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MEMORANDUM

From: Dave Rinebolt, Executive Director
To: OPAE Board and Members; OPAE Staff; Interested Parties
RE: SB 221 Summary
Date: April 24, 2008

Yesterday the Senate unanimously passed a compromise version of SB 221 to overhaul electric utility regulation in Ohio. The bill is an improvement over current law; had SB 3 remained in place, AEP customers would have seen increases of 70-90% in the generation portion of the bill, or about 11.5¢ overall, quite a jump from current rates. Customer bills would have gone up throughout Ohio. Given what natural gas prices look now for next winter, that would be a double-whammy for all customers.

OPAЕ helped protect and improve a couple of provisions of current law. Most importantly the low-income provisions were untouched, so the most progressive electric affordability program in the country was spared. The Alternative Energy Fund, which OPAЕ promoted in the '99 law, was strengthened and provided with additional funding sources though a longer-term funding source still needs to be found. And ex-Senator Leigh Herrington led the charge for governmental aggregation, a consumer protection option that will be critical in the years to come.

In the final days of the debate, the General Assembly came to the realization that this was all about the bills – utility bills. The Governor's veto was successful in focusing the debate on the dollars and cents, the issue most important to our network and clients.

What we will have going forward are Electric Security Plans (ESP) and the Market Rate Option (MRO). Neither of those names accurately describes these options, so I will just use the acronyms.

All the utilities have to file for an ESP at some point. If they stick with their current plans they can only adjust rates for fuel costs, just like in the old regulated days. That locks in rates that are not based on cost, but given the increases in price of every fossil fuel that are filtering through the economy that's probably not too bad.

The ESP is essentially a negotiated rate plan so, to a great extent, the rates we will ultimately pay will depend on the outcome of Commission proceedings. Let's hope the

Commission favors small customers. Large customers got pretty much the right to be exempted for adjustments like fuel cost, construction work in progress payments when the company is building a powerplants, cost of the efficiency and renewable requirement, and environmental compliance costs. They can still get special contracts but at least we will get to see them.

Under and ESP utilities get the right to build new powerplants if they are needed with ratepayers on the hook for construction costs. Traditionally, customers don't pay those costs until the plant is 75% complete. The new law authorizes the Commission to bypass those rules. We will have to work hard to prevent those waivers. Utilities can also ask for rate decoupling, an approach to designing rates that allows utilities to charge more if people use less so they don't lose any money. Again, this is an option so we will have to fight it as well.

The gas companies also got into the act, tacking on their own decoupling language. The approach makes a little more sense in natural gas, but only if it's tied to an aggressive energy efficiency program. This bill says you can't terminate an efficiency program if you want rate decoupling so existing low-income programs should stay in place, but it doesn't require any expansion.

If the ESP extends for more than 3 years, it has to be check against the market price. So, if a competitive market actually develops through some fluke, customers can pay the lower rate.

It is expected that AEP and Duke will stick with ESPs because both want to build new powerplants. Dayton Power & Light (DPL) has a current plan that runs through 2010. They will get to defer any unanticipated costs like renewable and efficiency investments for later collection. In 2010, DPL will probably opt for an ESP. FirstEnergy may opt for an ESP despite its blustering about going to market. It was the only company to spin off their powerplants to an unregulated affiliate. They have market power and can dictate the price in their service territory. Of all the utilities, FirstEnergy is most likely to choose to go to market.

That brings us to the MRO. A utility can file an MRO along with the ESP or any time in the future. The Commission will oversee a bidding process and the price that comes out will be compared to the ESP/regulated price. If the bid price is lower, then the utility starts on a path to pure market. The first year the market will set the price for a minimum of 10% of the electricity of the electricity we buy and goes up to 20%, then 30% to a minimum of 50% in year five. The Commission can waive the percentages and stretch it our over 10 years to prevent rate shock but the utility gets to defer all the money they would have made and collect it later with interest.

Those are the basics, though there's a lot more detail about the riders and whether you still have to pay them if through some miracle there is a competitive offer. And that is the problem we were trying to stop. The existing wholesale market does not work.

Hopefully the bill will be used to prevent Ohioans from paying prices set by unregulated oligopolies.

The primary tool to control prices is a standard in the bill which prohibits utilities from earning a “significantly excessive return on equity”, whatever that means. Consumers need that phrase to be strictly defined. The utilities at one point offered what was described as the Exxon-Mobil amendment that would let them earn a return equal to unregulated energy companies – read the oil and gas production companies. Consumers couldn’t afford that and the Governor properly rejected the idea.

We need to limit utility profits to a level that reflects what they are -- risk-free investments in companies that can never go bankrupt because ratepayers will be forced to bail them out no matter how much they screw up. ROE has traditionally been set in the 8-10% range. DP&L is earning 20% right now. The others are well over this standard. OPAE will argue the standard should be even lower because the provisions in this bill reduce the risk even more. (We’ll probably have to come up with the money to pay for an expert to help in these cases.)

There are other provisions scattered in current law as well as this new one that will give consumer advocates like OPAE some tools to fight against unjust and unreasonable rates. It should be a busy couple of years.

The best things in the bill are the energy efficiency and advanced energy standards. Efficiency will have to account for 22% of a utilities projected load by 2025, with targets (the infamous ‘benchmarks’) starting in ‘09. The renewable targets is similar; a minimum of 12.5% of generation by 2025. Advanced energy is to account for 25% of generation. Fossil and nuclear technologies can make up to 12.5% of this total, though theoretically renewables could gobble up the entire 25%. The bill includes a provision allowing ‘at risk populations’ (low-income customers) to avoid charges associated with the advanced energy standard. It is a provision OPAE will push to protect our clients.

There will be opportunities for this network as a result of the new standards. As the only organizations providing energy efficiency services to residential customers in all 88 counties, we should be able to help jump start the programs. This can diversify our funding base. With the State planning on spending the employment and training funds, we can also provide training to support development of an efficiency industry in Ohio, though moving into small-scale renewables is also a possibility.

Thanks to all of you for your efforts to educate opinion makers on the importance of blocking an unfettered move to market pricing. Ohio could not afford that. Like any piece of legislation, the bill is a compromise. OPAE was pushing for a higher degree of regulation because of the overwhelming nature of the evidence that no market exists. The General Assembly, especially the House, wanted market. The Governor, once again, negotiated a compromise that leaves no party completely happy or sad.

Thank you for the privilege of representing the interests of low- and moderate-income customers in this debate. I hope you will continue to support us as we move forward to implement the new statute and ensure small customers are protected.