

INDIVIDUAL ELECTRIC UTILITIES' RATE HISTORY AND RATE PLANS¹

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INTRODUCTION²

On January 20, 1999, Amended Substitute Senate Bill 3 (“SB 3”) was introduced in the Ohio General Assembly. The bill number and its relatively early introduction suggested that the long-standing campaign³ to bring Ohio into the customer-choice-for-electricity era was nearing the goal line. The pace of movement of this legislation accelerated in the wake of the reliability and price volatility problems that occurred in 1997 and 1998. These very visible problems sharply conflicted with claims that traditional regulation was working well. These problems also highlighted the extent to which the rather crude tool of curtailment (sometimes called transmission line loading relief) was used by vertically integrated monopolies to balance the system through negative intervention rather than positive performance.

Ohio’s legislation restructuring the retail electric sector made a number of assumptions about the implementation phase, the timing of critical developments (like fully functional regional transmission organizations or “RTOs”) and the complementary work that had to be completed at the federal level to remedy the anticompetitive structure of the vertically integrated electric utility sector. On July 6, 1999, Governor Taft signed SB 3 and efforts to implement the legislation began almost immediately. As the implementation effort began, one thing was clear, SB 3 commanded that customers⁴ would have the opportunity to select their generation supplier beginning on January 1, 2001.

Prior to SB 3, there was some customer choice in Ohio. Customers had the ability to self-generate electricity or substitute another form of primary energy (such as natural gas) for

¹ The law firm of McNees Wallace & Nurick LLC (“MWN”) prepared this document to chronicle the evolution of Ohio’s approach to the regulation of investor-owned electric utilities. It is MWN’s hope that the information assembled in this report will facilitate efforts to obtain price and service quality outcomes that are customer-driven.

² The views and opinions expressed in this introduction are mine (Sam Randazzo’s) and mine alone.

³ The first pro-choice bill, sponsored by Representative Ron Amstutz, was introduced in 1992.

⁴ The customer choice right provided by SB 3 extended to customers of investor-owned electric utilities and, potentially, the customers of rural electric utilities. It did not apply to customers of municipal electric utilities. In the case of rural electric utilities, the customer choice right could be extended by an affirmative election by the rural electric utility. Customers of rural electric utilities interested in obtaining the benefits of customer choice can and should press their distribution cooperative to make the election that is part of Ohio law as a result of SB 3.

electricity. The natural gas v. electricity retail competition was most visible in the residential sector until the natural gas shortages of the 1970s arrived. In addition, the powers delegated to municipalities under Ohio's Constitution allowed (and allows) municipal electric utilities to serve customers located within the municipality even if they were customers of an investor-owned electric utility. This same Constitutional authority allowed (and allows) municipalities to grant franchises to multiple electric suppliers without regard to Ohio's certified service area law. Prior to SB 3, these municipality powers were used by cities like Clyde, Ohio where a Whirlpool Corporation manufacturing facility switched from an investor-owned electric utility to Clyde's new municipal electric utility. Brookpark, Ohio was actively engaged in forming a new municipal electric utility with strong support from Ford Motor Company; the Brookpark initiative ended short of implementation but it provided the Ford plant in Brookpark with an advantage to improve its position with the investor-owned utility. Today, the customer choice opportunity that can be enabled by Ohio's municipalities remains a powerful, albeit localized, force.

The post-SB 3 work to restructure the electric sector followed similar efforts in the communications and natural gas sectors, both network industries subject to extensive state and federal price and service quality regulation. Essential service components previously provided by one supplier were functionally unbundled into a production or generation component, a transmission component and a distribution component; the unbundled services were classified as non-competitive or competitive retail electric services. In electricity, natural gas and communications, no customers remained "captive," physically or financially, to any particular supplier offering a competitive service except as judged necessary to permit the incumbent supplier to amortize above-market costs (sometimes called "stranded costs") associated with the competitive services. Retail electric customers (acting individually or through aggregation programs) were given the right to obtain their competitive retail electric service from any supplier certified by the Public Utilities Commission of Ohio ("PUCO").

SB 3 also contained a number of provisions that were designed to guard against or block efforts by incumbent utilities to create or resurrect a deregulated monopoly. Similar rules were put in place at the federal level. Any non-competitive service had to be available on a comparable and non-discriminatory basis. Ohio required transmission owners to place control over their network in the hands of an RTO that became the supplier of comparable and non-discriminatory transmission services and responsible for maintaining reliability in real time. At the federal level, the transfer of control over the transmission system to a regional organization was voluntary and the federal slowness and looseness on this important component negatively affected the development of wholesale and retail "competition."

The experience in the natural gas and communications sectors suggested that "competition" would also be superior to "regulation" in the electric sector. And, at the time, the relatively low price of natural gas combined with new gas-fired generation technologies suggested, in theory, that incumbent technologies and generators could be reasonably disciplined by market forces. The massive amount of the "transition cost" (also known as "stranded cost" or "above-market cost") claims submitted to the PUCO by

Ohio's electric utilities as a result of SB 3 seemed to confirm that "regulation" had not well served the public interest.

Over the last 19 years plus since the introduction of SB 3, we have seen a Governor and many customer groups initiate or join a bipartisan push to return Ohio to regulation; a reaction to the challenging mismatch between the SB 3 assumptions and real-world events. That political push towards reregulation in 2007 and 2008 was strongly resisted by incumbent electric utilities who expressed support for "competition;" the collision resulted in the addition of the "electric security plan" ("ESP") option to the menu for setting the price of default generation supply. More recently, as wholesale electric prices dropped significantly, each of these previously pro-competitive utilities changed their tune and asked the PUCO or General Assembly to make captive customers responsible for providing their preferred generating plants with above-market compensation. And the customer groups that previously pushed for reregulation (when wholesale electric prices were high) changed their tune as well; today many of these customer groups are supporting legislation that would eliminate their ESP option [over the objections of electric distribution utilities ("EDUs") who, with the approval of the PUCO, have used the ESP option to obtain out-of-market and above-market compensation].

