Substitute Senate Bill 221

House Public Utilities Committee

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Public Utilities Commission of Ohio

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Chairman Hagan, members of the committee, thank you for giving me the opportunity to participate in today's panel on electric security plans, market options and generation as these issues relate to Sub. Senate Bill 221.

Sub. SB 221 seeks to establish stable predictable rates for commercial, industrial and residential customers, create jobs of the future through an advanced energy portfolio standard, establish energy efficiency standards and conservation measures and confront the future environmental challenges of climate change and carbon restrictions.

Sub. SB 221 ensures price stability and an adequate, reliable supply of electricity. The bill includes a carefully crafted hybrid approach that recognizes how we generate, distribute and price electricity. This is particularly important since Ohio is fifth among the states in overall energy consumption and spends more than 30 billion dollars on energy every year. Electricity is the single biggest component of our energy use.

Before delving into the issues before us today, I feel it is important to recap where we have been since Ohio's electric restructuring legislation was signed into law back in 1999.

History

As many of you are aware, the electric industry consists of three main components: generation, transmission and distribution. Senate Bill 3 (SB 3), signed into law in 1999, allowed for competition in electric generation. SB 3 also provided a five-year market development period lasting from Jan. 1, 2001 to Dec. 31, 2005. During this period, rates were frozen in order to allow a competitive wholesale market to take shape.

Ohio moved toward restructuring the electric industry with the belief that competitive market forces would develop and hold down prices. Since electric choice began in 2001, the PUCO has been working to facilitate a competitive electric market in Ohio. However, it is widely acknowledged that a fully competitive market had not developed. As a result, the PUCO developed plans to secure the future of Ohio's retail electric market.

As the end of the market development period neared, the PUCO grew concerned that the limited number of competitive electric suppliers and low degree of market activity were an indication that an immediate shift to market-based rates in 2006 would not be in the best interest of customers. To minimize the effects of rate "sticker shock" and gradually transition customers to market-based rates, the PUCO worked with Ohio's electric utilities to develop rate stabilization plans (RSPs). These plans, coupled with other recent rate modifications, eliminate market uncertainty and provide customers with stable, predictable, just and reasonable rates.

As many of you may recall, the Ohio Legislature supported the establishment of RSPs in a report issued in October 2003 encouraging the PUCO to "continue to take the necessary steps … to ensure that a healthy competitive market is in place before full electric competition begins." RSPs are in place for American Electric Power (AEP), Dayton Power and Light (DP&L), Duke Energy Ohio and FirstEnergy. The RSPs have been challenged at the Ohio Supreme Court, and while parts of these RSPs have been remanded back to the PUCO, the Court preserved the most important elements of the plans.

There is significant evidence demonstrating that the prices customers are paying now under the RSPs are less costly than those that would result from market-based prices. According to the U.S. Department of Energy, customers in states with deregulated electricity paid 30 percent more last year than customers in regulated states. Recent events in states including Maryland, where prices increased 72 percent, and Illinois, where prices increased 55 percent, also support this point.

I would like to address our three topics – electric security plans, market options and generation – and provide you with what I believe to be the salient issues.

Electric Security Plans

The electric security plan (ESPs) might be thought of as an extension of the RSPs instituted in 2005 and which expire at the end of 2008 (except Dayton Power & Light which runs through 2010). There are some significant enhancements, however.

The electric security plans would enable an electric company to make adjustments for increased fuel and environmental costs, new generation dedicated to Ohio ratepayers, purchased power, operations and maintenance, taxes and the provider of last resort requirement. These adjustments would enable the electric company to establish rates that are just and reasonable. In exchange for these adjustments, electric customers could expect stable and predictable rates, and better service reliability.

The quality of the electric infrastructure in Ohio has diminished significantly over the last 15 - 20 years. Sub. SB 221 provides a mechanism for utilities to better maintain their aging infrastructure through long-term comprehensive planning and, in the short term, as single issue rate cases will be permitted under certain conditions. In this way, Ohio's electric infrastructure can be updated and modernized.

There has been a lot of discussion recently regarding the February 2008 date certain established in Sub. SB 221. The February 2008 date certain is a starting point for the electric security plans that represents a just and reasonable rate established by the PUCO in the rate stabilization plans, which were affirmed by the Ohio Supreme Court. This will ensure that the rates established through an electric security plan provide utilities with a fair return for their investment and that the charges paid by ratepayers are just and reasonable.

It is important to note that in reviewing electric security plans filed by the electric companies, the PUCO would be looking for provisions for advanced energy and energy efficiency. Also, we would hope that these plans would be more long-term than the three-year RSPs.

