THE PUBLIC UTILITIES COMMISSION OF OHIO

IN THE MATTER OF THE 2012 REVIEW OF THE DELIVERY CAPITAL RECOVERY RIDER CONTAINED IN THE TARIFFS OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY.	CASE NO. 12-2855-EL-RDR

FINDING AND ORDER

Entered in the Journal on April 10, 2019

I. SUMMARY

{¶ 1} In this Finding and Order, the Commission finds that the recommendations proposed by Blue Ridge Consulting Services, Inc., and agreed to by Staff and Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company regarding the 2012 audit review of the Delivery Capital Recovery Rider should be adopted.

II. HISTORY

{¶ 2} Ohio Edison Company (Ohio Edison), The Cleveland Electric Illuminating Company (CEI), and The Toledo Edison Company (Toledo Edison) (collectively, FirstEnergy or the Companies) are electric distribution utilities as defined in R.C. 4928.01(A)(6) and public utilities as defined in R.C. 4905.02, and, as such, are subject to the jurisdiction of this Commission.

{¶ 3} R.C. 4928.141 provides that an electric distribution utility shall provide consumers within its certified territory a standard service offer (SSO) of all competitive retail electric services necessary to maintain essential electric services to customers, including a firm supply of electric generation services. The SSO may be either a market rate offer in accordance with R.C. 4928.142, or an electric security plan (ESP) in accordance with R.C. 4928.143.

{¶ 4} On August 25, 2010, the Commission issued an Opinion and Order in *In re Ohio Edison Co., The Cleveland Elec. Illum. Co., and The Toledo Edison Co.,* Case No. 10-388-EL-SSO (*ESP II Case*). In the *ESP II Case,* the Commission approved a combined stipulation, as modified, authorizing the Companies to establish a delivery capital recovery rider (Rider DCR) effective January 1, 2012. Under the terms of the combined stipulation, FirstEnergy agreed to file quarterly applications to update its Rider DCR. Additionally, under the terms of the combined stipulation, FirstEnergy agreed to submit to an annual audit review process of its Rider DCR applications filed on or about January 31, 2012, January 31, 2013, January 31, 2014, and July 30, 2014. The combined stipulation also provided that Staff and signatory parties to the stipulation would be permitted to file recommendations or objections within 120 days following the filing of the Rider DCR applications.

{¶ 5} By Entry issued on December 12, 2012, the Commission chose Blue Ridge Consulting Services, Inc. (Blue Ridge), to conduct the audit review of Rider DCR for the calendar year 2012 pursuant to a request for proposal (RFP). On March 25, 2013, Blue Ridge filed a report on its audit review of Rider DCR (Audit Report).

{¶ 6} Initial comments on the audit report were jointly filed by FirstEnergy and Staff on May 23, 2013, and by the Ohio Consumers' Counsel (OCC) on July 17, 2013. Reply comments were timely filed by FirstEnergy August 16, 2013.

III. Summary of Audit Report

{¶ 7} Blue Ridge's report audits the accuracy and reasonableness of FirstEnergy's compliance with its Commission-approved Rider DCR with regard to the return earned on plant-in-service since FirstEnergy's last distribution rate case. Further, the audit identifies capital additions recovered through the Line Extension Recovery Rider (Rider LEX), Economic Development Rider (Rider EDR), and the Advanced Metering Infrastructure Rider (Rider AMI), or any other subsequent rider authorized by the

Commission to recover delivery-related capital additions to ensure they are excluded from Rider DCR. The purpose of the audit was also to identify, quantify, and explain any significant net plant increase within individual accounts. (Audit Report at 9-10.)

{¶ 8} The scope of the project as defined in the RFP was organized into two main areas. Scope Area 1 determines if FirstEnergy has implemented its Commission-approved Rider DCR and is in compliance with the Combined Stipulation set forth in the *ESP II Case*. Scope Area 2 examines the effects of the merger between FirstEnergy and Alleghany Energy to determine whether there are net job losses at FirstEnergy, or with respect to FirstEnergy Service Company employees who provide support for distribution services provided by the Companies, as a result of involuntary attrition from the merger. (Audit Report at 10.)

