Biennial Report of the Office of the Ohio Consumers' Counsel to the Ohio General Assembly on the State of Electric Restructuring

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**BIENNIAL REPORT OF
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL
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The passage of Senate Bill 3 ushered in the prospect of customer choice that hopefully could produce lower electricity rates and more options for Ohio consumers. The promise of restructuring, however, has been slower to materialize than the participants in the legislative process had anticipated. Nevertheless, history teaches us that progress in utility regulation is incremental and takes patience, perseverance and time to accomplish.

As the advocate for residential utility customers, the Office of the Ohio Consumers' Counsel (OCC) has been actively involved in the electric restructuring process since the very beginning. The OCC has monitored the progress of the market and participated in a variety of proceedings relating to electric choice since Ohio opened its doors to competition on January 1, 2001. Indeed, the Ohio General Assembly asked in Senate Bill 3 for the OCC to report biennially "regarding the effectiveness of competition in the supply of competitive retail electric services in this state." The OCC now submits its second biennial report.

The OCC is fully supportive of growing the fruits of the General Assembly's labor into a successful competitive retail electric market. We have seen competition emerge under governmental aggregation in northern Ohio. Elsewhere, aggregation has been stymied. We remain concerned about the dearth of competition for consumers in central and southern Ohio. There are precious few suppliers making direct offers to consumers anywhere in the state. And, the utilities' Rate Stabilization Plans are not hospitable to moving competition in the right direction.

It would be a mistake to abandon restructuring just four years into the process. Instead, we should examine our experience and determine what has worked, what has failed and what can be done to further enhance customer choice so that it delivers the benefits originally envisioned.

First, it is important to identify the residential customer's place in this great experiment and what has worked as of the end of 2004. Approximately 905,000 residential customers statewide – or about 22% of those who are eligible to participate in electric choice – have switched electric suppliers.

The competitive market has been most successful in the three FirstEnergy service territories where electric rates are the highest in the state. Notably, residential switching is highest – close to 70% – in the Cleveland Electric Illuminating service territory On average, 49% of the residential customers in the FirstEnergy service territory have switched suppliers, representing a significant exercise of customer choice. The vast majority of those who have switched suppliers participated in one of the more than 190 community aggregation groups. While customers have enjoyed the benefits of electric choice in northern Ohio, residential customers in central and southern Ohio and in the Miami Valley, have had virtually no choices for alternative suppliers.

It is important to note that those residential customers who remain with their investor-owned electric utility company have benefited from the 5% reduction on the generation portion of their bill as mandated by Senate Bill 3. This discount has saved customers approximately $506 million statewide through 2004 and will continue through the end of the market development period in 2005.

RESIDENTIAL CUSTOMERS WHO HAVE SWITCHED ELECTRIC SUPPLIERS (AS OF 12/13/04)			
	Total Number of Residential Customers	**# of Customers Who Switched**	**% of Customers Who Switched**
FirstEnergy			
Cleveland Electric Illuminating	650,000	445,044	68.5%
Ohio Edison	895,000	311,664	34.8%
Toledo Edison	260,000	130,670	50.3%
American Electric Power			
Columbus Southern Power	600,000	0	0%
Ohio Power	600,000	0	0%
Cincinnati Gas & Electric	572,000	17,317	3%
Dayton Power and Light	450,000	0	0%
Monongahela Power	25,000	0	0%

Ohio's electric restructuring legislation established a 20% residential switching goal for each operating company of the state's electric utilities. So far, progress is only evident in FirstEnergy's territory. We remain concerned that residential customers in the rest of the state lack competitive choices.

I. <u>GOVERNMENT AGGREGATION</u>

One reason for the success in northern Ohio can be traced to the foresight of the Ohio General Assembly in creating government aggregation. Ohio has the most successful aggregation program in the nation and serves as the model for other states. Aggregation represents an effective means to deliver value to residential customers in a manner that is simple and secure. Without aggregation, the costs for competitors to acquire individual residential customers can erode potential customer savings or deter competition altogether.

In FirstEnergy's service territory, two large governmental aggregators have played a major role in the switching by residential and small commercial customers to competitive suppliers. The Northeast Ohio Public Energy Council (NOPEC) is a council of governments that represents 113 communities with approximately 455,000 residential and small commercial customers, and the Northwest Ohio Aggregation Coalition (NOAC) is a coalition that represents eight communities and approximately 150,000 residential households.

