th Dist. 1987) 36

Petition of S. Indiana Gas and Electric Co.,
2011 Ind. PUC LEXIS 115, Ind. Util. Regulatory Comm. No. 43839,
Final Order (Apr. 27, 2011) 44

United States v. Gordon,
961 F.2d 426 (3d Cir. 1992) 36

Statutes

R.C. 4903.09 45

R.C. 4903.13 ..... 18, 36, 37

R.C. 4905.02 9

R.C. 4905.04 5

R.C. 4905.22 ..... 4, 27

R.C. 4905.32 39

R.C. 4905.402 14

R.C. 4909.04 ..... 4, 26

R.C. 4909.10 ..... 5, 27

R.C. 4909.15 ..... 4, 5, 26, 39

R.C. 4909.154 ..... 4, 26, 27

R.C. 4928.01 ..... 3, 6, 9

R.C. 4928.02 ..... 5, 6, 8

R.C. 4928.03 6

R.C. 4928.07 6

R.C. 4928.15 ..... 5, 25, 26

R.C. 4928.17 5

R.C. 4928.37 ..... 6, 31

R.C. 4928.38 ..... *passim*

R.C. 4928.40(A) 6

R.C. 4928.66(D) 3, 41, 42

R.C. 4928.141 .... 7, 31

R.C. 4928.142 7

R.C. 4928.143 .... *passim*

R.C. 4928.662(A) 42

Rules

Nevada Admin. Code 704.95225 44

Legislative materials

Am.Sub.S.B. No. 221 (SB221) 7

Am.Sub.S.B. No. 3, 148 Ohio Laws, Part IV, 7962 (SB3) 5

Other authorities

Andrew Cass,
FirstEnergy lobbying for state legislation upping revenue, The News-Herald (Jan. 26, 2018), available at https://goo.gl/tjqPqE 1

John Funk,
FirstEnergy hopes to move its power plants back under regulated rates, customer prices could increase, The Plain Dealer (Nov. 4, 2016), available at https://goo.gl/qkKZ5X 10, 11

John Funk,
FirstEnergy power plant bailouts rebuffed by state and federal leaders, The Plain Dealer (Aug. 23, 2017), available at https://goo.gl/grxUwB 1

John Funk,
FirstEnergy Solutions downgraded on bankruptcy expectation, FE parent seen as stable, The Plain Dealer (Aug. 21, 2017), available at https://goo.gl/zbbHY8 .... 11, 40

John Funk,
PUCO rejects challenge to FirstEnergy special subsidy, you'll keep paying more, The Plain Dealer (Aug. 17, 2017), available at https://goo.gl/Q1NaUB 33

Jim Mackinnon,
Moody's downgrades FirstEnergy Solutions, says default risk growing
(Jan. 23, 2018), available at https://perma.cc/LR2H-CABM 11

Julie Carr Smyth,
Ohio House Sidelines Bailout of 2 FirstEnergy Nuclear Plants, U.S. News
(May 19, 2017), available at https://goo.gl/UfPYPJ 1

Michael Schmidt,
Performance-Based Ratemaking: Theory and Practice (2000) 24

Andrew R. Thomas, et al.,
Electricity Customer Choice in Ohio: How Competition Has Outperformed Traditional Monopoly Regulation, Urban Publications: Cleveland State University 10 (2016), available at https://perma.cc/G52K-VQVK .... *passim*

PUCO,
FirstEnergy's Electric Security Plan (Oct. 12, 2016),
available at https://perma.cc/4NMU-NDUZ 14

PUCO, Glossary of utility-related terms,
available at https://perma.cc/VA6W-M8UN 20

Webster's New World Dictionary, Third College Ed. (1988) 24

GLOSSARY OF TERMS AND ABREVIATIONS

AEP: American Electric Power; an electric utility.

Att.: Attachment.

CAP: Consumer Action Program; a program that measures customer energy conservation efforts.

CFO: Cash Flow to Operations; a measure of the cash flow generated by a business generally calculated by subtracting operating expenses from the total revenues from a business's principal operations.

Commission or PUCO: The Public Utilities Commission of Ohio.

Distribution: The delivery of electricity to homes and businesses over the local poles and wires, transformers, substations and other equipment. Electricity distribution remains regulated by the Commission.

Eighth Entry: The Commission's Eighth Entry on Rehearing, Case No. 14-1297-EL-SSO (Aug. 16, 2017).

ESP: Electric security plan; the default plan for the supply and pricing of electric generation that is filed by the utility company.

Ex.: Exhibit.

Fifth Entry: The Commission's Fifth Entry on Rehearing, Case No. 14-1297-EL-SSO (Oct. 12, 2016).

FES: First Energy Solutions; the generation affiliate of FirstEnergy.

FERC: The Federal Energy Regulatory Commission; a federal agency.

FirstEnergy (the Companies): Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company, which are electric distribution utilities ad defined in R.C. 4928.01(A)(6) and public utilities as defined in R.C. 4905.02.

First Energy Corp.: First Energy Corporation is the parent holding company of, among other subsidiaries, FES and FirstEnergy.

Generation: The production of electricity in a power plant. The Commission no longer regulates electricity generation charges.

Lost Distribution Revenues: Revenue that the utility loses due to diminished consumer energy use accompanying energy efficiency programs.

MRO: Market rate offer; a type of ESP based on the market rate for electricity.

PPA: Power Purchase Agreement; an agreement from a distribution utility to purchase electricity supply from a generation company.

RESA: Retail Energy Supply Association; an organization comprised of retail electricity and natural gas suppliers.

Rider: An extra charge to distribution customers authorized under R.C. 4928.143(B).

- Rider AMI—Advanced Metering Infrastructure Rider
- Rider DCR—Delivery Capital Recovery Rider
- Rider DMR—Distribution Modernization Rider
- Rider RRS—Retail Rate Stability Rider

SB3: Senate Bill 3 (1999)

SB221: Senate Bill 221 (2008)

SSO: Standard Service Offer; the default electric generation service a customer will receive from the distribution utility if she does not choose a different electric generation supplier.

Tr. Vol.: Transcript Volume of testimony from hearings before the Commission conducted regarding FirstEnergy's ESP application. These transcripts were transferred to the Court on November 15, 2017, by the Commission.

Transmission: The transporting of high-voltage electricity from a power plant to the local distribution utility.

INTRODUCTION

It is no secret that, for years, FirstEnergy's power generation company has been failing in the competitive market for electricity. Reports of its plant closings and financial woes routinely make headlines in Ohio's newspapers. And FirstEnergy executives repeatedly lobbied the Governor and the Legislature for economic support.[1] But those efforts were unsuccessful, prompting FirstEnergy to pursue another route: It went to the Public Utilities Commission of Ohio seeking the cash infusion the Legislature refused to provide. The Commission, however, "is not a bank" or "a trust fund." Fifth Entry at ¶ 7 (Haque, Chairman, concurring). It is, instead, a utility regulator bound by a statute that does not authorize bailouts of utilities. But that's exactly what it did in this case—it wrote a blank check to FirstEnergy. This Court should not allow what the Legislature has refused.

Central to the Legislature's scheme governing electric utilities in Ohio is the principle that electric distribution (i.e., the delivery of electricity to a home or business) remains regulated by the Commission, but electric generation (i.e., the supply of electricity) is unregulated and "fully on its own in the competitive market." R.C. 4928.38. For distribution, that means the Commission gives a utility a monopoly over delivery services to all the customers in a particular geographic area, and those captive customers pay a rate set by the Commission based on the utility's distribution costs plus a reasonable rate of return. But the Commission cannot force a utility's captive distribution customers to compensate for its generation affiliate's failure in the competitive market. That would

---

[1] John Funk, *FirstEnergy power plant bailouts rebuffed by state and federal leaders*, The Plain Dealer (Aug. 23, 2017), available at https://goo.gl/grxUwB; Andrew Cass, *FirstEnergy lobbying for state legislation upping revenue*, The News-Herald (Jan. 26, 2018), available at https://goo.gl/tjqPqE; Julie Carr Smyth, *Ohio House Sidelines Bailout of 2 FirstEnergy Nuclear Plants*, U.S. News (May 19, 2017), available at https://goo.gl/UfPYPJ.

violate the legislative scheme, distort the market, and force ratepayers to shoulder the generation company's poor business decisions.

Yet, under the guise of promoting "grid modernization," that is what the Commission did in approving FirstEnergy's so-called "distribution modernization rider" (Rider DMR). FirstEnergy's parent company was saddled with debt from FirstEnergy's failing *generation affiliate*, threatening the parent company's credit rating. To make up for that debt, the Commission approved extra fees—in the form of Rider DMR—for FirstEnergy's captive *distribution* customers. By the Commission's own admission, Rider DMR requires FirstEnergy's captive distribution customers to provide FirstEnergy with "credit support"—a fancy term for a cash infusion.

Ostensibly, the Commission approved this cash infusion so that FirstEnergy can obtain more favorable borrowing terms when undertaking grid modernization which, in turn, would help deliver electricity to its customers. But, fatal to its plan, Rider DMR does not require FirstEnergy to actually engage in grid modernization at all. To the contrary, the Commission made clear that it would "not place restrictions on the use of Rider DMR funds." Fifth Entry at ¶ 282. With no strings attached, Rider DMR cannot reasonably be considered within the Commission's authority to approve riders "regarding . . . distribution services." R.C. 4928.143(B)(2)(h). Nor can it survive the Legislature's bar on "transition fees," because regulated rates are being used to offset free market losses. R.C. 4928.38. Rider DMR, therefore, cannot stand.

What's more concerning is the precedent that this case sets: the Commission can now use riders and other fees to pass generation-related losses to regulated distribution consumers. Today it's FirstEnergy, but other utilities struggling to compete in the electric

generation market will surely follow. That is not the Commission's role. It is the Legislature's choice if it wants Ohioans to bailout generation companies that cannot survive in the competitive market. But thus far it has declined, leaving generation utilities "wholly responsible for whether [they are] in a competitive position" in the free market. Neither this Court nor the Commission should authorize what the Legislature has not.

Even apart from Rider DMR, the Commission hands FirstEnergy cash without requiring it to improve its services in another area: energy efficiency. The Commission, following R.C. 4928.66(D), often allows utilities to charge extra fees to make up for revenues they lose "as a result of" energy conservation programs. But here, the Commission authorized FirstEnergy to charge its customers additional fees based on losses from conservation efforts undertaken independently by consumers without any help or incentive from FirstEnergy. That too is unreasonable and violates the Legislature's mandates.

