



MEMORANDUM

Date: September 17, 2020

To: The Ohio Manufacturers' Association

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

RE: H.B. 6's Decoupling Provision – A Primer on Decoupling and How H.B. 6 Decoupling Benefits FirstEnergy by Deviating from Best Practices

H.B. 6 has well-known provisions that affect Ohio's nuclear power plants, coal power plants, select solar power plants, and energy efficiency. Less well-known is a confusing decoupling provision. Fortunately, FirstEnergy's CEO put the effect of the provision in plain language for its investors:

“essentially it takes about one-third of our company and I think makes it somewhat recession-proof”¹

As a result of this decoupling provision, FirstEnergy could collect about \$355 million in unearned revenue through 2024. Ratepayers will incur higher electricity costs with no associated benefits. Moreover, a unilateral ruling from the PUCO could extend FirstEnergy's decoupling at the utility's discretion. This could, for example, cost FirstEnergy customers an additional \$400 million if extended from 2025 through 2030.²

Decoupling can be a legitimate policy when carefully implemented with best practices and coupled to other state policy objectives. However, H.B. 6's decoupling provision does not follow best practices, nor does it advance any state policy goal. The table below shows a comparison of the design features of a typical decoupling mechanism and those of FirstEnergy's HB6-enabled decoupling mechanism.

¹ <https://www.utilitydive.com/news/firstenergy-nears-proposal-to-decouple-ohio-utility-revenues-electricity-c/566610/>

² Memorandum to The Ohio Manufacturers' Association, “H.B. 6 Decoupling Provision - \$355 Million for FirstEnergy through 2024, Possibly Millions More”, [https://ohiomfg.informz.net/ohiomfg/data/images/-%20OMA%20MEMO%20-%20HB%206%20Decoupling%20-%20FINAL%20\(Aug.%2014,%202020\).pdf](https://ohiomfg.informz.net/ohiomfg/data/images/-%20OMA%20MEMO%20-%20HB%206%20Decoupling%20-%20FINAL%20(Aug.%2014,%202020).pdf).

Characteristic	Typical Decoupling Mechanism	HB 6 Decoupling Mechanism
Utility revenue recovered from ratepayers	Average sales year	Very high sales year
Overcharges	Credited to customers	Unlikely to be credited to customers
Revenue requirement reevaluation	Next scheduled distribution rate case	No scheduled distribution rate case (could be in perpetuity)
Joint policy initiatives	Energy efficiency programs, distributed generation programs	None
Effected utilities	Available to all state-regulated electric distribution utilities	Just FirstEnergy utilities
Regulatory process allowing customer engagement	Yes	No

Table 1. Typical Decoupling vs H.B. 6 Decoupling Design Features

In the remainder of this memo we review the policy behind decoupling and further describe differences between H.B. 6’s decoupling provision and typical decoupling provisions.

Decoupling Basics

Electric utility monopolies are motivated to increase their profits, like any business. However, electric utility monopolies do not compete for new customers or with new products to increase profits. Instead, monopoly electric utilities receive a government-administered return on and of its investments. Overtime, this traditional model has incited utilities to overbuild to increase its financial return. The more a utility builds, the greater its total return.

The utility recovers its costs and return - the sum of which is called the revenue requirement - through charges on electricity sold (kWh), charges on customer peak power needs (kW), and customer service charges set in rate cases which have been historically held every 3 to 10 years. However, because customer kWh and kW are not constant in any given year, a utility will collect more or less than its revenue requirement in years between rate cases. A utility would prefer to over-collect between rate cases. This dynamic incites utilities to actively discourage customer energy-efficiency and on-site generation. By driving up customer consumption between rate cases, utilities can increase their profits. As a result, utility cultures and practices can form that actively discourage customer energy-efficiency and on-site generation adoption. Utilities can actively discourage customer energy management through their electric tariff designs, interconnection policies, and account management culture.

Simply put, traditional electric utility monopolies are incited to overbuild, oversell, and discourage customer energy management and choice.

Importantly, competitive markets have been an effective policy antidote for the distorted economic incentives of monopolies. Competitive markets have been employed for power generation. However, they have not been employed for electric distribution companies (the “wires” companies).



While electric distribution utilities were originally competitive during the very early years of the industry, today, it is typical for distribution companies to be government-granted monopolies.

Absent readily competitive markets for “wires” companies, some states have implemented decoupling to combat utility overbuilding and overselling. Traditional decoupling requires a utility to true-up its collected revenue between rate cases to its revenue requirement. As a result, where true decoupling is in place, the utility is not incented to over-sell electricity between rate cases, because it would have to refund customers for over-collection. Constraining energy sales thus also limits overbuilding, which is driven by sales forecasts. And, if sales for some reason are too low, the utility is also protected. Subsequently, decoupling has several goals:

1. Protects customers and automatically issues customer rate decreases or credits between rate cases in case of over-collection;
2. Allows distribution utilities to recover prudent costs to provide distribution service;
3. Encourages the distribution utility to be more cost-efficient with their operational costs and capital costs; and
4. Reduces the distribution utility’s opposition to customer choice around energy efficiency and on-site generation.

