BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Review of the Distribution Modernization Rider of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company	)))))	Case No. 17-2474-EL-RDR

COMMENTS OF OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY

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I. INTRODUCTION

Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (the "Companies") appreciate the opportunity to address Daymark Energy Advisors' ("Daymark") Audit Report of the Ohio Companies' Rider DMR (the "Audit Report"), and they respectfully submit these Comments. As explained below, given Rider DMR's purpose, history, and structure, there is more than sufficient support to conclude that the Companies complied with the Commission's directive in the Companies' fourth electric security plan[1] ("ESP IV") to use Rider DMR funds, directly or indirectly, in support of grid modernization.

The Audit Report contains seventeen findings and two recommendations. Both recommendations are constructive suggestions to improve the Companies' policies and practices relating to dividends and money pool audits, and implementation is underway. However, many of the Audit Report's findings, and the underlying analyses, do not reflect the authorized terms and conditions of Rider DMR. This is understandable, given that Rider DMR, a credit support rider that was not cost-based, is unusual in its history, purpose, and structure. Certain findings also do not recognize how other programs of the Companies relate to, or are different than, Rider DMR, or the realities of how the cash management process works. As a result of these misunderstandings, the Audit Report is unable to conclude with confidence that revenue the Companies collected as a result of Rider DMR was, or was not, used for a specific purpose.

For instance, the inability to distinguish the funds the Companies collect from customers through Rider DMR is a reality of how the cash management process works. Given the inability to distinguish Rider DMR funds from the rest of the Companies' cash on hand, it is impossible for

[1] *See 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.

the Companies to pinpoint Rider DMR funds and dedicate them to any given expenditure. But contrary to the Audit Report's findings, specific identification of Rider DMR funds is not necessary to demonstrate compliance with the Commission's Rider DMR directives. Rather, the inability to distinguish dollars simply reflects the fungibility of money and was recognized in the ESP IV litigation. Therefore, the inability to trace Rider DMR funds is consistent with the authorized structure of Rider DMR, not an indication of non-compliance.

In some instances, the Audit Report appears to have analyzed the correct information, but did not reach the necessary conclusion supported by that information. For example, the Audit Report appropriately identifies that Rider DMR had a positive impact on the financial condition of the Companies and their parent, yet does not conclude that this improvement sufficiently demonstrates credit support as intended. In addition, the Audit Report correctly compares the amount of Rider DMR revenues to expenditures by the Companies that were directly or indirectly in support of grid modernization, without concluding that this comparison demonstrates compliance with the Rider DMR directives. Further, the Audit Report at times confuses Rider DMR with the first phase of the Companies' distribution grid modernization program[2] ("Grid Mod I"). While the Audit Report suggests, based on a perceived lack of familiarity with Rider DMR among employees, that grid modernization is not a priority of the Companies, this finding appears to be based on the incorrect assumption that Rider DMR was a grid modernization program. Rider DMR was intended to be a grid modernization incentive, through credit support. In contrast, actual grid modernization occurs through programs to make investments that modernize the distribution system, such as the Companies' Grid Mod I program. Therefore,

[2] *In the Matter of the Filing by Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company of a Grid Modernization Business Plan*, Case No. 16-481-EL-UNC, et al.

employees' lack of familiarity with Rider DMR—a credit support rider—is in no way evidence that grid modernization is not a priority at the Companies.

The Companies believe these issues and others in the Audit Report are largely attributable to the unique nature of Rider DMR and a misunderstanding of how Rider DMR relates to, or is different from, other programs of the Companies. The Companies intend to provide clarity on those matters here in their Comments. When the unique features of Rider DMR and other factors are taken into consideration, the Audit Report's findings demonstrate that the Companies complied with the necessary requirements. Accordingly, the Companies respectfully urge the Commission to find that the Companies complied with all requirements of Rider DMR.

II. COMMENTS

A. Rider DMR Was An Unconventional Rider, Unique In Purpose And Structure.

Rider DMR was a unique rider proposed by Commission Staff,[3] and authorized by the Commission to address the serious financial difficulties that threatened the Companies' ability to make the large investments required to modernize the distribution grid. The record in the proceeding where Rider DMR was approved—ESP IV—showed that the Companies and FirstEnergy Corp. were at serious risk of credit downgrades that would make attaining the Commission's goal of a modernized grid more difficult and ultimately more costly to customers. The Commission approved Rider DMR to mitigate that risk. Unlike most riders, Rider DMR is not a rider designed to recover the Companies' costs. Typically, riders are designed to recover specific costs. For instance, the Companies' Advanced Metering Infrastructure/Modern Grid Rider ("Rider AMI") is designed to recover costs associated with approved distribution grid

[3] *See generally*, ESP IV, Rehearing Testimony Joseph P. Buckley (June 29, 2016); Rehearing Testimony of Hisham M. Choueiki, P.H.D., P.E. (June 29, 2016).

modernization programs. In contrast, Rider DMR rates do not include any costs. Rather, Rider DMR's purpose was to incentivize grid modernization through credit support to assist the Companies in accessing the capital markets on more reasonable terms.

