BEFORE
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 Pursuant to R.C. 4928.143 in the Form of An Electric Security Plan	)))))))	**Case No. 14-1297-EL-SSO**

SIERRA CLUB'S APPLICATION FOR REHEARING OF THE FIFTH REHEARING ENTRY

On October 12, 2016, the Commission issued its Fifth Entry on Rehearing ("Rehearing Order" or "Order") approving a so-called Distribution Modernization Rider ("DMR") for inclusion in the Fourth Electric Security Plan ("ESP IV") for Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison (collectively, "FirstEnergy" or "Companies"). As demonstrated in the accompanying Memorandum in Support, the Order is unlawful and unreasonable for at least the following reasons:

1. The Commission lacked jurisdiction to consider the DMR on rehearing, and thus its approval of the DMR was unlawful.

2. The Rehearing Order unlawfully holds that the DMR is authorized under R.C. 4928.143(B)(2)(h) even though:

   - The DMR is wholly unrelated to distribution service;
   - The DMR cannot be characterized "incentive ratemaking," because (a) it does not provide any incentive for distribution investments, and (b) the DMR does not qualify as "ratemaking" under Ohio public utilities law.
   - The DMR is not related to any costs incurred by the Companies in providing services to their customers.

3. The Rehearing Order is unlawful and unreasonable because the DMR is an unlawful transition charge.

4. The Order is unlawful and unreasonable because FirstEnergy failed to meet its burden of demonstrating that the DMR is related to distribution service, and the Commission's finding that this Rider is related to distribution service is against the manifest weight of the evidence.

5. The Order is unlawful and unreasonable because FirstEnergy failed to meet its burden of demonstrating that the DMR is related to incentive ratemaking, and the Commission's finding that this Rider provides an incentive for grid modernization is against the manifest weight of the evidence.

6. The Rehearing Order is unlawful and unreasonable because the Commission approve the DMR even though the record demonstrates this rider is unjust, unreasonable, and not beneficial to customers because: (i) the DMR will not create an incentive for grid modernization; (ii) the Commission's findings regarding credit support are against the manifest weight of the evidence; (iii) the conditions placed on the DMR are illusory and unenforceable; (iv) the Commission unreasonably and unlawfully rejected conditions that would have benefited customers while providing credit support to the Companies; and (v) the Commission's finding that "placing restrictions on the use of Rider DMR funds would defeat the purpose of Rider DMR" is against the manifest weight of the evidence.

7. The Rehearing Order is unlawful, unreasonable, and against the manifest of the weight of the evidence because (i) the Commission erroneously concluded that placing restrictions on Rider DMR funds would defeat the Rider's purpose; and (ii) the manifest weight of the evidence establishes that a DMR with the restrictions proposed by Sierra Club would provide credit support to the Companies and advance grid modernization; and (iii) the DMR approved by the Commission places no restrictions on the use of DMR funds, and will do nothing to promote grid modernization.

8. The Order is unlawful and unreasonable because the Commission's approval of the DMR violates the ESP vs. MRO test set forth in R.C. 4928.143(C)(1), as the Commission (i) erroneously found that the DMR is quantitively neutral under the ESP vs. MRO test; (ii) erroneously relied on the purported qualitative benefits associated with the Third Supplemental Stipulation, which are already part of ESP IV; and (iii) relied on qualitative benefits that are illusory, unenforceable, or both.

9. The Order is unlawful and unreasonable because it failed to hold FirstEnergy to the burden of proof in the ESP IV proceeding as required by R.C. 4928.143(C)(1) and O.A.C. 4901:1-35-06(A).

10. The Order is unlawful and unreasonable because on multiple issues the Commission failed to satisfy its duty under R.C. 4903.09 to:
    - Set forth the reasoning followed by the Commission in reaching a decision
    - Support its decision with appropriate evidence

- Respond to contrary positions

For the reasons set forth in the accompanying memorandum, Sierra Club respectfully requests that the Commission grant this Application for Rehearing.

November 11, 2016

Respectfully submitted,

s/ Shannon Fisk

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MEMORANDUM IN SUPPORT OF
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OF THE FIFTH REHEARING ENTRY

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On October 12, 2016, the Commission issued its Fifth Entry on Rehearing ("Rehearing Order" or "Order") approving a so-called Distribution Modernization Rider ("DMR") for inclusion in the Fourth Electric Security Plan ("ESP IV") for Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison (collectively, "FirstEnergy" or "Companies"). Hastily cobbled together by the Commission Staff during the rehearing process, the DMR as approved would cost customers $612 million over the next three years, with the possibility of an additional two years of payments. None of that money would be required to be spent on distribution modernization or any other services for customers. Instead, the customer money is supposed to be used to provide "credit support" to FirstEnergy Corp. and the Companies, a term so broad that it provides no real limit on how the money would be spent. In short, the DMR is just the latest attempt in this proceeding to use customer money to prop up the bottom line of the FirstEnergy corporate family.

Rehearing is necessary because the Rehearing Order's approval of the DMR is unlawful, unjust, and unreasonable. The Commission attempts to sell the DMR as a distribution rider that would use "incentive ratemaking" to "jump start" distribution modernization investments by the Companies. But these claims are both legally and factually flawed as the provision of $612 million in unrestricted customer money without any requirement that the money be invested in distribution modernization has nothing to do with distribution, is a giveaway rather than an incentive, and is contrary to the well-established principle that rates should be based on the cost of providing service to customers. And even if the DMR could be legally authorized, its approval has not been demonstrated on this record to be just and reasonable for customers, who would be paying at least $612 million over the next three years while receiving virtually no benefits in return.

In a transparent attempt to make the Staff's DMR proposal look more reasonable than it was, FirstEnergy claimed in response to the proposal that it needed customers to shell out between $4.5 billion and $9.216 billion in credit support through May 31, 2024. This outlandish request was directly contrary to FirstEnergy's simultaneous claim that it could provide customers with $976 million in credits from 2019 through May 31, 2024 under its Modified Rider RRS proposal. The inconsistency between those claims raises serious doubts about the credibility of the testimony that FirstEnergy presented in this proceeding in support of both its Modified Rider RRS and the DMR. Regardless, the fact that the Rehearing Order rejects the truly absurd DMR proposal from FirstEnergy should not be used to excuse the fact that the DMR approved by the Commission is unlawful, unjust, and unreasonable. For each of the reasons detailed below, that approval must be reversed and the DMR must be withdrawn from ESP IV.

I. Grounds for Rehearing

The Order approving the DMR is unlawful and unreasonable for at least the following reasons:

11. The Commission lacked jurisdiction to consider the DMR on rehearing, and thus its approval of the DMR was unlawful.

12. The Rehearing Order unlawfully holds that the DMR is authorized under R.C. 4928.143(B)(2)(h) even though:

    - The DMR is wholly unrelated to distribution service;
    - The DMR cannot be characterized "incentive ratemaking," because (a) it does not provide any incentive for distribution investments, and (b) the DMR does not qualify as "ratemaking" under Ohio public utilities law.
    - The DMR is not related to any costs incurred by the Companies in providing services to their customers.

13. The Rehearing Order is unlawful and unreasonable because the DMR is an unlawful transition charge.

14. The Order is unlawful and unreasonable because FirstEnergy failed to meet its burden of demonstrating that the DMR is related to distribution service, and the Commission's finding that this Rider is related to distribution service is against the manifest weight of the evidence.

15. The Order is unlawful and unreasonable because FirstEnergy failed to meet its burden of demonstrating that the DMR is related to incentive ratemaking, and the Commission's finding that this Rider provides an incentive for grid modernization is against the manifest weight of the evidence.

16. The Rehearing Order is unlawful and unreasonable because the Commission approve the DMR even though the record demonstrates this rider is unjust, unreasonable, and not beneficial to customers because: (i) the DMR will not create an incentive for grid modernization; (ii) the Commission's findings regarding credit support are against the manifest weight of the evidence; (iii) the conditions placed on the DMR are illusory and unenforceable; (iv) the Commission unreasonably and unlawfully rejected conditions that would have benefited customers while providing credit support to the Companies; and (v) the Commission's finding that "placing restrictions on the use of Rider DMR funds would defeat the purpose of Rider DMR" is against the manifest weight of the evidence.

17. The Rehearing Order is unlawful, unreasonable, and against the manifest of the weight of the evidence because (i) the Commission erroneously concluded that placing restrictions on Rider DMR funds would defeat the Rider's purpose; and (ii) the manifest weight of the evidence establishes that a DMR with the restrictions proposed by Sierra Club would provide credit support to the Companies and advance grid modernization; and (iii) the DMR approved by the Commission places no restrictions on the use of DMR funds, and will do nothing to promote grid modernization.

18. The Order is unlawful and unreasonable because the Commission's approval of the DMR violates the ESP vs. MRO test set forth in R.C. 4928.143(C)(1), as the Commission (i) erroneously found that the DMR is quantitively neutral under the ESP vs. MRO test; (ii) erroneously relied on the purported qualitative benefits associated with the Third Supplemental Stipulation, which are already part of ESP IV; and (iii) relied on qualitative benefits that are illusory, unenforceable, or both.

19. The Order is unlawful and unreasonable because it failed to hold FirstEnergy to the burden of proof in the ESP IV proceeding as required by R.C. 4928.143(C)(1) and O.A.C. 4901:1-35-06(A).

20. The Order is unlawful and unreasonable because on multiple issues the Commission failed to satisfy its duty under R.C. 4903.09 to:
    - Set forth the reasoning followed by the Commission in reaching a decision
    - Support its decision with appropriate evidence

- Respond to contrary positions

Because the Commission's Rehearing Order is unreasonable and unlawful, Sierra Club respectfully requests rehearing so that the Order can be modified to rescind approval of the DMR.

II. The Rehearing Order is Unlawful and Unreasonable Because the Commission Lacked Jurisdiction to Consider the DMR Proposal.

In its post-hearing briefs, Sierra Club explained that the Commission lacked jurisdiction to consider – or approve – the DMR proposal because it was not a proper issue for rehearing under R.C. 4903.10.[1] Because the Commission approved a rider that it did not have jurisdiction to consider, the Rehearing Order is unlawful and unreasonable.

The Commission lacked jurisdiction to consider the DMR proposal for three independent reasons. *First*, the DMR proposal could not be reviewed in this rehearing proceeding because the DMR is unrelated to any of the issues that the Commission ruled upon in the March 31, 2016 Opinion and Order ("March 31 Order"). Under R.C. 4903.10, parties are limited to challenging and seeking reconsideration of only those matters that the Commission "determined in the proceeding."[2] The rehearing process cannot be used to consider an entirely new provision that is based on new facts and rationales wholly unrelated to the provisions approved in the Commission's original order. As the Supreme Court explained in *Columbus & S. Ohio Elec. Co. v. Pub. Util. Comm.*,

[1] Sierra Club's Initial Post-Hearing Brief on Rehearing at 41-43 (Aug. 15, 2016) ("SC Br."). Note: Unless stated otherwise, any references to "post-hearing" briefs in this memorandum are to the briefs filed by the parties on August 15 and August 29, 2016. In addition, unless stated otherwise, all transcripts cited in this memorandum refer to the rehearing volumes.

[2] R.C. 4903.10.

> A rehearing is limited, in the commission's discretion, first, to matters determined in the earlier proceedings, and second, among those, to matters for which, in the judgment of the commission, sufficient reason has been shown. <u>The General Assembly did not intend for a rehearing to be a *de novo* hearing.</u>[3]

Here, because the DMR is an entirely new ESP provision, rather than simply a modification of a provision that the Commission approved in its March 31 Order, the Commission could not lawfully consider the DMR proposal in this rehearing process.

It is readily apparent that the DMR would be a new ESP provision, rather than simply a modification of a previously-approved provision. In comparison to the Rider RRS provision that it would replace, the DMR involves a different mechanism that leads to different costs for customers, is presented on the basis of different rationales, and purports to provide different benefits. For example, Rider RRS would provide customers with a charge or credit based on market energy and capacity prices, and the levels of generation and capacity from particular power plants owned by FES. By contrast, none of the factors used to determine charges and credits under Rider RRS are relevant to the DMR. Instead, the DMR has been set at a fixed annual amount based on the level of credit support purportedly needed to help FirstEnergy Corp. maintain an investment-grade credit rating. In addition, whereas Rider RRS would purportedly have provided a net credit to customers over the term of ESP IV,[4] customers would indisputably lose hundreds of millions of dollars (or more) under the DMR. The DMR's rationale is also entirely different than Rider RRS's. The rationales offered for Rider RRS were that it would purportedly provide rate stability to customers, provide net credits to customers over the long term, and help preserve Ohio generation assets.[5] None of those rationales pertain to the Staff's

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[3] 10 Ohio St.3d 12, 13, 460 N.E.2d 1108, 1109 (1984) (emphasis added).

[4] March 31 Order at 78, 85.

[5] *See, e.g.*, *id.* at 78-79, 85, 100, 109.

DMR proposal, which was pitched as helping to preserve FirstEnergy Corp.'s (and, by extension, the Companies') investment-grade credit rating and purportedly "jump-starting" distribution modernization initiatives.[6] Because the DMR is wholly unrelated to "any matters determined in the [original ESP IV] proceeding,"[7] the Commission lacked jurisdiction to consider that proposal.

Second, the Commission could not lawfully approve the DMR in this rehearing proceeding because R.C. 4903.10(B) does not allow the Commission to approve entirely new provisions on rehearing. On rehearing, the Commission may either affirm its original order, or if it finds that the original order or any part thereof is unjust or unreasonable, the Commission may "abrogate or modify" the order.[8] Consequently, the Commission was well within its authority in abrogating its prior approval of Rider RRS.[9] And for similar reasons, this provision would allow the Commission to consider modifications to Rider RRS. But that is not what the Commission ultimately did in its Rehearing Order. Instead, the Commission replaced Rider RRS with the DMR, an entirely new rider that is based on new facts and rationales unrelated to the provisions approved in the Commission's original order. Regardless of the merits of Staff's claims

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[6] Rehearing Order at 51-53, 87-93; *see also, e.g.*, Staff Ex. 15, Rehearing Testimony of Hisham M. Choueiki, Ph.D., P.E ("Choueiki Test.") at 15.

