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 an Extension of Their Distribution Modernization Rider	)))))	Case No. 19-361-EL-RDR

APPLICATION

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ATTORNEYS FOR OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND THE TOLEDO EDISON COMPANY

I. INTRODUCTION

Pursuant to the Fifth and Eighth Entries on Rehearing issued by the Public Utilities Commission of Ohio ("Commission") in Case No. 14-1297-EL-SSO ("ESP IV"), Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI") and The Toledo Edison Company ("TE") (collectively, the "Companies") apply for approval of a two-year extension of their Distribution Modernization Rider ("Rider DMR"). The Commission approved Rider DMR in ESP IV as a distribution modernization incentive to advance the Commission's policy of providing Ohio's electric customers with enhanced reliability, innovation and customer choice. At the time the Commission approved Rider DMR in 2016, FirstEnergy Corp.'s ("FirstEnergy") and the Companies' investment-grade credit ratings were at risk of being downgraded. FirstEnergy's and the Companies' financial condition limited their ability to implement grid modernization initiatives. Also, because of its weakened financial condition, FirstEnergy was at risk of potential acquisition, and loss of its corporate headquarters in Ohio. Rider DMR (and FirstEnergy's commitment to become a fully regulated utility) helped strengthen the Companies' balance sheets and started to improve the Companies' financial position, thereby facilitating the Companies' access to lower cost capital and promoting a faster and more economical path to modernizing the Companies' grid. Rider DMR helps to ensure hundreds of millions of dollars of economic impact for Ohio if FirstEnergy maintains its corporate headquarters in Akron, Ohio. The Commission's approval of Rider DMR is working as intended.

Over the last few years, FirstEnergy and the Companies have taken many aggressive steps, in addition to Rider DMR, to strengthen their financial health. The Companies also have taken steps toward developing and implementing significant grid modernization programs. In addition to actively participating in all stages of the Commission's PowerForward proceedings, and

continuing to research, analyze and deploy grid modernization, the Companies developed and submitted grid modernization programs to the Commission for approval and entered into settlements with multiple interested stakeholders recommending approval of the first phase of the Companies' grid modernization programs. The vision behind PowerForward is becoming reality.

However, FirstEnergy and the Companies are still working to improve their financial position and are less financially secure than other regulated utility companies. FirstEnergy's credit ratings remain at or near the bottom of investment grade, and it is still highly leveraged, with cash constraints. FirstEnergy has limited financial flexibility to address significant obligations and continue to improve its financial condition. Extending Rider DMR at current levels will provide FirstEnergy and the Companies with valuable and necessary financial flexibility and reduce the risk of a potential ratings downgrade. Avoiding a ratings downgrade benefits customers by reducing the Companies' costs of doing business, incenting grid modernization investments in furtherance of the PowerForward Roadmap which enhance service at a lower cost, and avoiding future rate increases to customers based on higher cost of long-term debt. Further, the state of Ohio and customers continue to benefit when Ohio retains control of a major utility's corporate headquarters and nexus of operations, which provide valuable economic benefits to the State.

Through this Application, the Companies request an extension of Rider DMR at its current amount, and under the same terms and conditions, for an additional two-year period. Schedules of the existing Rider DMR and the proposed Rider DMR are attached to this Application.

II. APPLICATION FOR EXTENSION

A. The Commission Approved Rider DMR for Three Years, and Permitted the Companies to Apply for a Two-Year Extension

1. In ESP IV, the Commission approved Rider DMR as "a needed incentive to the Companies to focus innovation and resources on grid modernization." ESP IV, 5th Entry ¶ 185.

Rider DMR is a distribution modernization incentive authorized under R.C. 4928.143(B)(2)(h). *Id.* ¶ 190. By making grid modernization less expensive, Rider DMR put the Companies on a faster and more economical path to modernizing their distribution system.

2. The Commission approved Rider DMR for an initial three-year period, which ends December 31, 2019. *See* 5th Entry ¶ 210. The Companies receive annual Rider DMR revenues of $132.5 million on an after-tax basis.