STATUTORY BACKGROUND

Revised Code Title 49 governs the terms of Ohio's retail electric service "from the point of generation to the point of consumption." R.C. 4928.01(A)(27). Undoubtedly, it is a "labyrinthian scheme," which has been amended and changed over the years. *In re Application of Columbus S. Power Co.*, 147 Ohio St.3d 439, 2016-Ohio-1608, 67 N.E.3d 734, ¶ 72 (O'Connor, C.J., dissenting). But the myriad code provisions form a comprehensive scheme that serves an important purpose: to separate the utility's distribution service—which is regulated—from generation service—which is not. And it accordingly prohibits the Commission from requiring a utility's distribution customers, who are captive in a

regulated market, from having to pay additional fees to support a utility's generation affiliate that is failing in the free market.

1. For decades, Ohio employed a traditional model of utility regulation.

Until the late 1990s, Ohio's electric utilities followed a traditional approach to electricity regulation: generation and distribution services were bundled together by the local utility, which held monopoly rights to provide that bundled package to all consumers in a given geographic area.[2] Andrew R. Thomas, et al., *Electricity Customer Choice in Ohio: How Competition Has Outperformed Traditional Monopoly Regulation*, Urban Publications: Cleveland State University 10 (2016), available at https://perma.cc/G52K-VQVK. Under this arrangement, the rates charged to consumers by utilities were "cost-based"—that is, they were calculated based on the utility's cost of operation, plus a reasonable return on investment. *See* R.C. 4909.15. But utilities were not free to charge whatever rates they saw fit. Instead, because consumers in this scheme were captive—unable to choose between competing utilities or negotiate the terms or rates of their electricity service—Ohio created several safeguards designed to protect consumers from paying inflated rates. For starters, the Commission had to approve the rates. *Id.* And because the rates were based on costs, the Legislature charged the Commission with making sure a utility's costs were "prudent," "reasonable," and "used and useful" to render utility service to customers. R.C. 4909.154; 4909.04(A); 4905.22. Accordingly, Revised Code Chapters 4905 and 4909 set forth detailed standards and procedures for ensuring that the utility's rates were reasonably fixed. The Commission may conduct independent financial audits, hold public hearings, and require a

---

[2] Transmission services were also bundled. Because transmission is not relevant to this appeal, it is not included in the statutory background.

utility to refund or credit customers if the utility charged rates based on imprudent expenditures. *See* R.C. 4905.04; 4909.10; 4909.15.

2. The Ohio Legislature deregulates the generation component of the electricity market.

In 1999, the Ohio Legislature—at the urging of the utility companies—made a definitive choice to split up the distribution and generation components of electric service. *See* Am.Sub.S.B. No. 3, 148 Ohio Laws, Part IV, 7962 (SB3). On the distribution side, SB3 left undisturbed the traditional cost-based model that had governed it for years. *See* R.C. 4928.15; Thomas, *supra*, at 12. The utilities still had a monopoly over distribution in a given geographic territory, but the Legislature opted to deregulate the generation side. It believed market forces—instead of regulation—should govern generation because, in its judgment, creating a separate competitive market for electricity supply would result in lower utility bills for customers, while still allowing them to receive safe, adequate and reliable service. *See* R.C. 4928.02(A).

As a result, the industry was forced to restructure. *See generally* R.C. Chapter 4928; *Ohio Consumers Counsel v. Pub. Util. Comm. Of Ohio*, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269, ¶ 2. For the utilities, deregulation meant that they had to reform their corporate structures to separate their generation and supply entities; the distribution arm could not "extend any undue preference or advantage to any affiliate . . . of its own business" engaged in the newly competitive generation market. R.C. 4928.17. And, while the utilities were not required to sell their generation assets to third parties, they were required to place them into separately operated subsidiaries. *Id.*; Thomas, *supra*, at 12. Most critically—the "cornerstone of SB 3"—was that the utilities had to separate or "unbundle" their services and charges for electricity generation and distribution. *Ohio*

Consumers Counsel v. PUCO, *at* ¶ 22; R.C. 4928.07. That meant changes for consumers. With unbundled distribution and generation charges, consumers could choose their electric supplier. *Id.* Because the utility had to deliver power from any licensed supplier, not just its generation affiliate, consumers were no longer tied to the utility's supplier preferences. R.C. 4928.03. They had "effective choices over the selection of [their electric supplier]." R.C. 4928.02(I). Deregulation also meant a new role for the Commission, namely, policing the separation between regulated distribution utilities and their generation affiliates. Specifically, the Legislature mandated that the Commission "[e]nsure effective competition" in the electric generation market by "avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service." R.C. 4928.02(H).

The Legislature gave the utilities five years (until December 31, 2005) to complete the transition to an unregulated generation market. R.C. 4928.40(A), 4928.01(A)(17). To assist utilities in this "market development" period, SB3 provided each electric utility with a limited opportunity to "receive transition revenues that may assist it in making the transition to a fully competitive retail electric generation market." R.C. 4928.37(A)(1). Transition revenues were permitted because the existing utilities had to prepare for competition—they risked losing customers in a free market, and some of their capital investments (i.e., building a big power plant) or other decisions might have been predicated on the assumption of a captive generation market. Over these five years the utilities could receive transition fees, but then the Legislature intended that a generation

business “shall be fully on its own in the competitive market.” R.C. 4928.38.[3] After this window, SB3 thus specifically prohibited the Commission from “authoriz[ing] the receipt of transition revenues or any equivalent revenues by an electric utility.” *Id.*; *see also In re Application of Columbus S. Power Co.*, 147 Ohio St.3d 439, 2016-Ohio-1608, 67 N.E.3d 734, at ¶ 16.

3. The Ohio Legislature provides support for a growing free market for electricity generation.

In 2008, the Legislature made further changes to foster the transition to an open generation market. *See* Am.Sub.S.B. No. 221 (SB221). Competition in the electricity generation market had failed to develop as quickly as the Legislature anticipated, leading to volatility in electric supply prices. So SB221 sought to ease the transition to a market-based system by making changes that would stabilize rates, while still fostering competition. *In re Application of Columbus S. Power Co.*, 128 Ohio St. 3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶¶ 2–5.

To this end, SB221 allowed utilities some flexibility on how to offer generation plans to retail customers. In relevant part, SB221 required each distribution utility to provide a standard service offer (SSO) to serve as the default electricity generation plan for all the customers within its geographic territory. R.C. 4928.141(A). The electricity prices in the default plan must be set either as a market rate offer (MRO) or an electric security plan (ESP). *See id*. An MRO sets retail rates through a competitive bidding process where the utility seeks bids from wholesale suppliers of power. *See* R.C. 4928.142. An ESP, by contrast, does not require that the electricity supply be bought in a competitive market. *See*

[3] Transition fees for regulatory assets could be recovered through December 31, 2010. R.C. 4928.01(A)(26), 4928.40(A).

R.C. 4928.143. It can be based on the cost of electricity from the utility's existing generating capacity, from power the utility purchases (such as from bidding on the wholesale market), or a combination of both. R.C. 4928.142*;* Thomas, *supra,* at 14. But the Commission is required to determine that the ESP is "more favorable in the aggregate as compared to the expected results that would apply" with an MRO. Fifth Entry at ¶ 31; R.C. 4928.143(C)(1). Customers do not have to accept the standard service offer; they can choose an alternative retail supplier.

To help utilities cover the costs of special projects and programs, ESPs may contain extra fees in the form of "riders." For example, riders may charge customers "to reimburse [the utilities] for costs they incur in providing distribution services," to pay for need-based assistance programs, to comply with energy efficiency mandates, or for other bases specifically enumerated in the statute. Thomas, *supra*, at 15; *see* R.C. 4928.143(B)(2)(a)–(i). The ESP statute "states, 'The [electric security] plan may provide for or include, without limitation, any of the following,' and then lists nine categories of cost recovery." *In re Application of Columbus S. Power Co.*, at ¶ 31. Because the Legislature spells out exactly what riders an ESP may include, "if a given [charge] does not fit within one of the categories . . . it is not authorized by statute." *In re Application of Columbus S. Power Co*., at ¶ 32.

By allowing utilities some flexibility on how to offer generation plans to retail customers, the Legislature eased the transition to a still-developing market. But it doubled-down on its intention to have an independent competition-based generation market. SB221 forced utilities that had not yet separated their generation business to do so. Thomas, *supra,* at 15. And it specifically prohibited "the recovery of any generation-related costs through distribution . . . rates." R.C. 4928.02(H). Like SB3, SB221 again "expressly prohibits

the recovery of transition costs" by providing that any ESP "shall exclude any previously authorized allowances for transition costs." *In re Application of Columbus S. Power Co.*, 147 Ohio St.3d 439, 2016-Ohio-1608, 67 N.E.3d 734, at ¶ 17. The overall goal was for the electric generation market to stand on its own, without anticompetitive props from the regulated distribution companies. The plan has largely worked: "Since 2011, a robust retail market for electricity has developed in Ohio." Thomas, *supra*, at 1.

STATEMENT OF THE FACTS AND CASE

1. The three FirstEnergy entities in this case.

This case centers on the interplay between three related entities—FirstEnergy (the distribution company), FirstEnergy Solutions (the generation affiliate), and FirstEnergy Corporation (the parent company).

FirstEnergy is a public utility that distributes electricity to customers in Ohio and throughout the Midwest and Mid-Atlantic. *See* R.C. 4928.01(A)(6) and 4905.02. In Ohio, FirstEnergy is comprised of three smaller companies: the Ohio Edison Company, The Cleveland Electric Illuminating Company, and the Toledo Edison Company (collectively the "Companies" or "FirstEnergy"). As an electric distribution utility, FirstEnergy is governed by the traditional noncompetitive regulated scheme described above. Under this framework, the Commission has granted FirstEnergy the exclusive right to distribute electricity to customers within a particular geographic area (mainly northern Ohio). And through rates approved by the Commission, FirstEnergy collects its costs for delivering electricity and earns a reasonable rate of return. It also collects additional fees from riders for specific projects. For instance, through the existing Advanced Metering Infrastructure Rider (Rider AMI) and the Delivery Capital Recovery Rider (Rider DCR), FirstEnergy can

recover capital expenditures made on grid-modernization and other distribution-infrastructure investments. Fifth Entry at ¶ 108; *id.* at ¶ 4 (Haque, Chairman, concurring). This scheme ensures a safe and stable business; as a result, the Companies have a strong financial outlook. *Id.* at ¶ 11 (Haque, Chairman, concurring); Rehearing Testimony of Joseph Buckley (June 29, 2016), Staff Ex. 13, Att. 3, 6–7 (S&P report).