Further, all of the plans, once filed, would go through an adjudicatory process at the PUCO in which all interested stakeholders would have the opportunity to comment on the proposed ESPs and all comments would be considered by the PUCO before finalizing any ESP. The ESPs would go through a similar process that was used for the establishment of the RSPs to ensure accountability and transparency whereby customers would understand what they are paying for and what they are getting in return.

Finally, Sub. SB 221 would codify the process and methodology for the ESP ratemaking, ensuring a level playing field for all parties, and eliminating time consuming and expensive appeals to the Ohio Supreme Court.

Market Options

Sub. Senate Bill 221 also provides the opportunity for a competitive bid rate to be the standard service offer where it is comparable to the electric security plan rate. Further, the market rate option would be approved when the company can prove to the PUCO that a viable, competitive market exists.

In the event an electric company seeks a market rate, the Public Utilities Commission of Ohio (PUCO) could not approve the rate unless the utility demonstrates that effective competition exists in the market and that the rate is just and reasonable. Otherwise, the PUCO could prevent the company from implementing the market rate at which point a default standard service offer generation rate would apply or the company could file for an electric security plan.

Some will argue that markets are effective and viable. I would point out that the markets for electricity are varied and significantly different than the markets for most commodities. Electric markets differ according to the time frame over which they operate. Electricity cannot be stored, and therefore, supply and demand must always be kept in balance. Also, and most telling, the markets are still developing both at the wholesale and retail levels.

While some will argue that the Regional Transmission Organizations (RTOs) constitute the existence of a market, in my mind RTOs are the perfect example of one market in an entire realm of markets. The bottom line is that Ohio ratepayers should not be subjected to the volatility and risk of the current retail and wholesale markets.

The arcane business of trading in power markets leads me to conclude that debating the efficacy of such markets is a useless exercise. I have absolutely no doubt that if you line up a string of economists, myself included, that you will hear conflicting arguments regarding the existence of electric markets. I don't have a problem with that because it simply underscores the fact that we are not dealing with a perfect science. At the end of the day, it is all about outcomes – the prices, terms and conditions of the market prices made available at both the wholesale and retail level.

The Texas market is often used as the poster child of deregulation. Yet, the average electric rate, from 2000 to June of 2007, rose 56 percent, more than all but three states according to federal figures. Twenty-five percent of Texans live in areas still subject to regulation and generally pay less than in the competitive Texas markets. Texas has attracted more retail competition because the most recent Texas PUC "price to beat" was 15 cents per kilowatt-hour (kWh), nearly twice the level of Ohio's rates. That rate is based on the clearing price of the RTO, the Electric Reliability Council of Texas, of the most expensive power, natural gas powered plants. The theory was that the deregulated market would attract the construction of new lower cost coal plants, but an initial Texas proposal to build 11 new plants was reduced to three, with all plants in the planning stage. I have included three recent articles from the Galveston Daily News in Texas that further outlines the problems Texas has experienced with its deregulated industry and related markets.

When examining the existence or non-existence of markets in Ohio, we face another challenge; there is no clear definition for a market. In other words, is a market geographical or customer driven? Does the market include all energy or just electricity?

Herein presents another benefit of Sub. SB 221, we have options. If an electric company seeks a market option, the company must demonstrate to the PUCO a viable, competitive market exists. If the company fails to do this, it could opt for an electric security plan.

Generation

Sub. SB 221 allows for cost-based recovery for new electric generation to be built in the state based upon a showing of need. As some of you may hear, some areas of the state are in need of new generation to meet our state's growing demand for electricity. The costs for new, specified generation projects could be recovered through the electric security plans.

I would again stress that the PUCO would be looking for the utilities to invest in base-load generation that meets future environmental regulations as they pertain to climate change and carbon restrictions. We would also be looking for new generation from advanced energy technologies in order to fulfill the advanced portfolio provisions outlined in the bill. Further, energy efficiency and demand response can also be utilized for a more environmentally-friendly generation mix.

Conclusion

In conclusion, I believe that Sub. SB 221 is a sensible balance between regulation and competition as it provides utilities with the option of pursuing either a competitive market pricing plan or an electric security plan. The legislation ensures the predictability of reasonable energy prices and serves as a catalyst for attracting energy jobs of the future to our state through an Ohio advanced portfolio standard. The legislation also builds upon the existing state policy by ensuring that consumers and shareholders share the benefits of and responsibilities for electric utility investment in facilities supplying electric service, and protect at-risk populations when considering the implementation of any new advanced energy technology.

Thank you, again, for the opportunity to appear on this panel today to discuss electric security plans, market options and generation. I would be happy to entertain questions once all others on the panel have had an opportunity to present their opening remarks.