Staff's initial brief implicitly concedes that the DMR should not be considered on rehearing by noting that, in proposing the DMR, Staff "introduced an entirely new concept into this proceeding." Post-Hearing Brief Submitted on Behalf of the Staff of the Public Utilities Commission of Ohio, filed Aug. 15, 2016 ("Staff Br.") at 5. That description is correct, because the DMR, in comparison to Rider RRS, involves a different mechanism that leads to different costs for customers, is presented on the basis of different rationales, and purports to provide different benefits. Staff's concession further demonstrates why the DMR proposal is not simply a modification to an existing order but is instead an entirely new proposal that would have to be evaluated in a new proceeding.

[7] R.C. 4903.10.

[8] R.C. 4903.10(B).

[9] In fact, for the reasons set forth in Sierra Club's April 29, 2016 Application for Rehearing, it would have been unlawful to retain Rider RRS.

regarding the DMR's purported benefits, it is clear that the DMR was not a modification of Rider RRS but, instead, was entirely distinct from anything that was approved in the March 31 Order.[10] And because the plain language of R.C. 4903.10 does not authorize the Commission to approve entirely new provisions on rehearing, the Commission's approval of the DMR was unlawful.

Finally, the Commission's consideration of the DMR proposal also violated the rule that the Commission "shall not upon such rehearing take any evidence that, with reasonable diligence, could have been offered upon the original hearing."[11] There is absolutely no reason why Staff or the Companies could not have proposed a credit support rider like the DMR before the Commission issued its March 31 Order. Similarly, evidence regarding FirstEnergy Corp. and the Companies' credit ratings and metrics could have been presented earlier in this proceeding – but was not, because that is not what the first 21 months of this case was about. The fact that Staff and the Companies decided, at the eleventh hour, that a different rider with different rationales and goals should be pursued does not change the fact that the DMR proposal, and the evidence concerning it, could have been presented as part of the original testimony and hearing in this proceeding. Because evidence concerning the DMR could, with reasonable diligence, have been presented in the original case, the Commission could not lawfully hear that evidence on rehearing.

Although Sierra Club raised these points in its post-hearing briefs, the Commission failed to substantively address them in its Rehearing Order. Instead, the Commission claimed – erroneously – that these issues were addressed in the Third Entry on Rehearing ("Third

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[10] *Cf.* R.C. 4903.10(B). Indeed, in proposing the DMR, the Staff referred to it as an "Alternative Proposal," rather than as some sort of a modification to Rider RRS. Choueiki Test. at 14.

[11] R.C. 4903.10(B).

Rehearing Entry").[12] That Entry did not address the Commission's jurisdiction to consider the DMR proposal. Indeed, the Third Rehearing Entry does not mention the DMR at all. This is hardly surprising, given that the Third Rehearing Entry was issued less than a week after Staff first proposed the DMR, while the rehearing applications addressed in that Entry were all filed before Staff filed the DMR proposal.[13] As for the passages from the Third Rehearing Entry that the Commission claims "addressed these arguments,"[14] none of those passages discussed whether an entirely new proposal, such as the DMR, could be considered in the context of a rehearing process. Instead, those passages addressed certain parties' objections to the Commission's review of Modified Rider RRS. And the Commission's finding, that it could consider modifications to a rider it previously approved, does not mean that the Commission can review an entirely new rider that has no bearing on the issues decided in the March 31 Order. Simply put, the Commission has failed to address the argument presented in Sierra Club's briefs.

Even if the Third Rehearing Entry *had* found that the Commission could consider the DMR proposal, such finding would be contrary to the plain language of the rehearing statute. The statute makes clear that the rehearing process must be tied to the "matters determined" in the original proceeding,[15] and that the Commission's authority only extends to affirmance, abrogation, or modification of the original order.[16] If the Commission's position – that it had jurisdiction to consider, and authority to approve, a rider that is wholly unrelated to Rider RRS

[12] Order at 12 ("Once again, this Commission finds no merit in these jurisdictional and procedural arguments. We note that we sufficiently addressed these arguments raised by various parties . . . in the Third Entry on Rehearing.").

[13] Third Rehearing Entry (July 6, 2016) (addressing rehearing applications filed on May 31, and June 8, 10, and 24, 2016); *cf.* Choueiki Test. (filed June 29, 2016).

[14] Order at 12 (citing Third Rehearing Entry at 9-12, 14-16, 19).

[15] R.C. 4903.10.

[16] R.C. 4903.10(B).

and the issues litigated prior to the March 31 Order – were credited, there would be no effective limits on what could be considered in a rehearing process. By considering the entirely new DMR proposal, the Commission effectively treated the rehearing process as "a *de novo* hearing,"[17] contrary to the Legislature's intent. Because the Commission's position would render meaningless the limits established by R.C. 4903.10, that interpretation must be rejected. And because the Commission lacked jurisdiction to consider and approve the DMR, the Rehearing Order is unlawful.

Although the Commission tries to bolster its conclusions by citing *In re Ohio Consumers' Counsel v. Pub. Util. Comm.*, ("*CG&E*"),[18] its reliance on that case is misplaced. In *CG&E*, the Court considered an argument that focused, in large part, on the adequacy of the utility's rehearing application.[19] There, the Commission approved a utility's "alternative proposal" that proposed modifications to the Commission's original order, which had approved a stipulation filed by several parties.[20] This scenario – the Commission making modifications to its previously-approved provision on rehearing – is expressly contemplated by R.C. 4903.10(B),[21] and is a far cry from the situation here, where the Commission approved an entirely new proposal on rehearing. Nothing in *CG&E* suggests that the Commission may evaluate and approve a brand new rider proposal that has no connection to the issues that were debated during

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[17] *Columbus & S. Ohio Elec. Co. v. Pub. Util. Comm.*, 10 Ohio St.3d 12, 13, 460 N.E.2d 1108, 1109 (1984).

[18] 2006-Ohio-5789.

[19] *Id.* ¶ 14 ("OCC maintains that CG & E's first application for rehearing did not set forth specific grounds challenging the reasonableness or lawfulness of the commission's order . . . .").

[20] *Id.* ¶¶ 5, 8-9. More specifically, the modifications approved on rehearing involved changes to subcomponents of the provider-of-last-resort component of the utility's standard service offer. *Id.* ¶¶ 24-26.

[21] R.C. 4902.10(B) ("If, after such rehearing, the commission is of the opinion that the original order or any part thereof is in any respect unjust or unwarranted, or should be changed, the commission may abrogate or *modify* the same . . . .") (emphasis added).

the 21 months of the original proceeding. And as noted above, the Supreme Court has made clear that rehearing is not a proper mechanism for a *de novo* hearing.[22] Yet, that is exactly what the Commission did in this rehearing process. Because the Commission lacked jurisdiction to consider the DMR proposal, and lacked authority to approve this new rider, the Rehearing Order is unlawful and unreasonable.

III. The Rehearing Order is Unlawful and Unreasonable Because the DMR is not Authorized Under Ohio Law.

In its post-hearing briefs, Sierra Club explained that the DMR must be rejected because it is not authorized by R.C. 4928.143.[23] As the Ohio Supreme Court has held, a proposed rider cannot be approved as part of an ESP unless it falls within one of the enumerated categories set forth in R.C. 4928.143(B)(2).[24] Because the DMR does not fall within any of these categories, and is therefore legally impermissible, the Commission's approval of the DMR in the Rehearing Order is unlawful and unreasonable.

In its Order, the Commission brushed aside these arguments, finding – incorrectly – that the DMR could be approved under R.C. 4928.143(B)(2)(h). For the reasons explained in Sierra Club's post-hearing briefs, and as further explained below, the Commission's approval of the DMR is contrary to R.C. 4928.143 and is not authorized by any of the statutory provisions that the Companies rely on. To comply with Ohio law, the DMR must be removed from ESP IV and the Commission must rescind its approval of that rider.

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[22] *Columbus & S. Ohio Elec. Co. v. Pub. Util. Comm.*, 10 Ohio St.3d 12, 13, 460 N.E.2d 1108, 1109 (1984).

[23] *See generally* SC Br. at 43-55; Sierra Club's Post-Hearing Reply Brief on Rehearing (Aug. 29, 2016) ("SC Reply") at 31-39.

[24] *See, e.g.*, *In re Application of Columbus S. Power Co.*, 128 Ohio St.3d 512, 2011-Ohio-1788, 947 N.E.2d 655, ¶ 33.

A. The DMR Cannot be Authorized under R.C. 4928.143(B)(2)(h).

In the Rehearing Order, the Commission purports to find legal authorization for the DMR under R.C. 4928.143(B)(2)(h).[25] Under that statutory provision, an ESP may include "provisions regarding the utility's distribution service, including . . . provisions regarding single issue ratemaking, a revenue decoupling mechanism or any other incentive ratemaking, and provisions regarding distribution infrastructure and modernization incentives."[26] The Commission surmises that the DMR qualifies under R.C. 4928.143(B)(2)(h) because it would provide the Companies with an "incentive" that is "intended to stimulate the Companies to focus their innovation and resources on modernizing their distribution systems."[27] In reality, the DMR has nothing to do with distribution modernization as the Rehearing Order fails to require that any of the DMR revenues be spent on distribution modernization, and is not in any way connected to the recovery of any costs incurred for distribution modernization. As such, the DMR is not related to distribution service, does not qualify as "incentive ratemaking," and is contrary to the Commission's longstanding holding that a rider under R.C. 4928.143(B)(2)(h) must be based on a utility's prudential incurred costs.

1. The DMR is not related to distribution service.

A rider can be authorized under R.C. 4928.143(B)(2)(h) only if it is a provision "regarding the utility's distribution service." This threshold requirement is fatal to the Commission's holding in the Rehearing Order that the DMR qualifies under (B)(2)(h) because, as Sierra Club thoroughly explained in its post-hearing briefs,[28] the DMR is not related to

[25] Rehearing Order at 89-90.

[26] R.C. 4928.143(B)(2)(h).

[27] Rehearing Order at 90.

[28] SC Br. at 44-49; SC Reply at 31-34.

distribution service. In particular, there is no requirement that any of the $612 million or more in DMR revenues be spent by the Companies on distribution modernization, and the collection of such revenues is wholly unrelated to the recovery of any distribution modernization expenditures that the Companies might make in the future. In fact, separate and above the $612 million in DMR funds, the Companies would receive a return of and on any distribution modernization expenditures under the AMI or DCR riders.[29] And, the record clearly establishes that the Companies could dividend the DMR funds up to FirstEnergy Corp. which would then be free to use those funds to benefit shareholders or to provide support to its unregulated affiliates.[30] Given this complete lack of a requirement that the DMR funds be invested in distribution modernization, there is simply no legal basis upon which to conclude that the DMR is related to distribution service and approvable under R.C. 4928.143(B)(2)(h).

The Rehearing Order confirms that the $612 million in DMR funds that the Companies would receive would not have to be used to fund distribution modernization initiatives. The Commission makes clear that "we will not place restrictions on the use of Rider DMR funds" because doing so "would defeat the purpose of Rider DMR."[31] That "purpose" of the DMR is to bolster the finances of the FirstEnergy corporate family by providing the Companies with money that can be used to provide "credit support" to their parent, FirstEnergy Corp.[32] Nothing in R.C.

[29] *See* Tr. II at 460 (distinguishing between DMR and AMI); Tr. III at 691 (Mr. Buckley acknowledging that the DMR is in addition to any existing rider); *id.* at 570-71 (Mr. Buckley confirming that the Companies would get cost recovery for smart grid investments separate from the DMR); Tr. IV at 956-57, 1015 (Dr. Choueiki discussing cost recovery under DCR and AMI riders); Tr. V at 1229 (Dr. Choueiki confirming that, if the Staff Proposal were adopted, customers could end up paying both the DMR and Rider AMI); Tr. X at 1610 (Ms. Mikkelsen confirming that Rider AMI would provide a return on equity).

[30] Tr. II at 433; Tr. III at 584-85, 613-14, 702-03; Tr. IV at 956-57; Tr. X at 1606-09.

[31] Rehearing Order at 127.

[32] *Id*. That the purpose of the DMR was to provide credit support to the FirstEnergy corporate family was repeatedly acknowledged by Staff witnesses at hearing. See, e.g., Tr. IV at 959-60 (Choueiki cross) ("Q. So the purpose of the DMR is to enable the companies to provide credit support to both themselves and

4928.143(B)(2)(h), however, authorizes the Commission to require customers to provide an unrestricted pool of money to the Companies to be used to provide credit support to FirstEnergy Corp. or the Companies. Therefore, R.C. 4928.143(B)(2)(h) does not provide a legal basis for including the DMR as part of ESP IV.

The Rehearing Order tries to link the DMR with distribution service by claiming that the provision of credit support to the FirstEnergy corporate family is necessary to preserving the Companies' access to the credit markets.[33] According to the Commission, by providing the Companies with unrestricted funds that could help FirstEnergy Corp. avoid a downgrading of its credit rating, the DMR would help the Companies maintain their own credit rating. This would enable the Companies to continue to be able to access the credit markets which, in turn, will "enable the Companies to obtain funds to 'jumpstart' their grid modernization efforts."[34]

The Commission's "credit support" theory suffers from a number of evidentiary flaws that render approval of the DMR unjust and unreasonable.[35] But even setting those flaws aside, the "credit support" theory does not establish that the DMR qualifies as a distribution rider under R.C. 4928.143(B)(2)(h) for two reasons. First, as already noted and confirmed by the Rehearing Order, there is no requirement that any of the DMR funds be spent on distribution modernization initiatives. Second, even if the DMR were necessary and successful in preserving the Companies' access to the credit markets, there is no requirement in the Rehearing Order that the

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FE Corp.; is that correct? A. The purpose of the DMR is to provide credit support, correct."); Tr. III at 590 (Mr. Buckley acknowledging that "the purpose of the 131 million . . . is to provide credit support for the FirstEnergy organization"); *id.* at 598 (Mr. Buckley agreeing that the Staff Proposal "is intended to address possible future action by rating agencies"); Tr. II at 443 (Turkenton cross) ("Q. Would you agree with me, Ms. Turkenton, the -- the staff's proposal is for credit support? Isn't that what you state in your testimony? A. That is the purpose of the rider. It's not necessarily the name of the rider, but yes.").