In recognition of the rider's purpose, the Commission did not require the Companies to invest funds received from Rider DMR revenues directly in grid modernization projects. Indeed, Rider DMR was never intended to provide cash to the Companies to use directly for specific projects.[4] Instead, the purpose of Rider DMR was to provide improved access to the capital markets to ultimately allow the Companies to fund their grid modernization initiatives.[5] As a Commission Staff witness testified, Rider DMR was a means of credit support intended to ensure that the Companies could access the capital markets on more favorable terms which, in turn, would "enable the Companies to procure funds to jumpstart their distribution grid modernization initiatives."[6] In other words, there is a fundamental difference between *paying* for grid modernization projects and *receiving* credit support *to access* capital to fund such projects.[7] Rider DMR addressed the latter, while the former is addressed through Grid Mod I. Thus, while Rider DMR is credit support intended to incentive grid modernization investment, Grid Mod I is actual grid modernization investment. As explained further below, the Audit Report does not recognize this key distinction between Rider DMR and Grid Mod I.

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[4] ESP IV, Choueiki Rehearing Test., p. 15; ESP IV, Buckley Rehearing Test., p. 2.

[5] Fifth Entry on Rehearing, p. 91 (citing Rehearing Tr. Vol. III, pp. 571-73 (Buckley Cross) and Choueiki Rehearing Test., p. 15).

[6] ESP IV, Choueiki Rehearing Test., p. 15.

[7] Moreover, there was no evidence in the ESP IV record that Rider DMR revenues would be anywhere near sufficient to fund grid modernization initiatives. Rather, as the Companies explained, "the revenue collected under Rider DMR [would] only represent a fraction of the significant capital investment necessary to implement grid modernization projects" over many years. Eighth Entry on Rehearing at 26.

This point is further reinforced by the language the Commission used when it approved the rider: "Rider DMR is necessary *to assist the Companies in accessing the capital markets* in order to make needed investments in their distribution systems."[8] This finding, as the Commission later noted, was supported by substantial evidence that: (1) the Companies were at serious risk of a credit downgrade that would have adverse effects upon the Companies' ability to access the capital markets;[9] (2) the Companies would suffer adverse consequences as a result of a downgrade;[10] (3) Rider DMR was intended to provide credit support to the Companies in order to avoid a downgrade;[11] and (4) maintaining the Companies' then-current ratings would allow the Companies to access capital markets in order to fund grid modernization investments.[12]

It was for all these reasons that the Commission ruled that placing restrictions on Rider DMR funds "would defeat the purpose of Rider DMR."[13] This ruling expressly recognized that limiting the use of Rider DMR revenues would only undermine the rider's purpose by restricting the Companies' ability to take steps necessary to maintain investment grade ratings. And that ruling squarely rejected proposals from intervening parties who urged the Commission to implement such limitations.[14] For instance, one intervenor asserted that Rider DMR revenues should be set aside in a separate account (or accounts) and earmarked for grid modernization or

[8] Fifth Entry on Rehearing at 90 (emphasis added).

[9] *Id.* at 126.

[10] *Id.* at 127.

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *See* Fifth Entry on Rehearing at 86, 127.

other beneficial projects.[15] Many other intervenors raised similar arguments.[16] But the Commission twice rejected such proposals in terms that could not have been clearer.

Indeed, the Commission returned to this point in the Eighth Entry on Rehearing. There, the Commission addressed intervenor rehearing arguments that the Commission (1) should have adopted the proposals above on the use of DMR revenues and (2) rejected those proposals "without any evidentiary basis."[17] The Commission held that these arguments were "already raised" and "rejected by this Commission" on the basis of a substantial record.[18] Thus, contrary to the Audit Report's statement that "[FirstEnergy] rejected the use of a separate account for tracking Rider DMR funds,"[19] the record in ESP IV shows the Commission amply considered and denied the limitations and tracking mechanisms proposed by some parties in ESP IV.

The Audit Report also observes that Rider DMR funds cannot be "traced" to specific spending.[20] As noted in the Audit Report, while the Companies tracked Rider DMR revenues, the funds received from those revenues lost their identity upon receipt by the Companies.[21] All customer remittances received by the Companies are placed into the Regulated Utility Money Pool (the "Money Pool"), where the dollars are fungible.[22] The inability to trace Rider DMR funds was

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[15] *Id.* at 86.

[16] *See* Fifth Entry on Rehearing at 53 (noting objections from 11 intervenors because Rider DMR "provides no explicit requirements that the Companies use the revenues derived from Rider DMR to invest in distribution grid modernization.")

[17] Eighth Entry on Rehearing at 36.

