



House Public Utilities Committee

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November 28, 2007

**TESTIMONY OF JANINE MIGDEN-OSTRANDER
ON BEHALF OF THE OFFICE OF THE CONSUMERS' COUNSEL (OCC)
ON SUBSTITUTE SENATE BILL 221
ELECTRIC SECURITY PLAN, MARKET OPTION AND GENERATION
NOVEMBER 28, 2007**

Good morning, I am Janine Migden-Ostrander, the Consumers' Counsel for the State of Ohio, the statutory representative of Ohio's 4.2 million residential customers on utility issues. Residential customers contribute to approximately forty percent of the electric utilities' revenues and comprise the single largest group of ratepayers. I thank this committee for the opportunity to appear before you to discuss this very important issue of the structure of Ohio's energy future.

For at least the last fifteen years, Ohioans in the northern part of the state have paid among the highest electric rates in the U.S. -- contributing to the economic problems of the region and causing hardship for struggling families and businesses. Due to these high rates, industrial customers sought to deregulate electric generation service to provide their businesses with the flexibility to obtain lower cost electricity from competitive suppliers. Eight years after the passage of Senate Bill 3, the legislation that restructured the electric industry, Ohio continues to face the same dilemma -- high rates in northern Ohio. By contrast, Central and Southern Ohio have experienced more moderately priced electric service (although generation rates have risen dramatically in Southwestern Ohio). This geographical variance illustrates that the problem that the legislature sought then, and seeks now, to resolve is confined to certain areas of the state. Nevertheless, then as now, legislation is not designed to address the regional needs of Ohioans. Ohio would be better served to develop a regulatory approach that requires an analysis of alternative rates that result in optimal solutions for all customers. One procedure which allows for different outcomes among electric utilities and that is tailored to best serve the customers should be the goal.

Consider first the fact that there is a wide disparity in rates in Ohio. For example, it is anticipated that in 2008 - the year under Substitute Senate Bill 221 during which a

baseline will be determined for generation rates – the rates for the typical Ohio residential customer will range from 4.5 cents per kilowatt hour for Ohio Power (serving southern Ohio) to potentially 8.5 cents per kilowatt hour for the typical Toledo Edison residential customer. In a hearing before the Senate Energy and Public Utilities Committee, a vice president for one of the competitive suppliers testified that a competitive bid today would save FirstEnergy customers “north of ten percent.” Using either the retail impact of the average of recent bids conducted in Illinois which yielded an average price of 7.7 cents per kilowatt hour, or an average residential price based on market prices in the Regional Transmission Organizations, it is clear to see that customers in FirstEnergy service territory could save through a competitive bid. However, those in southern Ohio would see significant rate increases if that same “solution” is applied. To help all Ohioans, different solutions are warranted for the customers of different utility service territories.

OCC’s Proposal

Sub. Senate Bill 221 already contains three options for a utility with respect to its generation rates: 1) it can continue the standard service offer (SSO) set under its current rate stabilization plan (RSP); 2) it can modify that SSO by filing an electric security plan (ESP); or 3) it can file a market rate option. Thus, the proposed legislation recognizes the *possibility* of three different outcomes in Ohio – a decided lack of uniformity across the state. The problem with the legislation, however, is the *utility* gets to choose the option – selecting what works best for its shareholder which is likely not to be what is best for the customers who pay the rates. OCC believes the choice of the plan for generation rates ought to be based on what produces the lowest costs for consumers. That is the best direction for economic recovery in Ohio. While both an ESP and a market rate option exist in the proposed legislation, there is nevertheless a stated preference for the ESP. This is because an electric utility that opts for the ESP, need only file such a plan. However, if the electric utility files a plan to provide a market rate, it must compare that price with a price determined by the Commission in the manner of an ESP. Sub. Senate Bill 221 lacks the requisite parity to have both the market rate option and the electric security plan evaluated in the same manner. This is necessary to ensure that the ESP is in fact a lower cost option than a market rate option. It also acts as a ceiling on the level of

increases a utility may try to obtain from customers under an ESP so that the ESP is always lower than the market rate option. Otherwise, the market rate option would be adopted as the lowest cost for customers.