[33] *Id*.

[34] *Id.* at 90-91, 127.

[35] *See generally infra* at Section IV.

Companies use such access to "jumpstart" distribution modernization. While the Commission and Staff may "intend" for the DMR to provide such a "jumpstart,"[36] such intent is legally irrelevant in the absence of any requirement that the DMR funds actually be used to fund distribution modernization initiatives. Yet there is not only no requirement to do so; there is also not any distribution modernization initiatives that have been approved for implementation or even a schedule for getting such initiatives approved. Instead, the Rehearing Order attempts to shoehorn a credit support rider into R.C. 4928.143(B)(2)(h) on the hope that the Companies will eventually invest in distribution modernization initiatives that might someday be approved, and that the Companies will be separately paid to implement. Such amorphous hope does not provide a legal basis for making customers pay an additional $612 million over the next three years for which they will receive no benefits in return.

The Rehearing Order attempts to create the missing link between the DMR and distribution service by purporting to condition the DMR on "a demonstration of sufficient progress in the implementation and deployment of grid modernization programs approved by the Commission."[37] That "condition," however, is essentially meaningless and does not make the DMR related to distribution service for at least three reasons. First, the Rehearing Order sets forth a process that makes it highly unlikely that any grid modernization programs would be approved, much less need to be implemented, before most or even all of the DMR funds are collected. While FirstEnergy filed a grid modernization application with the Commission in February 2016 in docket 16-0481-EL-UNC, nothing substantive has happened in that docket since that filing. And before even turning to that docket, the Rehearing Order notes that the Commission first intends to "undertake a detailed policy review of grid modernization in the near

[36] Rehearing Order at 90.

[37] *Id.* at 96.

future."[38] Following this policy review, the Commission will address FirstEnergy's grid modernization application,[39] which proposes its own collaborative stakeholder process to evaluate three potential grid modernization scenarios that would take between five and fifteen years to implement. The Commission will then approve whatever programs that it deems appropriate and that FirstEnergy demonstrates are just and reasonable.[40] In short, by the time any distribution modernization programs may be approved, much less required to be implemented, FirstEnergy would have collected from customers much, if not all, of the DMR funds. But without such approved programs, there is no basis upon which to measure the "sufficient progress" that the Rehearing Order purports to require.

Second, even if there were approved distribution modernization programs, the Rehearing Order provides no standards as to what would constitute "sufficient progress" by the Companies in implementing such programs. Instead, the Rehearing Order states only that it will be within the Commission's "sole discretion" to decide whether FirstEnergy has made such "sufficient progress."[41] Third, the Rehearing Order is silent as to what, if any, consequences there would be if FirstEnergy did not make such "sufficient progress." And given that most, if not all, of the DMR funds would likely have been collected before any programs necessary to measure "sufficient progress" even exist, it is clear that there would not be any meaningful consequences. In short, the sufficient progress "condition" is nothing more than meaningless window dressing that fails to ensure that the DMR funds are spent on or even lead to the implementation of

[38] *Id.* at 96-97.

[39] *Id.* at 97.

[40] *Id.* at 97, 107.

[41] *Id.* at 97.

distribution modernization. It certainly does not turn the DMR into a distribution rider for purposes of R.C. 4928.143(B)(2)(h).

The Rehearing Order's directive to the Staff to "periodically review" how the Companies and FirstEnergy Corp. use the DMR funds[42] is similarly toothless. Through this review, the Staff is supposed to "ensure" that the DMR funds "are used, directly or indirectly, in support of grid modernization.[43] But "indirect" support of grid modernization is defined so broadly in the Rehearing Order as to be meaningless. In particular, the DMR is based on the theory that improving FirstEnergy Corp.'s cash flow from operations to debt credit metric indirectly supports grid modernization by reducing the chances of a credit downgrade and, therefore, helping to preserve for the Companies favorable access to the capital markets. If FirstEnergy dividends the DMR revenues up to FirstEnergy Corp., such revenues would provide credit support to FirstEnergy Corp. and, under this credit support theory, would "indirectly" support grid modernization, even though none of those funds would be spent on distribution modernization and the DMR is not conditioned on any distribution modernization programs actually being implemented.

The "periodic review" provision is also toothless because the Commission has no jurisdiction over FirstEnergy Corp. So, once the DMR funds are dividended up, the Commission cannot impact what happens to the revenue. Finally, even if the Staff somehow concluded that the revenues were not used to directly or indirectly support grid modernization, the Order does not establish any penalty and, therefore, this provision is entirely unenforceable. For each of those reasons, the "periodic review" provision fails to transform an unrestricted credit support rider into a distribution rider under R.C. 4928.143(B)(2)(h).

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[42] *Id.* at 127-28.

[43] *Id.* at 128.

2. The DMR cannot be characterized as "incentive ratemaking."

Even if the DMR were somehow related to distribution service, it is not approvable under R.C. 4928.143(B)(2)(h) because it does not qualify as an incentive or "incentive ratemaking" under that statutory provision. As Sierra Club explained in its post-hearing reply brief, the DMR does not qualify as either an "incentive" or "ratemaking" because it is not connected to any costs that the Companies have or will incur for distribution modernization.[44] In particular, the DMR is not an "incentive" because, as explained in Section III.A.1 above, the Companies would not be required to make any investments in distribution modernization under the DMR but, instead, would be provided $612 million in unrestricted funds on the "hope" that they might decide to make distribution modernization investments.[45] The DMR does not qualify as "ratemaking" because it is not connected to any costs that FirstEnergy has incurred or will incur to provide distribution service to its customers.[46] Given that the DMR simply gives the Companies $612 million in unrestricted customer cash so that the Companies can provide credit support to FirstEnergy Corp., the DMR cannot, under any stretch of the imagination, be considered "incentive ratemaking" for distribution modernization.

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[44] SC Reply Br. at 34-37.

[45] Tr. II at 426.

[46] SC Reply Br. at 35, *citing* R.C. 4909.15; *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 537, 620 N.E.2d 835 (1993); *Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St.3d 91, 103, 447 N.E.2d 733 (1983). Any argument that R.C. 4909.15 should be ignored because R.C. 4928.143(B)(2)(h) authorizes distribution riders "notwithstanding any other provision of Title XLIX of the Revised Code to the contrary" should be rejected. The argument here is not that 4909.15 forecloses a rider that would otherwise be approvable under 4928.143(B)(2)(h). Instead, the point is that in the absence of any definition of "ratemaking" in the ESP statute, the Commission must look to 4909.15 in determining what constitutes ratemaking. 4909.15 provides that rates must be set on the basis of charging customers for expenditures that are included in the rate base or properly categorized as costs for providing services to customers. Given that the DMR does not provide any services to customers, then applying the definition of ratemaking under 4909.15 makes clear that the DMR cannot constitute "incentive ratemaking" under 4928.143(B)(2)(h).

The Rehearing Order fails to grapple with either of these points. Instead, the Order simply cites to a dictionary definition of the word "incentive" to claim that the DMR qualifies as an incentive because it would purportedly encourage or stimulate FirstEnergy to take action regarding distribution modernization.[47] The only explanation that the Rehearing Order provides for how the DMR would purportedly provide such encouragement is that the "Staff intends for Rider DMR to jump start the Companies' grid modernization efforts" and that the "record demonstrates that Rider DMR is intended to stimulate the Companies to focus their innovation and resources on modernizing their distribution systems."[48] But in order to "encourage" or "stimulate" an entity to take a certain action through the payment of a financial incentive, you must condition the payment of that financial incentive on that entity actually carrying out the action. Otherwise, you are simply giving money away with no assurance that it will encourage or stimulate the action that is desired. Unfortunately, that is exactly what the DMR is – the giving away of $612 million of customer money on the hope that the Companies will someday invest in currently unidentified and unapproved distribution modernization initiatives that the Companies would be paid again to carry out. Such a giveaway is the definition of a "bailout," not an incentive, and is not approvable under R.C. 4928.143(B)(2)(h).

The Rehearing Order fails to cite to a single case in Ohio or any other state in which a Commission, under the guise of providing an "incentive," has authorized a utility to collect money from its customers that is unrelated to the cost of providing any services to those customers. In its post-hearing reply brief, Sierra Club explained that such an approach would be foreclosed under the Federal Energy Regulatory Commission's ("FERC") incentive program for

[47] Rehearing Order at 90.

[48] *Id.*

transmission investments.[49] In particular, the transmission incentives provided under the FERC program are all tied to costs that the recipient actually incurs in providing transmission services, and the applicant has to demonstrate a nexus between the incentive requested and the investment being made.[50] The Rehearing Order fails to even address this point, much less provide an explanation for how the DMR does not simply "serve to increase rates without providing any real incentives to" invest in distribution modernization.[51]

3. The DMR is legally unauthorized because it is not related to any costs incurred by the Companies in providing services to their customers.

In his explanatory concurrence, Chairman Haque acknowledges that the DMR is "undoubtedly unconventional [as] [t]ypical public utility regulation functions to provide utilities with recovery and a return for expenditures made in constructing/maintaining service."[52] Respectfully, the Commission's departure here from such "typical public utility regulation" is not just "unconventional"; it is illegal because there is simply no support under Ohio law or traditional ratemaking for requiring customers to pay charges that, as here, are entirely unrelated to the provision of any services to customers. Sierra Club explained this fundamental flaw in its post-hearing reply brief on rehearing,[53] but the Rehearing Order fails to address it.

Notably, the Commission has, in rejecting or modifying proposed distribution riders under R.C. 4928.143(B)(2)(h), recognized that any such rider must be based on a utility's

[49] SC Reply Br. at 35-36.

[50] *Id.*

[51] 71 Fed. Reg. at 43,295.

[52] Concurring Opinion of Chairman Asim Z. Haque ("Haque Concurrence") at 2.

[53] SC Reply Br. at 35-36, 47-48.

prudently incurred costs.[54] For example, in rejecting the inclusion of certain programs in a distribution rider proposed by AEP, the Commission explained:

> While SB 221 may have allowed Companies to include such provisions in its ESP, the intent could not have been to provide a 'blank check' to electric utilities.
> . . . . .
> 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. Therefore, the ESRP rider will be subject to Commission review and reconciliation on an annual basis. As for the recovery of any costs associated with the Companies' remaining initiatives (i.e., enhanced underground cable initiative, distribution automation initiative, and enhanced overhead inspection and mitigation initiative), the ESRP rider will not include costs for any of these programs until such time as the Commission has reviewed the programs, and associated costs, in conjunction with the current distribution system in the context of a distribution rate case as explained above.[55]

Similarly, in modifying a distribution rider proposed by FirstEnergy in its first ESP, the Commission held that:

> The 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. However, the Companies have not demonstrated that the proposed

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[54] *In re Application of Columbus Southern Power Co. for Approval of an Electric Security Plan*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Mar. 18, 2009 Order at 34-36; *In the Matter of the Application of Ohio Edison Co., the Cleveland Elec. Illuminating Co., & the Toledo Edison Co. for Auth. to Establish A Standard Serv. Offer Pursuant to Section 4928.143, Revised Code in the Form of an Elec. Sec. Plan.*, 08-935-EL-SSO, 2008 WL 5411710 (Dec. 19, 2008); *see also In re Application of Columbus S. Power Co.*, 2014-Ohio-462, ¶¶ 37-38, 138 Ohio St. 3d 448, 456–57, 8 N.E.3d 863, 872, *reconsideration denied*, 2014-Ohio-2245, ¶¶ 37-38, 139 Ohio St. 3d 1408, 9 N.E.3d 1064 (noting with respect to AEP's ESP 1 Order that "The commission found, consistent with its prior decisions, 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.").

[55] *In re Application of Columbus Southern Power Co. for Approval of an Electric Security Plan*, Case Nos. 08-917-EL-SSO and 08-918-EL-SSO, Mar. 18, 2009 Order at 34-36.

> Rider DSI is based on a reasonable, forward-looking distribution modernization program. Moreover, the testimony in this case clearly represented that the proposed Rider DSI is not cost-based. The Commission does not believe that a distribution rider should be approved, unless the program is shown to comply with both the intent and the scope of the statute and that it is based upon prudently incurred costs.[56]

The Rehearing Order represents a radical departure from these prior Commission rulings regarding distribution riders approvable under R.C. 4928.143(B)(2)(h). In particular, the DMR has no connection with any costs prudently incurred by the Companies, as it is not based on the recovery of costs already incurred or to be incurred to serve the Companies' customers. Instead, it is exactly the type of "blank check" that the Commission previously concluded is not "sound policy" and exceeds "both the intent and the scope of the statute." The Rehearing Order provides no basis to conclude otherwise with regards to the DMR. As such, the Commission should, consistent with its prior decisions, conclude that the DMR cannot be approved under R.C. 4928.143(B)(2)(h) and withdraw that rider from ESP IV.[57]

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[56] *In the Matter of the Application of Ohio Edison Co., the Cleveland Elec. Illuminating Co., & the Toledo Edison Co. for Auth. to Establish A Standard Serv. Offer Pursuant to Section 4928.143, Revised Code in the Form of an Elec. Sec. Plan.*, 08-935-EL-SSO, 2008 WL 5411710 (Dec. 19, 2008). In its post-hearing reply brief, FirstEnergy misleadingly claims that "Rider DMR is similar to the Companies' Delivery Service Improvement Rider ("Rider DSI") which was approved by the Commission in the Companies' ESP I under R.C. 4928.143(B)(2)(h)" because, according to FirstEnergy, "Rider DSI also provided annual revenue to support the delivery of distribution services without being tied to specific distribution investments." Co. Reply Br. at 91-92 n. 367, citing Case No. 08-935-EL-SSO, Opinion and Order, pp. 11-12, 17 (Mar. 25, 2009). But the Companies left out the fact that the Commission, in approving Rider DSI as part of a settlement, specifically noted that FirstEnergy had committed to, among other things, make "a total aggregate investment of not less than $615 million for January 1, 2009, through December 31, 2011" in distribution improvements as a condition of approval of the rider. Case No. 08-935-EL-SSO, Opinion and Order, p. 17 (Mar. 25, 2009). As such, that Rider DSI was still based on costs to be incurred by FirstEnergy in providing services to its customers.