[18] *Id.*

[19] Audit Report at 24.

[20] *Id.* at 7.

[21] *Id.* at 88.

[22] As the Commission has recognized, the Money Pool allows FirstEnergy's utilities to lend short-term funds to the Money Pool and receive interest income or to borrow short-term funds from the Money Pool at rates generally more attractive than those obtained through outside financing. The Commission annually reviews and approves the Companies' participation in the Money Pool, most recently authorizing such participation through December 31, 2022. And the Companies submit quarterly reports to the Commission regarding their participation in the Money Pool. *See*

recognized in the ESP IV litigation. Indeed, in testimony in ESP IV, a Commission Staff witness testified that "[t]he [Rider DMR] monies aren't going to be marked . . . We are not going to mark those dollars as DMR money."[23] The same witness later reiterated that "the money for the DMR is not going to be marked different than any other money that Ohio Edison were to receive"[24] and also that the "dollars are kind of fungible . . . we are not going to mark this dollar and say it's got to go to any certain purpose . . . ."[25]

Therefore, it is not possible to specifically determine the "use of Rider DMR funds." Generally, the only way to determine whether customers paid for a given cost is to identify the cost, and analyze whether that cost was included in rates paid by customers. Since Rider DMR was not a cost-based recovery mechanism, any such analysis is moot. In the case of Rider DMR, the best measure of compliance with the Commission's ESP IV directives on the use of Rider DMR funds is to compare the amount of funds used, directly or indirectly, in support of grid modernization to the amount of Rider DMR revenue the Companies collected.

The inability to track the flow of specific funds from Rider DMR revenues is not unique to Rider DMR. It is simply how the cash management process works. Therefore, the Audit Report's inability to conclude with confidence that revenue the Companies collected as a result of Rider DMR was, or was not, used for a specific purpose, is no revelation. Rather, the Audit Report should be read to acknowledge the well-understood realities of the Money Pool: that cash is fungible and that no specific dollar can be traced from the customer or identified by the Companies to use for a specific expenditure.

In the Matter of the Application of Ohio Edison Company for Authority to Issue, Renew, or Assume Liability on Notes and Other Evidences of Indebtedness, Case Nos. 21-930-EL-AIS, *et al.*, Finding and Order (Dec. 15, 2021).

[23] ESP IV, Rehearing Tr. Vol. III at 580:1-8.

[24] *Id.* at 584:13-18.

[25] *Id.* at 648:17-24.

B. The Companies And FirstEnergy Corp. Complied With The Commission's Rider DMR Requirements Because Their Grid Modernization-Related Spending Exceeded The Amounts Collected Under Rider DMR.

Staff was tasked with determining whether Rider DMR funds were used, directly or indirectly, in support of grid modernization, in compliance with the Commission's ESP IV directives. As explained in the previous section, given the recognized impossibility of tracing specific sources of funds to specific expenditures, and the fact that Rider DMR is not a cost-based rider, the best measure of compliance with the Commission's ESP IV directives on the use of Rider DMR funds is to compare the amount of funds used, directly or indirectly, in support of grid modernization, to the amount of Rider DMR revenue the Companies collected. The Audit Report conducts this analysis, and demonstrates that the Companies made expenditures in support of grid modernization that far exceeded the revenues recovered under Rider DMR during this time period.

In ordering Staff to review whether Rider DMR funds had been used to support grid modernization, the Commission noted various ways that such funds could be used, directly or indirectly, for that purpose.[26] Direct uses could include making "the large cash up front investments to fund grid modernization." And to "lower the cost of borrowing the funds needed to invest in grid modernization,"[27] permissible indirect uses called out by the Commission included "reducing outstanding pension obligations, reducing debt, or taking other steps to reduce the long-term costs of accessing capital." [28]

With respect to direct uses, the Audit Report found the Companies made nearly $40 million of direct investment relating to grid modernization while Rider DMR was in effect.[29] And the

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[26] Fifth Entry on Rehearing at 127-28.

[27] *Id.* at 128.

[28] *Id.*

[29] *See* Audit Report at 17, Table 2; Audit Report at Appendix C. These investments were not part of Grid Mod I.

Audit Report itself demonstrates that the Companies had substantial "cash outflows" falling into "indirect support categories for grid modernization" while Rider DMR was in place.[30] This includes $105 million in debt reduction and $102 million in contributions from the Companies to the FirstEnergy Corp. pension plan from 2017 through 2019.[31] And during the same period, FirstEnergy Service Company contributed over $1.2 billion to the pension plan, a substantial portion of which related to shared services employees supporting the Companies.[32] Further, the Audit Report notes the Companies paid nearly $1.5 billion in dividends during the Rider DMR period.[33] The Audit Report found that these dividends were not only reasonable compared to industry peers, but that they also played a role in improving FirstEnergy Corp.'s cash flow and ability to attract equity investment.[34] Beyond all this, the Companies used DMR funds indirectly by placing them all in the Money Pool where they could be available to support the Companies' capital spending. This placement improved cash or funds from operations ("CFO" or "FFO"), enhanced liquidity, and reduced borrowing needs."[35]

In short, the direct and indirect expenditures made by or on behalf of the Companies toward the permissible uses of Rider DMR funds identified by the Commission far exceed the roughly $333 million of after-tax Rider DMR revenue.[36] The Audit Report made all the findings necessary

[30] Audit Report at 5-6.