OCC's proposal for least cost generation has been criticized by the utilities as being a plan that wants the lesser of market or quasi-regulated rates. The characterization of OCC's position is fair. However, while stated as a criticism, it is also a fair position. Under the quasi-regulated rates, the electric utilities would not be deprived of full recovery of all costs plus a reasonable return. Under a market rate option, the electric utilities get to take their generation and sell it to states to the east of Ohio and make good money. They also get to compete in the Ohio market as well. Either scenario is a good deal and a fair deal. It just might not guarantee excessive profits. By contrast, the utilities want the higher of market or a regulated rate which comes at the expense of the average consumer.

In order to protect customers, OCC advocates for all the utilities to be required to file a three year ESP and a three year market rate option. Three years makes sense because it follows the same timeline as the current rate stabilization plans which the Public Utilities Commission of Ohio (PUCO) has indicated on numerous occasions worked well. It also replicates the three-year timeline used for many of the competitive bidding processes around the country. The process would require the electric utility to file its ESP which would include estimates for the automatic increases it would seek during the year. In its order, the PUCO could both set the initial rate and either include a determination of the estimated rate increases over the next three years or it could establish the rates for each of the next three years. Once the ESP rates are determined, a letter of interest would go out to all suppliers inquiring if there was an interest in participating in a bid process to essentially beat the ESP rate. A negative response would result in no further action with the ESP going into effect, whereas a positive response would culminate in a competitive bid process to hopefully obtain a lower rate.

The competitive bid process could be either through a request for proposal (RFP) or an auction. Under an auction the utility would divide its service territory into slices of the system, referred to as “tranches” typically consisting of 100 megawatts. Any supplier, including the utility’s affiliate (assuming codes of conduct are observed and an independent consultant conducts the auction) can bid up to an amount specified by the auction rules (usually not to exceed a certain percentage of the total in order to assure a diversity of suppliers and no market power). The price in the auction will start out at a level where it is believed there will be more than enough bidders. In a successive online process, the bid price is lowered in each round with suppliers responding to serve at the new lower price until the number of bids from multiple suppliers equals the number of tranches available. This is known as a reverse auction.

It is OCC’s recommendation that the competitive bid prices under the market rate option be compared with the electric security plan rates (including estimated cost increases) and that the lowest cost option be selected.

For customers in the southern part of the state, they will probably continue to have quasi-regulated rates under the ESP, while in the northern part of the state, competition as envisioned and decided upon by this legislature only nine years ago, would probably be the least cost option. Thus, a one size plan option does not fit all utilities and different outcomes may be appropriate on a utility-by-utility basis. It goes without saying that, if given the choice, consumers will want to pay the least cost possible. Customers care little about the details of public utility methodologies. However, they care a great deal about price. Any proposal that causes customers to pay higher rates simply to accommodate a methodology will not be embraced by customers. Put another way, to deny customers’ savings in their electric bills simply due to a predisposition or preference for a particular methodology will not be easily understood. It would be tantamount to voting to increase rates for customers already strapped with high rates. There is a simple and clean logic to choosing a methodology that provides the least cost to customers.

The Baseline Standard Service Offer (“SSO”) Rate

A key question in the legislation is how to value the generating assets of the utilities that have been depreciated and for which customers have paid stranded costs. First, a discussion of stranded costs is warranted. There are two categories of stranded costs:

- Generation Transition Charges (GTC): When Senate Bill 3 passed, the utilities argued they had an obligation to serve that resulted in them investing in generation plants. They argued that by restructuring generation to be competitive they would no longer have the captive customer base from whom they could recover generation costs that were above market should they try to sell the generation in the market. Thus, generation “stranded costs” were supposed to reflect the difference between what the utilities were approved to collect for power plant costs and the market price. In the FirstEnergy service territory, generation stranded costs were set at billions of dollars. Stated another way, the generating costs in customers’ rates were above market prices by billions of dollars. Under Senate Bill 3, the utilities were given five years to recover these costs - until December 31, 2005, the end of the market development period.
- Regulatory Transition Charges (RTC) – These charges reflect costs the utilities’ had incurred but which have been deferred for future recovery pursuant to PUCO decisions. Examples of these costs include taxes, deferred charges and in the case of FirstEnergy, nuclear fuel costs and nuclear decommissioning costs. Under SB 3, the utilities have until December 31, 2010 to recover these costs through the RTC. In the case of most of the utilities, these costs will have been fully recovered and RTCs are to expire by the end of 2008, with the exception of Cleveland Electric Illuminating, for whom the RTC cost recovery extends to the end of 2010.