3. The Commission's entries in ESP IV permit the Companies to apply in a separate proceeding on or before February 1, 2019, for a two-year extension of Rider DMR. 5th Entry ¶ 210; 8th Entry ¶ 113. The Commission stated that it would determine the two-year extension based upon evidence presented in the separate docket, including, without limitation: (1) "evidence of the Companies' financial needs" and (2) "evidence of the measures undertaken by the Companies, FirstEnergy Corp., and their stakeholders to address the financial issues discussed throughout this Fifth Entry on Rehearing." 5th Entry ¶ 210. The Commission also stated that it would consider whether to continue excluding Rider DMR revenues from the Significantly Excessive Earnings Test ("SEET") when evaluating an extension application. 5th Entry ¶ 212; 8th Entry ¶ 81.

B. <u>The Companies Have Satisfied the Conditions for Recovering Revenue Under Rider DMR</u>

4. The Commission conditioned recovery of revenue under Rider DMR upon (1) continued retention of the corporate headquarters and nexus of operations of FirstEnergy in Akron, Ohio (the "Headquarters Condition"); and (2) no change in "control" of the Companies. 5th Entry ¶ 206. These conditions have been met.

5. The Commission also conditioned Rider DMR on a demonstration of sufficient progress in the implementation and deployment of grid modernization programs approved by the Commission. *Id.* As outlined below, the Companies have met this condition by investing

substantial time and effort into researching and designing grid modernization programs that were filed with the Commission, and they have continued to work with other parties to negotiate and obtain approval of grid modernization programs.

6. The Companies committed in ESP IV to "empower consumers through grid modernization initiatives that promote customer choice in Ohio." ESP IV, 3rd Supp. Stip. p. 9. Examples of such initiatives referenced in ESP IV included: Advanced Metering Infrastructure ("AMI"), distribution automation ("DA") circuit reconfiguration, and integrated Volt/VAR control ("IVVC"). *Id.* As required by ESP IV, the Companies filed their Grid Modernization Business Plan in Case No. 16-481-EL-UNC on February 29, 2016, to highlight future initiatives for Commission consideration and approval. Further progress was made when the Companies filed their Distribution Platform Modernization ("DPM") Plan in Case No. 17-2436-EL-UNC on December 4, 2017. The Companies' smart grid efforts have been shaped by experience with researching, analyzing, and deploying grid modernization, including an on-going pilot program in CEI's service territory that includes AMI, DA and IVVC.

7. Also, between April 2017 and March 2018, the Companies actively participated in all phases of the Commission's PowerForward review of potential grid modernization efforts. The Companies continue participating in the PowerForward Collaborative and ongoing workgroups.

8. The Companies, Commission Staff and interested parties filed a Stipulation in the Grid Modernization Business Plan and DPM Plan cases on November 9, 2018, and a Supplemental Stipulation on January 25, 2019, which includes capital investments totaling $516 million over a three-year period in the Companies' first phase of grid modernization, called "Grid Mod I." Grid Mod I is the first step in a potentially multi-billion dollar transformation of the underlying configuration and architecture of the Companies' distribution system through innovative

technologies such as AMI, DA, IVVC, an Advanced Distribution Management System ("ADMS"), and other distribution system upgrades. Customer benefits resulting from Grid Mod I include improved system reliability, faster restoration times, reduced end-use energy consumption, and more access to information by customers and competitive retail electric service providers to better manage electricity consumption and deploy innovative services.

9. In addition, FirstEnergy has partnered with the Electric Power Research Institute and the U.S. Department of Energy in the development of the Next Generation System Platform (DSPx), with FirstEnergy helping to develop a grid modernization roadmap that will be utilized in an industry-referenced Grid Modernization Guidebook. FirstEnergy dedicated significant time and resources to investigating and researching new technologies and other innovative solutions for customers. Recognizing the evolving customer expectations for the distribution system, FirstEnergy formed an Emerging Technologies organization responsible for analyzing and implementing new technologies that bring value to customers, such as advanced metering technologies, distribution automation, microgrids, plug-in electric vehicles, energy storage and smart cities.

C. <u>Rider DMR Has Supported the Companies' Grid Modernization Efforts</u>

10. Further, the Commission directed Staff to review use of Rider DMR funds to ensure they are used, directly or indirectly, in support of grid modernization. *Id.* ¶ 282. Indirect support of grid modernization may include lowering the costs of borrowing funds, reducing outstanding pension obligations, reducing debt, and taking other steps to reduce long-term costs of accessing capital.

