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

REPLY COMMENTS
BY
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I. INTRODUCTION

The FirstEnergy Utilities collected nearly half a billion dollars from two million Ohioans for so-called distribution modernization charges that the PUCO authorized. Then the Ohio Supreme Court found the charges to be illegal, in an appeal by OCC and others.[1] While the PUCO could have made the charges to consumers refundable, as OCC and OMA requested,[2] it refused to do so.[3] The FirstEnergy Utilities were allowed to keep consumers' money despite the Court's ruling that the charge was illegal.

II. REPLY COMMENTS

A. FirstEnergy failed to overcome Daymark's finding that the FirstEnergy Utilities should have tracked their distribution modernization spending for transparency and consumer protection.

FirstEnergy states it had no duty to monitor whether Rider DMR revenues were used, directly or indirectly, for grid modernization because "Rider DMR was an

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

[2] *In the Matter of the Application of Ohio Edison, et al., 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, Motion to Reject Tariffs (Dec. 8, 2016).

[3] *Id*. Finding and Order (Dec. 21, 2016).

unconventional rider, unique in purpose and structure."[4] FirstEnergy notes that the PUCO did not require FirstEnergy to spend the DMR revenues on any specific grid modernization-related account.[5] But then FirstEnergy stretches this into an unsupported conclusion that it had no duty to track whether the funds were spent, directly or indirectly, on grid modernization.

The PUCO did not expressly require a tracking of the DMR funds. But tracking was the prudent thing to do given the PUCO's directive that required FirstEnergy to use the DMR revenues, directly or indirectly, for grid modernization.[6] The PUCO also required the PUCO Staff to hire an independent monitor to "ensure that such funds are used, directly or indirectly, in support of grid modernization."[7] And the PUCO determined that the Staff's review "will ensure that there is no unlawful subsidy of the Companies' affiliates."[8]

FirstEnergy now complains that "it is not possible to determine the 'use of Rider DMR funds.'"[9] Daymark found the same thing, concluding that there is no "conclusive evidence that Rider DMR did, in fact, contribute to any significant, incremental direct spend on grid modernization."[10] In Daymark's own words: "Given that the intent of Rider

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[4] FirstEnergy Utilities Initial Comments at 5 (Apr. 19, 2022).

[5] *Id*. at 9.

[6] Daymark Audit Report at 6-7 (Jan. 14, 2022).

[7] *In re Application of Ohio Edison Co.,* Case No. 14-1297-EL-SSO, Fifth Entry on Rehearing (Oct. 12, 2016) at ¶ 282.

[8] *Id.*

[9] *Id.*

[10] Daymark Audit Report at 26 (Jan. 14, 2022).

DMR was clearly to enable grid modernization, either directly or indirectly, it should have been incumbent on FirstEnergy to track such spending."[11]

Ironically, FirstEnergy's normal practice is to do detailed tracking of how it spends revenues collected by riders,[12] but it chose not to do so here. Daymark made this observation:

> Rider DMR spending on grid modernization was not tracked in the same way that Grid Mod I currently tracks spending. Numerous interviewees spoke to the high level of detail that is involved in tracking Grid Mod I investments.[13]

The PUCO should not be a bit surprised with FirstEnergy's failure to account for its spending of DMR revenues. FirstEnergy's lax accounting for the DMR funds matches a FERC finding in a recent audit report. There, FERC found that FirstEnergy Service Company "improperly accounted for and improperly reported lobbying expenses, donation and other costs that lacked proper supporting documentation or were misclassified (unsupported costs)."[14] The FERC Audit Staff also concluded that FirstEnergy Service Company "allocated and charged the improperly accounted for lobbying, donation, and unsupported costs to FirstEnergy and its subsidiaries."[15]

The FERC Audit Staff also concluded that there were "significant shortcomings in First Energy and its subsidiaries' internal controls over accounting for expenses

[11] *Id.* at 6-7.