In the Dayton, Power & Light (DP&L) service territory, the company agreed with OCC, the Staff of the PUCO, and some of the competitive providers and others to initiate an electric choice pilot program in 2004 that would enable customers to join or "opt-in" to a group – much like a government aggregation group – and pool their electric load. In just one month's time, 65,000 or 14% of DP&L's 450,000 customers signed up for the program – a program that only will be implemented if suppliers can guarantee savings. The OCC is hopeful that suppliers will participate in the program and beat DP&L's price in order to serve this new customer base. It is clear from these enrollment figures that consumers want the opportunity to choose their service provider and will take advantage of the prospect if they have the necessary information. This type of program can be a "win-win" solution for residential consumers to successfully participate in electric choice.

While government aggregation serves as an excellent means to reduce customer bills, it does not necessarily foster a competitive retail market unless there is a diverse number of aggregators offering services to customers. Otherwise, aggregation offers the alternative of a few suppliers serving large blocks of customers. This is why it is important to make sure that along with promoting aggregation, barriers are removed to provide the opportunity for suppliers to market to individual customers.

A. Resisting Government Aggregation, Competition and Change

The road has not always been smooth for local governments seeking to provide benefits to their residents. In fact, actions taken by some utilities run counter to the intent of the electric choice law.

There are situations in southern Ohio where utilities hindered the initial efforts local governments made to aggregate. For example, CG&E impeded the efforts of the Village of Indian Hill, a small community of 5,900 residents, from aggregating by first seeking to require government aggregators to post a bond to cover any potential supplier defaults. The OCC intervened in this proceeding in support of government aggregation and took the position that this action was a redundant and unnecessary requirement given that the suppliers were already required to post a hefty bond. In fact, the Village argued: "[T]o require a duplicate guarantee from the governmental aggregator is overkill and would deter most local governments from even attempting to facilitate electric competition for their residents."[1]

Next, CG&E refused to provide a listing of its electric customers located within the boundaries of the Village, a prerequisite to providing customers notice of their options. Indian Hill stated "CG&E's refusal to follow Commission's orders and rules is directly preventing Indian Hill from implementing its aggregation program."[2] These impediments have had a chilling effect on governments seeking to offer better options for customers in the CG&E service territory.

[1] *In the Matter of the Village of Indian Hill, Ohio for Certificate Approval as a Governmental Aggregator Pursuant to Section 4928.20 of the Revised Code,* Case No. 03-1145-EL-GAG, Response of the Village of Indian Hill to Motion of CG&E to Deny the Certification of the Village of Indian Hill at 7 (June 2, 2003).

[2] *In the Matter of the Application of the CG&E to Modify its Retail Electric Tariff and Certified Supplier Tariff,* Case No. 02-2906-EL-ATA, Comments of the Village of Indian Hill at 6 (August 8, 2003).

DP&L deterred governmental aggregation in its service territory as well. The Miami Valley Communications Council (MVCC) is a council of governments representing six communities and approximately 50,000 residential and small commercial customers in DP&L's service territory. MVCC attracted DP&L's attention when MVCC contemplated a governmental aggregation program in late 2003. According to MVCC, DP&L instituted an information program intended to dissuade governmental officials of the MVCC communities from proceeding with a governmental aggregation program. The OCC argued that DP&L's message lacked balance and was in some instances inaccurate.

MVCC ultimately filed a legal complaint against DP&L at the PUCO. DP&L filed with the PUCO an Application to modify its existing tariffs that affect aggregators. DP&L proposed that governmental aggregators or individual customers would be liable for any outstanding amounts owed to DP&L by a supplier if the collateral required by DP&L did not cover the provider's obligations in case of a supplier default. Finally, in certain instances DP&L decided to charge competitive suppliers of an aggregation program the costs of $1.90 per bill per month under a one-year contract and $1.56 per bill per month under a two-year contract, for its consolidated billing service.

The consolidated billing fees significantly eroded potential consumer savings from aggregation. In combination with the other impediments described above, DP&L successfully erected barriers to competition in their service territory. In his direct testimony, MVCC Executive Director, Kent Bristol, responded to a question regarding the harm that DP&L's conduct had caused the MVCC communities:

> Due to the hurdles, uncertainties, and risks associated with DP&L's billing charge demand, DP&L's tariff proposal, and DP&L and its affiliates' activities in general, MVCC's aggregation efforts are on hold until these cases are resolved in a manner that allows for aggregation. While we wait for much needed relief from the Commission, consumers are being denied the savings available to them through MVCC's aggregation pool. For example, based on supplier offers made to MVCC, across the MVCC Communities we estimate the maximum collective savings for residential consumers at *approximately $3.5 million over a two-year period.* To the extent these millions of dollars in aggregate savings do not flow to local consumers, it will not enter the local economies of the MVCC Communities, which ultimately harms economic development, job creation, and job retention in the MVCC Communities. DP&L and its

affiliates, however, benefit by this delay, especially if aggregation never occurs.[3] (Emphasis added).

