Northeast Ohio Public Energy Council ("NOPEC") appreciates the opportunity to provide comments for the Commission’s Cost of Capital Forum. NOPEC is a regional council of governments established under R.C. Chapter 167, and is the largest governmental retail energy aggregator in Ohio. NOPEC has approximately 950,000 residential and small business customers in over 240 communities in Ohio who take retail electric and natural gas service under NOPEC’s aggregation programs. NOPEC offers these comments to protect the interests of these customers.

I. INTRODUCTION – THE PROBLEM IN NEED OF CORRECTION

Before offering comments, it is important to state the problem that the comments are meant to address. Traditionally, the Commission set a utility’s rates, and its rate of return, for all services in a single rate proceeding under a formula prescribed by R.C. 4909.15. In the traditional rate proceeding all of the utility’s assets, revenues, and expenses could be reviewed at a single point in time. A fair and reasonable rate of return then would be set based upon the utility’s current capital structure, and costs of debt and equity. As a widespread regulatory principle, single-issue ratemaking generally was prohibited because it was deemed improper to consider changes to one component of the ratemaking formula in isolation. This is because a change in one item of the formula could be offset by a corresponding change in another component. See, e.g., Business and Professional People for the Public Interest v. Illinois Commerce Comm’n, 146 Ill. 2d 175 (1991).

While the Ohio legislature has retained this formulaic approach for base distribution rates filed pursuant to R.C. 4909.18, it has permitted single-issue ratemaking with respect to certain
items in R.C. Chapters 4928. and 4929. The costs for these items are recovered in single-issue cases through individual riders. This shift in ratemaking methodology has resulted in a bifurcated regulatory paradigm in which the Commission must, by statute, set a new rate of return for utilities in base distribution cases. However, the statutes do not address how a rate of return is to be set for single-issue riders. The Commission’s policy has been to use the rate of return established in the utility’s most recent distribution base rate proceeding when setting the rate of return for the riders. And that’s the problem. Utilities with rates of return that are higher than what they would receive under current market conditions have an incentive not to file a rate case. By refusing to file a distribution rate case, they preserve not only the outdated return on investments in the distribution case – but also are able to apply the stale, higher rate of return to new investments recovered by the individual riders. The problem is exacerbated under market conditions, like in the past 10-15 years, in which the cost of debt has plummeted. The following chart shows that the majority of Ohio’s major electric and gas utilities have not regularly updated (i.e., lowered) their existing rates of return, harming consumers by requiring them to pay more than existing market conditions require.

<table>
<thead>
<tr>
<th>Utility</th>
<th>Most Recent Distribution Rate Cases</th>
<th>Elapsed Time¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>DP&amp;L</td>
<td>15-1830-EL-AIR 10-20-2015</td>
<td>5 years²</td>
</tr>
<tr>
<td>Duke Electric</td>
<td>17-0032-EL-AIR 01-31-2017</td>
<td>4.5 years</td>
</tr>
<tr>
<td>FirstEnergy</td>
<td>07-0551-EL-AIR 05-08-2007</td>
<td>14 years</td>
</tr>
<tr>
<td>Ohio Power</td>
<td>11-0352-EL-AIR 01-27-2011</td>
<td>9.5 years³</td>
</tr>
<tr>
<td>Columbia</td>
<td>08-0072-GA-AIR 02-01-2008</td>
<td>13.5 years⁴</td>
</tr>
<tr>
<td>Dominion</td>
<td>07-0829-GA-AIR 07-20-2007</td>
<td>14 years</td>
</tr>
<tr>
<td>Duke Gas</td>
<td>12-1685-GA-AIR 06-07-2012</td>
<td>9 years</td>
</tr>
<tr>
<td>Vectren</td>
<td>18-0298-GA-AIR 02-21-2018</td>
<td>3.5 years</td>
</tr>
</tbody>
</table>

¹ Unless otherwise noted, the elapsed time is from the date of the utility’s last distribution rate case filing to the date of these comments, June 9, 2021.
² DP&L has a distribution rate case pending, Case No. 20-1651-EL-AIR, filed October 30, 2020.
³ Ohio Power has a rate case pending, Case No. 20-585-EL-AIR, filed April 9, 2020.
⁴ Columbia has a rate case pending, Case No. 21-0637-GA-AIR, filed May 28, 2021.
NOPEC also notes that under the traditional, formulaic ratemaking methodology, utilities were incented to minimize their costs (to their customers’ benefit) because they couldn’t recover a return on and on their investment until it was found to be used and useful in a rate case proceeding. This “regulatory lag” has been eliminated with single-issue ratemaking, and ensures that the utilities can recover their costs in real time, subject to a subsequent audit review. The elimination of regulatory lag, as well as the introduction of straight fixed variable rate design, lowers utilities’ risk profiles, and should be accounted for in the determination of the utility’s cost of equity.