11. Rider DMR has supported the Companies' efforts to research, analyze and deploy grid modernization, and has improved credit metrics, which supports grid modernization by

lowering the cost of debt. The Companies and FirstEnergy have reduced outstanding debt and contributed to pension plans for Ohio distribution utility employees and shared service employees, most of whom are located in Ohio and contribute to the Ohio economy. These uses of Rider DMR funds to indirectly support grid modernization lower the cost of funds needed for grid modernization.

12. As directed by the Commission, Staff has worked with a monitor to conduct an on-going and real-time review to ensure Rider DMR funds are expended appropriately. *See* 8th Entry, ¶ 113. This review includes quarterly interim updates on the use of Rider DMR to Staff, as well as a mid-term report to be docketed by the monitor in this proceeding within sixty days of the filing of this Application. *Id.*

D. <u>The Companies, FirstEnergy and their Stakeholders Have Taken Significant Measures to Address Financial Issues</u>

13. FirstEnergy has taken other significant measures to address its financial issues. In 2016 and earlier, FirstEnergy management took aggressive actions. These included staffing reductions, changes to employee benefits, and other cost reductions and efficiencies across FirstEnergy. FirstEnergy reduced the dividend by $300 million annually. FirstEnergy utilities implemented rate increases in Pennsylvania, New Jersey and West Virginia. FirstEnergy also announced its exit from the competitive generation business and deactivated and sold generating plants.

14. Since approval of Rider DMR, the Companies, FirstEnergy management, employees, shareholders, and the Companies' affiliated utilities in other states have continued taking aggressive measures to proactively address financial issues and improve credit metrics. In 2017, the Companies used Rider DMR funds to reduce their outstanding debt by $108 million. Additionally, the Companies and other FirstEnergy constituents have acted to improve their

financial standing and credit metrics by, among other things: (1) issuing $2.5 billion of equity in January of 2018; (2) repaying debt totaling $1.45 billion in January of 2018; (3) contributing over $800 million into the pension plan for Ohio distribution utility and shared service employees; (4) implementing an ongoing initiative to align FirstEnergy's cost structure with that of a fully regulated utility company, including voluntary employee reduction plans for approximately 500 employees; (5) pursuing distribution rate increases in Pennsylvania, Maryland and New Jersey, as well as transmission rate increases at the federal level in Ohio, Pennsylvania and New Jersey; and (6) taking steps to eliminate risk from the competitive generation business, including the sale of competitive generation assets and the filing of Chapter 11 bankruptcy by FirstEnergy Nuclear Operating Company, FirstEnergy Solutions Corp. ("FES") and FES's subsidiaries (collectively, the "FES Debtors") on March 31, 2018. The latter included FirstEnergy entering into a bankruptcy-court approved, definitive settlement agreement that settled potential claims against FirstEnergy by the FES Debtors and their creditors, which allows FirstEnergy and the Companies to focus on distribution service improvements.

E. Rider DMR and Other Actions Have Begun to Strengthen the Companies' and FirstEnergy's Balance Sheets and Financial Ability to Make Grid Modernization Investments

15. Rider DMR and these other proactive steps have begun to improve credit metrics. Over 2017 and 2018, Rider DMR has strengthened the Companies' balance sheets. Credit rating agencies have recognized the importance of Rider DMR to maintaining FirstEnergy's and the Companies' investment grade credit ratings. Indeed, one rating agency has described Rider DMR as "an even stronger signal of support for the credit quality of FirstEnergy." Another rating agency described Rider DMR "as favorable for credit quality, resulting in our view of a mostly supportive regulatory framework." Because of Rider DMR and the regulatory environment in Ohio being

credit supportive, the Companies' credit ratings currently are more stable than otherwise would be the case. This has resulted in the Companies being in a stronger financial position to access capital markets at a reasonable cost to make grid modernization investments. Nevertheless, the Companies' financial needs continue, as explained below.

F. A Rider DMR Extension Helps Improve FirstEnergy's and the Companies' Financial Positions to Further Support Grid Modernization Investments and to Provide Significant Benefits to Customers

16. A two-year extension of Rider DMR at its current level of $132.5 million annually, grossed up for federal income taxes, and under the same terms and conditions, is needed to provide FirstEnergy and the Companies the financial flexibility to continue to address their significant ongoing cash needs. It will help protect the Companies against a potential future ratings downgrade by improving their cash flow from operations to debt ratio. Also, it will provide the Companies with more attractive borrowing costs, which will reduce their costs of doing business and support increased investments in grid modernization over the longer term, benefitting customers. Extending Rider DMR also supports the retention of the FirstEnergy headquarters in Akron, Ohio, which will help to keep jobs and economic benefits in Ohio.