{¶ 9} Initially, Blue Ridge's audit report addressed Scope Area 1, which encompasses processes and controls, variance analysis, Riders LEX, EDR, AMI, and general exclusions, gross plant-in-service, accumulated reserve for depreciation, accumulated deferred income taxes (ADIT), depreciation expense, property tax expense, service company, commercial activity tax and income taxes, return, Rider DCR calculation, projections, and the overall impact of the findings on Rider DCR revenue requirements (Audit Report at 11-18).

{¶ 10} Blue Ridge stated that it reviewed FirstEnergy's processes and controls to ensure that they were sufficient so as to not adversely affect the costs in Rider DCR, and concluded that FirstEnergy's cost controls were adequate and not unreasonable. Further, Blue Ridge found that the Companies provided proper justification and support for the level of overheads that are added to project and work order costs and that the Companies provide proper justification and back-up documentation to show overheads are appropriate, as recommended by Blue Ridge in the prior DCR audit. *In re Ohio Edison Co., The Cleveland Elec. Illum. Co., and The Toledo Edison Co.,* Case No. 11-5428-EL-RDR (*2011 Rider DCR Review*), Finding and Order (Aug. 22, 2012) at 4. (Audit Report at 11.)

{¶ 11} Next, Blue Ridge stated that it conducted variance analysis of plant-in-service balances for 2012 with 2011. Blue Ridge stated that FirstEnergy's responses regarding plant account balances variances provide work order activity not uncommon among utilities. Further, Blue Ridge found the rate of increase for total plant balances for each of the Companies was not unreasonable. (Audit Report at 11-12.)

{¶ 12} Blue Ridge also reviewed Riders LEX, EDR, and AMI, as well as general exclusions, and concluded that capital additions associated with Riders LEX, EDR, or AMI had either been appropriately excluded or had never been included within Rider DCR (Audit Report at 13).

{¶ 13} Further, Blue Ridge reviewed gross plant-in-service for each Company. Blue Ridge's review of gross plant-in-service, specifically the transactional testing of the work order sample, had several findings that individually would have minimal impact on Rider DCR. The impact of the combined findings on Rider DCR reduced the Rider DCR revenue requirement by $477,401. (Audit Report at 13-14.) Further, Blue Ridge noted that the prior audit included a recommendation that the Companies reduce the utilization backlog and to reduce the potential for over- or under-accrual of depreciation. *2011 Rider DCR Review*, Finding and Order (Aug. 22, 2012) at 7. Blue Ridge determined that the Companies have reduced and are continuing to reduce the utilization backlog. Blue Ridge recommended that the Companies continue their efforts to reduce the backlog to reduce the potential for over- or under-accrual of depreciation. (Audit Report at 14-15.)

{¶ 14} Blue Ridge next reviewed accumulated reserve for depreciation. Blue Ridge found several adjustments that should be made to the DCR reserve balances. Blue Ridge notes that these adjustments would have minimal impact on the Rider DCR revenue requirements, supporting the conclusion that the accumulated reserve for depreciation is not reasonable. (Audit Report at 15.)

{¶ 15} Blue Ridge also reviewed ADIT, identifying items which were inappropriately included in ADIT. However, Blue Ridge found that the actual impact to Rider DCR was immaterial. Based upon the immaterial impact of amounts inappropriately included, Blue Ridge concluded that the ADIT was not unreasonable. Blue Ridge also reviewed property tax expense, and found that the property tax expense for each company was not unreasonable. (Audit Report at 15-16.)

{¶ 16} As to depreciation expense, during transactional testing, Blue Ridge found several adjustments that should be made to the Rider DCR plant-in-service balances, which are used to develop the depreciation expense component of the revenue requirements. However, Blue Ridge concluded that the adjustments would have minimal impact to the Rider DCR revenue requirements and that depreciation expense was not unreasonable. (Audit Report at 15-16.)