[31] *Id.* at 6, Table 1.

[32] Exhibit A, DM Set 04-DR-002, Attachment 1.

[33] Audit Report at 6, Table 1.

[34] *See id.* at 9, 64-65

[35] *See id.* at 42, Figure 8.

[36] *See* Fifth Entry on Rehearing at 95 ("Therefore, the Commission directs that Rider DMR should recover $132.5 million, adjusted for recovery of taxes at the prevailing Federal corporate income tax rate."). *See* Audit Report at 6 for the annual Rider DMR revenue. Annual after-tax Rider DMR revenues are calculated as follows: 2017 = $201.7 million x (1 – 35% tax rate) = $131.1 million; 2018 = $173.4 million x (1 – 21% tax rate) = $137.0 million; 2019 = $82.6 million x (1 – 21% tax rate) = $65.2 million; and total 2017-2019 = $333.4 million.

to conclude that Rider DMR revenues were used in compliance with the Commission's ESP IV Entries. Without the benefit of a complete understanding of the history, purpose, and structure of Rider DMR, the Audit Report was unable to reach the conclusion with certainty. The Commission, however, should find more than sufficient record support to conclude that the Companies complied with the directive to use Rider DMR funds, directly or indirectly, in support of grid modernization.

C. The Audit Report Does Not Reflect The Unique Structure, Purpose, And History Of Rider DMR.

1. The Audit Report Should have Concluded That Rider DMR Funds Were Used as Authorized in ESP IV.

Given the uniqueness of Rider DMR (*see* Section II.A above), it is understandable that the Audit Report includes findings and conclusions that are inconsistent with the authorized purpose of Rider DMR.[37] For example, the Audit Report has difficulty reaching conclusions with respect to the use of Rider DMR funds, due to the impossibility of tracing Rider DMR funds from the customer to any uses by the Companies. While the Audit Report acknowledges that the Commission did not restrict the use of Rider DMR funds,[38] its ultimate findings center on the fact that funds from Rider DMR revenues cannot be traced to specific grid modernization expenditures or other grid modernization-related uses. This leads the auditor to conclude that it cannot say definitively whether Rider DMR funds were used for the purposes outlined by the Commission in ESP IV or for any "unapproved purposes."[39] For similar reasons, while the Audit Report found "no documented evidence that ties Rider DMR spending to lobbying for the passage of H.B. 6, the

[37] Further, the Audit Report explains that the auditor's communications with Staff were limited to one-way progress updates: "To maintain independence throughout the audit, our communications with Staff were structured to update them on the progress only, as opposed to seeking Staff's direction on what to examine." Audit Report at 4.

[38] *See* Audit Report at 3-4, 24-25, 27, 93.

[39] *See* Audit Report at 89.

auditor "cannot rule out with certainty use of Rider DMR funds to support of the passage of H.B. 6."[40]

Both of these indeterminate conclusions appear to ignore or overlook not only the fungibility of money but also the unique structure of Rider DMR, as explained above. Simply put, it is impossible to distinguish Rider DMR funds from the Companies' other funds and direct Rider DMR funds to support HB 6 or grid modernization, or any other use. As explained earlier, the way to determine if Rider DMR funds were used as approved in ESP IV is to compare funds put toward appropriate uses with Rider DMR revenues collected. And the way to determine if customers paid costs in support of HB 6 is to first identify a cost in support of HB 6, and determine whether that cost was included in rates paid by customers. That analysis is already underway in other Commission proceedings.[41]

2. Rider DMR is Not a Grid Modernization Program.

The Audit Report also does not accurately differentiate between Rider DMR and the Companies' Grid Mod I program. For instance, the Audit Report's conflation of the Companies' Grid Mod I program with Rider DMR leads to the misunderstanding that the "Grid Mod I program is a much more effective and transparent way to incentivize and track grid modernization spending than the Rider DMR"[42] and that "Grid Mod I is a much more comprehensive grid modernization program [than Rider DMR]."[43] Again, Rider DMR was not a "grid modernization program," and

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[40] *Id.* at 7.

[41] *See, generally*, *In the Matter of the Review of the Political and Charitable Spending by Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company*, Case No. 20-1502-EL-UNC; *In the Matter of the 2020 Review of the Delivery Capital Recovery Rider of First Energy*, Case No. 20-1629-EL-RDR.