[12] *Id.* at 24-25.

[13] *Id.* at 24.

[14] *In re FirstEnergy Audit*, Docket No. FA19-1-000 at 46 (Feb. 4, 2022).

[15] *Id*.

relating to civic, political, and related activities, such as lobbying activities performed by or on behalf of FirstEnergy and its subsidiaries."[16]

And the FERC Audit Staff found even more issues with FirstEnergy's reporting for lobbying:

> Even more concerning, several factual assertions agreed to by FirstEnergy in DPA and the remedies FirstEnergy agreed to undertake, *point towards internal controls having been possibly obfuscated or circumvented to conceal or mislead as to the actual amounts, nature, and purpose* of the lobbying expenditures made, and as a result, the improper inclusion of lobbying and other nonutility costs in wholesale transmission billing rates.[17]

FirstEnergy has the burden to show that it complied with the PUCO's DMR Orders. This means that FirstEnergy must establish it spent the funds, directly or indirectly, for grid modernization. The FirstEnergy Utilities admit "it is impossible for the Companies to pinpoint Rider DMR funds and dedicate them to any given expenditure."[18] Nonetheless the FirstEnergy Utilities claim there is more than sufficient support to conclude that they complied with the PUCO directives to use the funds, directly or indirectly. in support of grid modernization.[19] And they claim that the Auditor's conclusions were based on "misunderstandings."

But, as discussed below, any misunderstanding is attributable to the FirstEnergy Utilities, not the Auditor. Daymark was correct in its conclusion that there is no "conclusive evidence that Rider DMR did, in fact, contribute to any significant,

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[16] *Id*. at 48.

[17] *Id*. (Emphasis added).

[18] FirstEnergy Utilities Initial Comments at 3-4 (Apr. 19, 2022).

[19] *Id*. at 3.

incremental direct spend on grid modernization."[20] And Daymark correctly found that it was impossible to determine whether the DMR revenues were spent in a way that directly or indirectly supported grid modernization [21] Additionally, Daymark appropriately concluded that it could not "rule out with certainty use of Rider DMR funds to support the passage of H.B.6."[22]

The PUCO should therefore rule, consistent with its state-hired Auditor Daymark, that the FirstEnergy Utilities violated PUCO Orders regarding the use of DMR charges. Accordingly, the PUCO should order substantial forfeitures and award damages as recommended in OCC's Initial Comments.

B. FirstEnergy's claimed uniqueness of Rider DMR does not undermine the Auditor's conclusion that the funds were not shown to have been used to support grid modernization directly or indirectly as required by the PUCO for consumer protection.

The FirstEnergy Utilities argue at length that Rider DMR was unique and that its uniqueness was misunderstood by the Auditor.[23] The FirstEnergy Utilities argued that Rider DMR was a non-cost-based rider that was to incentivize grid modernization through credit support so that the FirstEnergy Utilities could access the capital markets at more reasonable terms.[24]

FirstEnergy asserts that there is a key distinction between Rider DMR and the Grid Modernization Rider that collects actual costs of grid modernization investment. [25]

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[20] *Id*. at 4.

[21] *Id*. at 4-5.

[22] Daymark Audit Report at 6-7 (Jan. 14, 2022).

[23] FirstEnergy Utilities Initial Comments at 5-9, 12-16 (Apr. 19, 2022).

[24] *Id*. at 5.

[25] *Id*. at 6.

The FirstEnergy Utilities also argue that the PUCO did not place restrictions on the use of Rider DMR funds and did not require the funds be tracked. [26] But what the Auditor understood was the PUCO's clear direction to the FirstEnergy Utilities that the DMR funds are to be "used, directly or indirectly, in support of grid modernization."[27]

Contrary to the FirstEnergy Utilities' assertions otherwise, the PUCO order did place restrictions on the use of the DMR. The DMR funds were to be used to directly support grid modernization (i.e., actual spending on grid modernization) or to indirectly support grid modernization. The FirstEnergy Utilities bear the burden of showing that they complied with the PUCO's Order. They failed to meet that burden because of their decision to throw the funds into a money pool, and not track the spending.