[57] While the Commission conditioned the DMR on FirstEnergy Corp. maintaining its corporate headquarters and nexus of operations in Akron, Ohio, Rehearing Order at 96, the Commission appears to have properly rejected FirstEnergy's contention that such headquarters provision would justify approving the DMR as an economic development and job retention program under R.C. 4928.143(B)(2)(i). As Sierra Club explained in detail in its post-hearing briefs on rehearing, any attempt to approve the DMR under 4928.143(B)(2)(i) would be contrary to law and the evidence in the record. SC Br. at 52-55; SC Reply at 37-40. These arguments are incorporated by reference as if fully set forth herein.

B. The DMR Constitutes an Unlawful Transition Charge.

The Commission should also rescind its approval of the DMR because that rider constitutes an unlawful transition charge under R.C. 4928.38. As explained in Sierra Club's post-hearing reply brief on rehearing, the DMR is quite similar to the rate stability riders that the Ohio Supreme Court recently rejected as improper transition charges[58] because the DMR would provide additional revenue to the Companies, unrelated to any costs incurred to serve customers, in order to help FirstEnergy Corp. and the Companies maintain their credit rating.[59] In addition, nothing in the Rehearing Order prohibits FirstEnergy from simply funneling the DMR revenues up through dividends to FirstEnergy Corp., which could then use such funds to increase shareholder dividends or support FES. As such, the DMR is contrary to the prohibition on transition revenues, which was intended to ensure that the deregulated entities are "fully on their own in the competitive market."[60]

The Rehearing Order fails to address the fundamental similarities between the DMR and the riders that were rejected by the Ohio Supreme Court as unlawful transition charges. Instead, the Order finds import in the claim that the DMR involves distribution charges that are purportedly approvable under 4928.143(B)(2)(h), while the riders rejected by the Ohio Supreme Court were generation charges approved under 4928.143(B)(2)(d).[61] But the Court specifically rejected such an approach of basing its analysis on what the rider purports to be and, instead, evaluated whether the impact of the rider was to effectively provide transition revenues or the

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[58] *In re App. of Columbus S. Power Co.*, --N.E.3d--, 2016 WL 1592905 at *3 - *5 (2016); In re App. of Dayton Power & Light Co., 147 Ohio St. 3d 166 (2016).

[59] SC Reply at 40-41. These arguments are incorporated by reference as if fully set forth herein.

[60] R.C. 4928.38.

[61] Rehearing Order at 130.

equivalent thereof.[62] As explained in Section III.A.1 above, the DMR has nothing to do with distribution services and, therefore, the claim that it cannot be a transition cost because it is a distribution rider falls flat.

The Commission's assertion that the DMR cannot be a transition charge because FirstEnergy "transitioned" its generating plants to FES a number of years ago is also meritless.[63] The entire point of the statutory provisions regarding transition revenues is to foreclose such revenues after a date certain. Nothing in that statutory language says that such prohibition expires at some point. And while the Commission correctly notes that FirstEnergy cannot transfer the DMR funds directly to FES, there is no prohibition on the indirect funneling of such funds to FES via the dividending up of the DMR revenues to FirstEnergy Corp., which could then use the funds to prop up FES. The fact that such indirect transfer of funds to unregulated affiliates could happen years after the transition period was supposed to end does not change the fact that the DMR constitutes an improper transition charge.

IV. The Rehearing Order is Unlawful and Unreasonable Because the Commission Approved the Unjust and Unreasonable DMR.

In its Rehearing Order, the Commission approved a rider that will require customers to pay at least $612 million (and perhaps more than $1 billion) in exchange for nothing tangible. Although customers will pay hundreds of millions of dollars per year under the DMR, those funds will not be used to cover revenue requirements for providing any service to customers. Instead, the DMR revenues are intended to provide credit support to the FirstEnergy corporate

[62] *In re Columbus S. Power Co.*, 2016 WL 1592905 at *4 (holding that "the fact that AEP did not explicitly seek transition revenues does not foreclose a finding that the company is receiving the equivalent of transition revenue under the guise of the RSR.").

[63] Rehearing Order at 130.

family. As explained above in Section III, the DMR is impermissible under multiple provisions of Ohio law. But even if this credit support rider could legally be included in an ESP, there is no evidence in the record that the DMR is just, reasonable, or beneficial to customers. Because the DMR is neither just nor reasonable, the Commission's approval of this rider was unreasonable and unlawful.

In its post-hearing briefs, Sierra Club explained in detail why the DMR is neither just, reasonable, nor beneficial to customers.[64] The Rehearing Order, however, erroneously reaches the opposite conclusion. It does so based on a series of flawed findings, as discussed below. Each of these errors demonstrates that the DMR is unjust and unreasonable.

A. The DMR will Not Incentivize Grid Modernization.

At the core of the Commission's ruling is its finding that the DMR "would provide a needed incentive to the Companies to focus innovation and resources on grid modernization."[65] This finding, however, is contradicted by the record, because there is no evidence that the DMR, which will provide FirstEnergy with $204 million annually of unrestricted cash, will result in any additional expenditures on grid modernization. Because the Companies are not required to spend *any* of the DMR revenues on grid initiatives, this rider does nothing to incentivize grid modernization investments.[66] The Commission's finding otherwise, based on a record that directly contracts its finding, is unreasonable.

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[64] *See* SC Br. at 56-74; SC Reply Br. at 42-45. These arguments are incorporated by reference as if fully set forth herein.

[65] Rehearing Order at 88.

[66] Because the DMR will do nothing to spur investments in grid modernization, the Rehearing Order's reliance on the recommendations of Dr. Choueiki, and the benefits of grid modernization discussed by RESA witness Crockett-McNew, is misplaced. *See* Rehearing Order at 88-89. The benefits discussed by Ms. Crockett-McNew might result from a properly-structured distribution modernization rider that earmarks funds for grid modernization, but the DMR approved in the Rehearing Order.

B. The Commission's Findings Regarding Credit Support are Against the Manifest Weight of the Evidence.

The fact that the DMR will do nothing to advance grid modernization, standing alone, demonstrates that the Rehearing Order is unlawful and unreasonable. But even setting aside that fatal flaw, the Order's other findings regarding the DMR are contrary to the manifest weight of the evidence in the record, and therefore unreasonable.

In approving the DMR, the Commission endorsed Staff's belief "that Rider DMR is necessary to assist the Companies in accessing the capital markets in order to make needed investments in their distribution systems."[67] This finding is built on a series of speculative and unsupported assumptions. Under this theory, by providing hundreds of millions of dollars of unrestricted cash to FirstEnergy, customers would reduce the chance of a possible future credit downgrade of FirstEnergy Corp. And if a credit downgrade were avoided, the Companies would maintain favorable access to credit markets, which would keep the Companies' borrowing costs low, thereby enabling the pursuit of distribution modernization initiatives that would benefit customers.[68]

The problem, however, is that even if a credit support rider were legal, the Rehearing Order's assumptions about how customers would purportedly benefit from the DMR is unsupported and, at times, directly contradicted by the record. First, as explained above in Section III.A.1, there is no basis for the Commission's belief that the DMR would result in

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[67] Rehearing Order at 90; *see also id.* at 91 (citing Dr. Choueiki's testimony that "credit support provided by Rider DMR will assist the Companies in receiving more favorable terms when accessing the credit market and that accessing the credit markets will, in turn, enable the Companies to obtain funds to 'jumpstart' their grid modernization efforts").

[68] *See generally* Rehearing Order at 88-89, 90-96.

"investments in [the Companies'] distribution systems."[69] The purported distribution modernization benefits of the DMR are illusory because the Companies would not be required to spend any of the DMR revenues on distribution modernization, and there has been no evaluation of the negative economic impacts on northern Ohio and its residents of forcing customers to pay the Companies an extra $204 million per year. In addition, the Commission's findings regarding the Companies' purported credit metric and financial shortcomings lack evidentiary support, because the record lacks any projections or other evidence regarding the Companies' future credit metrics and financial health. And the evidence that the Commission does rely upon is either not probative or not credible. The Rehearing Order also disregards the fact that the DMR costs are being imposed on the Companies' customers without any showing about what, if any, role the Companies have in causing whatever credit problems are expected to confront FirstEnergy Corp. or how that role compares to that of other FirstEnergy Corp. subsidiaries. Finally, although customers are being asked to pay more to help stave off a possible credit downgrade at FirstEnergy Corp., there is no quantification of what cost impact a downgrade might have on customers, no basis to conclude that the DMR revenue would succeed in preventing a credit downgrade, and no written plan for how FirstEnergy Corp. intends to achieve satisfactory credit metrics. The fatal shortcomings in the Commission's findings in support of the DMR are further described below.

[69] Rehearing Order at 90; *see also id.* at 91 (citing Dr. Choueiki's testimony that "credit support provided by Rider DMR will assist the Companies in receiving more favorable terms when accessing the credit market and that accessing the credit markets will, in turn, enable the Companies to obtain funds to 'jumpstart' their grid modernization efforts").

1. The record does not include any forward-looking financial information regarding the Companies or FirstEnergy Corp.

Apart from an illusory grid modernization goal, the stated purpose of the DMR is to provide credit support to the Companies in hopes of preventing a possible future credit downgrade at FirstEnergy Corp. and/or the Companies.[70] Given that the DMR's purpose is to avert a possible future event, approving this costly rider could only be reasonable if there were evidence regarding the Companies' and FirstEnergy's projected credit metrics.

But the record is devoid of any forward-looking financial information regarding the Companies or FirstEnergy Corp. Thus, while customers would be paying to increase the Companies' cash flow in future years, both Staff and the Companies relied solely on historic information regarding FirstEnergy Corp.'s CFO to debt level.[71] Neither FirstEnergy nor Staff provided any forecast of the CFO to debt level for the Companies or FirstEnergy Corp., either with or without the DMR, for any year of ESP IV.[72] And the Companies failed to update the pro forma financial projections through May 2019 that were provided with their August 2014 ESP IV application.[73] In short, the Rehearing Order requires customers to pay $204 million annually for at least three years (and possibly five) in order to shore up the credit metrics and finances of the Companies and FirstEnergy Corp. without any up-to-date forecasts of what those credit

[70] Rehearing Order at 87, 91-92.

[71] Staff Ex. 13, Rehearing Testimony of Joseph P. Buckley ("Buckley Test.") at 3-4; Co. Ex. 206, Rehearing Rebuttal and Surrebuttal Testimony of Eileen M. Mikkelsen ("Mikkelsen Rebuttal") at 9-10.

[72] Tr. X at 1617-18; Tr. III at 524-25.

[73] As Sierra Club explained in its post-hearing brief, the Companies' failure to provide this information is inconsistent with O.A.C. 4901:1-35-03(C)(2). The only pro forma projections in the record were provided in August 2014 application, and those outdated projections only through May 31, 2019, and assumed the initial version of Rider RRS. As such, they do not provide the projections that O.A.C. 4901:1-35-03(C)(2) requires to evaluate the potential inclusion of the DMR in ESP IV. By approving the DMR despite the lack of such projections, the Rehearing Order is unlawful and unreasonable.

metrics and finances are expected to be.[74] Although Sierra Club pointed out these problems in its post-hearing briefs, the Commission's decision approving the DMR disregarded them.[75]

Rather than review any forward-looking financial information, the Commission relies on a Moody's credit opinion and an S&P research update to support its finding that the Companies are at "serious risk" of a credit downgrade.[76] But neither of these documents include the type of forward-looking financial information necessary to assess the reasonableness of the DMR and that is required by the O.A.C. 4901:1-35-03(C)(2). The Commission's reliance on these two reports, without more, was unlawful and unreasonable.

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[74] This evidentiary gap is entirely of FirstEnergy's making, because the record demonstrates that the Companies have this forecasted financial information and have simply refused to provide it in this proceeding. For example, the Staff submitted a data request to the Companies seeking "detailed projected financial statements," and forecasted FFO, CFO, and adjusted debt levels for the years 2016 through 2018. SC Ex. 99 (Staff DR-34). The Companies flatly objected to those requests and did not produce any of the requested information to the Staff (or to any other party) in discovery. Tr. I at 107-08; Tr. III at 527-31. Instead, the Companies apparently allowed the Staff to see some of the requested information in the context of settlement discussions, but did not allow the Staff to retain any of that information. Tr. III at 527-28. With the Companies refusing to produce forecasted information for use in this proceeding, the Staff had to "fall back on" the use of historic data in creating the DMR even though, as Mr. Buckley noted, "probably the best thing to do would be to look at forecasted numbers." *Id.* at 742. Similarly, while Ms. Mikkelsen testified at deposition to the existence of a spreadsheet forecasting the impact of ESP IV with Modified Rider RRS on the Companies' credit metrics, the Companies refused to produce such information. Tr. I at 19-30. In opposing a motion to compel the production of that spreadsheet, the Companies' counsel acknowledged that the spreadsheet provided a forecast of the Companies' CFO to debt and FFO to debt over the term of ESP IV, *id.* at 24, but the parties were never provided such information.

In its memorandum *contra*, FirstEnergy may again claim that such forward-looking financial information could not be presented because it purportedly "material nonpublic information," the provision of which the Companies' counsel claimed could violate federal securities law. Tr. X at 1617-18; Tr. I at 26-27. As Sierra Club explained in its post-hearing brief, these claims are without merit. SC Br. at 62-63.

[75] Another part of the Rehearing Order briefly summarizes this point, Rehearing Order at 63-64, but the Commission did not address the substance of these arguments.

[76] *Id.* at 91-92. These reports were attached to Staff witness Joseph Buckley's testimony.

2. The evidence cited by the Rehearing Order does not show a need for the DMR revenues.

Even if it were permissible to approve the DMR proposal without the benefit of any forward-looking financial information – as explained above, it is not – the Commission erred by relying on unreliable or irrelevant information to support its finding that the Companies need credit support.