FirstEnergy Solutions (FES) is the affiliate generation entity that spun off from FirstEnergy in 2006 after SB3. By all accounts, FES has struggled in the competitive market. Fifth Entry at ¶ 6 (Haque, Chairman, concurring). FES has repeatedly "bet heavily on coal-fired generation as the cheapest source of base load electricity," Thomas, *supra*, at 6, and it bet that it could sell its electricity to retail customers for more than its cost of production. But that bet turned out to be wrong, as "low natural gas prices" drove down the price of power and thus undercut FES's generation sources, placing "considerable strain on FES' business." Tr. Vol. X (Aug 1, 2016), P3/EPSA Ex. 21. As Moody's has reported, FES's competitive-market weakness stems in part on "the composition of [its] generation portfolio, which is roughly 50% coal, 40% nuclear, and 5% each of gas and renewables." *Id*. FES's "old power plants cannot generate electricity as cheaply as the constantly growing number of gas-fired power plants and wind farms pushing power into wholesale power markets." John Funk, *FirstEnergy hopes to move its power plants back under regulated rates, customer prices could increase*, The Plain Dealer (Nov. 4, 2016), available at https://goo.gl/qkKZ5X. But independent market forces are not solely to blame for FES's financial woes: As recently as 2013, FES continued to bet heavily on coal and nuclear-powered plants, investing upwards of $1.8 billion to upgrade its coal-fired Sammis plant in Stratton, Ohio—only to later concede that the investment and upgrade had failed. Tr. Vol.

XI (Sept. 15, 2015), 2280:16–2282:2. Less than five years later, four of the units in the Sammis plant are scheduled to close. Fifth Entry at ¶ 204.

FES's poor investment decisions have, as a result, become a "dangerous drag on the parent company." Funk (Nov. 4, 2016), *supra*. Things had gotten so bad that FES's chief executive recently urged the Ohio Legislature to approve a bailout for the failing generation company. *Id*. One proposal requested that FES be allowed to return to a regulated system where customers are forced to buy electric supply from FES, covering the costs of generating electricity plus a reasonable profit margin. *Id.*; *see also supra* n.1. But the Legislature refused. All indications now are that FES will soon file for bankruptcy. *See* John Funk, *FirstEnergy Solutions downgraded on bankruptcy expectation, FE parent seen as stable*, The Plain Dealer (Aug. 21, 2017), available at https://goo.gl/zbbHY8.

FirstEnergy Corp. is the parent holding company of FirstEnergy, FES, and other affiliates. Due in large part to FES's failings, FirstEnergy Corp. has been "experiencing financial challenges," and—at the time of the relevant hearings in this case—the Commission determined that it was at risk for a credit downgrade.[4] Fifth Entry at ¶¶ 143, 194. The credit agencies' reports (all available in the record) demonstrate that FirstEnergy Corp.'s potential downgrade was tied directly to generation-related losses. Standard & Poor's, one such credit rating agency, described "weak commodity prices" and "[t]he higher-risk competitive businesses" as increasing FirstEnergy Corp.'s likelihood for a downgrade. Rehearing Testimony of Joseph Buckley (June 29, 2016), Staff Ex. 13, Att. 3, at 2–3. Because the Companies are subsidiaries, "if FirstEnergy Corp. were downgraded, the

[4] Since the administrative proceedings' termination, Moody's has downgraded FES. *See* Jim Mackinnon, *Moody's downgrades FirstEnergy Solutions, says default risk growing* (Jan. 23, 2018), available at https://perma.cc/LR2H-CABM.

Companies would also be downgraded." *Id.* at ¶¶ 111, 194. A downgrade, in turn, could limit the Companies' "access to the credit markets," "may result in higher borrowing costs," or could mean "more restrictive terms and conditions" if the Companies sought to access capital in the future. *Id*. at ¶ 195. But "rather than acknowledge that technology, regulation and markets have changed over the decades, and retire their uncompetitive generation capacity, [FirstEnergy Corp.] . . . instead turned [its] attention to identifying alternative strategies for offsetting the costs of the competitive portions of [its] generation fleet"—including squeezing more money from its captive distribution customers. Thomas, *supra*, at 7.

2. Regulators reject FirstEnergy's initial efforts to prop up its struggling generation affiliate.

FirstEnergy's initial ESP application in this case was an overt attempt to prop up its struggling affiliate FES. The application proposed a power purchase agreement (PPA) that would have required FirstEnergy to purchase the output from FES's aging and uneconomic power plants at rates well above the market and then sell that electricity supply on the wholesale market for a clear loss. FirstEnergy would then pass the *entire* loss on to all of its captive distribution customers via a mandatory retail rate stability rider (RRS) on their electric bills. FirstEnergy explained that the deal was necessary "because without [it], major existing generation facilities"—which were no longer competitive on the open market—"would be shut down, threatening grid reliability." Thomas, *supra*, at 1. But as Cheryl Roberto, a former PUCO commissioner testified during hearings on this proposal, the plan was "a non-competitive purchase agreement," which would subsidize "the Companies' uneconomic generation . . . and lock the Companies into a risky long-term supply contract." Direct Testimony of Cheryl Roberto (Dec. 22, 2014) 4:24–5:3.

Nevertheless, the Commission approved this initial proposal, concluding that Rider RRS would serve the public's interest. Federal regulators saw it differently. Less than two months after the Commission's initial approval, the Federal Energy Regulatory Commission (FERC), following a U.S. Supreme Court ruling on a similar generation subsidy scheme in Maryland, determined that FirstEnergy could not force its captive distribution customers into a bad deal with its own generation affiliate. *See EPSA v. FirstEnergy*, 155 FERC ¶ 61,101, No. EL16-34-000 (April 27, 2016). That would be anticompetitive. As a consequence, FirstEnergy was required to scrap that plan.

Its second effort was no more successful. After FERC rejected its initial proposal, FirstEnergy filed a second proposal with the Commission. Fifth Entry at ¶¶ 9–14. This time, the proposal no longer involved contracting with its unregulated affiliate FES; but it nevertheless still proposed to be compensated for FES's failings. *See id.* at ¶ 41. In particular, although there was "no actual purchase or sale of energy and capacity at all," *id*. ¶ 101, FirstEnergy proposed charging a rider to all customers to pay for the "net difference between an assumed cost (and assumed quantity) of generation service from FES and actual market rates." *Id.* at ¶101. That approach was unacceptable, and the Commission rejected it. *Id*. at ¶ 96. Because there was no direct purchase from FES, unlike the original proposal, the new proposal would not save FES's struggling plants, and so it lacked sufficient public benefit. *Id*. at ¶¶ 103–08.

3. After rejecting FirstEnergy's proposal, the Commission proposes its own bailout—a distribution modernization rider.

Although FirstEnergy's two attempts to secure a cash-infusion to prop up the FES generating plants failed, the Commission's staff came up with a third plan to help FirstEnergy deal with the fallout from its struggling sister affiliate. But its solution was just

another cash-infusion. Its proposal: a so-called "distribution modernization rider" (Rider DMR) that required FirstEnergy's captive distribution customers to provide FirstEnergy with an infusion of over $600 million in "credit support" with the "intention" that FirstEnergy would be "stimulated" to access capital and update the electric grid. Fifth Entry at ¶¶ 190, 281. Specifically, Rider DMR allows FirstEnergy to recover fees from customers amounting to approximately $204 million annually ($132.5 million, grossed-up for taxes) for a period of three years, which the Commission can extend for an additional two years. *Id.* at ¶ 188; PUCO, FirstEnergy's Electric Security Plan (Oct. 12, 2016), available at https://perma.cc/4NMU-NDUZ. The Rider has three conditions: (1) FirstEnergy Corp. has to keep its headquarters in Akron for the duration of the ESP; (2) there can be no change in "control" of the Companies, as that term is defined in R.C. 4905.402(A)(1); and (3) there must be "sufficient progress" in grid modernization programs approved by the Commission. Fifth Entry at ¶ 206.

4. The Commission approves Rider DMR in its Fifth Entry on Rehearing, rejecting challenges that it is unlawful and unreasonable.

After extensive testimony, on October 12, 2016, the Commission approved Rider DMR in its Fifth Entry on Rehearing, rejecting all of the appellants' challenges to it. Fifth Entry at ¶ 185.

The Commission main goal in embracing Rider DMR was "to improve FirstEnergy's credit position." Fifth Entry at ¶ 118. Staff witness Joseph Buckley introduced Rider DMR at the hearing, and explained that the purpose of Rider DMR was to provide credit support to FirstEnergy Corp. so that it would maintain an investment grade rating. Tr. Vol. III (July 13, 2016), 509:25–510:19. Testimony at the hearing focused on FirstEnergy Corp.'s credit rating and potential downgrade, which is driven by the market failures of FES. *See supra*

10–12. The Commission concluded that a downgrade for the parent company could, in turn, trigger a downgrade for the Companies. *Id.* at ¶ 278. By requiring captive customers to shoulder additional charges, the Commission explained that Rider DMR would "provide credit support to the Companies in order to avoid a downgrade in credit ratings." *Id.* at ¶ 281.

Consistent with these credit rating concerns, the Commission calculated the amount recoverable through Rider DMR by first determining the amount of cash necessary for FirstEnergy Corp. to maintain a Cash Flow to Operations (CFO) debt ratio of 14.5 percent—the CFO/debt ratio that experts testified would avoid a downgrade. *Id.* at ¶ 197. Next, the Commission allocated 22 percent of that to the Companies, based on the Companies' share of FirstEnergy Corp.'s operating revenues. *Id*. at ¶ 196.

The calculations were not based on the cost of any grid modernization. Costs that the Companies expend on actually modernizing the grid can be recovered through a separate infrastructure rider, as staff witness Tamara Turkenton testified. *See* Tr. Vol. II (July 12, 2016), 473:22–474:3. Chairman Haque further confirmed: "After this initial [cash] infusion, . . . Rider AMI will function as the corresponding traditional regulatory mechanism, providing a return for monies expended to construct/maintain service." Fifth Entry at ¶ 4 (Haque, Chairman, concurring).

Even though there is a separate rider to fund actual grid modernization expenditures, the Commission tied this credit-support plan to distribution modernization and concluded that it was authorized under R.C. 4928.143(B)(2)(h). Under this subsection, an ESP may include:

> Provisions regarding the utility's distribution service, including, without limitation and notwithstanding any provision of Title XLIX of the Revised

> Code to the contrary, provisions regarding single issue ratemaking, a revenue decoupling mechanism or any other incentive ratemaking, and provisions regarding distribution infrastructure and modernization incentives for the electric distribution utility. The latter may include a long-term energy delivery infrastructure modernization plan for that utility or any plan providing for the utility's recovery of costs, including lost revenue, shared savings, and avoided costs, and a just and reasonable rate of return on such infrastructure modernization.