The first Auditor (Oxford Advisors) reported in their filed Mid-Term Audit Report that FirstEnergy "declined to restrict the use of the funds and did not contemplate the tracking of Rider DRM funds to specific expenditures."[28]

All of this was clearly understood by the Daymark Auditor when they found no conclusive evidence of direct spending on grid modernization and concluded that it was impossible to say whether the DMR funds were used indirectly to support grid modernization. The FirstEnergy Utilities cannot blame the Auditor when they made themselves "unauditable" by their unilateral decision not to restrict the use of the funds and their decision not to track DMR spending.

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[26] *Id*. at 7, 8.

[27] *In the Matter of the Application of Ohio Edison, et al., 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, Fifth Entry on Rehearing at ¶ 282.

[28] Oxford Mid-Term Audit Report at 16 (Jun. 14, 2019).

C. To protect consumers, the PUCO should reject FirstEnergy's argument that it complied with the PUCO's Rider DMR Orders because it spent more on grid modernization than it collected under Rider DMR.

FirstEnergy argues that it followed the PUCO's DMR Orders because "the Companies made expenditures in support of grid modernization that far exceeded the revenues recovered under Rider DMR."[29] FirstEnergy conveniently overlooks the fact that Daymark already considered, and rejected, this argument.[30]

FirstEnergy attempts to compare apples to oranges. It compares all spending on grid modernization versus the revenues collected under Rider DMR but fails to account for the fact that *other riders paid for by consumers provided the funds for this grid modernization spending*. In rejecting FirstEnergy's argument, Daymark concluded: "The capital costs for the grid modernization projects identified by FirstEnergy during 2017 to 2019 were recovered under separate riders."[31] The PUCO should adopt Daymark's reasoning and reject FirstEnergy's argument because the argument fails to account for the revenues FirstEnergy collected under other grid modernization-related riders.

D. The Auditor correctly concluded that grid modernization was not a well communicated priority within FirstEnergy and that there was no "sufficient progress" on grid modernization during the Rider DMR Term.

The FirstEnergy Utilities argue that, again, there is a difference between Rider DMR and the Companies' Grid Mod I program – and that the Auditor fails to recognize

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[29] FirstEnergy Utilities Initial Comments at 3-4 (Apr. 19, 2022).

[30] Daymark Audit Report at 22 (Jan. 14, 2022).

[31] *Id*.

it.[32] The FirstEnergy Utilities claim that the Audit Report "includes findings and conclusions that are inconsistent with the authorized purpose of Rider DMR."[33]

The FirstEnergy Utilities also complain that the Auditor's conclusion ignores or overlooks the fungibility of money and the unique structure of Rider DMR.[34] The FirstEnergy Utilities also take issue with the Auditor's conclusion that there was a "overall lack of knowledge on the specifics of Rider DMR" among employees interviewed.[35] Additionally, the FirstEnergy Utilities dispute that there was not sufficient progress on grid modernization during the DMR term.[36]

To the contrary, the Daymark Auditor did not ignore or overlook the fungibility of money issue. In fact, Daymark expressly acknowledged that when they found the DMR expenditures could not be traced because they were placed in the money pool. [37] The Auditor's findings were driven by the PUCO's guidance that it was to examine whether the FirstEnergy Utilities had complied with the PUCO's order to use the funds directly or indirectly in support of grid modernization.

Moreover, we are not surprised that there was a lack of knowledge within FirstEnergy on the specifics of the Rider. That failing should not be attributed to Daymark. Rather, the lack of knowledge should be attributed to the corporate culture at FirstEnergy. Standard and Poor's, the well-known credit ratings agency, dourly described FirstEnergy's culture as "demonstrative of insufficient internal controls and a cultural

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[32] FirstEnergy Utilities Comments at 13.