[42] *Id.* at 7.

[43] *Id.* at 26.

Grid Mod I does not "incentivize . . . grid modernization spending." Rather, Grid Mod I *is* grid modernization spending.

Additionally, the Audit Report observes "a general lack of knowledge on the specifics of Rider DMR" among employees interviewed. The Audit Report concludes that "the overall lack of knowledge suggests that grid modernization was not a well-communicated priority."[44] As explained above, however, Rider DMR was not a grid modernization program. Rather, it was credit support intended to incentivize grid modernization. The Companies' actual grid modernization program is Grid Mod I, in which the Companies are authorized to recover their actual capital costs up to $516 million of Grid Mod I assets through a separate rider. Therefore, a lack of familiarity with Rider DMR, a credit support rider, does not mean that grid modernization is not a well-communicated priority.

The Audit Report also does not recognize how the development, approval, and implementation of Grid Mod I represents "sufficient progress" in grid modernization as directed by the Commission in ESP IV. In its analysis of direct uses of Rider DMR funds for grid modernization, the Audit Report concludes there was not "significant progress" on grid modernization during the Rider DMR term. Further, the Audit Report suggests that the Companies did not "prioritize" grid modernization during Rider DMR because they made comparatively few modernization investments during the rider's term, as opposed to the period following the Commission's approval of the Companies' Grid Mod I program.[45]

However, the Companies were not authorized to implement their large-scale grid modernization efforts during Rider DMR's term. The Audit Report overlooks an important

[44] *Id.* at 6, 93.

[45] *See Id.* at 13-21.

qualification of the Commission's "sufficient progress" requirement in the Fifth Entry on Rehearing. There, the Commission specifically stated that the Companies' grid modernization progress "will only be determined with respect to the implementation and deployment of grid modernization programs *actually approved by the Commission*."[46] The Companies made significant efforts to obtain Commission approval of a grid modernization program during this time period. While the Companies first filed their grid modernization business plan in 2016,[47] filed another proposed interim plan in 2017,[48] and filed a partial stipulation providing for Grid Mod I on November 9, 2018,[49] these matters were not resolved until the Commission approved the Companies' Grid Mod I program on July 17, 2019.[50] That approval came *after* the Ohio Supreme Court decision striking down Rider DMR in June 2019.[51] The Audit Report's finding that the Companies did not prioritize grid modernization investments while Rider DMR was in effect disregards this fact.

Instead of acknowledging the development and litigation of what became Grid Mod I as "sufficient progress" in the implementation and deployment of grid modernization programs approved by the Commission, the Audit Report examines FirstEnergy Corp.'s and the Companies' capital budgeting processes as well the Companies' recent reliability metrics.[52] Exploration of

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[46] Fifth Entry on Rehearing at 97.

[47] *See In the Matter of the Filing by Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company of a Grid Modernization Business Plan*, Case No. 16-0481-EL-UNC, Companies' Grid Modernization Business Plan (Feb. 29, 2016).

[48] *See In the Matter of the Application for approval of a distribution platform modernization plan filed by J. Lang on behalf of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company*, Case No. 17-2436-EL-UNC.

[49] *See In the Matter of the Filing by Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company of a Grid Modernization Business Plan*, Case Nos. 16-0481-EL-UNC, et al., Stipulation and Recommendation (Nov. 9, 2018).

[50] *See* Case Nos. 16-0481-EL-UNC, *et al.*, Opinion and Order (July 17, 2019).

[51] *In re Ohio Edison Co.*, 2019-Ohio-2401, 157 Ohio St. 3d 73.

[52] *See* Audit Report at 13-21.

these ancillary topics, however, overlooks Grid Mod I as a clear indication that the Companies satisfied Rider DMR's "sufficient progress" condition.

D. Other Areas Of Disagreement With the Audit Report's Methodology And Analysis.

Much of the Audit Report discusses the "indirect uses of DMR funds for credit support," covering an array of issues ranging from debt reduction to equity infusions.[53] As explained below, however, these analyses often understate the impact of Rider DMR. At the same time, the Audit Report appears to overlook that Rider DMR was not approved in 2016 as a cure-all for the financial difficulties facing the Companies and their parent. Rather, as the Commission found in ESP IV, the burden of improving the company's financial health was being addressed by numerous initiatives across FirstEnergy Corp., with Rider DMR being but one factor of many that would—and ultimately did—bolster FirstEnergy Corp.'s financial position.[54] And while the Audit Report casts doubt on whether Rider DMR tangibly benefited the Companies and their customers, the record shows that Rider DMR improved cash flow. During the period Rider DMR was in effect, the Companies reduced their debt obligations and borrowing costs and avoided incurring additional debt and associated interest expenses. Significant pension contributions were made by the Companies and FirstEnergy Service Company on behalf of the Companies during this period as well. The Companies respectfully submit that the Audit Report's methodology does not sufficiently recognize the positive impact Rider DMR had on the financial health of the Companies and FirstEnergy Corp.