17. While Rider DMR has helped strengthen FirstEnergy's and the Companies' balance sheets and financial position to make grid modernization investments, the Companies' financial needs continue and an extension is needed. Improving FirstEnergy's and the Companies' financial condition takes time. Even with Rider DMR, FirstEnergy is less financially secure than other fully regulated utilities, as proven by credit ratings that remain at or near the bottom of investment grade, a significantly more leveraged balance sheet than other fully regulated utilities, and a price to earnings ratio that is lower than others in the industry. For these reasons, FirstEnergy is vulnerable to being acquired.

18. Meanwhile, FirstEnergy and the Companies have substantial current and future needs for cash which include:

- FirstEnergy and the Companies have a continual need to make substantial capital investments, including grid modernization investments that will extend well beyond the term of Rider DMR and ESP IV.
- FirstEnergy's pension is expected to be underfunded by over one billion dollars in 2022 and beyond.
- FirstEnergy and the Companies have significant cash needs for debt redemption requirements. The Companies' and FirstEnergy's long-term debt maturities total $350 million and $1.35 billion, respectively, through 2024. Additionally, FirstEnergy has another $1.75 billion of bank loans maturing over the next two years.

19. FirstEnergy and the Companies need as much financial flexibility as possible to become stronger in the long term and to continue to support grid modernization. Financial flexibility is necessary for a purely regulated public utility company to address significant obligations. Financial flexibility (the ability to react to unexpected circumstances and grid modernization investment opportunities) increases the Companies' ability to withstand a major unforeseen event, such as a major storm event, which results in significant and immediate cash outlay. A major storm event would immediately reduce cash flow (even if deferred or capitalized for eventual recovery). In addition, an economic downturn will result in a significant reduction in load, with a corresponding decline in cash flow for FirstEnergy and the Companies. Rider DMR provides financial flexibility, helping FirstEnergy and the Companies prevent a potential future downgrade. Avoiding a downgrade will preserve FirstEnergy's and the Companies' access to

capital markets, make capital less expensive and subject to less restrictive terms and conditions, and prevent negative actions on borrowings and contracts.

20. In addition, extending Rider DMR is necessary to provide FirstEnergy with the ability to maintain its corporate headquarters and nexus of operations in Ohio. A corporation with a weaker balance sheet, particularly one such as FirstEnergy with a substantial price/earnings multiple discount relative to others in the industry, is at increased risk of becoming an acquisition target. The Akron headquarters supports thousands of local jobs and generates hundreds of millions of dollars in annual payroll throughout Ohio. Indeed, the Commission found in ESP IV that maintaining FirstEnergy's corporate headquarters in Akron, Ohio, generates $568 million in annual economic impact. ESP IV, 8th Entry ¶ 160. Rider DMR and its associated Headquarters Condition reduces the risk that Ohio's jobs and dollars will flow out-of-state.

21. By ensuring more attractive borrowing costs for the Companies, Rider DMR will reduce the Companies' costs of doing business, which will benefit customers. Rider DMR provides for more favorable terms with the Companies' vendors and suppliers, which should reduce the cost of grid modernization investments collected from customers. And by avoiding an increase in the Companies' long-term cost of debt due to a poor credit rating, customers avoid rate increases in the long-term. Additionally, the state sees economic development benefits both directly from Rider DMR spending and indirectly from the Headquarters Condition and from the innovation and customer choice arising from grid modernization.

G. <u>Rider DMR Funds Should Continue to be Excluded from SEET</u>

22. The Commission should continue to exclude Rider DMR revenue from the SEET calculation because a SEET refund due to Rider DMR revenues would effectively defeat the purpose of Rider DMR. Improved access to capital markets would be negated if the Companies

had to return revenues from Rider DMR to customers. Moreover, under the SEET, the earned return on equity of the Companies is compared to the earned return of comparable companies. Because Rider DMR is unique, it is impossible to create a valid comparison for purposes of the SEET calculation. Therefore, Rider DMR must continue to be excluded to allow for a valid comparison. In addition, excluding SEET is consistent with the Commission's Order in the generic SEET case (Case No. 09-786-EL-UNC), which specifically allows for special items to be excluded from the SEET calculation.