Decoupling policies are often jointly implemented with state policies to encourage energy efficiency and on-site generation. Sometimes these proactive policies are desired, especially where local utilities have strong anti-efficiency and anti-customer choice cultures. Common sense and recent experience tell us that an anti-customer choice culture persists within Ohio’s utilities.

H.B. 6’s Decoupling Provision Design Features

H.B. 6’s decoupling provision is missing or distorts important design features of a typical decoupling mechanism and will not have the intended effect of a true decoupling policy. In this sense, it is decoupling in name only. In effect, it is a semi-permanent over-charge policy that allows FirstEnergy’s utilities to profit. And, currently, it is only FirstEnergy’s utilities that profit.

There are best practices when designing decoupling. FirstEnergy’s decoupling does not follow those best practices.

Very High Utility Sales and Customer Overcharges

A typical decoupling mechanism pegs a utilities revenue requirement to a typical year of capital and operational expenses. H.B. 6 severely distorted this approach by instead prescribing FirstEnergy’s revenue requirement to the revenue it received in a peak sales year, 2018. Note, it was not based on the revenue requirement for 2018, which is based on expected costs, but, instead, it was based on the actual revenue FirstEnergy received. FirstEnergy had higher sales in 2018 as compared to other years, partially due to abnormally high temperatures which increased customer consumption. By prescribing 2018 as a representative year, this inflates the revenue requirement, which increases customer bills with no associated benefits.



Moreover, FirstEnergy's decoupling mechanism includes no revenue adjustments, and its resulting significantly excessive profits are unlikely to be capped. Typically, there are adjustments required for situations such as unseasonable weather, major changes in number of customers, or economic recession. Such adjustments are to mitigate the risk to customers of the distribution utility receiving windfall profits from circumstances that make an actual year much different than the representative or "test" year. These adjustments are in place to handle the very circumstance we are facing in 2020. COVID-19 has significantly reduced customer consumption and peak usage than a typical year, causing the distribution utility to receive less revenue. Yet, since FirstEnergy's decoupling plan includes no adjustments, FirstEnergy can receive greater profit due to the economic downturn, which increases customer bills with no associated benefits. Despite the economic downturn, the H.B. 6 decoupling mechanism will allow FirstEnergy to receive the same record revenue that it received in 2018.

Additionally, unusual revenue was also included in the H.B. 6 decoupling provision. Typically, decoupling establishes the revenue requirement based on typical operational and capital costs. FirstEnergy's decoupling provision also included so-called "lost revenue" from energy efficiency programs from the past as revenue they also need in the future. This so-called lost revenue equals approximately \$66 million per year, potentially in perpetuity. Put proverbially, FirstEnergy is having its cake and eating it too.

Moreover, a near simultaneous law change governing FirstEnergy's significantly excessive profits will allow FirstEnergy utilities to keep profits that previously may have been refunded to customers.³

Joint Policy Initiatives

As discussed, decoupling is often paired by lawmakers with policies that advance customer energy-efficiency or customer-sited distributed generation. FirstEnergy CEO Chuck Jones even referenced energy efficiency to justify this decoupling provision, saying it "Allows us to continue to promote energy efficiency with our customers so that they can get the benefit of that without impacting our base revenues."⁴ This is a curious statement as H.B. 6 simultaneously ended the requirement for Ohio's distribution utilities to achieve energy efficiency savings. And, FirstEnergy proactively suspended the bulk of their energy-efficiency programs early, in January 2020, even though they were under no requirement to do so. The other Ohio utilities, which have not implemented the H.B. 6 decoupling mechanism, offered efficiency programs through 2020. Furthermore, FirstEnergy also has taken no steps to offer non-mandated efficiency programs in 2020 as Jones' statement may suggest.

The H.B. 6 decoupling provision furthers none of Ohio's policy goals.

³ Memorandum to the Ohio Manufacturers' Association Energy Group, "Impact of the 2019 FirstEnergy SEET Amendment", <https://www.ohiomfg.com/wp-content/uploads/OMA-Memos-SEET-Combined-CLL-and-RS-Aug-20-2020.pdf>.

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



Effected Utilities

H.B. 6's decoupling provision does not apply statewide. H.B. 6 included some eligibility limitations to the decoupling provision that have constrained its application to other utilities. For example, the provision states that revenue recovery be "recovered pursuant to an approved electric security plan under section 4928.143 of the Revised Code, as of the twelve-month period ending on December 31, 2018." As it happens, only FirstEnergy has implemented a decoupling mechanism and is receiving decoupling revenues based on the H.B. 6 provision. Duke is not eligible for the decoupling mechanism and AEP Ohio and DP&L have not yet implemented an H.B. 6 decoupling mechanism (although AEP Ohio has tried).

Regulatory Process with Customer Engagement

Typically, the details of a decoupling mechanism will be determined within a regulatory process that allows customer intervention. H.B. 6's decoupling provision prescribed considerable detail without customer input. The design process was non-transparent and non-representative.

Finally, the PUCO issued a ruling on its own accord after the passage of H.B. 6, which gives FirstEnergy discretion on when it next files a distribution rate case. H.B. 6's decoupling provision's term is limited to its current distribution rate case. Thus, the PUCO's ruling could allow the H.B. 6 decoupling provision to extend in perpetuity. We expect that FirstEnergy will do so, so long as decoupling is more financially beneficial to it than what could be achieved with a new rate case.