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[53] *See generally*, *id*. at 35-87.

[54] *See* Fifth Entry on Rehearing at 95-96.

1. The Audit Report did Not Examine how Rider DMR Functioned in Conjunction with Other Events.

The Audit Report states that the auditor "could not ascertain any significant, tangible benefit to customers from the Rider DMR as it relates to the Ohio Companies' cost of debt,"[55] and otherwise finds little positive impact of Rider DMR on the financial health of the Ohio Companies or FirstEnergy Corp. But the Audit Report either concludes that other key events (whether positive or negative) "made it impossible to separate the effects of Rider DMR funds from these major events" with respect to FirstEnergy's and the Ohio Companies' financial health,[56] or it assumes, without analysis, that some events had a more positive influence than Rider DMR on FirstEnergy Corp.'s and the Companies' credit ratings or debt reduction.[57]

To be sure, the Audit Report acknowledges that key events impacting FirstEnergy's financial health took place, listing those occurring at the time of Rider DMR as: FirstEnergy Corp.'s asset impairments (February 2017), the equity issuance (January 2018), the subsequent bankruptcy of FirstEnergy Corp.'s competitive operations (March 2018), the settlement of the bankruptcy case (September 2018), the Commission's approval of Grid Mod I (July 2019), and the return of tax savings to customers pursuant to the Tax Cuts and Jobs Act of 2017 (the "TCJA") (July 2019). But, in evaluating the degree to which Rider DMR benefited FirstEnergy Corp.'s and the Companies' financial health, the Audit Report does not seek to explore how Rider DMR offset the negative events or supplemented the positive ones.

One stark example of this shortcoming can be seen with respect to the TCJA's impacts. That Act led to the return of $900 million in excess tax costs to customers, had a negative cash

[55] Audit Report at 36.

[56] *See id.*

[57] *Id.* at 53-54, 56, 62-63

flow impact on FirstEnergy Corp., and resulted in an overall negative credit impact on regulated utilities.[58] Indeed, in a January 24, 2018 release, Moody's stated:

> For the investor-owned utilities sector, the 2017 tax reform legislation will have an overall negative credit impact on regulated operating companies and their holding companies. Moody's calculates that the recent changes in tax laws will dilute a utility's ratio of cash flow before changes in working capital to debt by approximately 150-250 basis points on average, depending to some degree on the size of the company's capital expenditure program.[59]

While FirstEnergy Corp. took steps to prepare for the effects of tax reform, notably the issuance of $2.5 billion in equity in January 2018, the company had a significantly more leveraged balance sheet than its industry peers.[60] And Rider DMR, which improved FirstEnergy Corp.'s CFO or FFO to debt ratio by about 60 to 80 basis points annually, was a key factor in offsetting the cash flow impacts of the TCJA and guarding against a potential ratings downgrade.[61] The Audit Report does not, however, sufficiently account for these benefits. Nor does the Audit Report fully recognize that this was precisely the type of event that Rider DMR was meant to address. Indeed, the ESP IV record demonstrates that the Companies were at an imminent and "serious risk" of a credit downgrade. And Rider DMR was expressly intended to act as a buffer against that risk in case of future credit-negative events, such as the TCJA.[62]

The Audit Report likewise does not appreciate that Rider DMR was never intended to exist in a vacuum—that is, that "all of FirstEnergy Corp.'s stakeholders [were] sharing the burden of improving its financial health."[63] Rider DMR functioned in conjunction with a host of other

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[58] *See In the Matter of the Application for an Extension of the Distribution Modernization Rider*, Case No. 19-0361-EL-RDR, Direct Testimony of Steven Staub, at 9:7-20 (March 1, 2019).

[59] *Id.*

[60] *Id.* at 9:21-26.

[61] *See* Audit Report at 42, Figure 8.

[62] *See id.* at 49-50.

[63] Fifth Entry on Rehearing at 95.

proactive steps necessary to improving FirstEnergy Corp.'s and the Companies' financial position, including equity issuances, debt repayments, exiting the competitive generation business, and resolving many potential claims in FirstEnergy Solutions' bankruptcy proceedings via settlement.[64] These measures were always intended to coincide with Rider DMR to provide a holistic remedy for FirstEnergy Corp.'s financial difficulties.[65]

But instead of analyzing the additive, and necessary, benefits of Rider DMR, the Audit Report subsumes any potential benefits of the rider into other events and assumes without further analysis that these other events were the cause of improvements.[66] While the Audit Report is no doubt correct that major developments such as the exit from competitive generation and the resolution of the bankruptcy proceedings had significant positive impacts on FirstEnergy Corp.'s risk profile,[67] this is no reason to ignore the tangible cash flow benefits of Rider DMR or to doubt that the rider was working as the Commission intended.