First, the Commission's reliance on the Companies' testimony regarding their financial needs is not credible and should be disregarded.[77] As Sierra Club previously explained, the Companies' testimony regarding its financial needs is contradicted by the Companies' testimony only a few weeks earlier in the case. After Staff initially proposed the DMR at a level of $131 million for 3-5 years, FirstEnergy submitted testimony arguing that the DMR should be set at an amount of at least $558 million per year (and possibly as much as $1.126 billion) through May 31, 2024.[78] The Companies claimed that this significant expansion in the amount and duration of the DMR was necessary both to provide credit support[79] and to enable the Companies to "jump-start" grid modernization.[80] But, just a couple weeks earlier, FirstEnergy claimed that, over the term of ESP IV, it could provide customers with $561 million in net credits under Modified Rider RRS while still advancing grid modernization and maintaining the Companies' investment grade credit rating.[81] Such testimony inherently conflicts with the Companies' claims, just two weeks later, that ESP IV would need to include, through the DMR, at least $558 million of additional cash from customers per year for the full term of ESP IV in order to "jump-start" grid

[77] Rehearing Order at 91-92 (citing Mikkelsen Rebuttal at 6-7, and noting testimony "regarding the challenges faced by the Companies in competing for investor dollars").

[78] Buckley Test. at 2, 7; Mikkelsen Rebuttal at 14.

[79] Tr. X at 1625.

[80] Mikkelsen Rebuttal at 9.

[81] This testimony is summarized on pp. 57-60 of Sierra Club's initial post-hearing brief.

modernization and provide credit support.[82] Regardless of the Companies' motivations in making these inconsistent claims, the fact remains that FirstEnergy's recent testimony regarding Modified Rider RRS belies its claim that it needs hundreds of millions of dollars for credit support and to "jump-start" distribution modernization. While the Commission noted the glaring inconsistency in FirstEnergy's testimony as a reason for rejecting Modified Rider RRS,[83] that inconsistency also undermines the credibility of the Companies' witnesses regarding the DMR. Consequently, the Commission's reliance on FirstEnergy's testimony in approving the DMR is misplaced.

Second, the Commission errs in citing Rider DCR in support of its conclusion that the Companies need credit support. The mere existence of a grid-related rider does not say anything about the Companies' future credit metrics or financial health, and is therefore irrelevant to the evaluation of the DMR. Not surprisingly, the Commission cites no evidence in the record indicating that Rider DCR was created to shore up the Companies' or FirstEnergy Corp.'s credit metrics. And as the Commission acknowledges, FirstEnergy itself has not provided any estimate of its future revenues from this rider.[84] Because the existence of another rider does not say anything about FirstEnergy's future credit metrics, the Commission's reliance on Rider DCR is misplaced.

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[82] Notably, there was not any change in FirstEnergy Corp.'s credit ratings between Ms. Mikkelsen's July 11, 2016 oral testimony and her July 25, 2016 rebuttal and surrebuttal testimony that could justify this major shift in her testimony. Moody's decision to put FirstEnergy Corp. on negative credit watch was issued on April 28, 2016, and the only other rating action identified by Ms. Mikkelsen before her July 25 testimony was a July 22 Standard & Poor's Financial Services LLC ("S&P") report that affirmed the FirstEnergy Corp. credit ratings and did not change the outlook for either FirstEnergy Corp. or the Companies. Tr. X at 1614-15.

[83] Rehearing Order at 48-49.

[84] Rehearing Order at 48 (noting that "the Companies' witness had not calculated how much the Companies projected to be received from Rider DCR or the return on smart grid investments").

Third, much of the other testimony that the Commission cites for its conclusion that "Rider DMR is necessary to assist the Companies in accessing the capital markets" is also not probative. For example, the Commission cites the fact that the Companies would need to access capital markets if it wished to make addition grid investments.[85] But that simple observation does not mean that the Companies are unable to access such markets. And there has been no showing that the Companies, all of which have investment grade credit ratings, are currently unable to access the financial markets. And the Commission's observation says nothing about whether a true ratemaking approach, where the Companies receive a return of and on capital for investments that benefit ratepayers, could not be funded by such markets.

Likewise, neither Dr. Choueiki's observations about Staff's hopes that the DMR will "'jumpstart' their grid modernization efforts," nor Staff and FirstEnergy testimony regarding current credit ratings, nor Dr. Choueiki's observation that financing cost could increase "*if* the Companies are downgraded," demonstrate the Companies would be unable to access capital if they wish to increase grid modernization investments.[86]

3. There is no record evidence regarding the potential cost to customers of a downgrade of FirstEnergy Corp.

In its Rehearing Order, the Commission concludes that a credit downgrade "would have adverse consequences for the Companies."[87] This finding purportedly supports the Commission's imposition of a DMR. But the Commission's finding is erroneous, because the record lacks any evidence regarding the potential costs to customers of a downgrade. Without

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[85] Rehearing Order at 91 (citing Tr. III at 571-573).

[86] *Id.* (emphasis added).

[87] Rehearing Order at 92.

such information, there is no basis for concluding that the DMR, which will cost customers at least $612 million (and perhaps more more) is just, reasonable, and beneficial to customers.

In support of its conclusion, the Commission provides a generic list of adverse consequences that could result from a credit rating downgrade: it "may result in limited access to the credit markets," it "may result in more restrictive terms and conditions," it "may trigger requirements that the Companies or FirstEnergy Corp. post cash as collateral," it "may result in higher borrowing costs, increasing the Companies' long-term cost of debt."[88] Even assuming that such consequences could occur if there were a downgrade, that does not automatically justify the imposition of a costly new rider. And there has been no showing that the costs the Companies' customers might incur in the event of a downgrade of FirstEnergy Corp. to a non-investment grade credit rating would exceed the costs that customers would incur under the DMR.

As explained below in Section IV.B.4, there is little evidentiary support for the claim that the DMR would prevent a credit rating downgrade. But even if the DMR were the decisive factor for whether FirstEnergy Corp. is downgraded, the critical question remains as to whether the possible cost impacts to customers of a downgrade outweigh the amount customers would have to pay under the DMR. For example, if a downgrade of FirstEnergy Corp. could increase costs for customers by $300 million per year, then (depending on the likelihood of a downgrade, the impact that the DMR would have on that likelihood, and other factors) it might be beneficial for customers to pay $204 million to reduce the likelihood of such downgrade. If, however, a downgrade of FirstEnergy Corp. would increase costs for customers by $50 million per year,

[88] *Id.* Most of these possible effects were pulled from a generic bullet list included in one-page discovery response from the Companies. SC Ex. 98. These generic points were then repeated in the testimony of Mr. Buckley and in Ms. Mikkelsen's rebuttal testimony.

then it would not be just, reasonable, or beneficial to customers to force them to pay $204 million in credit support under the DMR.

There is nothing in the record, however, that provides any estimate of the possible cost impacts to customers of a downgrade of FirstEnergy Corp. to non-investment grade. At hearing, Mr. Buckley acknowledged that Staff had not calculated by how much the Companies' borrowing costs might increase if FirstEnergy Corp. were downgraded.[89] The Staff asked the Companies for "general calculations or general expenses" from a credit downgrade at FirstEnergy Corp., but the Companies did not provide such information.[90] At hearing, Ms. Mikkelsen acknowledged that she had not attempted to quantify the magnitude of the impact to customers if FirstEnergy Corp. were downgraded to a non-investment grade credit rating.[91] She further contended that she could not provide an estimate of how much increased borrowing costs customers would incur as the result of such a downgrade.[92]

Ms. Mikkelsen attempted to justify the lack of any quantification of how much customer costs might increase if FirstEnergy Corp. were downgraded by claiming that no such "quantification can occur today"[93] because such quantification "would be dependent upon a number of factors which aren't -- aren't known at this time."[94] She further explained that any such estimate:

> would be dependent upon a number of future circumstances such as what level of debt is being sought, what the market conditions

[89] Tr. III at 575-76. *See also id.* at 674 (noting that Staff was unable to quantify the costs associated with the reduced access to capital markets that could result if FirstEnergy Corp. were downgraded).

[90] Tr. III at 575-76. *See also id.* at 674.

[91] Tr. I at 102-05.

[92] Tr. X at 1628.

[93] *Id.* at 1627.

[94] Tr. I at 102.

> are at that time, what the companies' credit ratings are at that time; things of that nature would be very important in order to provide an estimate.[95]

But the fact that the future is not certain does not excuse the need for a reasonable projection of the cost, or possible range of costs, of a downgrade based on reasonable forecasts of likely future conditions. Just as FirstEnergy and a number of the parties projected future costs and revenues of Rider RRS based on forecasts of factors such as energy, capacity, and natural gas prices, the Companies and/or Staff could have projected the cost impacts of a credit downgrade using reasonable forecasts of future market conditions, credit ratings, levels of debt that may be sought, etc. Their decision not to do so should not be used as an excuse to require customers to pay at least $612 million on the hope that this might avoid future cost increases that are speculative and un-quantified on the record in this proceeding. Without a reasonable estimate of the credit downgrade harm that customers purportedly face, the Commission could not reasonably determine that it is just and reasonable to require customers to pay hundreds of millions of dollars to avoid such harm. Because the Commission approved the DMR without such evidence, the Rehearing Order is unlawful and unreasonable.[96]

4. There is no basis in the record upon which to conclude that the DMR would prevent a downgrade of FirstEnergy Corp. to a non-investment grade credit rating.

The purported benefit of the DMR – the avoidance of increased costs if FirstEnergy Corp. were to be downgraded to a non-investment grade credit rating – would only accrue to customers if FirstEnergy Corp. actually avoided such a downgrade. The record, however, fails to

[95] Tr. X at 1627-28.

[96] Although Sierra Club raised these points in briefing, SC Br. at 68-71, SC Reply at 44-45, the Commission ignored them in reaching its decision to approve the DMR. *See generally* Rehearing Order at 87-98. By failing to address these points, the Commission violated R.C. 4903.09.

provide any credible basis upon which to conclude that the DMR would enable FirstEnergy Corp. to avoid such a downgrade. Instead, there is a significant risk that even with the DMR, FirstEnergy Corp. would still be downgraded, which would mean that customers would pay hundreds of millions of dollars for credit support and still be subjected to whatever deleterious impacts result from a downgrade. The possibility of this result underscores that there has been no showing that the DMR is just, reasonable, or beneficial to customers. Because the Rehearing Order approves the DMR despite this risk – a risk that the Commission disregarded in its decision approving the rider – the Rehearing Order is unlawful, unreasonable, and against the manifest weight of the evidence.

A primary basis for the concern that FirstEnergy Corp. may still be downgraded even with the DMR payments is that the record is devoid of any plan or strategy explaining how FirstEnergy Corp. intends to maintain an investment grade credit rating. Staff witness Buckley acknowledged that he had not "examined any specifics or detailed plans" for how FirstEnergy Corp. would address its financial situation.[97] Ms. Mikkelsen similarly admitted that she had not seen any written plan for FirstEnergy Corp. to achieve the target 15% CFO to debt level.[98] The lack of any plan to provide credit support to FirstEnergy Corp. (besides collecting DMR revenues from the Companies' customers) is especially problematic given that FirstEnergy Corp. has had a sub-14% CFO to debt level since 2011,[99] and the Companies could not provide any estimate of how long it would take for FirstEnergy Corp. to improve its credit rating.[100] In addition, both Moody's and S&P identify continued weakening markets with low energy prices

[97] Tr. III at 569.

[98] Tr. X at 1619.

[99] Buckley Test. at 4.

[100] Tr. X at 1731-32.

as a factor that could lead to a downgrade of FirstEnergy Corp., even with the DMR, because of the merchant generation owned by the company's affiliates.[101] Given the significant financial challenges facing FirstEnergy Corp., it was unjust and unreasonable for the Commission to approve charging customers at least $612 million to provide credit support to FirstEnergy Corp. without evaluation of a detailed plan of how the company plans to improve its financial condition. Without such a plan, there is a significant risk that any DMR funds paid by customers would be the equivalent of pouring money down a drain. As such, there is no evidence that approval of the DMR would be just, reasonable, or beneficial to customers. Because the Commission nonetheless approved the DMR, the Rehearing Order is unlawful and unreasonable.

In its decision approving the DMR, the Commission sidesteps these concerns, and attempts to justify approval of the DMR by noting that "all of FirstEnergy Corp.'s stakeholders are sharing in the burden of improving its financial health."[102] In support, the Commission cites testimony identifying steps other constituents have purportedly taken to help improve FirstEnergy Corp.'s credit metrics.[103] All of the steps so identified, however, are ones that have already been taken by employees, shareholders, and other FirstEnergy Corp. subsidiaries, rather than elements of a future plan for improving FirstEnergy Corp.'s credit metrics and preserving its investment-grade credit rating. These steps therefore provide no assurance that the DMR will stave off a credit rating downgrade. For these reasons the Rehearing Order is unlawful and unreasonable.

[101] *Id.*; Buckley Test., Att. 3 at 4.

[102] Rehearing Order at 95.

[103] Mikkelsen Rebuttal at 17-18.

5. The DMR credit support payments have not been shown to reflect the relative responsibility of the Companies for FirstEnergy Corp.'s credit issues.

Relatedly, another fundamental flaw of the DMR approved by the Commission is that there has been no showing that the credit support customers would be required to provide is reflective of the relative responsibility, if any, of the Companies for FirstEnergy Corp.'s credit issues. FirstEnergy Corp. is a large corporate family made up of approximately 75% regulated distribution and transmission utilities, and 25% competitive businesses.[104] On the regulated side, FirstEnergy Corp. has twelve subsidiaries operating in five states with an aggregate rate base of approximately $16 billion.[105] Even if the DMR were legally permissible – it is not, as explained above in Section III – it could only be just and reasonable if there were a showing that: (1) the Companies reasonably bear some responsibility for the credit issues that FirstEnergy Corp. is facing, and (2) the level of credit support customers would be required to pay is consistent with the level of responsibility the Companies bear. Neither showing has been made on this record.

As an initial matter, there has been no showing that the Companies reasonably bear some responsibility for FirstEnergy Corp.'s credit issues. In fact, what limited evidence does exist in the record suggests that it is the competitive generation businesses, not the regulated entities, that are leading to concerns about a potential downgrade of FirstEnergy Corp.'s credit rating. For example, in revising its outlook for FirstEnergy Corp. to "negative," S&P explained that:

> The higher-risk competitive businesses greatly increases the company's exposure to lower generation volumes and commodity prices.
>
> FirstEnergy's financial risk profile reflects our revised base-case scenario that does not include a PPA but includes sustained weak

[104] Buckley Test., Att. 3 at 3.