Initially, PUCO Chairman Schriber testified that the basis for valuating cost would be a just and reasonable rate and in subsequent testimony he clarified that generation would be valued at cost. OCC would have concurred with this latter clarification on cost-based

valuation because it is entirely proper to charge customers based on the utilities' reasonable costs in order to avoid over-recovery from captive customers. However, this matter was amended to create a new, much higher base – that being the rates already charged in the rate stabilization plan. This is problematic because the starting point from which numerous new costs will be added to customers' bills is too high.

A further concern with respect to this high starting point is that the rates may go even higher. For example, under its current rate plan, AEP's rate increase requests can be implemented within ninety days of filing, subject to reconciliation. AEP had one increase request for 2008 pending and just recently filed a second. Those two increases could be in effect on February 1, the date that becomes the starting point for its baseline SSO rate under an ESP, subject to a reconciliation adjustment *after* February.

The question is whether that February baseline SSO rate in the proposed legislation will be based on the inflated filing that has yet to be fully scrutinized or will it be adjusted later, after the Commission has determined the appropriate amount?

In the case of FirstEnergy, as a result of a Supreme Court appeal¹, the utility filed for recovery during 2008 of fuel costs that were supposed to be deferred and recovered through distribution rates over twenty-five years. Had the deferral continued, there would have been no increase in the base rate. Now there will be. FirstEnergy has filed to request that an estimated \$390 million in fuel costs, of which over \$200 million is deferred fuel, be put in rates in 2008 subject to reconciliation – again, thus inflating the baseline rate under Sub. SB 221 to its advantage.

OCC believes it is unjust and unreasonable to approve a fuel increase of that magnitude without a complete review of the costs and a hearing. OCC has requested an audit of these costs as would have occurred if there were still fuel proceedings under the law. A ruling is pending before the Commission.

¹ *Elyria Foundry Company v. Public Utilities Commission of Ohio*, 114 Ohio St.3d 305 (August 28, 2007)

When FirstEnergy filed its rate stabilization plan, it requested – and received approval from the Commission – to charge a rate stabilization charge beginning in 2006, which coincidentally was equal dollar-for-dollar to the GTC charge recovering generation stranded costs that was supposed to be removed from customers’ bills by the end of 2005. For the typical residential customer, this costs them an additional \$15 to \$19 per month depending on the service territory in which they resided. While one might argue that a rate stabilization charge to compensate a utility for being the default service provider is reasonable, the disparity in a charge for that service statewide cannot be justified.

For example, American Electric Power charges one-tenth of one cent for providing default service for its customers in the Ohio Power and Columbus Southern Power service areas whereas Toledo Edison customers pay 2.5 cents – 25 times more – for the same service. One has to question why it costs Toledo Edison so much more. Or one has to consider that the rate stabilization plan rates are built on a shaky foundation in which there are no justifications for many of the charges. Yet these rates under the RSPs’ opaque constructed boxes in which transparency in costs are missing is what will be used as the baseline for new generation SSO rates in 2009. Setting the baseline to include these high costs is not appropriate and will result in customers paying far more than they should. *Fairness to consumers would dictate that the quasi-regulated SSO generation baseline rates would be based on cost.*

The Electric Security Plan

Consumers’ Counsel is concerned that the electric security plan will result in significant rate increases for customers without a prescribed process to assure customers an ample opportunity to review costs and without the opportunity to verify the prudence of expenditures. The electric security plans to some degree seem to model the current rate stabilization plans – but with even less consumer protections. When they were first created, the goal of the rate stabilization plans was to stabilize rates for consumers, provide revenue stability for the utilities and foster competition. Unfortunately, the RSPs did not uniformly achieve those objectives. Generation rates for residential customers in the Duke service territory, while fluctuating, have at times been almost 40% higher than

in 2005. The current rate plans did provide revenue stability for utilities. In fact, Standard and Poor's recently downgraded FirstEnergy based on its aggressive efforts to expose its generating assets to market commodity risk. Thus, Wall Street recognizes how beneficial these quasi-regulated rates are for their shareholders. Translated differently, the rate stabilization plans and their progeny benefit shareholders because they provide lucrative rates at consumers' expense. Finally, the current rate plans were supposed to enhance competition. A review of the PUCO's reports tracking competition speak for themselves in demonstrating how competition did not occur and in fact in some quadrants of the state, decreased. For example, the shopping credit – which is the portion of the bill customers can avoid paying to the utility if they switch generation suppliers – actually went *down* at a time when rates everywhere were going up. Hardly enhancing competition, the rate plans took a bad state of affairs and made it worse.