The Commission concluded that Rider DMR is "related to distribution rather than generation" because "Rider DMR will provide credit support . . . , which will allow the Companies to access capital markets and obtain favorable borrowing terms and conditions, enabling investment in a more extensive grid modernization program." Fifth Entry at ¶¶ 190, 358. Specifically, the Commission held that Rider DMR is a "distribution modernization incentive." *Id*. at ¶ 190. "Webster's [Dictionary] defines an 'incentive' as 'something that stimulates one to take action, work harder, etc.; stimulus; encouragement." And the "Staff intends for Rider DMR to jump start the Companies' grid modernization efforts." *Id*. at ¶ 190; *see also id.* ("Rider DMR is *intended* to stimulate the Companies to focus their innovation and resources on modernizing their distribution systems." (Emphasis added)).

The Commission explicitly rejected any requirements that any portion of the funds be used for actual distribution enhancements, or that the Companies even ever attempt to access capital for modernization projects. It declared: "[W]e will not place restrictions on the use of Rider DMR funds" *Id.* at ¶ 282. The Commission did, however, "direct Staff to periodically review how the Companies, and FirstEnergy Corp., use the Rider DMR funds to ensure that such funds are used, directly or indirectly, in support of grid modernization." *Id*. at ¶ 282. And it mandated that there be "sufficient progress" toward grid modernization, which is to be determined "in the sole discretion" of the Commission. *Id*. at ¶ 208. But it did

not mandate any particular grid modernization plan or benchmarks for progress. Instead, FirstEnergy was required to submit a modernization plan in a separate proceeding, not tied to customer charges under Rider DMR. *Id*. at ¶ 188. "The Commission intends on having a very robust conversation about the future of the grid and the electric industry" at an unspecified point "in the near future." *Id.* at ¶ 207; *id*. at ¶ 3 (Haque, Chairman, concurring). The Commission would evaluate FirstEnergy's plan to modernize the grid at that time. *Id*. If FirstEnergy fails to follow-through with a plan or any actual grid modernization, if it fails to make "sufficient progress" as determined by the Commission, or even if it moves from Akron, there is no provision allowing consumers to be refunded for these costs. *Id.* at ¶ 209.

Lastly, the Commission rejected the argument that Rider DMR would "collect transition revenue or its equivalent" in violation of R.C. 4928.38. *Id*. at ¶ 284–87. Multiple parties, including the Environmental Advocates, argued that because Rider DMR was targeted to compensate for FES's generation failings, and the attendant potential downgrade to FirstEnergy Corp., it constituted an unlawful transition charge. Per the legislative scheme, FES was supposed to act independently in the competitive generation market; yet with Rider DMR, FirstEnergy's captive distribution customers were being forced to compensate for its shortfalls. The Commission disagreed, concluding that "there is no 'transition' involved in this case" because FirstEnergy's separation of its generation assets occurred "many years ago." *Id*. at ¶ 287. And although FES's failings on the generation market necessitated the rider, the Commission stated that Rider DMR is "entirely unrelated to generation because the Companies have no generation assets." *Id*.

Chairman Haque concurred, openly acknowledging that the Commission's decision was "undoubtedly unconventional." *Id*. at ¶ 4. "Typical public utility regulation" provides

utilities with "recovery and a return for expenditures made in constructing/maintaining service." *Id*. But Rider DMR "will serve to provide FirstEnergy with an infusion of capital" so that FirstEnergy "will be healthy enough" to make modernization investments in the future. *Id.* As for what those grid investments are, Chairman Haque expressly recognized that there are none delineated. But he would not "tie DMR recovery to certain grid modernization endeavors" because the Commission's vision for "the future of the grid and electric industry" remained uncertain. And, thus, he recognized "Rider DMR may feel a bit premature." *Id*. at ¶ 5.

5. The Commission reaffirms Rider DMR in its Eighth Entry on Rehearing.

Along with multiple other parties, the Environmental Advocates filed for rehearing arguing, among other things, that the Commission exceeded its statutory authority in approving Rider DMR. The Commission reaffirmed Rider DMR largely relying on the reasons articulated in its Fifth Entry.

STANDARD OF REVIEW

Revised Code 4903.13 provides that a PUCO order "shall be reversed, vacated, or modified by the supreme court on appeal," if the Court finds the order to be either "unlawful or unreasonable." This Court's review of factual questions is deferential, as it "will not reverse or modify a PUCO decision as to questions of fact where the record contains sufficient probative evidence to show the PUCO's determination is not manifestly against the weight of the evidence." *Monongahela Power Co. v. Pub. Util. Comm.,* 104 Ohio St.3d 571, 2004-Ohio-6896, 820 N.E.2d 921, ¶ 29. But this appeal does not challenge any factual findings; it presents only legal questions about the statutory authority and reasonableness of the PUCO's determinations. And the Court has "complete and

independent power of review as to all questions of law" in appeals from the Commission. *Ohio Edison Co. v. Pub. 868 Util. Comm.,* 78 Ohio St.3d 466, 469, 678 N.E.2d 922 (1997).

ARGUMENT

<u>Proposition of Law 1</u>: R.C. 4928.143(B)(2)(h) does not permit distribution modernization riders that fail to require any grid modernization or other distribution investments.

The Commission cannot authorize Rider DMR under R.C. 4928.143(B)(2)(h). That provision permits riders based on the costs the utility bears in providing "distribution service." *Id*. But Rider DMR is meant only to provide credit support to FirstEnergy Corp., with the "intention" that FirstEnergy *hopefully*, *someday*, *in some form*, accesses credit to modernize the distribution infrastructure; in which case, it will then be compensated for its actual modernization expenditures through other riders. The Commission, however, "as a creature of statute, has no authority to act beyond its statutory powers." *Discount Cellular, Inc. v. Pub. Util. Comm.,* 112 Ohio St.3d 360, 2007-Ohio-53, 859 N.E.2d 957, ¶ 51. "So if a given provision does not fit within one of the categories listed [in R.C. 4928.143(B)(2)], it is not authorized by statute." *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, at ¶ 32. Because Rider DMR "does not fit" in R.C. 4928.143(B)(2)(h), the Commission acted beyond its authority in allowing FirstEnergy to charge its captive customers these excessive fees.

A. The Commission exceeded its statutory authority in creating and approving Rider DMR under R.C. 4928.143(B)(2)(h) because it does not require any distribution investments, and hence does not "regard[] distribution service."

The starting place for determining which riders can be authorized under R.C. 4928.143(B)(2)(h) is the plain language of the statute. *In re Application of Columbus S.*

Power Co., at ¶ 34. Here, the relevant statutory language authorizes only riders "regarding the utility's distribution service." R.C. 4928.143(B)(2)(h). Distribution service, in turn, is "the delivery of electricity to homes and businesses over the local poles and wires, transformers, substations and other equipment." PUCO, Glossary of utility-related terms, available at https://perma.cc/VA6W-M8UN.

The Commission's approval of Rider DMR fails for the simple reason that it does not "regard[] distribution services." At a minimum, the requirement that a rider be "regarding . . . distribution services" means that approval of the rider fees is contingent on the utility undertaking some actual investment in its distribution services. To be sure, the term "regarding" is not specific. And the myriad parts of the electric industry are interdependent—generation impacts distribution, and vice versa—they all arguably "regard[]" one another. "[A]pplying the [regarding] provisions according to its terms," therefore, is a "project doomed to failure, since, as many curbstone philosopher has observed, everything is related to everything else." *California Div. of Labor Stds. Enforcement v. Dillingham Constr., N.A., Inc*., 519 U.S. 316, 335–336, 117 S.Ct. 832, 136 L.Ed.2d 791 (1997) (Scalia, J., concurring). But just as courts have construed such broad language in other statutes, the Court here too should not "read [the Legislature's] words of limitation as mere sham." *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co*., 514 U.S. 645, 655, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995). Rather, to give R.C. 4928.143(B)(2)(h) meaning, the Commission can only approve a rider "regarding . . . distribution service" if—at a minimum—it imposes a requirement that the utility make *some* investment in distribution service. Revised Code 4928.143(B)(2)(h), in short, only allows riders "regarding the utility's distribution service," not unrestricted cash infusions.

But that is what Rider DMR is. The Fifth and Eighth Entries confirm that the purpose of the rider was to provide needed credit support to FirstEnergy Corp., and that it imposes no actual requirement that FirstEnergy invest in grid modernization. *See* Fifth Entry at ¶ 127 ("We intend for Rider DMR to provide the minimum amount necessary to provide credit support for the Companies to facilitate access to the credit markets."); *id.* at ¶ 281 ("Rider DMR is intended to provide credit support to the Companies in order to avoid a downgrade in credit ratings."); Eighth Entry at ¶ 84 ("Rider DMR is intended to provide credit support to the Companies in order to prevent such a downgrade."). The Commission sought to tie credit support to distribution service on the theory that it "intends" for FirstEnergy, with access to credit markets on more favorable terms, to borrow capital to modernize the grid. But that fails to satisfy the statute's clear mandate. Despite its name, Rider DMR does not require a *single* penny to be spent on distribution service or infrastructure, or even that a *single* improvement or change be made in distribution service.

A careful review of the Commission's Fifth and Eighth Entries makes that clear. Although the Commission frequently mentions distribution modernization, Rider DMR is connected to distribution only by the Commission's "intention" that by "enabling" FirstEnergy to "access" capital markets, FirstEnergy will indeed access capital and undertake unspecified distribution modernization projects. *See, e.g.*, Fifth Entry at ¶ 118 (Rider DMR is meant to "assure continued *access* to credit on reasonable terms in order to *allow* the borrowing of adequate capital to support its grid modernization initiatives.") *id.* at ¶ 185 ("Rider DMR will . . . ensure that the Companies have *access* to capital markets in order to make investments in their distribution systems."); *id.* at ¶ 190 ("Rider DMR is

intended to stimulate the Companies to focus their innovation and resources on modernizing.); *id.* at ¶ 385 (Rider DMR "will allow the Companies to *access* capital markets and obtain favorable borrowing terms and conditions, *enabling* investment in a more extensive grid modernization program."); Eighth Entry at ¶ 84 ("Rider DMR is *intended* to enable the Companies to procure funds to jumpstart their distribution grid modernization initiatives."). Under the Rider, then, FirstEnergy is *not* required to even try to access capital for a distribution modernization project, let alone undertake one.