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[64] *In the Matter of the Application for an Extension of the Distribution Modernization Rider*, Case No. 19-0361-EL-RDR, Direct Testimony of Steven Staub, at 6:1-21.

[65] *See* Fifth Entry on Rehearing at 95-96; Eighth Entry on Rehearing (Aug. 16, 2017), at 23 (where the Companies asserted that a "properly constructed Rider DMR, in addition to other simultaneous actions taken by the Companies and FirstEnergy Corp. as part of a collective effort, should be able to avoid a credit rating downgrade.").

[66] *See* Audit Report at 63 ("Credit agencies did view Rider DMR as positive, however, it appears FirstEnergy's decision to become a fully regulated company influenced their credit ratings during Rider DMR more than any other factor"); *id.* at 53-54 ("[I]t is impossible to directly observe the impacts of Rider DMR. In the aggregate across the Ohio Companies, the embedded cost of long-term debt fell approximately 1% over the Rider DMR period. However, this decreased cost related to market conditions and other steps taken by FirstEnergy to avoid a downgrade."); 56 ("Although FirstEnergy achieved some debt reduction during the Rider DMR period, it is difficult to pinpoint the use of Rider DMR monies as the funding mechanism for such reduction. . . . Therefore, it does not appear that Rider DMR funds were used to reduce FirstEnergy's long-term debt in any significant way."); *id.* at 62 ("Daymark finds that FirstEnergy appears to have taken steps to reduce the pension underfunding level," and "Daymark considers these holding company actions as evidence that FirstEnergy has continued to take steps to improve its financial position," but "[t]here is no specific evidence that Rider DMR had any impact on pension plan funding.")).

[67] *See* Audit Report at 36.

2. The Audit Report does Not Properly Take into Consideration Other Relevant Factors.

In measuring Rider DMR's impact on the Companies' financial health, the Audit Report also neglects to address what would have happened if Rider DMR revenues had never been recovered in the first place. At the outset, while the Audit Report correctly notes that the Companies paid down $105 million in debt during Rider DMR's term,[68] missing from its analysis is any mention that Rider DMR eliminated, or at least delayed, the need to access *new* debt. Put another way, the very existence of Rider DMR funds provided tangible credit support by reducing borrowing needs, adding cash flow, and enhancing liquidity—all of which left the Companies in a better position to procure capital at reasonable costs to invest in grid modernization.

The Audit Report's analysis of FirstEnergy Corp.'s debt balances is also flawed. It highlights that FirstEnergy Corp.'s total debt increased during the Rider DMR period, suggesting that the rider did not serve its intended purpose.[69] In particular, the Audit Report doubts that "[t]he Companies and other FirstEnergy constituents have acted to improve their financial standing" because FirstEnergy Corp.'s "debt increased by over $2.4 billion."[70] There are several problems with this approach.

First, the Audit Report overlooks FirstEnergy Corp.'s increase in capital spending over the Rider DMR period. While the rider was in place, FirstEnergy Corp. invested $7.5 billion in capital expenditures across the company. These capital expenditures included, but were not limited to, work on reliability projects, system reinforcement, aging infrastructure, and storm restoration. And additional long-term debt cited in the Audit Report supported these expenditures.

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[68] *See id.* at 8.

[69] *Id.* at 56 ("[I]t does not appear that Rider DMR funds were used to reduce FirstEnergy's long-term debt in any significant way.").

[70] *Id.* at 55-56.

Second, between Rider DMR's initial approval and mid-2019, FirstEnergy Corp. contributed $1.75 billion into the pension plan, of which over $1.3 billion was apportioned for Ohio distribution utility and shared services employees.[71] These contributions significantly reduced the company's debt-like pension liabilities, thereby reducing long-term debt obligations from a ratings agency perspective.

Third, the Audit Report relies on the wrong metrics to evaluate the use of Rider DMR revenues. Basing its analysis on leverage, the Audit Report asserts that FirstEnergy Corp.'s "mid 70% debt/equity ratio is and has been highly leveraged according to Moody's metrics and would place FirstEnergy in a non-investment grade category," thus suggesting that Rider DMR funds have not had a significant impact on financial health.[72] But reliance on leverage is incorrect. Because of its exit from unregulated generation, FirstEnergy Corp. recorded $10 billion in non-cash expenses between 2016 and 2020. As a result, FirstEnergy Corp.'s retained earnings, and therefore its equity, were disproportionately decreased, thus resulting in an exaggerated debt-to-equity ratio. This one-off non-cash event is exactly why rating agencies use CFO or FFO, as opposed to leverage, as the primary metric for measuring FirstEnergy Corp.'s financial health. Not taking this balance sheet anomaly into account impairs the Audit Report's analysis by focusing on the wrong metrics to evaluate Rider DMR.