Looking back will yield history. But, what will happen in the days ahead to affect the price and availability of electricity in Ohio?

Clearly, the abundant and relatively cheap supply of natural gas is at the top of the list of fundamentals that will continue to affect the generation mix, reliability and price of electricity in wholesale and retail markets. Most forecasts indicate that this trend will continue.

Most of the Ohio generation plants owned or controlled by vertically integrated electric utilities have been sold or transferred. And, Ohio's investor-owned EDUs have adopted "new" business models that "conservatively" promise to grow their earnings by 5 to 8% **per year** through investments in distribution and transmission (the non-competitive services) while continuing to "derisk" their business. (Derisking the business in this context seems to be less about reducing risk and more about shifting risks to ultimate customers.) In an era of little or no growth in the size of the electric market, there is little, if any, sales growth to mitigate the upward pressure that these business models place on the "regulated" D (distribution) and T (transmission) prices. The cost of D and T services is rising, in some cases significantly, as a result.

The cost-plus traditional regulation formula used to set prices for regulated services paid by "captive customers" tends to encourage excess investment and overcapitalized lines of business. The current somewhat politicized regulatory emphasis on "grid modernization" or "smart grids" is a signal that regulators may offer little resistance to this excess and overcapitalized investment tendency which results, under regulation, in excessive prices. History tells us that this excess investment and capitalization tendency will give way to a "correction" that broadly affects financial markets and credit (the US and British railroad development history or, more recently, the home mortgage fiasco that

ignited the Great Recession come to mind). Might the Constitutional authority of Ohio's municipalities provide some "bypass" opportunities?

Customers interested in improving their weighted average delivered cost of purchased electricity are increasingly resorting to capturing value from their demand response capabilities and behind the meter options. But, the use of demand response capabilities for this purpose requires customers to "chase" and avoid peaks that have billing demand significance at times when the peak is nowhere near the physical capability of the supply chain. This chasing-the-peaks behavior forces Ohio businesses to cut back on production for other than network emergency reasons thereby contributing to under-utilization of their productive capacity and the electric network (which, in turn, negatively affects the larger economy). Perhaps our current scarcity-oriented demand response approach needs to be reformed to better fit with our current abundant supply scenario.

Despite the obvious reliability-related problems created by deploying intermittent (don't show up for work) and non-dispatchable (can't be made to show up for work) generating technologies, government (local, state and federal) continues to spend taxpayers' and customers' money to fund subsidies for this purpose. In an era of little demand growth, subsidies that overheat investment in some generating technologies work to reduce market share and cash flow opportunities for other technologies. But, there are signs that the massive amount of land use and the invasiveness of this use that are necessary parts of utility scale wind and solar projects are increasingly igniting fierce local opposition that sometimes brings down elected officials. Strong resistance in Michigan that is prompting local officials to delay and prevent large wind project development or face recall provides a nearby example of the growing resistance to utility scale wind projects. The push-back in Michigan is also occurring in many areas in Ohio where large wind projects have been constructed or proposed (a condition that seems to go unnoticed by Ohio's current Governor). Germany made a show of accelerating the retirement of nuclear plants and heavily subsidizing "renewables" while promising to reduce air emissions. The German people have had enough; they are pushing back because electric prices have soared while air emissions have increased because coal (mostly lignite) plants are being run harder and longer to cover for the "renewable" resources when they don't show up for work. The experience in Ontario, Canada is similar to that in Germany. If they are attentive, there are lessons that can be learned by Ohio regulators and elected officials.

Governments' willingness to directly or indirectly subsidize⁵ some generating plants or generating technologies and demand side goods and services is producing a feeding frenzy where businesses on the supply side or demand side are increasingly engaged in a highly politicized competition for subsidies paid for by captive customers or taxpayers. These large-dollar subsidies work initially to allocate market share and divert cash flow to the benefited business while raising the clearing price of electricity. As they rise, the higher prices invite innovation and new entry that can erode the advantage granted to the subsidized supply or demand side option. While some businesses have been able to secure these subsidies, the size of the subsidy advantage is limited by the power to collect

⁵ As used here, portfolio mandate is an indirect subsidy while the federal production tax credit would be a direct subsidy.

the subsidy. The power-to-collect limitation on the advantage of a subsidy explains why those businesses seeking a subsidy also demand funding for the subsidy to be unavoidable (non-bypassable) by customers or taxpayers.

For more than 40 years, I have had the privilege of working with and on behalf of Ohio businesses that recognized, through word and deed, the importance of proactive engagement on issues that affect the price and availability of energy. I have been fortunate; much of my professional career involves advocating for and advancing proposals that displace monopoly-friendly natural gas, communications and electricity laws and policies with structures that respect the superior power of “customer choice.”

The lessons of history tell us that most of the potential continuous improvement value of “competition” and “customer choice” is determined by what happens on the implementation side of our policy and law. Customers that are not proactively engaged in the local, state and federal implementation efforts will leave an intellectual and political vacuum to be filled by people with a seat at the table. The customer is always right, but only if the customer is in the room.

This important energy conference, which began well before the introduction of SB 3, can help to identify things that real customers can do to continuously improve their delivered cost and quality of energy. But, the value of this knowledge can be and will be diminished by customers that absent themselves from the important work that must be completed on the implementation side of our law and policy; also a customer choice.

May the force be with you.