The Commission's "sufficient progress" requirement does not change the analysis. The Commission stated in the Fifth Entry that its staff would monitor to make sure FirstEnergy made "sufficient progress" in approved grid-modernization projects, though it is unclear what progress would count as "sufficient" because there is no approved plan nor any benchmarks for grid modernization. Regardless, the Commission walked back that requirement in the Eighth Entry, explaining that the "'sufficient progress' language should not be interpreted to mean that Rider DMR revenues be limited in the deployment of grid modernization programs" because it can be "used for other purposes related to improving the Companies' ability to access capital markets such as debt repayment and funding pension obligations." Eighth Entry at ¶ 115. Moreover, it's entirely within the Commission's "sole discretion" to determine whether there's been sufficient progress, making it a meaningless standard. And assuming FirstEnergy is not making "sufficient progress"—whatever that means—it does not matter: there is no consequence, as Rider DMR does not provide for a refund and this Court cannot order it. *See In re Rev. of Alternative Energy Rider Contained in Tariffs of Ohio Edison Co.*, Slip Opinion No. 2018-Ohio-229, ¶ 19.

Ultimately, therefore, the connection between Rider DMR revenues and actual distribution modernization is too attenuated to meet R.C. 4928.143(B)(2)(h)'s statutory requirement that the rider "regard[] distribution service." If the Commission's "intentions" were enough, the Commission would be able to approve any and all charges to FirstEnergy customers. Imagine, for instance, if there were a coal ash spill at an FES plant that cost hundreds of millions of dollars in environmental remediation and personal injury costs. Could the Commission approve a rider for FirstEnergy's captive distribution customers to pay for the clean-up? By the Commission's rationale, yes. Eliminating FES's debt would help FirstEnergy Corp. maintain its credit rating, so that it might hopefully, but not necessarily, invest in distribution. Indeed, because money is fungible, approving any charge for FirstEnergy helps "enable" it to fix electric lines, replace poles, and otherwise support its distribution infrastructure, and the Commission may "intend" that the rider ultimately inure to support "distribution service." The implications are endless.

But that broad reading of R.C. 4928.143(B)(2)(h) cannot stand. Adopting the Commission's "interpretation would remove any substantive limit to what an electric security plan may contain, a result we do not believe the General Assembly intended." *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, at ¶ 34. At a minimum, for the Commission to authorize a rider under R.C. 4928.143(B)(2)(h) there must be some concrete requirement that the utility make an expenditure or investment in its "distribution service." Yet here, there is not a single distribution service expenditure or upgrade required.[5]

---

[5] The Commission's staff did not even believe Rider DMR could be considered a proper "distribution modernization rider." Staff witness Tamara Turkenton testified: "[I]t is named 'distribution modernization rider,' but I believe Staff Witnesses Buckley and Dr. Choueiki

B. Rider DMR cannot be considered an "incentive" to modernize the grid.

The Commission fares no better in attempting to characterize Rider DMR as a distribution modernization "incentive" authorized under R.C. 4928.143(B)(2)(h). Fifth Entry at ¶ 190. In describing those types of riders that satisfy the statutory mandates, R.C. 4928.143(B)(2)(h) specifically enumerates "distribution infrastructure and modernization incentives." Seizing on this language, the Commission defined an "'incentive,'' per Webster's Dictionary, as "something that stimulates one to take action, work harder, etc.; stimulus, encouragement."" Fifth Entry at ¶ 190 (quoting Webster's New World Dictionary, Third College Ed. 682 (1988)). Because a Rider DMR was "intended to stimulate the Companies to focus . . . on modernizing their distribution," the Commission concluded it was "[t]herefore . . . a distribution modernization incentive authorized by R.C. 4928.143(B)(2)(h)." *Id.*; *see also* Eighth Entry at ¶ 114 ("Rider DMR qualifies as a provision 'regarding distribution infrastructure and modernization incentives' for the Companies."). But this reasoning is flawed.

An "incentive" encourages or stimulates an entity to perform in a particular manner because the proffered "incentive" is *contingent* on that performance. In the context of ratemaking, an "incentive" scheme works by offering the utility increased compensation—the "incentive"—if the utility surpasses a particular performance standard (e.g., it beats a deadline for construction, conserves more energy than expected, or completes a project for less cost). "[T]he primary method of adding incentives is by allowing regulated entities to

---

and myself believe that this is a form of credit support for the company to be able to access -- access the capital markets and hopefully they will, in turn, modernize the grid. So there is a distribution component to it, but I don't know that staff believes that it is a distribution rider, per se. That late recovery will happen when they apply for this in the SmartGrid rider." Tr. Vol. II (July 12, 2016), 429:11–21.

earn . . . extra profits above their allowed rate of return, tied to improvements in performance." Michael Schmidt, Performance-Based Ratemaking: Theory and Practice 15 (2000). Record evidence reinforces this understanding. At the ESP hearing, for example, the Retail Energy Supply Association (RESA) witness emphasized that "the Commission could also provide performance incentives to the Companies if a more accelerated rollout [for a grid modernization plan] is achieved, such as a higher rate of return or a performance related true-up." Fifth Entry at ¶ 123. But Rider DMR includes no such incentive mechanism.

Moreover, even outside of the ratemaking context, an incentive-based mechanism requires conditioning the receipt of payment (or other reward) on a particular action. That contingency is what distinguishes an incentive from a gift. A person is "incentivized" to act because of a particular reward or outcome—like money—that he would not receive otherwise. Quite simply, if the reward accrues without the action, there is no incentive to take the action. It is giving away money and hoping that the action will happen anyway. Unfortunately, that's what Rider DMR does because the Commission did "not place restrictions on the use of Rider DMR funds." Fifth Entry at ¶ 282. Rider DMR is akin to an illusory promise: the Commission is forcing consumers to pay FirstEnergy, and it merely hopes to get something in return. It cannot reasonably be characterized as an incentive.

C. Rider DMR cannot be approved under R.C. 4928.143(B)(2)(h) because it is not based on the utility's costs incurred in providing services, in violation of the statute and the Commission's own longstanding precedent.

Rider DMR cannot be approved under R.C. 4928.143(B)(2)(h) for another reason—it is not based on any costs that the utility incurs in providing distribution service. As described above, *supra* 4–5, in restructuring the electricity industry, the Legislature

designed a hybrid scheme. It deregulated the generation market, but it left electric distribution service subject to the traditional regulatory scheme where a utility has a monopoly over a geographic area and rates are calculated based on the utility's prudent costs plus a reasonable rate of return. *See* R.C. 4928.15. Because riders under R.C. 4928.143(B)(2)(h) regard "distribution service," they too must be cost-based, as the Commission itself has consistently held.

The Revised Code makes this cost-based requirement clear. Revised Code 4928.15 prohibits a utility from providing "distribution service in this state . . . except pursuant to a schedule for that service." Moreover, "[d]istribution service rates and charges under the schedule shall be established in accordance with Chapters 4905. and 4909. of the Revised Code." *Id*. Riders under R.C. 4928.143(B)(2)(h) are, according to the plain language of that statute, charges for "distribution service," and must be part of the schedule mandated by R.C. 4928.15. Accordingly, these riders must also comply with the protections set forth in Chapters 4905 and 4909.

Chapters 4905 and 4909—which were enacted before SB3—set forth the traditional cost-based regulatory scheme. Specifically, R.C. 4909.15 establishes detailed requirements for "fixing and determining just and reasonable rates." Under this system, the Commission determines the utility's costs and multiplies that amount by an allowed rate of return. This product, when added to the utility's operating expenses and taxes, determines how much revenue the utility should be allowed to earn, known as the revenue requirement. Working backwards from this revenue requirement, the utility's rates are then calculated based on the number of customers and the amount of energy they use. *See id*.

The Legislature also included important consumer protections in Chapters 4905 and 4909 to make sure consumers captive in the utility's monopoly are not overcharged. These protections allow the Commission to demand detailed information about the utility's costs and its "management policies [and] practices." *See* R.C. 4909.04, 4909.154. The utility can only recover its costs from customers if the costs are not "imprudent" and are actually "used and useful" to render utility service to customers. *Id.* Mandated public hearings further make the process transparent and provide accountability. R.C. 4909.10. In the end, "[a]ll charges made or demanded . . . shall be just [and] reasonable." R.C. 4905.22.

Revised Code 4928.143(B)(2)(h) does not eliminate all these protections. The few examples provided in R.C. 4928.143(B)(2)(h) demonstrate that the Legislature intended "distribution service" riders to be cost-based. For instance, as mentioned above, that section specifically provides for "distribution infrastructure and modernization incentives." *Id*. The Legislature specified that those "may include a long-term energy delivery infrastructure modernization plan . . . or any plan providing for the utility's recovery of costs, . . . and a just and reasonable rate of return on such infrastructure modernization." *Id*. The cost-based mechanism is written right into R.C. 4928.143(B)(2)(h). Similarly, as described above, "incentive ratemaking" (which is explicitly listed in the statute) is a cost-based mechanism; a utility receives a higher rate of return on its costs for exceeding particular performance standards. *Supra* at 16.

It's no surprise, then, that the Commission has consistently ruled that ESP provisions approved under R.C. 4928.143(B)(2)(h) must be cost-based. Yet in approving Rider DMR it departed from its own precedent, and it provided no reasoning for reversing course. In fact, FirstEnergy may have been just as surprised as any other party that the

Commission sua sponte proposed Rider DMR as an alternative to FirstEnergy's original bail-out proposals, because FirstEnergy is no stranger to the Commission's long-standing position that distribution riders must be tied to the cost of providing distribution services. A decade ago, FirstEnergy sought approval for a rider that it acknowledged was "not based on historically incurred costs." But FirstEnergy insisted that it could "take[] advantage of [R.C. 4928.143(B)(2)(h)], which it claimed was "not a cost-based proceeding." *In re Ohio Edison Co., The Cleveland Electric Illuminating Co., Toledo Edison Co.*, Pub. Util. Comm. No. 08-935-EL-SSO, Opinion and Order, at 40 (Dec. 19, 2008), available at https://perma.cc/JH35-X59P. The Commission disagreed, explaining:

> [T]he Commission does not believe that a distribution rider should be approved, unless it is based on a reasonable, forward-looking modernization program and prudently incurred costs. At the hearing. Staff indicated that it could only support mechanisms such as Rider DSI if such mechanism is cost-based (Tr, VII at 302). The Commission believes that this is a sound policy. Although Section 4928.143(B)(2)(h), Revised Code, does provide for distribution modernization riders as part of an ESP, following the sound policy goals of Section 4928.02, Revised Code, the Commission believes that such riders should be based upon prudently incurred costs, including a reasonable return on investment for the electric utility.