[105] *Id.*, Att. 2 at 3.

> commodity prices, capital spending of about $3 billion, and minimal sales growth.[106]

S&P further opined that a possible "upside scenario" for FirstEnergy Corp. could occur if "the company's business risk profile materially improves by reducing the size of its higher-risk competitive business."[107] While requiring customers to provide credit support may help improve FirstEnergy Corp.'s credit position, doing so is neither just nor reasonable given the evidence that FirstEnergy Corp.'s credit issues stem from its competitive businesses and the impacts of low commodity prices and sales growth that they expose FirstEnergy Corp. to.[108]

Even if it were reasonable to assign some responsibility for FirstEnergy Corp.'s credit issues to the Companies, the DMR would still not be reasonable because there has been no showing that the amounts customers would pay the DMR are reflective of the relative level of responsibility the Companies might reasonably bear. In the Rehearing Order, the Commission set the DMR amount based on a calculation of the additional cash flow that would have been needed to bring FirstEnergy Corp.'s CFO to debt level up to 14.5% in 2011 through 2015, then allocating 22% of that amount based on the proportion of FirstEnergy Corp.'s operating revenue that came from the Companies.[109] This allocation was adopted from a Staff recommendation.

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[106] *Id.*, Att. 3 at 3.

[107] *Id.*, Att. 3 at 4.

[108] Further evidence that FirstEnergy Corp.'s credit issues stem largely from its higher-risk competitive business comes from the fact that the Companies' initial proposal in this proceeding, which they spent a year and a half advocating for, was to require customers to assume virtually all of the financial risk of 3,257 MWs of generation owned by FirstEnergy Corp.'s merchant generation affiliate FirstEnergy Solutions Corp.

[109] Rehearing Order at 93.

But in recommending this allocation, Staff did not attempt to demonstrate that such allocation reflects the proportion of FirstEnergy's Corp.'s shortfall that the Companies could reasonably be considered responsible for. Staff witness Buckley acknowledged that the CFO to debt level of each subsidiary contributes to the overall CFO to debt level for FirstEnergy Corp.[110] Yet neither Staff nor FirstEnergy provided any calculation of the CFO to debt level for any of the Companies or any of the other FirstEnergy Corp. subsidiaries.[111] As such, neither the Staff nor FirstEnergy witnesses could provide any information regarding what portion of FirstEnergy Corp.'s CFO to debt shortfall any of the subsidiaries were responsible for.[112] Without such information, there is no way to determine what, if any, level of charges under the DMR might be just and reasonable. Consequently, the Commission is wrong in claiming that the allocation factor it adopted represents the Companies' "proportionate share."[113]

The Commission defends its allocation by claiming that "all of FirstEnergy Corp.'s stakeholders are sharing in the burden of improving its financial health,"[114] specifically citing to commission proceedings on New Jersey, Pennsylvania, and West Virginia.[115] But those proceeding merely underscore the unreasonable of the no-strings-attached DMR that the Companies' customers would pay. The out-of-state commission proceedings cited by the Commission are all traditional base rate cases, or cases in which the subsidiaries are seeking recovery of costs for particular spending that has already been incurred or that is planned for the

[110] Tr. III at 539.

[111] *Id.* at 540-42; Tr. X at 1630.

[112] Tr. III at 540; Tr. X at 1630.

[113] Rehearing Order at 95.

[114] Rehearing Order at 95.

[115] The Rehearing Order cites these out-of-state proceedings twice. Rehearing Order at 95-96, 128.

future.[116] In other words, in those proceedings the utilities were recovering the revenue requirements for providing services to their customers, and the recovery of such revenue requirements would also provide credit support to the utility and FirstEnergy Corp. By contrast, under the DMR, customers will pay money solely to provide credit support to the Companies and FirstEnergy Corp., not to cover the revenue requirements for any services that have been or will be provided to them. The Commission fails to explain why customers of FirstEnergy Corp. utilities in other states should receive something for their ratepayer dollars, while the Companies' customers get nothing in return for the hundreds of millions of dollars that would be paid through the DMR.[117]

6. The conditions placed on the DMR are illusory and unenforceable.

In the Rehearing Order, the Commission announces several conditions on the Companies' collection of DMR revenues, including "continued retention of the corporate headquarters and nexus of operations of FirstEnergy Corp. in Akron, Ohio," and "a demonstration of sufficient progress in the implementation and deployment of grid modernization programs approved by the Commission."[118] Both conditions are illusory and, as such, do nothing to cure the unreasonableness of the DMR approved in the Rehearing Order.

The headquarters condition is illusory because there is no evidence in the record that the FirstEnergy Corp. headquarters and nexus of operations might leave Akron before the end of

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[116] Tr. X at 1641, 1645, 1651, 1657, 1662, 1665, 1668; SC Ex. 104.

[117] The Commission also errs in citing to FirstEnergy Corp.'s announced retirement of four units at the Sammis plant as an example of "sharing in the burden of improving [FirstEnergy Corp.'s] financial health." Rehearing Order at 95-96; *see also id.* at 128 (repeating this point). This announcement was only briefly mentioned at hearing, Tr. at 1702, and there is no evidence in the record that those announced retirement were motivated by an effort to shore up FirstEnergy Corp.'s credit metrics or financial health. The Commission's reliance on this extra-record evidence is misplaced.

[118] Rehearing Order at 96.

ESP IV.[119] Indeed, the only credible evidence in the record establishes the opposite: namely, that the headquarters would not move anytime before June 2025 – when FirstEnergy Corp.'s current lease ends.[120] And even if there were evidence that the headquarters might move sometime before May 31, 2024, that could not cure the DMR's unreasonableness, especially where the Commission has failed to assess the economic impacts of the DMR on Ohio businesses and other customers.

As for the Commission's "sufficient progress" language, this vague condition is both unenforceable and effectively meaningless. The Rehearing Order makes no attempt to define that phrase, or to establish any benchmarks or other standards that would enable the Companies' customers and other stakeholder to assess whether such progress had been made. Indeed, the Order takes pains to ensure that this condition cannot be evaluated or enforced by any stakeholders, arrogating to itself "sole discretion" to determine whether "sufficient progress" has been made.[121] Put simply, this opaque, standardless condition does nothing to ensure that any grid modernization investments will result from the DMR, or that the Companies' customers will benefit in any way from the DMR. Far from mitigating the unjust and unreasonable aspects of the DMR, this ill-defined condition simply compounds them.[122]

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[119] Tr. X at 1603-04 (Mikkelsen cross);

[120] *See* Dynegy Ex. 1, Direct Testimony of Dean Ellis, at 10-11 (discussing FirstEnergy Corp.'s commitment to keep the headquarters in Akron). The Rehearing Order extols the economic impacts of FirstEnergy Corp.'s headquarters, and notes that the Third Supplemental Stipulation's headquarters commitment will end with the removal of Rider RRS from the ESP. Rehearing Order at 111-12. But, crucially, the Commission failed to address the absence of evidence of that the headquarters might move, and the affirmative evidence to the contrary.

[121] Rehearing Order at 97.

[122] In their memoranda *contra*, the Companies and Staff will presumably argue that purported economic development and job benefits from distribution modernization and the location of FirstEnergy Corp. headquarters and nexus of operations in Akron should count towards determining whether the DMR would be just, reasonable, and beneficial to customers. Such arguments are meritless because these purported benefits are illusory as there is no assurance that any of the DMR funds would be spent on

The Commission attempts to justify this approach by suggesting that it will take awhile time before any specific programs are approved pursuant to the Companies' grid modernization filing (Case No. 16-0481-EL-UNC).[123] But that does not cure the standardless nature of the "sufficient progress" condition. More generally, the Commission's attempt to tie to the DMR to the grid modernization filing underscores the meaninglessness of this condition: In effect, the Commission is saying that the Companies will only receive DMR revenues if they comply with a Commission order (i.e., the order that will eventually be issued in Case No. Case No. 16-0481-EL-UNC). As Chairman Haque described it, the Rehearing Order adopts a "'carrot' and 'stick' approach" because "[a]s a condition to receiving revenues under Rider DMR, FirstEnergy must comply with what the Commission orders in its grid modernization filing."[124] But the Companies are already required to follow the Commission's orders – that's part and parcel of being a public utility under the Commission's jurisdiction. Establishing a "condition" that requires the Companies to do what they are otherwise required to do simply underscores the unreasonableness of the Rehearing Order. In sum, the DMR approved in the Rehearing Order not only disregards the manifest weight of the evidence, it is also unlawful and unreasonable.

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distribution modernization, and there is no evidence that FirstEnergy Corp. would move its headquarters and nexus of operations without the DMR.

[123] Rehearing Order at 96-97 ("We note that the Commission will undertake a detailed policy review of grid modernization in the near future. Following such review, we will address FirstEnergy's pending grid modernization application, and, informed by the results of that detailed policy review, the Commission will grant approval of the grid modernization programs as we deem appropriate in light of the policy review."); *see also* Haque Concurrence at 2-3.

[124] Haque Concurrence at 2-3.

7. The Commission unreasonably and unlawfully rejected conditions that would benefit customers while providing credit support to the Companies, and the Rehearing Order's finding that "placing restrictions on the use of Rider DMR funds would defeat the purpose of Rider DMR" is against the manifest weight of the evidence.

If the Commission truly wanted to incentive grid modernization, the rider would look far different than the DMR approved in the Rehearing Order. In particular, there are several features that the Commission could have adopted so that customers received *some* benefit from the significant sums of money they would be required to pay. Although such features would not resolve the DMR's legal shortcomings,[125] they would help ensure that customers get something in return for the higher rates that they would pay.

First, in order for the DMR to incentivize grid modernization – or to provide *any* benefit to customers – the Commission would need to mandate that the DMR revenues be set aside in a separate account (or accounts) within the Companies.[126] The disbursement of funds from this account would be restricted, including a condition that these DMR funds cannot be transferred to FirstEnergy Corp. (or any other affiliate of FirstEnergy Corp.), either through dividends or other means. Requiring the DMR funds to be separately accounted for would help ensure that such funds are not funneled out of the Companies, and are instead being used for customers' benefit.

Second, the Commission would need to mandate that each dollar collected through the DMR be earmarked for grid modernization. The Commission would also need to set benchmarks to ensure that the Companies invest the DMR funds in beneficial projects within a

[125] *See generally supra* at Section III.

[126] At hearing, FirstEnergy witness Mikkelsen repeatedly claimed that it is the Companies' "intention" to use DMR funds within the Companies. *See e.g.*, Tr. X at 1604-05, 1607, 1826. The Companies, however, steadfastly refused to commit to only using DMR funds within the Companies. *Id.* at 1606, 1826-27. If the Commission created such requirement, it could hold the Companies to their stated intention regarding the use of DMR funds.

reasonable amount of time. Such requirements would help ensure that this rider's revenues are ultimately used for grid modernization.[127]

Third, the Commission would need to specify that the Companies cannot get double recovery on capital investments made with the DMR funds. In particular, the Companies should not be allowed to collect depreciation payments for capital investments made with DMR cash. Because customers would be covering the upfront capital costs for such investments (i.e., by paying the DMR in the first place), it would be unreasonable if the Companies received a return of investment for those projects.[128]

Adopting the three safeguards mentioned above would help ensure that customers receive some benefit from any DMR funds, while FirstEnergy would still receive credit support from such funds. In effect, these would ensure that rather than simply providing FirstEnergy with unrestricted cash, the DMR would serve as a more traditional rider under which the Companies would receive the revenue requirements of making specific investments, including a return on the investment and associated taxes. In other words, with such safeguards the DMR would have a revenue effect similar to FirstEnergy's existing Riders AMI and DCR – which provide for a return of and a return on grid investments – except that a return of the investment is not necessary under the DMR because the Companies would be receiving the cash to make such investments up front.

[127] Requiring that the DMR funds be earmarked would also promote the State policies identified by Staff witness Choueiki. *See* Choueiki Test. at 14-15. In contrast to the DMR proposed by the Staff, which offers no assurance that the DMR revenues stay with the Companies, earmarking the DMR funds will further those State policies.

[128] The Companies would, however, be entitled to receive a reasonable return on equity for those capital investments, which will incentivize the development of such projects, while also providing credit support to the Companies.

The record is clear that a DMR restructured to more closely replicate a rider that provides for the recovery of the revenue requirements of specific investments by the Companies would still provide credit support to the Companies. Ms. Mikkelsen's testimony at hearing on this point was unequivocal:

> If the Ohio Commission were to approve capital recovery for investment in the distribution system, that would -- and it included a return on investment, that would provide credit support to the companies.[129]

Similarly, Ms. Mikkelsen acknowledged that the approval of investments under Rider AMI would provide credit support to the Companies and to FirstEnergy Corp.[130] And Ms. Mikkelsen made clear that the $245 million capital recovery filings by other FirstEnergy Corp. regulated utility subsidiaries in Pennsylvania identified in her rehearing rebuttal and surrebuttal testimony would provide credit support.[131] Under those capital recovery filings, the Pennsylvania subsidiaries sought approval of Long-Term Infrastructure Improvement Plans ("LTIIPs") and a "cost recovery mechanism associated with recovery of the dollars spent as part of" the LTIIPs.[132] If the Pennsylvania PUC approves those capital recovery filings, the Pennsylvania subsidiaries would be committed to moving forward with the infrastructure investments set forth in the LTIIPs.[133] And those subsidiaries would also receive credit support because "any time a utility company makes a filing that includes a return on investment, that return on investment serves to provide credit support to that company."[134] With the safeguards discussed above, the DMR

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[129] Tr. X at 1643.

[130] *Id.* at 1644.

[131] Mikkelsen Rebuttal at 18; Tr. X at 1641.

[132] Tr. X at 1635.

[133] *Id.* at 1641.