While the MVCC signed an agreement to settle the case with DP&L, the OCC has opposed the settlement because it allows DP&L to recover costs associated with modifying its billing system from its customers.[4] This cost recovery is a violation of an earlier agreement. The PUCO has yet to render a final decision in either the MVCC or the Indian Hill cases.

Government aggregation has played an important role for delivering the consumer benefits of Senate Bill 3. More needs to be done, however, to foster residential competition on a customer-by-customer basis, as has been the case with gas choice. The reasons for the underdeveloped market are manifold.

II. RATE STABILIZATION PLANS

As we near the end of the market development period without large-scale competition for individual residential customers, the PUCO ordered the electric distribution companies to submit Rate Stabilization Plans for 2006 through 2008. These plans were to balance three goals: rate certainty; financial stability for the utility; and future development of the competitive market. The only criterion for which the electric distribution companies can be credited as successfully achieving is the second – financial stability for the companies.

A. Problems for Competition Under the FirstEnergy Plan

OCC strongly opposed the Rate Stabilization Plans and also argued that these plans could destroy competition and the savings from which customers in the economically strapped northern part of the state could benefit. NOPEC and NOAC also took a strong stand against FirstEnergy's Rate Stabilization Plan because of the detrimental effect they believed the Rate Stabilization Plan would have on the competitive market in FirstEnergy's service territory. It is particularly poignant to read their words as they are very directly affected:

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[3] *In the Matter of the Complaint of Miami Valley Communications Council v. The Dayton Power and Light Company,* Case No. 04-85-EL-CSS, et al., Direct Testimony of Kent Bristol on Behalf oh Miami Valley Communications Council at 10 (September 15, 2004).
[4] *In the Matter of the Complaint of Miami Valley Communications Council v. Dayton Power and Light Company*, Case No. 04-85-EL-CSS, et al., Stipulation and Recommendation (October 14, 2004).

> NOPEC argued on brief: "These shopping credit levels * * * are below the shopping credit levels in effect in 2003, and <u>substantially</u> below those currently in effect in 2004. The shopping credit levels * * * will eliminate competition.
>
> Even at current levels, there is a dearth of potential CRES providers willing to bid on governmentally aggregated retail electric customer load in the state. * * * Of course there are <u>no</u> suppliers currently offering retail electric service to residential customers on an individual opt-in basis on the Commission's website. If current shopping credit levels are not attracting suppliers into this market, a <u>reduction</u> in those levels will surely drive out whoever remains."[5]
>
> NOPEC argued further: "The elimination of shopping in FirstEnergy's service territories during the rate stabilization period through radical shopping credit reductions in the [RSP] Application will result in NOPEC's approximately 455,000 consumers returning to FirstEnergy-provided POLR [Provider Of Last Resort] service. This will be a disaster of epic proportions for the Commission to deal with. There will be no "options" or "choices" as to suppliers and no "diversity" whatsoever as required by Ohio law. There will be one choice and one supplier-FirstEnergy.

NOAC also presented arguments against the FirstEnergy Rate Stabilization Plan by stating: "Applicant's [Rate Stabilization] Plan utterly fails to satisfy this third objective [further competitive market development] * * *. Instead, Applicant's Plan will: prevent any independent consumer shopping, destroy governmental aggregation, currently <u>the</u> success story of Ohio's deregulation process and the engine driving residential and small commercial shopping to date; and, prematurely abort the development of a fully competitive marketplace before Ohio can even complete its "market development period."[6]

B. <u>A Failed Auction for FirstEnergy</u>

In the case of FirstEnergy, the PUCO ordered a competitive wholesale bid under which all of FirstEnergy's load was auctioned on a three-year basis. The auction was conducted under the PUCO's auspices on December 8. The bid process was a New Jersey style, declining clock auction. The price

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[5] *In the Matter of the Application of the Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Continue and Modify Certain Regulatory Accounting Practices and Procedures, for Tariff Approvals and to Establish Rates and Other Charges Including Regulatory Transition Charges Following the Market Development Period,* Case No. 03-2144-EL-ATA, Initial Brief of NOPEC at 20 (March17, 2004).

[6] *In the Matter of the Application of the Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Continue and Modify Certain Regulatory Accounting Practices and Procedures, for Tariff Approvals and to Establish Rates and Other Charges Including Regulatory Transition Charges Following the Market Development Period,* Case No. 03-2144-EL-ATA, Initial Brief of NOAC at 60. (March 17, 2004).

for providing power was reduced each round until arriving at the lowest possible rate at which there was sufficient capacity to cover the load.