Id. at 41. The Commission has subsequently reaffirmed that position. For example, the Commission approved a distribution rider under R.C. 4928.143(B)(2)(h) relating to American Electric Power's (AEP) vegetation management program, stating: "Consistent with prior decisions, the Commission also believes that, pursuant to the sound policy goals of Section 4928.02, Revised Code, a distribution rider established pursuant to Section 4928.143(B)(2)(h), Revised Code, should be based upon the electric utility's prudently incurred costs." *In re Application of Columbus S. Power Co.,* Pub. Util. Comm. Nos. 08-917-EL-SSO, 08-918- EL-SSO, at 34 (Mar. 18, 2009), available at https://perma.cc/W7ZP-P8G6 (citations omitted). And this Court, in reviewing that ruling, likewise acknowledged the

Commission's long-standing rule that "a distribution rider established pursuant to R.C. 4928.143(B)(2)(h) should be based on the electric utility's prudently incurred costs." *In re Application of Columbus S. Power Co.,* 138 Ohio St.3d 448, 2014-Ohio-462, 8 N.E.3d 863, ¶ 38.

In approving Rider DMR, the Commission's Chairman acknowledged that "[t]ypical public utility regulation functions to provide utilities with recovery and a return for expenditures made in constructing/maintaining service." Fifth Entry at ¶ 4 (Haque, Chairman, concurring). He further explained that, "[a]fter this initial infusion," the Commission would return to this "traditional regulatory mechanism" through Rider AMI. So Rider DMR, in his words, is "undoubtedly unconventional." *Id*. But that's euphemistic. Rider DMR breaks from "convention" because it breaks from the statutory scheme the Legislature enacted and from the Commission's precedent. Yet without providing any explanation why its previous view was wrong, the Commission switched position. Its new view, therefore, should be given no weight. The Commission had it right before this case—distribution service riders under R.C. 4928.143(B)(2)(h) must be cost-based. And for that reason, it should have rejected Rider DMR. This Court should reverse the Commission's decision, and place it back on course.

D. If affirmed, the Commission's decision to save FirstEnergy from its own poor investment decisions will invite bailout applications from other utilities.

The Commission's decision to bail out FirstEnergy Corp., though the guise of a distribution service rider, creates a dangerous precedent. Other utility companies will seek similar compensation for the financial troubles of their generation business; indeed, some already have. *See, e.g., In the Matter of the Application seeking Approval of Ohio Power Co.'s Proposal to Enter Into an Affiliate Power Purchase Agreement for Inclusion in the Power*

Purchase Agreement Rider, Pub. Util. Comm. Nos. 14-1693-EL-RDR, 14-1694-EL-AAM (pending before this Court, Case No. 17-0752), available at https://perma.cc/6YTG-L3KA; *In re App. of the Dayton Power and Light Company for Approval of Its ESP*, Pub. Util. Comm. No. 16-0395-EL-SSO, available at https://perma.cc/3G5F-UBMY. FirstEnergy Corp. "is not the only utility . . . invested in either coal-fired or nuclear generation" that is struggling to compete on the open generation market. Fifth Entry at ¶ 6 (Haque, Chairman, concurring). Losses from generation affiliates threaten the financial integrity of myriad parent corporations, they too could benefit from "credit-support" and cash infusions that would enable them to borrow at better rates for future projects. *See id.* ("wholesale market difficulties are not unique to [FirstEnergy Corp.]"). But the Commission cannot saddle captive distribution consumers with such costs in this case or any other. "[R]ates and charges . . . come directly from the pockets of consumers and businesses in this state." *Id*. at ¶ 6. If they have to pay for FES's losses, what other losses will they have to pay for as well?

The Commission's decision also sets a bad precedent for the market. Almost two decades ago the Legislature decided to deregulate the generation market, making it plain that electric suppliers would have to sink or swim on their own. And the Legislature reaffirmed that goal a decade ago with SB211. *See* R.C. 4928.38. But if the Commission continuously forces distribution consumers to cover for generation affiliates that are failing in the market, then what of the free market? A cash infusion here, even if it does not go directly to FES, props up FirstEnergy Corp for mistakes made by FES. That is, indeed, Rider DMR's purpose. But by artificially propping up FirstEnergy Corp., the Commission distorts the market. The generation affiliate, FES, is bolstered not because of its innovation, management, or superior service, but because the Commission has forced the customers

within the utility's monopoly to pay more. That's antithetical to the Legislature's scheme, and thwarts market development going forward.

Addressing this point, the Chairman stated that he was not "terribly concerned" that the Commission was setting bad precedent by "providing recovery based mathematically upon the financial condition" of a utility's parent company *Id.* at ¶ 10. Why not? Because the Commission promised to "closely monitor this going forward." *Id*. at ¶ 11. But that's not how the law works—if it is legal for one company, it is legal for others. The Court must stop these anticompetitive cash infusions, setting the Commission on a stable path for the next case.

<u>Proposition of Law 2</u>: Awarding a distribution utility a rider to compensate for debt accumulated by its poor performing market-based generation affiliate constitutes unlawful transition revenue or "any equivalent revenues" under R.C. 4928.38.

Rider DMR also runs afoul of the Legislature's prohibition on providing "transition revenues or any equivalent revenues" after the date of deregulation. R.C. 4928.38; *see also* R.C. 4928.141. Transition revenues were meant to assist the utilities "in making the transition to a fully competitive retail electric generation market." R.C. 4928.37(A)(1). With the passage of SB3, the Legislature recognized that it might be difficult for the utilities to transition to a free market for electric generation. So during the five year "market development period,"—until December 31, 2005 (or, in the case of regulatory assets, until December 31, 2010)—it allowed the utilities to charge extra fees to their distribution customers to make up for losses on the generation side. That is, even if the utility's distribution customers had chosen to get their electricity from another generation source, those captive customers would still pay to help the utility's generation arm transition to the free market. R.C. 4928.37. But "the utility's receipt of transition revenues . . . terminate[d] at

the end of the market development period." R.C. 4928.38. The Legislature mandated that after this period, a utility is "wholly responsible for whether it is in a competitive position after the market development period." *Id*. And it barred the Commission from "authoriz[ing] the receipt of transition revenues or any equivalent revenues by an electric utility." *Id*. The Commission's approval of Rider DMR thwarts this restriction.

This Court has taken a searching approach to determine whether the Commission has improperly authorized transition revenues. *In re Application of Columbus S. Power Co*., 147 Ohio St.3d 439, 2016-Ohio-1608, 67 N.E.3d 734, at ¶ 21. By "inserting the phrase 'any equivalent revenues,' . . . the General Assembly has demonstrated its intention to bar not only transition revenue associated with costs that were stranded during the transition to the market following S.B. 3 but also any revenue that amounts to transition revenue by another name." *Id*. So the Court has accordingly dug beneath the surface of riders to determine whether they are "allow[ing] the company to recover costs that are otherwise unrecoverable in the competitive generation market." *Id*. at ¶ 14.

For instance, the Court recently reversed the Commission's approval of AEP's rate stability rider (Rider RSR), finding that it constituted an unlawful transition charge. *Id.* Because it would "promote stable retail-electric-service prices," the Commission had authorized Rider RSR under R.C. 4928.143(B)(2)(d). *Id*. But "after looking at the nature of the revenue" recovered by Rider RSR, the Court concluded that "AEP is receiving the equivalent of transition revenues through that rider." *Id.* at ¶ 22. Rider RSR revenues were tied to generation "revenues that AEP would expect to lose based on the projected shopping" and it "was intended to provide AEP with sufficient revenue to maintain its financial integrity and ability to attract capital during the ESP." *Id*. at ¶¶ 8, 24, 36. Hence

they were transition revenues, just "by another name." *Id*. at ¶ 21. *See also In re Application of Dayton Power & Light Co.*, 147 Ohio St.3d 166, 2016-Ohio-3490, 62 N.E.3d. 179.

Rider DMR does exactly the same thing. Although not called "transition revenues," Rider DMR provides a mandatory charge to the utility's captive distribution company to compensate for troubles on the open generation market—it therefore operates no differently from the original transition revenues following SB3. As the background of this case demonstrates, Rider DMR was a response to the financial troubles of FirstEnergy Corp. due to the failing of its generation affiliate, FES. *Supra* at 9–15. Moody's and Standard & Poor's emphasized that FES's reliance on coal, nuclear, and other costly sources of generation were the root of the parent corporation's shortcomings. *See* Tr. Vol. X (Aug 1, 2016), P3/EPSA Ex. 21 (Moody's report); Rehearing Testimony of Joseph Buckley (June 29, 2016), Staff Ex. 13, Att. 3, at 2–3 (S&P report). And it's no secret that "[w]hen this rate case began just over three years ago, the company's objective was to find a way to have customers help support its financially failing power plants." John Funk, *PUCO rejects challenge to FirstEnergy special subsidy, you'll keep paying more*, The Plain Dealer (Aug. 17, 2017), available at https://goo.gl/Q1NaUB. FirstEnergy had twice asked the Commission for a bailout; first, with Rider RRS, which was denied by FERC as an anti-competitive contract with a generation affiliate, then with a second proposal that did virtually the same thing, which even the Commission rejected.

The third attempt—Rider DMR—fares no better. Just like the revenues this Court rejected for AEP, the Rider DMR revenues are meant to compensate for a utility's generation failings. Just as the Commission was worried about AEP's "financial integrity [and] its ability to attract capital," the Commission staff here too designed Rider DMR

precisely to "provide FirstEnergy Corp., through the Companies, with funds to assure continued access to credit," due to the generation affiliate's financial woes. Fifth Entry at ¶ 118. Yet, for generation, the law is clear: "the utility shall be fully on its own in the competitive market." *Id*. If AEP's Rider RSR gave unlawful transition revenues, so too does Rider DMR.

The Commission improperly dismissed concerns that Rider DMR constitutes unlawful transition revenue, providing four unpersuasive reasons for dismissal. *First*, it concluded that this Court's AEP decision does not apply because "Rider DMR is authorized by R.C. 4928.143(B)(2)(d) rather than R.C. 4928.143(B)(2)(d), the statute which authorized the AEP stability charged overturned by the Supreme Court." Fifth Entry at ¶ 287. But that is a meaningless distinction. This Court's analysis turned on the "nature of the revenue" recovered; if the rider forces captive customers to compensate for losses on the generation side, it is an unlawful transition revenue regardless of its label.