[134] *Id.* at 1642.

could similarly ensure that distribution modernization initiatives that benefit customers would be funded while the Companies would still receive credit support. In its Rehearing Order, the Commission references these proposed safeguards, but does not substantively address them in approving the DMR.[135]

Elsewhere, the Commission claims that "placing restrictions on the use of Rider DMR funds would defeat the purpose of Rider DMR,"[136] but this finding is unreasonable and against the manifest weight of the evidence. The Commission cites no record evidence in support of this conclusion. In reaching this conclusion, the Commission observes that (i) "the evidence [] demonstrates that a downgrade of the Companies' credit ratings is a serious risk and that a downgrade would have adverse effects upon the Companies' ability to access the capital markets," (ii) "a downgrade would have adverse consequences for the Companies," (iii) "Rider DMR is intended to provide credit support to the Companies in order to avoid a downgrade in credit ratings, and (iv) "[m]aintaining credit ratings at current levels will allow the Companies to access the capital markets in order to fund needed investments in grid modernization."[137] Even assuming, *arguendo*, that each of these statements were accurate,[138] none of them to speak to whether restrictions on the DMR funds would defeat the credit support goals of this rider. The Commission's conclusion that "placing restrictions on the use of Rider DMR funds would defeat the purpose of Rider DMR" lacks any evidentiary basis and is unreasonable.

By contrast, as noted above there *is* ample evidence that a true ratemaking approach – where the Companies receive ratepayers dollars (including a return on capital) in exchange for

[135] *Compare* Rehearing Order at 86 *with id.* at 87-98.

[136] Rehearing Order at 127.

[137] Rehearing Order at 126-27.

[138] As explained above in Section IV.B.1–.5, many of these claims are unsupported by the record.

services and investments that benefit customers – would provide credit support to the Companies. The Companies have conceded as much.[139] Consequently, a DMR that included restrictions on the expenditure of those funds would further the Commission's goal of "provid[ing] credit support to the Companies in order to avoid a downgrade in credit ratings."[140] The Commission's refusal to consider a DMR with restrictions was unreasonable and unlawful.

V. The Commission's Order Is Unlawful and Unreasonable Because it Fails to Apply the Governing Legal Standards.

In addition to violating the specific requirements of R.C. 4928.143(B)(2), the Rehearing Order is also unlawful because it departs in multiple respects from the legal standards that govern his ESP. First, throughout its Order, the Commission fails to hold FirstEnergy to its burden of proof. As R.C. 4928.143(C)(1) makes clear, the "[t]he burden of proof in the proceeding shall be on the electric distribution utility." This statutory standard is mirrored by provisions in the Administrative Code, which also puts the burden of proof on the utility "to show that the proposals in [its] application are just and reasonable."[141] Although the posture of the Rehearing Order is somewhat different than the March 31 Order, because the DMR was initially proposed by Staff, the Companies' burden of proof remains. In addition to being mandated by statute, this requirement makes policy sense, because the Companies will be the recipients of customer dollars through the DMR.

Consequently, when the Commission evaluated the DMR proposal, and the modified ESP more generally, the Commission was required to place the burden of proof on the Companies.

[139] Tr. X at 1635, 1641-44.

[140] Rehearing Order at 127.

[141] O.A.C. 4901:1-35-06(A).

But the Commission failed to do so in considering the DMR. The Order's disregard of R.C. 4928.143(C)(1) and O.A.C. 4901:1-35-06(A) is pervasive throughout the discussion of the DMR.[142] Because the Commission failed to hold FirstEnergy to its burden of demonstrating that the DMR is "just and reasonable,"[143] the Rehearing Order is unlawful and unreasonable.[144]

FirstEnergy's failure to meet its burden of proof is, in part, a consequence of the expedited hearing process for consideration of the DMR proposal. The cramped rehearing process did not provide for a full and fair evaluation of the proposal. In particular, the Companies' Rider RRS proposal and modifications thereto were debated for nearly two years with extensive discovery, multiple rounds of testimony, and 41 days of hearing. By contrast, the DMR proposal was first made by Staff on June 29, 2016, was significantly expanded in both proposed amount and duration on July 25, and the record closed on August 1. During that less than five week period, no written discovery on any of the issues surrounding the DMR occurred, and intervenors were provided four day's notice of the July 15 deadline for rebuttal testimony

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[142] Numerous examples of the Commission's disregard of these standards are discussed above in Section IV.

[143] O.A.C. 4901:1-35-06(A); *see* R.C. 4928.143(C)(1); *see also, e.g.*, *Re Duke Energy Ohio, Inc.*, Case No. Case No. 12-2400-EL-UNC, et al., 2014 WL 1385220 (Feb. 13, 2014) (rejecting Duke's application where the utility had not sustained its burden of proof); AEP ESP III Order at 23 (considering, based on the record, whether AEP Ohio's "PPA rider proposal is reasonable and whether customers would, in fact, sufficiently benefit from the rider's financial hedging mechanism").

[144] Relatedly, the Commission misapplied the ESP vs. market rate offer ("MRO") test by failing to hold FirstEnergy to its burden of demonstrating that the ESP, "including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate as compared to the expected results that would otherwise apply under section 4928.142." R.C. 4928.143(C)(1). Because many of the qualitative and quantitative benefits cited in the Commission's discussion, Rehearing Order at 160-65, are premised on unreasonable findings that are against the manifest weight of the evidence, the Commission's application of the ESP vs. MRO test is fundamentally flawed. The Commission must view the record with the appropriate burden of proof, and rescind its approval of the unlawful and unreasonable DMR, before it can properly evaluate the benefits of this ESP.

regarding the DMR.[145] As a result of this highly expedited timeline, the record is devoid of the information necessary to evaluate the DMR. And apart from the prejudice that intervenors suffered as a result, this rushed process also prevented the development of a record that would have permitted a full and fair evaluation of the DMR. Put simply, the Companies cannot meet their burden of proof on the present record.

Second, the Order also fails to satisfy R.C. 4903.09, which requires that "[i]n all contested cases . . . the commission shall file . . . findings of fact and written opinions setting forth the reasons prompting the decisions arrived at, based upon said findings of fact."[146] In applying this standard, the Ohio Supreme Court has explained that "[i]n order to meet the requirements of R.C. 4903.09, . . . the PUCO's order must show, in sufficient detail, the facts in the record upon which the order is based, and the reasoning followed by the PUCO in reaching its conclusion."[147] In addition, the case law makes clear that there is "[a] legion of cases establish[ing] that the commission abuses its discretion if it renders an opinion on an issue without record support."[148] In the Rehearing Order, however, the Commission repeatedly failed to satisfy R.C. 4903.09 by asserting various claims about the DMR and its purported benefits

[145] Tr. I at 16 (note: the transcript erroneously identified the deadline as July 13, but the Friday following Monday, July 11, 2016, was July 15 which was the actual deadline for intervenor rebuttal testimony to the Staff's DMR proposal).

[146] *See also Indus. Energy Users-Ohio v. Pub. Util. Comm.*, 117 Ohio St.3d 486, 2008-Ohio-990, 885 N.E.2d 195, ¶ 30 (discussing R.C. 4903.09, and noting that "[a] legion of cases establish that the commission abuses its discretion if it renders an opinion on an issue without record support.") (quotation marks and citations omitted); *Ohio Consumers' Counsel*, 111 Ohio St.3d 300, 2006-Ohio-5789, 856 N.E.2d 213, ¶ 23 (same).

[147] *MCI Telecommunications Corp. v. Pub. Util. Comm.*, 32 Ohio St.3d 306, 312, 513 N.E.2d 337 (1987).

[148] *Tongren*, 85 Ohio St.3d at 90, 706 N.E.2d 1255 (quoting *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.*, 76 Ohio St.3d 163, 166, 666 N.E.2d 1372 (1996)).

without explaining the reasoning that the Commission followed or providing any record support.[149]

Because the Commission repeatedly failed to apply the standards set forth in R.C. 4903.09, R.C. 4928.143(C)(1), and O.A.C. 4901:1-35-06(A), the Rehearing Order is unlawful and unreasonable.

VI. The Commission's Order is Unlawful and Unreasonable because Approval of the DMR Violates the ESP vs. MRO Test.

As Sierra Club explained in its post-hearing briefs, the DMR proposal could not lawfully be approved because ESP IV with the DMR would be less favorable to customers than the expected results under an MRO.[150] It is well established that an ESP cannot be approved unless its terms and conditions are more favorable in the aggregate than the expected results under an MRO.[151] Here, the Commission's approval of the DMR runs afoul of this requirement. Specifically, the DMR approved by the Commission will cause ESP IV to have a net cost to customers because the $51.1 million in shareholder-funded initiatives are far outweighed by the projected $612 million cost of the DMR.[152] If the DMR were extended to five years,[153] the net loss to customers under ESP IV would be even larger. Moreover, these levels of losses would more than swamp the largely illusory qualitative benefits that ESP IV purportedly provides. As such, the DMR cannot pass the ESP vs. MRO test and, therefore, could not be approved.

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[149] Specific examples of the Commission's failure to apply R.C. 4903.09 are set forth at, *inter alia*, 9, 24, 26, 32 n.97, 33, 34, and 51.

[150] SC Br. at 74-78; SC Reply at 45-49.

[151] R.C. 4928.143(C)(1).

[152] *See* Rehearing Order at 4.

[153] *See id.* at 97 ("The Commission agrees with Staff's recommendation that Rider DMR be limited to three years with a possible extension of two years.")

Because the Commission nonetheless approved the DMR, the Rehearing Order is unlawful and unreasonable.

In its March 31 Order approving ESP IV, the Commission identified several quantitative and qualitative benefits of the ESP.[154] The Commission's quantitative discussion identified $307.1 million in benefits – $256 million associated with Rider RRS, and $51.1 million associated with several shareholder-funded initiatives.[155] In the Rehearing Order, however, Rider RRS was removed from ESP IV, and the DMR was added in.[156] Consequently, the ESP has lost a rider that the Commission found would provide $256 million in quantitative benefits, while adding in a rider that will cost customers at least $612 million.[157] On a nominal basis, this represents a negative swing of $868 million – an amount that easily swamps the remaining $51.1 million in benefits, and would result in a massive quantitative loss associated with ESP IV.[158] If the DMR were extended to a fourth and fifth year at the same level of funding, the loss would be even higher, with quantitative losses of almost a billion dollars.[159] Because approval of the DMR would render the ESP less favorable than an MRO, the Commission must reject it.

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[154] Sierra Club disagrees with the Commission's application of the ESP v. MRO test in the March 31 Order, including the conclusion that Rider RRS would provide $256 million in benefits to customers, and reserves all rights to challenge any aspect of the Commission's Order. But for purposes of this rehearing application, and solely for the sake of argument, Sierra Club accepts the Commission's application of this test.

[155] March 31 Order at 118-20. Consistent with the approach taken in the March 31 Order and the Rehearing Order, this section of the brief uses nominal dollars.

[156] Rehearing Order at 98-99.

[157] *Compare* March 31 Order at 118 *with* Rehearing Order at 4. *See also id.* at 97 (providing for a possible two-year extension of the DMR).

[158] By contrast, if the Commission had simply removed Rider RRS, without adding in the DMR, the ESP would have $51.1 million in quantitative benefits.

[159] If the DMR were extended to five years at the same level of funding, the DMR would cost customers $1,020,000,000. Subtracting the $51.1 million in shareholder-funded credits would result in a quantitative detriment of approximately $970 million.

In its Rehearing Order, the Commission erroneously found that "ESP IV, as modified by this Fifth Entry on Rehearing, is more favorable in the aggregate than the expected results of an MRO under R.C. 4928.142."[160] In so finding, the Commission repeated the error made by Staff and FirstEnergy, who claimed that the DMR would be quantitatively neutral under the ESP vs. MRO test.[161] According to the Commission, these DMR revenues could potentially be recovered under R.C. 4928.142(D)(4), and specifically under this provision:

> Additionally, the commission may adjust the electric distribution utility's most recent standard service offer price by such just and reasonable amount that the commission determines necessary to address any emergency that threatens the utility's financial integrity or to ensure that the resulting revenue available to the utility for providing the standard service offer is not so inadequate as to result, directly or indirectly, in a taking of property without compensation pursuant to Section 19 of Article I, Ohio Constitution. The electric distribution utility has the burden of demonstrating that any adjustment to its most recent standard service offer price is proper in accordance with this division.[162]

The Commission's finding is misplaced for multiple reasons. First, there was no evidence presented at rehearing that the Companies are facing an "emergency that threatens [their] financial integrity." None of the written Staff testimonies address that issue, and no witness was able to state that FirstEnergy faces an emergency for purposes of 4928.142(D)(4).[163] Second, if such evidence had been presented, this statutory provision cannot be used to justify the DMR. The plain language of R.C. 4928.142(D) only permits adjustments to the SSO price, a

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[160] Rehearing Order at 160.

[161] Staff Ex. 14, Rehearing Testimony of Tamara S. Turkenton, at 3-4 (claiming that the DMR "revenues, which are costs to customers, would have no impact on the ESP vers[u]s MRO test, since equivalent revenues could potentially be recovered through an MRO application under R.C. 4928.142(D)(4) or an ESP application per R.C. 4928.143(B)(2)(h)"); Mikkelsen Rebuttal at 19-20.

[162] R.C. 4928.142(D)(4); *see* Rehearing Order at 161-63.

[163] *See, e.g.*, Tr. II at 439-40; *id.* at 450 (Ms. Turkenton testifying that she does not know if there is any emergency that threatens the utilities' financial integrity); Tr. III at 515-16 (Mr. Buckley not testifying as to whether the Companies face "any emergency that threatens their financial integrity")

price that only applies to non-shopping customers. By contrast, the DMR will be a non-bypassable charge for shopping and non-shopping customers alike. Because the costs of the DMR could not be collected through R.C. 4928.142(D), the Commission is wrong in concluding that "revenues under Rider DMR should be excluded from the quantitative analysis because equivalent revenues are likely to be recovered under a hypothetical MRO application pursuant to R.C 4928.142(D)."[164] And because the Commission's application of the ESP vs. MRO test is based on a misreading of the relevant statutes, the Commission's holding – and, consequently the Rehearing Order – is unlawful and unreasonable.

Although Sierra Club raised these points in its post-hearing briefs, the Commission ignored them in reaching its conclusion that "it is likely that the Commission would grant relief in response to a hypothetical application under R.C. 4928.142(D)." Instead, the Commission justifies this conclusion by analogizing to *In re Cleveland Elec. Illum. Co.* ("*CEI*"), a case that involved an emergency rate relief request under R.C. 4909.16.[165] In the 1988 *CEI* decision, the Commission found that Cleveland Electric Illuminating and Toledo Edison faced a financial emergency.[166] One of the factors that the Commission noted in support of this finding was that the utilities had a BBB- bond rating from S&P.[167] In the Rehearing Order, the Commission cites this factor to support its conclusion that the Companies face an emergency under 4928.143(D). But the Commission's reliance on this case is entirely misplaced.