It is important to understand how the pieces and parts of this complex legislation work. To begin, the utilities can continue under the rate stabilization plans until such time as they desire to increase rates. At that point, they can file for new rates in which, based on our understanding, increases and decreases in costs – with the exception of the Regulatory Transition Charge (discussed below) - may be examined. However, no mention is made of reviewing the level of the utilities' return to determine if they are earning excess profits at the customers' expense. The electric security plan review is not done in the context of a full rate proceeding under section 4909.18 of the Ohio Revised Code and other than stating that there will be a hearing, no details on the procedure are set forth. *Clarification in the legislation is necessary to ensure that there is full due process and a fair and reasonable opportunity to review the ESP filing, conduct discovery and prepare for litigation or negotiation. A nine-month process with a staff report embedded in the law for rate increases would be appropriate to assure that consumers are protected.*

A. The Regulatory Transition Charges (RTC)

The proposed legislation as amended in the Senate under 4928.14(D)(1), specifically excludes consideration of the amortization of regulatory transition charges in terms of

determining any cost decreases that can offset cost increases. This one phrase of exclusion inserted in legislation will have the dramatic – and unjust - consequence of requiring FirstEnergy customers to continue to pay in aggregate what FirstEnergy has estimated as over \$590 million annually in costs that can only be described as “phantom.” It is a like a mortgage company telling homeowners after they think they’ve made the last payment that they continue to owe principal payments.

FirstEnergy itself recognized that it had no right to continue to recover regulatory transition charges when it stated in its letter of intent to file an application to increase distribution rates by \$340 million, “However, this distribution increase, which would average 8 percent annually for all customers served, would be more than offset by the elimination of certain charges related to electric restructuring in Ohio - resulting in the overall decrease in regulated charges.” And in a letter to the investment community on the distribution rate case, FE stated, “Although not a part of the Application, the Ohio Companies will reduce or eliminate their Regulatory Transition Charge (RTC) rates concurrent with the effective dates of the proposed distribution rate increases. For OE and TE, the RTC will be eliminated and for CEI there will be a reduction of about 30% in the RTC rate. The RTC for CEI will continue at this reduced level through 2010 and then cease.” Thus FirstEnergy correctly acknowledged that the transition charges were based on discreet costs, which once recovered from customers, would cease to be charged because it was paid in full. Paying these costs is like an extra tax on the average customer. *Once the regulatory transition charges are paid in full, the RTC charge should be removed from customers’ bills and should not become part of the baseline SSO generation rate.*

Consider further the impact on the typical FirstEnergy residential customer. By legislating this gift of continued RTC to FirstEnergy, the impact on the typical residential customer in the Ohio Edison, Cleveland Electric Illuminating and Toledo Edison will range from between approximately \$90 to \$144, \$198 to \$297, and \$243 to \$342 per year, respectively, depending upon whether credits to the RTC are also continued, as is discussed in the next paragraph. Add this to the unreasonable rate stabilization charge,

and the ranges of total annual continued payment for the typical residential customer becomes \$288 to \$342 for Ohio Edison, \$387 to \$486 for Cleveland Electric Illuminating customers and \$468 to \$567 for Toledo Edison customers. Stated a different way, even though by current law *all* transition charges are supposed to have expired by either the end of 2005 or the end of 2010, customers in First Energy will *de facto* continue paying them.

There are currently credits in FirstEnergy's tariffs that reduce regulatory transition charges and, if also continued, would continue to reduce the impact of this charge. The legislation is unclear as to whether these credits to the RTC would continue to be applied as part of the electric security plan. Should the regulatory transition charges remain on customer bills, the legislation needs to clarify that the credits should also continue. Even with the credits applying, however, the magnitude of the windfall to FirstEnergy at the expense of the average customer is enormous. The range of dollars in the preceding paragraph show the regulatory transition charges with and without the credits. *In any event, Consumers' Counsel strongly urges this legislature to remove the windfall regulatory transition cost payments that further tax customers so that they can put their hard-earned money to better use to buy food, and pay for housing and medical needs.*

B. The Automatic Increases

Under 4928.14(D)(1), once electric security plan rates are determined, utilities can file for automatic increases in a number of categories of generation costs including:

- Environmental costs;
- Fuel costs;
- Cost of investment in new construction;
- Operating and maintenance costs and taxes outside the utilities' control;
and
- Cost of providing standby and default service

Each of these categories will be discussed below, but some preliminary comments about some serious concerns are in order first. To begin, each of these costs represent single

issue increases without necessarily the possibility to review whether there are decreased costs in other areas of the utility's operations that can be used to offset some or all of the increases. It is not clear from the proposed legislation how decreases in costs that are to offset increased costs will be determined, reviewed and considered when such automatic adjustments are allowed. For example, if the utility is earning excess profits due to the largess of the customers, can that cost be used to offset the increase granted? What about a reduction in costs if a utility reduces its workforce? Shouldn't costs in rates to compensate the utility for its workforce be reduced to reflect the new more modest costs and be used to offset the increase? Automatic increases potentially leave it within the utility's control to determine what costs get reviewed and what costs do not. Adoption of this section may very well remove the need for a utility to ever file a full rate case, depriving customers of the opportunity to seek relief from rates that may be inflated and/or are unjust and unreasonable. From a policy standpoint, this is not a good road to go down. *This section should be removed from Substitute Senate Bill 221 in order to ensure that rates are prudent, just and reasonable and that customers are not overpaying for electric generation service.*

It is important to consider that without clear scrutiny and tests for prudence, customers will be paying for utility decisions that may not result in the lowest cost option adopted and that may not be the most efficient solution. If the utilities know they will obtain full recovery and their decisions will not be subject to close review, they may – as is sometimes human nature - be a little less diligent in going the extra mile to save customers money. After all, it is not the utility's money on the line.

Moreover, while under Sec. 4928.14 (C) there is a hearing on the initial electric security plan proceeding, there is no clear requirement for a hearing on these costs which could go into the billions of dollars. While OCC cannot imagine the PUCO granting such increases without a hearing, whether they choose to do so is entirely left to the PUCO's discretion. Since there are no details about this in the current legislation, there are a number of unanswered questions:

- Will there be a hearing and, if so, how often?

- Will there be a separate hearing on a single category of costs, or will several be combined?
- Can a utility file for increases every month or will there be some kind of limitation?
- How much time will intervenors be given to prepare?
- Will there be formal audits of these costs?
- Will the Commission staff issue a report of investigation on these potentially very large increases?

These points need to be clarified in legislation – not through PUCO rulemaking – to protect customers.

It is worth noting that this uncertain process replicates most closely the process established under the Duke rate stabilization plan, in which the utility has been able to apply for periodic increases – and occasional decreases - in costs. While generation rate impacts have at times increased by nearly 40 percent, the typical length of time from the filing of an application to the hearing date is two and a half months. This is hardly sufficient given that OCC and other intervenors must review the application, conduct discovery (and hope that the data responses from the utility are timely) and prepare and prefile testimony. The constant pressure on intervenors to rush their work and lack of opportunities to fully prepare can be viewed as a means to reduce the public’s ability to scrutinize the utility’s requests. Having the opportunity to fully complete the review necessary, and justified by the size of the increases, has been a problem. This is not in the public interest. *Therefore, should this single-issue ratemaking process be permitted for modifying an SSO generation rate under an electric security plan, there should be a full hearing providing intervenors ample time to prepare that is similar to that in a rate case.*

Also of concern is the lack of detail as to what is meant by “automatic” increases? Does it mean it goes into effect only after serious review, audit and hearing? Does it mean that significant increases will automatically go into effect as filed without review or subject to reconciliation? Note also that the proposed legislation contains language that the

following costs “*include but are not limited to*” meaning that in addition to the broad categories of costs that could be automatically recovered, should there be additional categories, the utilities can ask for those as well. *No increases should be automatic and permitted without a full hearing, ample opportunity for discovery and where necessary, an audit.*

1. Environmental Costs

Allowing recovery of environmental compliance costs through an *automatic* increase is tantamount to an abdication of responsibility to consumers. It cannot be stressed enough that the costs that are at issue can reach into the billions of dollars. With costs of such an extraordinary magnitude as these and without the opportunity for careful scrutiny, it is easy to have situations of unwarranted excess costs and possible duplication. FirstEnergy is required to pay \$1.5 billion for violations of the Clean Air Act at its W.H. Sammis Plant. This is an addition to the \$1.8 billion it anticipates spending on nitrous oxide, sulfur dioxide and mercury cleanup. AEP and Duke have similar clean-up provisions at costs of \$5.1 billion and \$1.1 billion respectively. These costs could go even higher as talks about capping carbon emissions continue. AEP estimates prices in Ohio could climb \$2.5 billion with a cap-and-trade system solution to carbon emissions. It is imperative that under a regulated or quasi-regulated paradigm, where customers have no competitive choices, that regulation provide consumer protection. The only protection against being forced to pay unreasonable rates is to be sure that the rates charged have been verified and are just, reasonable and prudent.