Second, the Commission reasoned that "there is no 'transition' involved in this case" because the Companies "transferred their generation assets to FES many years ago." Fifth Entry at ¶ 287. But that rationale overlooks R.C. 4928.38's prohibition of "transition revenues or *any equivalent revenues*." (Emphasis added.) It would make no sense if the Legislature's prohibition on transition charges did not apply *after* the transition period elapsed and the companies separated their generation business. That is precisely when the Legislature wanted to prohibit anticompetitive revenues and ensure that the companies were "fully on [their] own." R.C. 4928.38.

Third, the Commission stated that, in its view, Rider DMR "is entirely unrelated to generation because the Companies have no generation assets." Fifth Entry at ¶ 287. But the

entire case history contradicts that claim. Chairman Haque, in his attempt to place this case into "plain language," asked: "How did we get here?" Fifth Entry at ¶¶ 1, 6. His response: FirstEnergy's "wholesale market difficulties" (i.e., the generation market difficulties) from "invest[ing] in either coal-fired or nuclear generation in a restructured state." Fifth Entry at ¶ 6. As he explained, the "regulated distribution utilities [like FirstEnergy] get a regulated rate of return for everything that they do. There is no reason why these regulated distribution utilities should ever be in a position of true financial harm whereby they can't make necessary investments to better the delivery of power and innovate." *Id*. at ¶ 11. Rider DMR was needed because of FES, not because of any FirstEnergy failings.

Lastly, the Commission concluded that Rider DMR was not a transition fee because "Staff will periodically review how the proceeds of Rider DMR are used in order to ensure that such proceeds are used, directly or indirectly, in support of grid modernization." *Id*. at ¶ 287. But its concession that the funds can be used "indirectly" to support modernization undermines its case. The Commission considers paying off FirstEnergy debts, such as "pension obligations," *id.* at ¶ 115, an "indirect" support of modernization because the goal is to improve FirstEnergy Corp.'s cash-to-debt ratio; a ratio plagued by FES's financial collapse. If the revenues are going to compensate for FES's failings on the open market, it runs afoul of the statute.

The Companies, for their part, assert a different argument—one that the Commission did not adopt. They argue that there is no prohibition on receiving transition revenues from distribution service riders because R.C. 4928.143(B) allows for the Commission to approve riders "notwithstanding any provision of Title XLIX of the Revised Code to the contrary," including R.C. 4928.38's prohibition on transition revenues. Fifth

Entry at ¶ 284. But the Companies take this "notwithstanding" language too far. By their reading, the Commission can authorize any rider under the ESP statute without regard to anything else in Title 49. That would mean the Commission could authorize riders without being subject to judicial review, R.C. 4903.13, or without regard to the Legislative policies articulated in R.C. 4928.02.

That interpretation defies the "the common-sense principle of statutory construction that sections of a statute generally should be read 'to give effect, if possible, to every clause.'" *Heckler v. Chaney,* 470 U.S. 821, 829, 105 S.Ct. 1649, 84 L.Ed.2d 714 (1985). A statute's use of a "notwithstanding" clause "signals the drafter's intention" that certain provisions of the "notwithstanding" section may "override" other directly "contrary or conflicting provisions" contained in other sections, but it does not "operate to override non-conflicting or non-contrary provisions" of the statute. *Broad Street Energy v. Endeavor Ohio*, *LLC*, 975 F. Supp. 2d 878, 885 (S.D.Ohio 2013); *see also see also NLRB v. SW General*, ___ U.S. ___, 137 S.Ct. 929, 940, 197 L.Ed.2d 263 (2017) (explaining that a "notwithstanding" clause "just shows which of two or more provisions prevails in the event of a conflict"). To the contrary, when construing a "notwithstanding" clause, courts must be "careful to adhere to more general canons of statutory interpretation by applying a 'notwithstanding' clause in context with the rest of the statute in which it appears." *Bark v. USFS*, 37 F. Supp. 3d 41, 53 (D.D.C. 2014). In practice, that means that "where literal application of the clause would lead to so broad an application that it would negate another section of the same statute," applying "a narrower reading of the 'notwithstanding' clause" is the better approach. *Id.* Put another way: "Courts should attempt to reconcile two seemingly conflicting statutory provisions whenever possible, instead of allowing one provision

effectively to nullify the other provision." *United States v. Gordon*, 961 F.2d 426, 431 (3d Cir. 1992); *see Ottery v. Bland*, 42 Ohio App.3d 85, 87, 536 N.E.2d 651 (10th Dist. 1987) (explaining that courts should "attempt to harmonize all the provisions rather than produce conflict in them").

Following that approach here leads away from the companies' interpretation of R.C. 4928.143(B). There is no inherent conflict between the Legislature's decision to allow "distribution service" riders in R.C. 4928.143(B)(2)(h) and prohibit transition revenues in R.C. 4928.38. A distribution service rider does not, by definition, have to compensate for generation losses. That is, it does not have to provide transition revenue. For example, as the Legislature explained in R.C. 4928.143(B)(2)(h), a distribution service rider may provide "for the utility's recovery of costs . . . [for] infrastructure modernization." Simply compensating a utility for its distribution expenditures—as with Rider AMI—does not offend the Legislature's bar on transition revenues. Because the two provisions are not directly "contrary or conflicting," *Broad Street Energy*, 975 F. Supp. 2d at 885, and can be read in harmony, they should be. The Court should reverse the Commission's improper approval of unlawful transition revenues.

Proposition of Law 3: The Commission's approval of the modified DMR is unreasonable because, contrary to the Commission's established standards, it does not provide for safeguards to ensure that the revenues be used for grid modernization.

The Commission's approval of Rider DMR is not only unlawful, it is also unreasonable. This Court has an independent obligation to ensure that the Commission's determinations are not "unreasonable." R.C. 4903.13; *Ohio Consumers Council v. PUCO*, 114 Ohio St.3d 340, 2007-Ohio-4276, 872 N.E.2d 269, at ¶ 41. By vesting this Court with exclusive review of the Commission's decisions, the Legislature entrusted this Court to

serve as a check on the Commission's power. *Id*. And that check is needed here because under any rational measure Rider DMR comes up short. It requires consumers to give the Companies more than $600 million without *any* of three indispensable safeguards: (1) a plan for grid modernization; (2) a mechanism for refunding or crediting consumers if the Companies fail to modernize the grid; or (3) ring-fencing to protect ratepayers from having to dig FES out from financial crisis again. That, standing alone, warrants reversal.

First, Rider DMR is an unreasonable distribution modernization rider because it is not tied to a modernization plan.[6] In prior cases where the Commission has approved distribution riders, the Commission has required that the rider be based on a distribution improvement plan. *See, e.g.*, *In re Ohio Edison Co., et al.*, Pub. Util. Comm. No. 08-935-EL-SSO, at 40–41. But, as described above, there is neither a plan nor any "restrictions on the use of Rider DMR funds." Fifth Entry at ¶ 282. Consequently, there are no benchmarks—none—to measure the Companies' progress in modernizing the grid. There are similarly no deadlines to keep and no way to evaluate whether the Companies have appropriately used the funds. In approving Rider DMR, the Commission relied heavily on RESA's testimony regarding the benefits of grid modernization. Fifth Entry at ¶¶ 116, 186; Eighth Entry at ¶ 65. But even RESA refused to support Rider DMR because it "lacks any directives regarding the amount of grid modernization to be undertaken by the Companies or the necessary timeframes for making such investments." Fifth Entry at ¶ 122.[7]

---

[6] The Companies were required to file a grid modernization plan in a separate case, not tied to Rider DMR revenues. *See* Fifth Entry at ¶ 188. Even the Commission's staff did not believe that filing an application in a separate case was sufficient basis for Rider DMR. *Id*.

[7] RESA, for example, recommended that the Commission impose the following minimum conditions on Rider DMR's approval: "(1) smart meter roll-out through 100 percent of the Companies' service territories in five years, with the exception for very rural areas; and (2) the implementation timeframe should be 20 percent a year over the five-year rollout

In defense of its position, the Commission explained that "placing restrictions on the use of Rider DMR funds would defeat the purpose of Rider DMR . . . . [which] is intended to provide credit support to the Companies." *Id*. at ¶ 281. But if the purpose of providing credit support to the Companies is so that they can invest in grid modernization, it is reasonable to expect that they actually make such investments. Yet the Commission did not require that the Companies even attempt to access capital to make modernization improvements. Without "specific directives to the Companies to implement grid modernization," *id.* at ¶ 122, Rider DMR is essentially a blank check. This Court shouldn't sign it.

Second, Rider DMR is unreasonable because it does not include any consequence for the Companies' failure to invest in grid modernization. That is, it lacks a plan for modernization up-front (as explained above), and it fails to protect consumers on the back-end if the Companies do not deliver. It is commonplace for the Commission to subject the utilities to an annual audit and hearing process to determine whether the rider revenues collected were appropriately utilized. *See* R.C. 4909.15. And, likewise, the Commission regularly includes "true-up" provisions that require the utilities to refund or credit customers for any amounts not prudently spent. *See* R.C. 4905.32 (refund or remittance allowed if specified in rider); *In re Rev. of Alternative Energy Rider Contained in Tariffs of Ohio Edison Co.*, Slip Opinion No. 2018-Ohio-229, at ¶ 19.

In this instance, however, the Commission repeatedly rejected calls that the utility be required to refund customers (or credit their accounts) for Rider DMR in the event that it failed to modernize the grid. The Commission worried that subjecting FirstEnergy to a

---

period" with "performance incentives . . . if a more accelerated rollout is achieved." Fifth Entry at ¶ 123.

refund would be "counterproductive" because it would "impose additional risks on the Companies." Eighth Entry at ¶ 76. But, as a result, it is the consumers that bear all the risk. They bear the risk that FirstEnergy will collect Rider DMR revenues but won't prudently and efficiently undertake grid modernization. And if that happens, this Court will be powerless to impose a refund. *See In re Rev. of Alternative Energy Rider Contained in Tariffs of Ohio Edison Co.*, at ¶ 19 (where no refund was given because the rider did not specify a refund process).

Lastly, Rider DMR is unreasonable because it does nothing to prevent the Companies' captive distribution customers from having to compensate for FES's future market failings. To protect the Companies—and most importantly, their ratepayers—in the future, the Commission should have implemented ring-fencing (i.e., provisions to insulate the Companies from their affiliates).

The record, as detailed above, demonstrates that FES's poor performance on the open generation market was the main contributor to its parent company's, First Energy Corp.'s, financial troubles and the need for Rider DMR. And unfortunately, the problem is just getting worse. Recent developments demonstrate that FES is further failing in the competitive market—experts expect that it may go bankrupt. Funk (Aug. 21, 2017), *supra*. So the ongoing financial troubles of FES—an entity that should be on its own in the generation market—continuously threaten to drag down its parent company, FirstEnergy Corp., and its regulated affiliates, the Companies. After three years of Rider DMR, the Commission will have to decide whether to extend it for another two. If FES keeps spiraling down, then FirstEnergy Corp. may still have credit troubles that it will use to justify an

extension. Ohio ratepayers will then have to pay hundreds of millions more dollars for FES's poor market performance.