[33] *Id*. at 12.

[34] *Id*. at 13.

[35] *Id*. at 14.

[36] *Id*.

[37] Daymark Audit Report at 7 (Jan. 14, 2022).

weakness***significantly outside of industry norms and in our view, they represent a material deficiency in the company's governance."[38]

The FirstEnergy Utilities were handed a half-billion-dollar check with few strings attached. They pocketed the money –pure revenue without expenses. The lack of tracking, making the FirstEnergy Utilities unauditable, is FirstEnergy's imprudence and inadequate service in violation of R.C. 4905.22, among other laws and rules. The lack of tracking led the Auditor to conclude that the Utilities have not shown that they have complied with the PUCO's orders.

As for "sufficient progress," we agree with Daymark that the FirstEnergy Utilities did not show sufficient progress in regard to grid modernization efforts. As the PUCO noted, FirstEnergy's obligation to show sufficient progress was "intended to be an ongoing commitment throughout the entire recovery period of Rider DMR."[39]

The FirstEnergy Utilities' Grid Modernization Plan was not approved until mid-July 2019.[40] By then, the DMR was no longer being collected from consumers. Rider DMR did not "jump start" the FirstEnergy Utilities' grid modernization. If grid modernization was allegedly jump-started, that happened when the PUCO approved a settlement where consumers would pay the capital costs up to $516 million through FirstEnergy's Advanced Metering Infrastructure Rider.

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[38] *See* Khalid, U., *S&P downgrades FirstEnergy following $1.95B draw on revolving credit facility*, S&P Market Intelligence (Nov. 25, 2020).

[39] *In the Matter of the Application of Ohio Edison Company et al,* Case No. 14-1297-EL-SSO, Finding and Order at ¶ 14 (Dec. 21, 2016).

[40] FirstEnergy Utilities Initial Comments at 15 (Apr. 19, 2022).

E. To protect consumers, the PUCO should reject FirstEnergy's "Other Areas of Disagreement with the Audit Report's Methodology and Analysis."

FirstEnergy lists several areas of "disagreement with the Audit Report's methodology and analysis."[41] Examples of these disagreements include "the Audit Report did not examine how Rider DMR functioned in conjunction with other events"[42] and "the Audit Report does not properly take into consideration other relevant factors."[43]

How Rider DMR functions "in conjunction with other events" and the "other relevant factors" cited by FirstEnergy have no bearing on the issue in this case – whether FirstEnergy can establish that it used the Rider DMR funds in compliance with the PUCO's DMR Orders. As discussed above, FirstEnergy cannot show that it used the DMR funds in support of grid modernization, either directly or indirectly. Under these circumstances, the significant forfeitures and damages outlined in OCC's Initial Comments are appropriate.

III. CONCLUSION

Consumers can't get a refund of the $456 million they paid in so-called Distribution Modernization Rider charges – charges that the PUCO approved and that the Ohio Supreme Court then found illegal. Distressingly, we learned from FirstEnergy's discovery responses that it apparently was known within the PUCO that the DMR charges would likely be found illegal and that, even so, FirstEnergy would get to hold onto the funds because they could not be refunded to consumers.

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[41] *Id.* at 16-23 (Apr. 19, 2022).

[42] *Id.* at 17-20.

[43] *Id.* at 20-22.

Now the PUCO can right some of this wrong for two million Ohio consumers. The PUCO should adopt OCC's *preliminary* recommendations for substantial forfeitures (tens of millions of dollars or more per R.C. 4905.54) and damages ($456 million trebled per R.C. 4905.61) for FirstEnergy's violations of the PUCO's Orders and law and rule.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Comments was served on the persons stated below via electronic transmission, this 4th day of May 2022.

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The PUCO's e-filing system will electronically serve notice of the filing of this document on the following parties:

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