In its comments below, NOPEC proposes a rate structure in which utilities’ lower risk profiles and reduced cost of debt should be considered in setting a utility’s rate of return in its next distribution base rate proceeding. This rate of return can be used when initially setting the rate of return for single-issue riders or deferrals, with adjustments for intervening changes to the utility’s risk profile and cost of debt. In any proceeding in which a rider rate for ongoing investments and expenses or prior deferrals is established or changed, any intervening party or the Commission may object to the cost of capital as being too high, based on current market conditions or other circumstances. Upon such objection, the utility shall be required to show cause why the rate of return should not be lower than its most recently approved rate of return from a base rate case or the utility can propose a rate of return that is lower than its most recently approved rate of return. Intervenors and the Commission Staff shall then have an opportunity to propose a cost of capital that is lower than the utility’s most recently approved rate of return. The Commission shall then conduct a review to reduce the cost of capital. In any event, the Commission should review the rate of return for each rider no later than three years after the initial rider rate of return is set, and each three year period thereafter.
II. COMMENTS

1. What are the advantages and disadvantages with updating the authorized returns on equity, costs of long-term debt, and capital structure, based on fluctuating costs of capital and changes in capital structures outside of base rate proceedings?

- The main advantage is that Ohio’s consumers will pay rates that align with more current market conditions, and will not be forced to continue to pay exorbitant rates of return over numerous years when a utility’s risk profile and cost of debt decrease significantly.

- NOPEC sees no disadvantages. Although utilities likely will claim that consumers will be harmed in periods of rising cost of debt, utilities already have the authority to seek a higher rate of return under R.C. 4909.18. Under the current regulatory paradigm, utilities control a “heads I win, tails you lose” environment. They can refuse to seek rate changes when the cost of capital and their profile risks drop, and can choose to seek rate relief when the costs increase. Consumers would be better off if the cost of capital changes are reflected outside of a distribution base rate proceeding.

2. How often should a company’s authorized return be reviewed and/or updated? Is the timing of the review within a calendar year important?

- Utilities’ authorized return should be set in distribution base rate proceedings pursuant to the formulaic methodology contained in R.C. 4909.15.

- The rate of return set in base rate proceedings may be used as the starting point for initially setting rates of return in single-issue rider cases. However, in any proceeding in which a rider rate for ongoing investments and expenses or prior deferrals is established or changed, any intervening party or the Commission Staff may object to the cost of capital as being too high, based on current market conditions or other circumstances. Upon such objection, the utility shall be required to show cause why the rate of return should not be lower than its most recently approved rate of return from a base rate case or the utility can propose a rate of return that is lower than its most recently approved rate of return. Intervenors and the Commission Staff shall then have an opportunity to propose a cost of capital that is lower than the utility’s most recently approved rate of return. The Commission shall then conduct a review to reduce the cost of capital based upon (i) the utility’s actual, current embedded cost of debt, (ii) the utility’s actual, current capital structure, and (iii) a return on equity that is based on current market conditions and applicable regulatory principles. In any event, the Commission should review the rate of return for each rider no later than three years after the initial rider rate of return is set, and each three year period thereafter.

- In any proceeding in which a single-issue rider rate or deferral is established or changed, the utility may not propose a rate of return greater than that approved in its most recent distribution base rate case. If the utility believes that the rate of return
approved in its most recent base rate case is too low, the utility can file a new base rate case.

3. Should a threshold delta between a company’s authorized return and current market-based capital costs be established to determine whether a review or an update is necessary?

- No. Establishing a threshold delta would involve many of the same analyses that must be undertaken in determining the periodic adjustments. Performing a threshold analysis, for example every year, would impose extra burdens on Staff and interested parties and would not be cost effective.

4. What do you believe is the proper methodology to determine a return for investments that are made outside of a rate case proceeding test year, and why is your proposed methodology appropriate?

- The proper methodology is to set rates of return for individual rider programs or deferrals in proceedings where the initial rates are established or changed so that they align with a utility’s current capital structure and costs of debt and equity.