2. Fuel Costs

With the passage of Senate Bill 3 came the repeal of Sec. 4905.301 of the Ohio Revised Code. That section required hearings and allowed utilities to recover fuel costs through an adjustment clause in recognition that fuel costs were subject to fluctuation. The process under the statute and associated rules called for annual reviews with biennial financial audits and fuel procurement management performance audits in which auditors would submit a report and testify in a hearing. The burden was on the utilities to demonstrate that the costs were prudently incurred and the resulting rates were just and

reasonable. An important flaw in Sub. S.B. 221 with respect to this issue is that it permits automatic changes to generation rates for changes in fuel costs without such procedures and safeguards in place.

3. Construction Costs

The legislation allows for adjustments to the SSO generation rate for recovery of construction costs of one or more new specified generating units or the cost in excess of \$250 million of construction of an environmental retrofit. This section requires that the price adjustment be consistent with sections 4909.15 and 4909.18 of the Ohio Revised Code. While it is good for consumers that the law is not being amended with respect to requiring that a plant be 75% complete or “used and useful” prior to inclusion in rates as found in current law, OCC objects to the manner in which these costs will ultimately be recovered, which is through adjustments to the SSO price for the life of the plant. Given this, it is unclear as to what kind of process will be in place and what kind of criteria will be used to determine how much of the cost will be recovered over what period of time. The lack of clarity raises the concern that cost recovery could be accelerated, creating significant burdens for the average customer. Allowing cost recovery for the life of the plant through adjustments to the SSO price also provides a convenient vehicle to avoid full rate reviews which require all of the utility’s costs to be laid out and subject to review.

4. Operating, Maintenance and Other Costs

Like construction costs, these costs are at the very heart of what is considered and reviewed in a traditional full rate case. Allowing these costs – even limited to those beyond the utilities’ control – to be included as part of an automatic increase, provides the utilities with even more tools to circumvent a rate review process. Again, rate reviews in the context of a rate case provide regulators and advocates alike the opportunity to assure that rates are just and reasonable and that the utility is not over-recovering in any category of costs and helps prevent customers from overpaying for electric service.

5. Costs of Investment in Specified Generating Facilities

It is clearly possible to interpret the proposed section under 4928.14(D)(1)(e) which simply states, “(e) Costs of investment in one or more specified generating facilities;” as allowing from day one, automatic increases for recovery if a utility *invests* as opposed to *constructs* a power plant. For example, AEP, through a joint venture invested in by both Ohio Power and Columbus Southern Power, could create a new company to construct a power plant. Under that scenario, AEP’s customers could begin paying for the plant from the ground up, absorbing significant increases in rates and taking on the risk for new plants in terms of cost, construction and operational risks. With such an open checkbook there is little confidence plants will be constructed as efficiently as they would be in a competitive market, where investors bear the risk for cost overruns.

Anecdotally, it has been stated that this is not the intent of the language, however the language speaks for itself and the courts will interpret that language. If this is not the intent, then the language needs to be clarified or preferably, removed.

6. Costs of Providing Standby and Default Service

Allowing adjustments to the SSO price for the cost of providing standby service makes no logical sense. Utilities already may charge standby rates that represent the rates a self-generator pays a utility to provide backup power when the self-generation unit is not available. It is entirely unclear how such a discreet service provided by a utility to a self-generator translates into a cost that must be absorbed by all customers. A reasonable explanation is needed as to exactly what is meant by this potential payment from customers who have no relationship to the charge. *This cost should be eliminated.*