{¶ 17} Blue Ridge reported that several errors were identified during the transactional testing of the sampled work orders related to the service company that the Companies should correct. However, Blue Ridge found nothing that would indicate that service company costs included with Rider DCR are unreasonable. (Audit Report at 16-17.) Further, Blue Ridge found that commercial activity tax and income taxes, return on rate base, and Rider DCR calculation were all not unreasonable. Blue Ridge noted that, during transactional testing of the work order sample, balances used in the Rider DCR calculations should be adjusted. However, Blue Ridge found that the Rider DCR calculation is not unreasonable and that Rider DCR revenues are below the $150 million annual cap. (Audit Report at 17.)

{¶ 18} Blue Ridge further states that it examined FirstEnergy's compliance filing projections for the first quarter of 2013 and found nothing indicating that the projected amounts are unreasonable (Audit Report at 18).

{¶ 19} Blue Ridge also examined the overall impact of its findings on the Rider DCR revenue requirement and notes the cumulative impact to the Rider DCR revenue requirement amounts to a reduction of $470,614 (Audit Report at 18).

{¶ 20} Next, Blue Ridge's audit report addresses Scope Area 2: the effects of the merger between FirstEnergy and Allegheny Energy. Blue Ridge states that the Commission agreed not to review the merger because it was an all-stock transition and no change would result in control of the Companies; however, the Commission order held that net capital additions for plant-in-service for general plant shall be included in the Rider DCR so long as there are no net job losses at the Companies resulting from involuntary attrition as a result of the merger. *ESP II Case*, Opinion and Order (Aug. 25, 2010) at 17; 35. Blue Ridge found that, over the period under review, merger-related changes in employee levels resulted in an actual increase of 14. Thus, Blue Ridge concluded that no net job losses resulted from the merger. (Audit Report at 20.)

IV. COMMENTS AND RECOMMENDATIONS

{¶ 21} On May 23, 2013, joint comments on the audit report were filed by FirstEnergy and Staff. FirstEnergy and Staff state that they agree the Commission should adopt the recommendations contained in the audit report as specified below:

(a) Blue Ridge's recommendation that the Companies include quantification of any increase in efficiency and savings within its IT project justification (Audit Report.)

(b) Blue Ridge's recommendation for a reduction in the Rider DCR revenue requirement of $470,614. FirstEnergy and Staff state that the Companies implemented this recommendation in Rider DCR effective July 1, 2013 (Audit Report at 14.)

(c) Blue Ridge's recommendation that the Commission consider an updated depreciation study be conducted (Audit Report at 16). Staff recommends that the Commission direct the Companies to submit this study to Staff no later than June 1, 2015.

(d) Blue Ridge's recommendation that the Companies continue to review IT project planning and implementation (Audit Report at 25).

(e) Blue Ridge's recommendation that the Companies continue their efforts to reduce unitization backlog before the next audit to reduce the potential for over or under accrual of depreciation (Audit Report at 25).

(f) Blue Ridge's recommendation that the sample of December 2012 work orders be included in the test sample for the 2013 compliance audit (Audit Report at 46).

{¶ 22} Thereafter, on July 7, 2013, OCC filed comments regarding the Audit Report. OCC argues that, since FirstEnergy's customers pay the Rider DCR, FirstEnergy's customers should receive the benefit of any savings and efficiencies gained as a result of the investment in plant-in-service that they pay for through Rider DCR.

{¶ 23} OCC notes that Blue Ridge noted the possibility that some merger costs exceeded expectations or should result in savings (Audit Report at 48). OCC contends that significant departures from budget projections justifies a more in depth audit of Rider DCR to determine how both costs and savings associated with the merger affect the revenue requirement of Rider DCR. Therefore, OCC recommends that the Commission order a supplemental audit of merger-related costs and savings.