[71] *In the Matter of the Application for an Extension of the Distribution Modernization Rider*, Case No. 19-0361-EL-RDR, Direct Testimony of Steven R. Staub at 6:1-21.

[72] Audit Report at 55.

3. The Audit Report's Conclusion that Financial Metrics were Only "Marginally" Benefited by Rider DMR Lacks Support.

The Audit Report also qualifies Rider DMR impacts on FirstEnergy Corp.'s cash flow metrics as "marginal" but nowhere defines or supports that statement.[73] To the contrary, the Audit Report itself shows significant increases in both the CFO or FFO metrics each year Rider DMR was in effect, for both the Companies (increases of approximately 300 to 1,100 basis points annually) and FirstEnergy Corp. (increases of 60 to 80 basis points annually).[74] And ratings agencies expressly recognized the importance of Rider DMR to maintaining FirstEnergy Corp.'s and the Companies' investment grade ratings while the rider was in place.[75]

4. Dividends and Equity Infusions Should be Netted.

The Companies also offer a correction to the Audit Report's dividend analysis. Though the Companies do not disagree with the ultimate finding that dividends paid by the Companies during the Rider DMR period were reasonable, the Audit Report overstates the percentage of dividends paid to investors with dividends from the Companies while Rider DMR was in place. This is because the Audit Report's analysis does not take into account the equity infusions FirstEnergy Corp. provided to the Companies. Had equity infusions in 2017 ($160 million) been netted against dividends, the Audit Report would have determined that only 42 percent, as opposed to 52 percent, of FirstEnergy Corp. dividends paid to investors originated from the Companies during the Rider DMR period.[76]

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[73] *See, e.g.*, Audit Report at 37 ("In all instances Rider DMR likely did contribute, at least marginally, to improvement these metrics."); *id.* at 63 ("Rider DMR had only a marginal effect on the cash flow metrics of FirstEnergy").

[74] Audit Report at 42, Figure 8; *see also In the Matter of the Application for an Extension of the Distribution Modernization Rider*, Case No. 19-0361-EL-RDR, Direct Testimony of Steven R. Staub at 11:3-15.

[75] *See id.* at 4:7-5:2 (March 1, 2019).

[76] *See* Audit Report at 66, Table 12.

5. The Companies' Rider DCR Revenue Requirements are in Excess of the Authorized Revenue Caps.

Finally, in evaluating costs associated with grid modernization projects, the Audit Report correctly points out that the Companies' delivery capital recovery rider (Rider DCR) is subject to revenue caps.[77] However, the Audit Report also appears to conclude that the Companies' Rider DCR revenue requirements did not exceed the applicable revenue caps during the 2017-2019 period.[78] This is not correct. As previously demonstrated to the Commission, the Companies' Rider DCR revenue requirements were in excess of the authorized revenue caps during this time period.[79]

III. CONCLUSION

The Companies appreciate this opportunity to comment on the Audit Report, and urge the Commission to find that the Companies complied with all applicable requirements regarding Rider DMR.

[77] *See id.* at 22.

[78] *Id.*

[79] *See* the audit report filed with the Commission on August 3, 2021 in Case No. 20-1629-EL-RDR, at pp. 18-22.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing was filed electronically through the Docketing Information System of the Public Utilities Commission of Ohio on April 19, 2022. The PUCO's e-filing system will electronically serve notice of the filing of this document on counsel for all parties.

/s/ Shalini B. Goyal
Attorney for the Companies

EXHIBIT A

DOCUMENT PRODUCED NATIVELY

Operating Company	2014	2015	2016	2017	2018	2019	2020	2021	Total
Ohio Edison			$122		$15	$35			$172
Penn Power			$15		$12	$8			$35
CEI			$71		$31	$10			$112
Toledo Edison			$8		$11				$19
JCP&L		$60	$25		$197				$282
Met-Ed		$23	$40		$28				$91
Penelec			$181		$65	$1			$247
Mon Power			$14		$87				$101
Potomac Edison			$18		$17	$6			$41
WPP		$60	$10		$14	$6			$90
FEU Total	$0	$143	$504	$0	$477	$66	$0	$0	$1,190
FE Solutions			$9						$9
FE Generation			$129						$129
FEG Total	$0	$0	$138	$0	$0	$0	$0	$0	$138
ATSI									$0
TrAIL									$0
FET Total	$0	$0	$0	$0	$0	$0	$0	$0	$0
FE Service			$191		$773	$434			$1,398
FENOC			$50						$50
Corp./Other Total	$0	$0	$241	$0	$773	$434	$0	$0	$1,448
FE	***$0***	***$143***	***$883***	***$0***	***$1,250***	***$500***	***$0***	***$0***	***$2,776***
AYE	***$0***	***$0***	***$0***	***$0***	***$0***	***$0***	***$0***	***$0***	***$0***
Total	**$0**	**$143**	**$883**	**$0**	**$1,250**	**$500**		**$0**	**$2,776**