- This methodology is appropriate because utilities with rates of return that are higher than what they would receive under current market conditions have an incentive not to file a rate case. By refusing to file a distribution rate case, they preserve not only the outdated return on investments in the distribution case – but also are able to apply the stale, higher rate of return to new investments recovered by the individual riders or deferrals. The problem is exacerbated under market conditions, like in the past 10-15 years, in which the cost of debt has plummeted. Utilities should not be able to profit – at their customers’ expense – by refusing to update their rates of return. Refusal results in their customers paying a higher rate of return that is not reflective of the utility’s current cost of debt and capital structure, or a cost of equity based on current market conditions.

- This proposal is reasonable because it permits consumers to object to a utility’s proposed cost of capital and for the utility to show cause why its cost of capital should not be lower. It also is reasonable because it affords the utility to propose a lower cost of capital after objection, which could lead to resolution of the issue without further review. Without resolution, the proposal is reasonable because it calls upon the Commission to determine whether the proposed cost of capital is fair and reasonable under current market conditions. Overall, the proposal is reasonable because it prevents the utility from continuing to charge its customers for the outdated, higher cost of capital.

- For example, with regard to the cost of debt, should the weighted average cost of debt for a period of time, such as the last five years of issuances be used? If no debt issuances occurred during that period, then should a market average cost of debt that most closely matches the credit profile of the company be used?
• A weighted average cost over a period of time should not be used. A utility is responsible for managing and issuing its debt and the most recent embedded cost of debt should be used regardless of when the debts are issued.

• Only if no debt issuances have occurred for a significant period of time should a market average cost of debt be considered, provided it closely matches the credit profile of the utility.

  o Or, would use of an industry standard/average return be appropriate? If so, what standards/averages might be appropriate? Does an industry standard/average increase transparency?

• Each utility is different and has its own specific risk profile. An industry standard/average return generally should not be used as the updated cost of capital. However, in extreme cases, if a utility’s risk profile is significantly different from the industry standard, an industry standard/average return can be considered in updating the cost of capital.

5. Should authorized returns for single issue matters, such as rider program rates, be different or set independently from base rate returns? Should authorized returns vary based upon the type of investment?

• Authorized returns for single-issue matters (i.e., individual riders or deferrals) may be different (i.e., lower) from base rate returns, considering the reduced risk single issue ratemaking provides utilities, as discussed above.

• Yes, authorized returns should vary based upon the type of investment.

6. Should any consideration be given to a risk adjustment based on the type of investment? If so, how should that risk adjustment be calculated? Are there other factors, either regulatory or financial, that should also be considered when reviewing authorized returns?

• Returns on equity should be adjusted for risk based upon the type of investment. As stated above, investments made through individual rider programs have less risk of recovery due to the elimination of regulatory lag and the recovery of investments in real time. The return on equity in single-issue cases should be lower than the rate set in distribution rate proceedings.

• Rates of return for rider programs or deferrals also should be adjusted lower if the utility has failed to regularly file distribution rate cases, when the analyses undertaken in setting rates for the rider program or deferral show that customers are paying a higher rate of return on base distribution assets than market conditions warrant. For this same reason, rates should be adjusted lower in base rate proceedings if analyses show that a utility’s rate of return has been higher than market conditions for a number of years. This policy could incent utilities to file base rate proceedings when conditions warrant and eliminate the problem that resulted in this forum.

• The returns authorized in base rate proceedings also should be adjusted to recognize the lower risk of the straight fixed variable rate design.
7. Hypothetically speaking, if an authorized return review indicates that an adjustment (increase/decrease) to a company’s authorized return needs to be made:

- How and when should the adjustment be applied in different rate recovery mechanisms?

- The cost of capital for individual rider rates and deferrals should be adjusted as discussed above.

- Should the adjustment apply to all recovery mechanisms, including base rates, or just single-issue rate-related cases such as rider rates and accounting deferral authorizations?

- Adjustments should apply only to individual rider cases or deferrals. Adjustments to base rates should not be made between distribution base rate filings. However, the Commission should adopt policies designed to require utilities to regularly file distribution base rate proceedings when warranted, including the reduction to the utility rate of return if analyses show that a utility’s rate of return has not been reflective of market conditions for the past three years.

- What impact(s) would adjustments have on other proceedings?

- As discussed above, a policy to downwardly adjust rider program and base distribution rates of return when analyses show that a utility’s rate of return has not been reflective of market conditions could incent a utility to make base rate filings when warranted and eliminate the problem that resulted in this forum.

- Should the Commission take into consideration whether the company is earning at or above its authorized return when it determines whether, or to what extent, it should authorize accounting deferral authority?

- Yes. A utility that is earning at or above its authorized rate of return does not need deferral authority.

Respectfully submitted,

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