As an initial matter, as the Rehearing Order implicitly acknowledges (with little elaboration), R.C 4928.143(D) and R.C. 4909.16 are different statutes, with different purposes,

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[164] Rehearing Order at 163.

[165] Case Nos. 88-170-EL-AIR, et al., 1988 WL 1617994, Opinion and Order (Aug. 23, 1988).

[166] *Id.* at 11.

[167] *Id.*

and different standards. And a Commission finding under R.C. 4909.16, involving a different set of facts, is hardly dispositive of whether an emergency under 4828.143(D) could be construed to exist in this case. More importantly, the decision in *CEI* undercuts the very conclusion that the Commission cites it for. In *CEI*, the S&P bond rating was only one of many factors that supported the finding of a financial emergency. There, the utilities faced many additional financial challenges:

> [T]he companies have a negative cash flow and, as a result, are unable to pay their bills with current revenue receipts; the coverage ratios of the utilities are imperiled; and, finally, applicants are not receiving the carrying charges on the equity component of their investment not yet included in rate base.[168]

Yet the Rehearing Order overlooks the fact that none of those other factors are present in this case. For this reason alone, *CEI* is inapposite. In addition, although the utilities in *CEI* were granted some relief, the Commission refused their requested rate increases, noting that "[i]t is the responsibility of the companies to increase revenues and decrease expenses."[169] Thus, if anything, the holdings in *CEI* simply underscore the unreasonableness of giving the Companies a $204 annual revenue stream with no strings attached. And *CEI* certainly does not support the Commission's holding that the DMR is quantitatively neutral for purposes of the ESP vs. MRP test.[170] Finally, even *if* the Companies' current situation somehow mirrored the one in *CEI* – it does not – the Commission could still not lawfully conclude that the DMR revenues would be

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[168] *Id.*

[169] *Id.* at 13-14, 18.

[170] The Rehearing Order also ignores other parts of CEI that cut against a finding that the Companies are entitled to DMR revenues due to their purported financial emergency. For example, in *CEI* the Commission noted that the utility's "evidence will be reviewed with the strictest scrutiny and that evidence must clearly and convincingly demonstrate the presence of extraordinary circumstances which constitute a genuine emergency situation." The Commission also made clear that rate relief would be denied if the utility failed to sustain its burden of proof of showing that, "absent emergency relief, the utility will be financially imperiled or its ability to render service will be impaired." *Id.* at 6. The Commission disregarded these standards in its discussion of CEI.

recovered under R.C. 4928.142(D). Because the plain language of the statute makes clear that any rate increase would be limited to SSO customers, the nonbypassable DMR approved by the Commission cannot be shoehorned into this provision. Consequently, the Commission erred as a matter of law in concluding that "revenues under Rider DMR should be excluded from the quantitative analysis."[171]

Because the Commission misapplied the quantitative element of the ESP vs. MRO test, its entire application of that test is fatally flawed. The Commission failed to satisfy R.C. 4928.143(C)(1)'s requirement that it assess whether the modified ESP, "is more favorable in the

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[171] Rehearing Order at 163.

Although the Commission did not endorse the argument in its Rehearing Order, FirstEnergy's memorandum *contra* may again argue that that the DMR is quantitatively neutral because that cash could be collected through a base rate case or Rider AMI. *See* Mikkelsen Rebuttal at 19-20; Co. Br. at 44-45. This argument is misplaced. For one thing, there is no evidence in the record that the DMR amounts being proposed (either by Staff or by FirstEnergy) could be collected through those alternative means. Because the Companies have provided no evidence detailing what this alternative funding mechanism might look like, their hypothetical rider or rate increase cannot shield the DMR costs from the MRO vs. ESP test. This argument fails because, as discussed in Section III.A.3 above, the DMR is not based on the recovery of any costs that the Companies have incurred or investments the Companies would make to provide service to their customers. Rider AMI, by contrast, is designed to ensure that the Companies can receive a return of and on any investments that they make in advanced metering for their customers.

In addition, the Companies can only seek through a base rate adjustment a reasonable rate of return on utility property in service and recovery of expenses incurred in providing service to customers. R.C. 4909.15; *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 535, 620 N.E.2d 835 (1993); *Dayton Power & Light Co. v. Pub. Util. Comm. of Ohio*, 4 Ohio St.3d 91, 103, 447 N.E.2d 733 (1983) ("consumers may not be charged 'for utility investments and expenditures that are neither included in the rate base nor properly categorized as costs.'"). What FirstEnergy cannot do through a base rate case or Rider AMI is to require customers to pay money for nothing, but that is exactly what the DMR will do. For this reason, *inter alia*, FirstEnergy's reliance on *In re Application of Ohio Edison Co.*, 2016-Ohio-3021, ¶¶ 23-27 146 Ohio St. 3d 222, is misplaced. *See* Co. Reply at 147. The unlawfulness of the Rehearing Order cannot be saved by the fact that the Commission considered a hypothetical rider, under a different provision of R.C. 4928.142, for which customers receive something tangible in return for their rate payments. The reasons why FirstEnergy could not seek the DMR revenues through a base rate case proceeding are further explained at pp. 34-37 in Sierra Club's post-hearing reply brief. Those arguments are incorporated by reference as if fully set forth herein.

The Rehearing Order also notes, but does not rely on, FirstEnergy's claim that there are quantitative benefits from the condition that FirstEnergy Corp.'s headquarters and nexus of operations remain in Akron. Rehearing Order at 161 (citing Mikkelsen Rebuttal at 19-20; Murley Rebuttal at 4-5). FirstEnergy's claims should be disregarded for the reasons explained in Section III.B.3 and Section II.D of Sierra Club's reply brief. These arguments are incorporated by reference as if fully set forth herein.

aggregate as compared to the expected results that would otherwise apply under section 4928.142 of the Revised Code." Thus, the Rehearing Order is unlawful and must be reversed, and the Order's qualitative benefits discussion cannot cure this violation of the ESP statute.

Nonetheless, the Rehearing Order's treatment of the modified ESP's qualitative benefits is also unlawful and unreasonable. First, the Rehearing Order errs in relying on the purported qualitative benefits associated with the Third Supplemental Stipulation, which were discussed in in the March 31 Order.[172] Those identified benefits – including the purported grid modernization benefits stemming from previously-filed stipulations – were already approved by the Commission, and will remain in ESP IV regardless of whether the DMR is implemented. In their memoranda *contra*, FirstEnergy and Staff may assert that these qualitative benefit would outweigh the quantitative costs of the DMR. But any such argument would be meritless and should be rejected. Nothing in the record supports the notion that whatever qualitative benefits might arise from ESP IV could outweigh the hundreds of millions of dollars of costs that the DMR would impose on customers. And even if the Commission did believe that those qualitative benefits somehow outweighed the DMR's costs – again, a belief with no support in the record – it would be arbitrary at this stage of the case to approve a new, single-issue rider whose costs would fundamentally skew the results of the ESP vs. MRO test. Consequently, R.C. 4928.143(C)(1) precludes the DMR being added to the ESP on rehearing.

Second, most of the qualitative benefits identified in the Rehearing Order are illusory, unenforceable, or both. Foremost among these illusory benefits is grid modernization. The Rehearing Order touts the purported grid modernization benefits of the DMR,[173] but such benefits cannot be attributed to the DMR because, as discussed above in Section III.A, the DMR

[172] *See* Rehearing Order at 163-64 (citing March 31 Order at 119-20; Co. Ex. 154; Co. Ex. 155).
[173] *Id.* at 163.

has nothing to do with distribution modernization and, instead, is only about providing credit support to the FirstEnergy corporate family. For this reason, the Rehearing Order errs in claiming that the DMR would further "investment in a more extensive grid modernization program."[174] Because the DMR has nothing to do with grid modernization, this means that the Order further errs in suggesting that the DMR would "promote customer choice and promote the state's competitiveness in the global marketplace."[175] In any event, any purported economic benefits of the DMR would be outweighed by the fact that, as FES has argued in a previous proceeding, "charging above market charges to customers would slow business development and job growth."[176]

Many of the other qualitative benefits cited in the Rehearing Order are illusory and unenforceable. First, the Commission errs in suggesting that the modified ESP would result in "procuring or constructing new renewable energy resources."[177] This conclusion is belied by the record. The renewable energy provision, which was included in the Third Supplemental Stipulation and approved (with a modification) in the March 31 Order, does not include a firm commitment to procure any renewable energy resources.[178] This provision is riddled with so many conditions that, taken together, they make it highly unlikely that FirstEnergy would ever need to procure the 100 MW of renewable resources. First, Staff would need to conclude that a law or rule for which new renewable resources would be helpful for compliance had not fostered

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[174] *Id.*

[175] *Id.*

[176] *In Re Dayton Power & Light Co.*, Case Nos. 12-426-EL-SSO, et al., 2013 WL 5221187, Opinion and Order at 48 (Sept. 4, 2013).

[177] Rehearing Order at 163.

[178] March 31 Order at 97; Stipulation at 12.

the development of new renewable resources.[179] Second, the Companies would then make a filing at Staff's request, and the Commission would need to approve the Companies' proposal.[180] At that point, although the Companies would be required to seek the procurement of 100 MW of wind or solar, this requirement would still be sharply limited, because the procurement would not last for any period of time beyond the May 31, 2024 end date of ESP IV.[181] Given these various conditions, and the May 2024 end point, the time period in which any renewables development could occur would be far too short to support the development of new renewable resources.[182] Thus, even if all the conditions were met, there is little chance that the Companies would successfully procure 100 MW of renewable resources in that narrow timeframe.[183] And because there is no reasonable basis for believing that the ESP will result new renewable energy resources, the Commission erred in claiming this as a qualitative benefit.

Second, the Commission improperly cites FirstEnergy Corp.'s wholly unenforceable 2045 CO2 emission reduction "goal" as a benefit of the modified ESP.[184] This provision, which was included in the Third Supplemental Stipulation, is so weak as to be almost meaningless. By

[179] Stipulation at 12.

[180] *Id.*

[181] *Id.* In the March 31 Order, the Commission removed an additional condition that had been included in the Third Supplemental Stipulation, namely, eliminating the "requirement that the procurement must be related to the enactment of new Federal or state environmental laws or regulations." March 31 Order at 97.

[182] Even if the many conditions were satisfied, the chances of the Companies successfully procuring 100 MW of renewable resources in such a tight timeframe is not realistic, as a wind or solar developer would not be interested in a project where the procurement would only last a couple of years.

[183] For these reasons, the Commission misses the mark in rejecting "the contention that the renewable energy resource provision is not a firm commitment by the Companies." Rehearing Order at 109. Although the Companies may be required to submit an application to the Commission in the unlikely event that certain conditions are met, there is no credible evidence that any renewable resources will be developed as a result of this Stipulation provision. Additionally, it is worth noting that the single excerpt of testimony that the Commission cites for its conclusion, Tr. XXXVI at 7740-43, does not address the renewable resource provision at all.

[184] Rehearing Order at 163.

its terms, this provision cannot be considered a "qualitative benefit" because it does not promise anything. Rather, it merely establishes an ill-defined goal, on an extraordinarily elongated timeline, by a company that was not a signatory to the Stipulation, and is not subject to the Commission's jurisdiction.[185] The unenforceability of this provision is underscored by the fact that there is no penalty – or *any* consequence – if the CO2 emission reduction goal is not met.[186]

Finally, the Commission errs in claiming that the modified ESP would promote "cost-effective energy efficiency programs."[187] In support, the Commission cites to the Third Supplemental Stipulation's energy efficiency provision, including the "goal of saving 800,000 MWh of electricity annually." But this provision is both unenforceable and illusory. The provision is unenforceable because the Companies did "not commit[] to propose any minimum level of funding for these energy efficiency programs," and rather than committing to achieve at least 800,000 MWh of energy savings annually, the Companies have instead only promised they would "strive to achieve" such savings.[188] The Companies are therefore not required to achieve that level of energy savings.[189] And the energy efficiency provision is illusory because the Companies are already forecasted to achieve much of the energy savings promised in this Stipulation provision. Companies' witness Eileen Mikkelsen confirmed that the 800,000 MWh of savings are not in addition to the forecasted levels of energy efficiency and demand response identified in the Companies' 2015 Electric Long-Term Forecast Report, which was issued in

[185] As the Rehearing Order acknowledges, "[w]ith respect to the CO2 reduction provision, the Commission has no authority to order FirstEnergy Corp. to undertake this program." *Id.* at 109.

[186] Third Supplemental Stipulation at 11; *see also* Tr. XXXVI at 7532 (Ms. Mikkelsen conceding that the Stipulation "does not include explicit language with respect to a penalty associated with the failure to meet the CO-2 emission reduction goal").

[187] Rehearing Order at 164.

[188] *Id.* at 7534; Stipulation at 11.

[189] Tr. XXXVI at 7535.

April 2015, many months before the Stipulation was filed.[190] In that report, the forecasted combined annual incremental energy savings for the Companies for each of the years 2021, 2022, 2023, and 2024 is greater than 800,000 MWh.[191] This means that, according to FirstEnergy's April 2015 forecast, the Companies were already expecting to achieve the 800,000 MWh in energy savings for at least the last 3½ years of the ESP. Consequently, the energy efficiency provisions in the Stipulation are essentially toothless, and the Commission erred in relying on that provision for the ESP vs. MRO test.

For all these reasons, the Rehearing Order's treatment of qualitative benefits in its discussion of the ESP vs. MRO test is seriously deficient. Because the Commission misapplied that test with respect to both quantitative and qualitative benefits, the Rehearing Order is unlawful and unreasonable.

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[190] *Id.* at 7536-37; SC Ex. 93.

[191] SC Ex. 94 at 39, column 5b; Tr. XXXVI at 7537-40.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of Sierra Club's Application of the Fifth Rehearing Entry and Memorandum in Support have been served upon the following parties via electronic mail on November 11, 2016:

s/ Michael Soules
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