Costs for default service represent a “cover-the-bases, include the kitchen sink” kind of charge for the utilities to make sure no stone is left unturned in their quest to get recovery for all costs through automatic increases in order to circumvent the rate case process. Default service charges are intended to compensate the utilities for the risk associated with having to provide power in the event of a supplier default or if a customer decides to return to the utility as the provider of last resort. These costs range from a high of 2.1

cent to 2.5 cents per kilowatt hour for FirstEnergy residential customers to a low of one-tenth of one cent per kilowatt hour for AEP customers. The disparity in the cost of this service is certainly difficult to understand. The magnitude of FE's charge is especially hard to fathom when consideration is given to the fact that all the electric utilities require competitive suppliers to post a bond or letter of credit of sufficient size to cover the cost of purchasing electricity in the market for several months in the event of a supplier default. *Adjustments should not be allowed to the SSO generation for costs of providing standby or default service.*

Prudence

“The difference between the almost right word and the right word is really a large matter – ‘tis the difference between the lightning bug and the lightening.” Mark Twain

It's all in a word, yet this word matters greatly to consumers. Costs for which utilities seek recovery that fall within the zone of reasonableness are not necessarily – and should not be presumed to be – prudent. In LSC Draft 6 of the pending legislation, the Commission was required to find that for an electric security plan “...(t)he offer and the prices it establishes are just, reasonable, and **prudent** as to each customer class...” (Lines 1609-1610) and that for a market rate option “... the price is just, reasonable, and prudent...” (Lines 1661-1662) The version that passed the legislature removes this prudence language for both options - (Line 2096) and (Line 2147).

Prudence is defined in Black's Law Dictionary as “carefulness, precaution, attentiveness and good judgment, as applied to action or conduct. That degree of care required by exigencies or circumstances under which it is to be exercised...This term, in the language of the law, is commonly associated with ‘care’ and ‘diligence’ and contrasted with ‘negligence.’”

The importance is that a cost for which a utility seeks recovery could fall within the zone of reasonableness but it may not have been the most prudent option. The removal of the word “prudence” removes a standard of care to which customers are entitled. It is

entirely appropriate and fitting to include a prudence standard under which the electric utilities are held accountable for costs they seek to pass on to customers. The requirement of prudence, for example, currently exists in the purchase gas adjustment also known as the gas cost recovery rider. See Sec. 4905.302 Ohio Revised Code. The deliberate removal of such a standard of accountability is disturbing. If the utilities intend to act prudently, if they intend to adhere to a reasonable level of accountability, then they should not object to a prudence standard. Just as they are accountable to their shareholders, they should be accountable to their customers who pay the bills. *OCC recommends that the word “prudent” be reinserted.*

Unjust and Unreasonable Subsidies

Under Sec. 4928.14(B) (4), Substitute Senate Bill 221 establishes separate baseline SSO generation rates for each customer who signed a special contract or agreement approved by the Commission as of October 28, 2007. While OCC cannot verify the exact number, OCC has an understanding that there are several thousand special contracts in effect. This translates into several thousand customers having their own personalized rate.

Historically, special contracts fell into several categories, which included economic development contracts and competitive response contracts. The payment of delta revenues – being the difference between the full rate and the discounted rates were shared equally by the utility and all other customers in the case of economic development, and were borne completely by the utility in the case of a competitive response contract.

It is OCC’s understanding that those subsidies would be shifted entirely to customers under the electric security plan. These subsidies for large users are based on contracts which OCC was not even able to ever review in proceedings in which OCC’s intervention was routinely denied. This is ironic given that the cost subsidy for most of these special contracts was being socialized and passed on to residential customers among others.

While the residential customers will be asked to pick up these costs, we have no information as to exactly how many contracts exist, the amount of all the discounts, or

how the discounts will translate into total costs to be absorbed by all customers. Because the process has been far from transparent, there is no information as to the justification for these thousands of special contracts. For example, does each industrial customer who received Commission approval for an economic development rate a decade ago still need it? Is each industrial customer still providing the same level of jobs as it did at the time the special contract was approved, or have they outsourced jobs to other states or overseas? How is this special contract impacting other Ohio businesses that compete with the special contract recipient but did not receive the discount? From a public policy perspective, is it fair to ask all residential customers to subsidize large corporations? How does that impact affordability for struggling families just barely making ends meet? Does this tip the scales such that more families will face the threat of disconnection because they cannot afford the bill? From a public policy standpoint would it not be better to start fresh and make a determination on a case by case basis if such subsidy must be implemented? *Before all these subsidies from secret contracts are thrust on residential customers, a discussion needs to take place that satisfactorily answers the questions posited above. If good rationales are not forthcoming, then this section (lines 1971 – 1978) should be deleted.*