On December 9, the PUCO announced that the auction did not produce a price lower than the price offered through FirstEnergy's Rate Stabilization Plan. The OCC had argued that the auction should have been structured differently and conducted in the summer of 2005 when the Midwest Independent System Operator (MISO), a Regional Transmission Organization (RTO) is expected to be fully operational. Waiting until then would have the benefit of reducing supplier risk and providing better market conditions which in turn could yield significantly lower bids. While the auction itself failed, the good news is that there is sufficient capacity available in the competitive market to participate. The OCC plans to advocate for a second auction to be conducted in 2005 for electric service in 2006 when MISO is fully operational.

C. Fall Back to Rate Stabilization Plan for FirstEnergy Translates Into Additional Costs for Ratepayers

Since the FirstEnergy auction was not successful, the company's modified Rate Stabilization Plan will go into effect in 2006. Because the plan violates Ohio's electric choice law and fails to protect residential consumers, the OCC has appealed the PUCO's approval of the plan to the Ohio Supreme Court.

Under the rate plan, customers would be provided a rate that is not market based as required by law and that can increase annually by significant magnitudes upon PUCO approval. There is no basis in the law for FirstEnergy's rate plan, which allows the highest rates in the state to continue through 2008 with the potential for significant increases.

Beginning in 2006, FirstEnergy will be allowed to impose an unjustified and excessive "Rate Stabilization Charge" through 2008. This charge exactly equals the amount of the generation transition charges currently paid by customers. Those charges are, by law, mandated to end no later than December 31, 2005. Allowing this fee unlawfully extends the collection of the generation transition charges by three years, costing residential consumers as much as $20 per month, or $720 for the average residential consumer during the three-year plan.

In addition to this charge, increases in FirstEnergy's fuel costs – without limit – could result in rate increases upon approval by the PUCO.

FirstEnergy's plans would likely harm all customers, even those who have chosen an alternative supplier to provide generation service. Under the rate plan, customers who live in aggregated communities or have chosen a supplier on their own still may be required to pay some or all of the Rate Stabilization Charge, which is a generation charge. The OCC believes that any customer who no longer receives generation service from FirstEnergy should not be required to pay for any portion of generation charges.

C. Twenty Percent Rate Increases Under the Rate Stabilization Plan for CG&E Customers

On November 23, the PUCO approved a modified Rate Stabilization Plan for CG&E. That Rate Stabilization Plan fails to meet two of the goals to which the Commission subscribed. The generation rate impact in 2006 for residential customers is estimated at 20% with additional increases expected for each of the next two years thereafter. This can hardly be considered rate stabilization.

Moreover, competition is severely impeded by the amount of nonbypassable charges, which result in customers who switch to competitors still paying the same sorts of costs to CG&E in addition to their supplier. There is no competitive bid even though required by law. Also, the Commission has declared the CG&E Rate Stabilization Plan rate to be a market-based standard service offer pursuant to statute. This claim is unsubstantiated in the case and there was no information provided that compared CG&E's Rate Stabilization Plan rate with market prices. Given that the Rate Stabilization Plan rate is unknown since it will be based on increases yet to be filed, it is unclear how a determination can be made today that the rate is market-based.

To further compound the potential adverse impact on customers, CG&E has filed for authority to recover the cost of building a new generating unit or purchasing equivalent power. It proposes to begin collecting the cost plus a return for this through a nonbypassable charge that is part of its Rate Stabilization Plan. (At the same time, CG&E is transferring three collectively low-cost plants that were paid for by Ohio consumers to its Kentucky affiliate.) Customers also could be required to pay for a power plant while it is under construction and before any benefits from the operations of the plant have been obtained. This would leave customers assuming much, if not all, of the risk for power plant costs even if the facility is never finished and fails to produce any electricity. This upfront collection of generation costs is not allowed under current Ohio law and would not have been permitted under traditional rate of return regulation in effect prior to January 1, 2001.

III. <u>CORPORATE SEPARATION</u>

Under Ohio's electric restructuring law, the utilities were required to corporately separate their generation assets from their distribution and transmission assets. This was seen as a necessary step to create a level playing field and to ensure that the generation affiliates of the electric companies did not have a competitive advantage. It was also done to protect the utilities' distribution customers from having to pay for the companies' generation services.