H. Procedural Schedule

The Companies recommend the following procedural schedule, which will provide intervening parties an adequate opportunity for discovery and preparation for hearing while still providing the Commission with a reasonable amount of time to render a decision:

Application filed	February 1, 2019
Company testimony due	March 1, 2019
Motions to intervene due	March 1, 2019
Monitor mid-term report due	April 2, 2019
Company supplemental testimony	May 3, 2019
Intervenor and Staff testimony	May 31, 2019
Procedural conference	July 1, 2019
Hearing begins	July 8-11, 2019

The Companies request that, based upon the foregoing procedural schedule, the Commission render a decision approving this Application no later than October 30, 2019.

WHEREFORE, the Companies ask the Commission to approve this Application.

Respectfully submitted,

/s/ *Brian J. Knipe*

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VERIFICATION

STATE OF OHIO)
) SS:
COUNTY OF SUMMIT)

The undersigned, being first duly sworn in accordance with law, state that they have the authority to verify the foregoing Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company (collectively, the "Companies"); that they have read said Application and are familiar its contents; and that the statements contained therein made on behalf of the Companies are true and correct to the best of their knowledge, information and belief.

Jason J. Lisowski
Vice President, Controller and Chief Accounting Officer

Ohio Edison Company
The Cleveland Electric Illuminating Co.
The Toledo Edison Company

Steven R. Staub
Vice President and Treasurer

Ohio Edison Company
The Cleveland Electric Illuminating Co.
The Toledo Edison Company

SWORN TO BEFORE ME and subscribed in my presence this 1st day of February, 2019.

NOTARY PUBLIC

NOTARIAL SEAL STATE OF OHIO

Ashlee Waite
Resident Summit County
Notary Public, State of Ohio
My Commission Expires:
June 19, 2019

RIDER DMR
Distribution Modernization Rider

APPLICABILITY:

Applicable to any customer who receives electric service under the Company's rate schedules. This Distribution Modernization Rider (DMR) will be effective for service rendered beginning January 1, 2019. This Rider is not avoidable for customers during the period the customer takes electric generation service from a certified supplier.

The DMR charges will apply, by rate schedule, as follows:

RATE:

RS (all kWhs, per kWh)		0.3332¢
GS (per kW of Billing Demand)	$0.5177	
GS (all kWhs, per kWh)		0.1560¢
GP (per kW of Billing Demand)	$0.6023	
GP (all kWhs, per kWh)		0.1560¢
GSU (per kVA of Billing Demand)	$0.4309	
GSU (all kWhs, per kWh)		0.1560¢
GT (per kVA of Billing Demand)	$0.3945	
GT (all kWhs, per kWh)		0.1560¢
STL (all kWhs, per kWh)		0.1560¢
TRF (all kWhs, per kWh)		0.3310¢
POL (all kWhs, per kWh)		0.1560¢

RIDER UPDATES:

The charges contained in this Rider shall be updated on an annual basis. No later than December 1st of each year, the Company will file with the PUCO a request for approval of the Rider charges which, unless otherwise ordered by the PUCO, shall become effective on a service rendered basis on January 1st of each year.

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GP (per kW of Billing Demand)	$0.8126	
GP (all kWhs, per kWh)		0.1589¢
GSU (per kW of Billing Demand)	$0.6235	
GSU (all kWhs, per kWh)		0.1589¢
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GP (all kWhs, per kWh)		0.1587¢
GSU (per kVA of Billing Demand)	$0.5892	
GSU (all kWhs, per kWh)		0.1587¢
GT (per kVA of Billing Demand)	$0.5339	
GT (all kWhs, per kWh)		0.1587¢
STL (all kWhs, per kWh)		0.1587¢
TRF (all kWhs, per kWh)		0.2833¢
POL (all kWhs, per kWh)		0.1587¢

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Case No(s). 19-0361-EL-RDR

Summary: Application electronically filed by Mr. James F Lang on behalf of Ohio Edison Company and The Cleveland Electric Illuminating Company and The Toledo Edison Company