{¶ 24} OCC also contends that the Commission should order a supplemental audit to ensure that FirstEnergy's customers receive the benefits of the operations and maintenance (O&M) cost savings that result from the investment in distribution facilities. OCC notes that the Companies' O&M costs are embedded in base rates and are paid by customers so the Companies can operate and maintain the distribution system. OCC posits that, by investing in a new and updated distribution infrastructure though Rider DCR, the Companies should have reduced many of the O&M costs embedded in existing base rates. OCC notes that, when the Commission approved the accelerated replacement of aging natural gas pipelines, the Commission required that the reduction in maintenance costs associated with the reduction in pipeline leaks be captured and passed along to customers as part of the annual rider calculation. *In re Duke Energy Ohio, Inc.*, Case Nos. 01-1228-GA-AIR, et al.; *In re Dominion East Ohio Gas,* Case No. 08-169-GA-ALT, et al.; *In re Vectren Energy Delivery of Ohio, Inc.,* Case No. 07-1028-GA-AIR, et al.; *In re Columbia Gas of Ohio, Inc.,* Case No. 08-72-GA-AIR, et al. Further, OCC alleges that Rider DCR may be used to install facilities to serve new customers and that the investment in new facilities to serve new customers would generate new revenues for the Companies. Thus, OCC argues that the Commission should order a supplemental audit to ensure that FirstEnergy's customers receive the benefits of any increased revenues created by additional investment in distribution facilities.

{¶ 25} On August 16, 2013, FirstEnergy filed reply comments responding to the comments filed by OCC. FirstEnergy claims that OCC's comments are untimely and should be stricken, contending that the comments should have been filed within 120 days of the application filed on February 1, 2013 to update Rider DCR. The Companies further claim that OCC misunderstands the nature and scope of the Rider DCR audit. The Companies note that no O&M expenses are recovered through Rider DCR, and, thus O&M expenses are not reviewable in the Rider DCR audit. The Companies also allege that OCC misconstrues the recommendations set forth in the Audit Report. The Companies note that Blue Ridge recommended, to which FirstEnergy agreed, that the

Companies include quantifications of any increase in efficiency and savings *within IT project justifications* rather than merger costs and savings.

{¶ 26} The Companies also argue that the OCC recommendation that cost savings be passed back to customers, based on precedent set in the natural gas industry, is misplaced. Finally, the Companies argue that OCC's recommendations that any hypothetical O&M savings and that additional revenues be included as an offset to the Rider DCR revenue requirement calculation is contrary to and a collateral attack upon the Commission's order approving the combined stipulation in the *ESP II Case*.

V. CONCLUSION

{¶ 27} Based upon our review of the comments filed in this case, the Commission finds that the recommendation submitted by Blue Ridge and agreed to by Staff should be adopted and that OCC's request for a supplemental audit should be rejected. With respect to both the merger costs and savings and potential O&M cost savings, the parameters of the Rider DCR audit were established in the *ESP II Case;* and, in that proceeding, OCC had a full and fair opportunity to advocate for the inclusion of both merger costs and savings and potential O&M savings in the audit process. However, in the *ESP II Case,* the Commission did not modify the provisions of the combined stipulation to include, in the scope of the audit, merger costs and savings or potential O&M savings. Likewise, the *ESP II Case* did not provide for review of any increased revenues created by additional investment in distribution facilities. We will not reconsider the *ESP II Case* in this proceeding in order to expand the scope of the Rider DCR audit.

{¶ 28} Accordingly, the Commission finds that the recommendations by Blue Ridge agreed to by Staff and FirstEnergy and set forth in Paragraph 21 are reasonable and appropriate and should be adopted.

VI. Order

{¶ 29} It is, therefore,

{¶ 30} ORDERED, That the recommendations of Blue Ridge enumerated by FirstEnergy and Staff and summarized in Paragraph 21 be adopted. It is, further,

{¶ 31} ORDERED, That FirstEnergy comply with the recommendations set forth in Paragraph 21. It is, further,

{¶ 32} ORDERED, That a copy of this Finding and Order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

M. Beth Trombold, Chair

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