The PUCO, however, approved the utilities' interim corporate separation plans, none of which provided for full, structural separation of the ownership of their generation assets. As a result, there has been a movement back towards requiring customers of distribution companies to pay for costs associated with generation. This can be seen in the recently approved Rate Stabilization Plan proceedings in which customers will be forced to pay the costs of environmental controls, etc. for the utilities' power plants, even if they have switched to another supplier and are not getting their power from the utilities. Clearly, this kind of double payment exacted from customers who exercise choice is wrong. Moreover, the law was very clear that once the utilities recovered their stranded costs, they were on their own for future costs. Instead, under these Rate Stabilization Plans, the utilities have gone back to the well.

Amidst this backdrop, other problems plagued the competitive market. For example, under the Commission's rules, sales by a subsidiary are counted towards the number of customers switching. In the FirstEnergy service territory, counting the number of customers that switched to its subsidiary had the adverse impact of increasing deferrals that are charged back to customers in the Regulatory

Transition Charge. Senate Bill 3 was never intended to create a link that penalized all customers through higher rates because some exercised their option to choose an alternative provider.

IV. TRANSMISSION

Ohio unfortunately is divided between two Regional Transmission Organizations (RTOs). RTOs serve as the operators and gatekeepers to parts of the nation's electric grid, bringing much needed coordination to the transmission system. FirstEnergy and CG&E belong to MISO, while American Electric Power Company (AEP), DP&L and Monongahela Power Company belong to PJM. The impact of two RTOs within the state has created "seams" that inhibit the reliable and cost effective movement of power into, through and out of Ohio.

The development of a robust, liquid wholesale market is imperative to the creation of a fully functioning retail environment. Much work is needed to ensure that these seams do not impede fair and open access to the transmission grid, which may result in unnecessarily high transmission rates that customers ultimately pay.

We are anxious that these issues be resolved and are working towards that end. It is anticipated that by the second quarter of 2005, the MISO system will unveil its short-term energy markets and a significant barrier to competition will be lifted.

V. CONCLUSION AND RECOMMENDATIONS

The OCC has vigorously opposed the AEP, CG&E and FirstEnergy Rate Stabilization Plans. We have argued that these plans violate Ohio's electric choice law and do not provide stable rates for customers, but instead provide for unjustified rate increases. Senate Bill 3 requires the utilities to file a market-based standard service offer and conduct a competitive bid to determine rates at the end of the market development period in 2005. None of the Rate Stabilization Plans address both of these requirements fully and appropriately as contemplated by law. These plans constrict the further development of the competitive market and provide barriers to residential customer choices. The OCC's case against FirstEnergy's plan rests in the hands of the Ohio Supreme Court. We are filing for a rehearing before the PUCO on the CG&E case and we await a decision by the PUCO on the AEP case.

The OCC believes, like the legislators who passed Ohio's electric restructuring law, that competition is in the best interests of residential customers. However, much work remains to turn benefits envisioned into benefits realized. Our consistent message has been that the PUCO and the utilities should just follow the law. Doing so will provide customers with the opportunities for the benefits they deserve. The OCC believes that there is a way to balance the need for reliable electric service with the benefits of electric restructuring within the confines of the law.

The question for legislators, regulators and energy participants is where do we go from here? The recommendations of the OCC are as follows:

- Require proceedings and actions by the PUCO to remove existing barriers to competition.
- Require compliance with the law so that a true Market-Based Standard Service Offer and Competitive Bid Price can be made available to customers after the market development period ends.
- Require the active pursuit of a joint and common market that encompasses MISO and PJM to assure the implementation of a liquid, wholesale market, and a market that does not inhibit fair and open access to the transmission grid.
- Evaluate different options for the competitive bid process.
- Evaluate, at the end of 2005, the results of progress made over the year. The Commission should open a formal proceeding to seek comments from stakeholders for the exclusive purpose of identifying the barriers to competition around the state. The Commission should consider these comments and then aggressively remove any and all barriers that run counter to Senate Bill 3. These efforts will help bring the benefits of competition to all customers.

The OCC believes that the tenets of Senate Bill 3 are sound and that if implemented appropriately, customer choice can succeed. The course set forth in the legislation should be followed before any attempts are made to modify the law. The bottom line is that more time is needed to judge the efficacy of customer choice before any changes are made. The fact that all the benefits envisioned have not been achieved is not a reflection that Senate Bill 3 has failed. It is imperative that we give the law a chance to work the way the law was supposed to work.

Finally, we need to acknowledge that no customer has paid more under electric restructuring, and many have saved on their electric bills. Some of the savings are attributed to customer switching. We need to continue to make these options available so that customers who want to can exercise more control over their energy use. Senate Bill 3 empowered customers to take charge of their electric service. We should not now implement government controls that take that independence away.