The Commission, however, rejected ring-fencing proposals as "premature." Eighth Entry at ¶¶ 87–88. The Chairman cautioned that "[g]oing forward, in the event that the Commission sees our regulated distribution utilities suffer as a result of actions from parent companies or affiliates, the Commission should very seriously consider ring-fencing the distribution utilities." Fifth Entry at ¶ 11 (Haque, Chairman, concurring). As he further acknowledged, "our regulated distribution entities should not be utilized to subsidize market difficulties, risky behavior, etc., associated with parent and affiliate companies." *Id*. But that is exactly what happened with Rider DMR, and it provides no protection against it happening again. Even if it were permissible to make ratepayers bailout FirstEnergy Corp. this time (which it was not), it certainly is unreasonable to refuse precautions to prevent another bailout.

<u>Proposition of Law 4</u>: It is unreasonable and contravenes R.C. 4928.66(D) for the Commission to allow a utility to recover lost distribution revenues stemming from independent customer decisions that improve energy efficiency rather than any affirmative efficiency program sponsored by the companies.

The Commission's approval of FirstEnergy's ESP improperly serves to enrich the Companies in another way, entirely separate from Rider DMR: it allows the Companies to collect "lost distribution revenues" for energy saved by the independent conservation actions of consumers, rather than from any FirstEnergy conservation program. Fifth Entry at ¶¶ 317, 324; Eighth Entry at ¶¶ 140–142. Under federal and state law, utility companies are both required and encouraged to implement energy efficiency programs. But efficiency programs can hurt a utility's bottom line because if less energy is distributed, the utility collects less from consumers. The Legislature has thus allowed the Commission to approve

compensation for "lost distribution revenues" stemming from a utility's energy efficiency programs. *See* R.C. 4928.66(D). But in this case, FirstEnergy's Customer Action Program (CAP) is an efficiency "program" in name only. It simply measures customer energy reduction efforts undertaken without any assistance or funding from FirstEnergy, such as a consumer's choice to use more efficient light bulbs or upgrade to energy-saving appliances. Tr. Vol. XXXVII (Jan. 15, 2016), 7861:23–7864:10. The Commission's decision to allow FirstEnergy to recover lost distribution revenues for CAP is therefore both unlawful and unreasonable.

Revised Code 4928.66(D) provides for a "revenue decoupling mechanism," so that a utility may recover for lost distribution revenue when the Commission:

> determines both that the revenue decoupling mechanism provides for the recovery of revenue that otherwise may be forgone by the utility *as a result of or in connection with* the implementation by the electric distribution utility of any energy efficiency or energy conservation programs and reasonably aligns the interests of the utility and of its customers in favor of those programs.

As the plain language of this provision demonstrates, lost distribution revenue can be recovered only for revenue that was reduced "as a result of or in connection with" an energy efficiency program "implement[ed] by the electric distribution utility." *Id.* Otherwise, the customers' interest would not "reasonably align[]" with the utility. *Id*. A customer has no interest in paying extra fees to a utility for the customer's own conservation efforts in which the utility had no role.[8]

[8] Under R.C. 4928.662(A), a utility may count energy savings resulting from independent customer actions toward compliance with the state's energy efficiency requirements. But that is distinct from receiving lost distribution revenues, which is governed by R.C. 4928.66(D).

This limitation is not only in the statute's text, it also makes sense. The utility should not be harmed by its own efforts to increase efficiency. But if consumers take independent actions that are not prompted or incentivized by the utility, the utility does not deserve a reward. As the Commission has explained, awarding this recovery revenue is only reasonable when the implementation of effective energy efficiency programs would otherwise reduce the utility's revenue from volumetric rates and "penalize a utility for encouraging customers to use less power." *In the Matter of Aligning Electric Distribution Utility Rate Structure With Ohio's Public Policies to Promote Competition, Energy Efficiency, and Distributed Generation*, Pub. Util. Comm. No. 10-3126-EL-UNC, Entry, at 1 (Dec. 29, 2010), available at https://perma.cc/G3L6-8Y4K. Therefore, "once a utility demonstrates that it successfully implemented energy efficiency programs with documented energy savings, the utility is permitted to recover the 'lost' volumetric revenue for each kWh saved by the energy efficiency program." *Id*. at 2.

Consistent with R.C. 4928.66(D), the Commission has historically authorized recovery of lost distribution revenues only to compensate for a utility's conservation efforts—lest the utilities be discouraged from helping customers save energy. *In re AEP Request for Approval of Its Program Portfolio Plan*, Pub. Util. Comm. No. 09-1089-EL-POR, Opinion and Order, at 26 (May 13, 2010), available at https://perma.cc/LZE7-ELR6; *see also In the Matter of Aligning Electric Distribution Utility Rate Structure*, *supra*. In the context of smart grid deployment, for example, the Commission clarified that "approval of lost distribution revenues is limited to those lost revenues which can be demonstrated to be the *result* of FirstEnergy's proposed alternative pricing program." *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The*

Toledo Edison Company for Approval of Ohio Site Deployment of the Smart Grid Modernization Initiative, Case Nos. 09-1820-EL-ATA *et al.*, Finding and Order, at 10 (June 30, 2010), available at https://perma.cc/UC2K-MFBJ (emphasis added). In short: lost distribution revenues are meant to reflect "the *actual impact* of [a utility's efficiency programs] . . . upon energy savings[,]" *In the Matter of the Application of The Cleveland Electric Illuminating Company, Ohio Edison Company, and The Toledo Edison Company for Approval of Their EE/PDR Program Portfolio Plans for 2010 through 2012*, Pub. Util. Comm. Nos. 09-1947-EL-POR *et al.*, Opinion and Order, at 18 (Mar. 23, 2011), available at https://perma.cc/7VBG-GT9N (emphasis added), not independent consumer action.

Other states have adopted a similar approach of limiting lost revenues to the energy savings directly resulting from a utility's energy efficiency or demand-side management programs. Indiana specifically rejected the idea that lost revenues should be awarded based on independent customer efficiency improvements rather than energy savings "specifically caused by that utility's energy efficiency efforts," concluding that "[i]t would not be equitable to allow [a utility] to recover from its ratepayers for energy savings caused by ratepayers' own responsible efforts to conserve." *Pet. of S. Indiana Gas and Electric Co.*, 2011 Ind. PUC LEXIS 115, Ind. Util. Regulatory Comm. No. 43839, Final Order, at 85 (Apr. 27, 2011). *See also, e.g.*, Nevada Admin. Code 704.95225 ("An electric utility may recover an amount based on the measurable and verifiable effects of the implementation by the electric utility of programs for energy efficiency and conservation described in the demand side plan of the electric utility . . . .").

Despite this, the Commission allowed FirstEnergy to earn extra revenue based on its customers' independent efficiency improvements without any utility assistance. The CAP

simply provides after-the-fact documentation of the results of these independent customer efforts. Neither the Companies nor the Commission dispute that. *See* Fifth Entry at ¶ 147 (CAP "involves no action by the Companies to achieve the energy savings."). Yet the Fifth and Eighth Entries offer no reason why lost distribution revenues for the CAP are justified or permissible under the statute if they are not the "result of" the utility's actions. Instead, the Commission merely reasoned that the savings under the CAP could be recovered as long as they were "verifiable." Fifth Entry at ¶ 324; Eighth Entry at ¶ 142. But the fact that "verifiable" energy savings occur when customers implement energy efficiency measures on their own does not mean that ratepayers should pay FirstEnergy extra for documenting those savings. The Commission's bare-bones statement makes no sense, and falls short of the Commission's obligation under R.C. 4903.09 to "set[] forth the reasons prompting the decisions arrived at." Its inability to justify its decision is not surprising. The award of lost distribution revenues based on the CAP is unlawful, unreasonable, and inconsistent with the Commission's own precedent. This Court should reverse.

CONCLUSION

For the reasons given above, the Environmental Advocates respectfully request that the Court reverse the Commission's Fifth and Eighth Entries on Rehearing.

Respectfully submitted,

<u>/s/ Rachel Bloomekatz</u>

RACHEL BLOOMEKATZ (0091376)
Counsel of Record
GUPTA WESSLER PLLC
1148 Neil Avenue,
Columbus, OH 43201
(202) 888-1741
(202) 888-7792 (fax)
rachel@guptawessler.com

JOHN FINNIGAN
ENVIRONMENTAL DEFENSE FUND
6795 Hidden Hills Drive
Cincinnati, Ohio 45230
(513) 226-9558
jfinnigan@edf.org

TRENT DOUGHERTY (0079817)
MIRANDA LEPPLA (0086351)
OHIO ENVIRONMENTAL COUNCIL
1145 Chesapeake Ave., Suite I
Columbus, OH 43212
(614) 487-7506
(614) 487-7510 (fax)
tdougherty@theoec.org
mleppla@theoec.org

MADELINE FLEISHER (0091862)
ENVIRONMENTAL LAW & POLICY CENTER
21 W. Broad St., 8th Floor
Columbus, OH 43215
(614) 569-3827
mfleisher@elpc.org

Counsel for Appellants, Ohio Environmental Council, Environmental Defense Fund, and Environmental Law & Policy Center

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing brief was served upon the following parties of record via electronic transmission this 26th day of February, 2018.

/s/ *Rachel Bloomekatz*
RACHEL BLOOMEKATZ
Counsel for Appellants

SERVICE LIST FOR PARTIES OF RECORD

william.wright@ohioattorneygeneral.gov
thomas.mcnamee@ohioattorneygeneral.gov
thomas.lindgren@ohioattorneygeneral.gov
steven.beeler@ohioattorneygeneral.gov
maureen.willis@occ.ohio.gov
william.michael@occ.ohio.gov
gkrassen@bricker.com
dstinson@bricker.com
rachel@guptawessler.com
jfinnigan@edf.org
tdougherty@theoec.org
mleppla@theoec.org
mfleisher@elpc.org
trhayslaw@gmail.com
leslie.kovacik@toledo.oh.gov
jaborell@co.lucas.oh.us
mkurtz@BKLlawfirm.com
jkylercohn@BKLlawfirm.com
jlang@calfee.com
talexander@calfee.com
ymcgeebrown@jonesday.com
cdunn@firstenergycorp.com
sfisk@earthjustice.org
bojko@carpenterlipps.com
mwallach@trzlaw.com