Bypassability

As has been discussed above, there are a plethora of charges being foisted on residential customers, from continuing rate stabilization charges to regulatory transition charges to automatic increases for a whole parade of potential costs. The elephant in the room so-to-speak is whether all these components of the SSO generation rate will be bypassable. Under Senate Bill 3, it was envisioned that after all the stranded costs relating to generation and regulatory transition costs were paid off, customers who switched to a competitive supplier would pay their local electric utility for transmission and distribution services and nothing more. By so doing, a customer could comparison shop and choose between the generation rate the utility is charging and the generation rates that one or more suppliers might be offering. This is key to making competition work and providing an escape route for those customers burdened with high rates under the electric security plan.

If the utilities' generation rates are not entirely bypassable, then customers' ability to shop may be curtailed because the portion of the customer's bill that could be avoided would be less than the market price. For example, assume hypothetically a supplier price of 7.7 cents per kilowatt hour and assume that the Commission determines that the 2.1 cent rate stabilization charge for Cleveland Electric Illuminating (CEI) customers is non-bypassable, meaning that a customer who switches would have to pay CEI a distribution, transmission and rate stabilization charge every month. Assume further that the generation rate is 8.2 cents per kilowatt hour (based on CEI receiving 100% of its requested fuel cost increase). Subtracting the 2.1 cents per kilowatt hour from the 8.2 cents per kilowatt hour means that for a customer to save money, an electric supplier would have to offer a generation rate of 6.1 cents per kilowatt hour or lower. Given that the supplier price is 7.7 cents per kilowatt, it is unlikely that the customer would save money. This scenario illustrates why competition did not work during the market development period and why it did not work under the rate stabilization plan. It was designed for failure.

If that same scenario is analyzed, but instead with the rate stabilization charge bypassable, the amount that a customer who switches can avoid becomes 8.2 cents per kilowatt hour. If that is compared against a supplier price offering of 7.7 cents per kilowatt hour, then the customer saves a half a cent per kilowatt hour. Even this modest savings would add up to \$45 per year for a typical residential customer and much more for commercial and industrial users.

Another concern regarding bypassability ties in with the issue of residential customers subsidizing industrial customers. One of the artificial reasons for keeping customers tied to the regulated rate is to assure the utilities of full recovery of the subsidy. If residential customers switch in large blocks as a result of better rates offered through government aggregation, then the utility may not recover its full subsidy. Making portions of the generation rate nonbypassable thereby punishes customers twice – it requires them to pay a subsidy and it ties them to a higher utility rate with no means of escape.

Given the high baseline SSO generation rate used as the starting point under an electric security plan and given the multitude of potential cost increases customers could be subjected to, customers need a safety route to lower rates. Failing to provide for full bypassability of the utilities' generation rates is like Sartre's "No Exit." Customers remain trapped, only here, with high rates.

There has been speculation around this subject and no definitive answers. *The legislature should determine the issue of bypassability of the utility's SSO generation rates.*

Commission Discretion

A basic problem with the proposed legislation is that it provides tremendous discretion to the PUCO. This problem permeates the proposed legislation, and can be illustrated in this testimony using the topic of the day -- electric security plans and the competitive market option for pricing generation service. Two weeks ago, OCC noted that Sub. S.B. 221 requires a market rate option to be compared to an electric security plan under Sec. 4928.14 (specifically, Sec. 4928.14(E)(2)(d)), but no requirement exists under an electric security plan to compare (in any form, whether by conducting a bid or testimony) the results to a market rate option.

The Senate made an effort to set criteria that the Commission would use to determine whether a market rate option should be approved, which resulted in the present content of proposed Sec. 4928.14(E). Proposed Sec. 4928.14(E)(2)(d), for instance, requires that the market rate option be "more favorable than or at least comparable to, [the utility's] price-to-compare for that class." That provision may appear to state an objective criterion, but "price-to-compare" is not defined in Sub. S.B. 221, which is an invitation to discretionary interpretation by the Commission. The entire determination of what is comparable rests on what portions of the generation rate are deemed to be bypassable by the Commission. If the Commission determines that a significant portion of the rate is nonbypassable then comparison between the market rate option and the electric security

plan becomes meaningless, since the Commission's discretion will have been utilized to assure a particular outcome.

Under proposed Sec. 4928.14(C), a utility may file for modification of its standard service offer for generation service. Sub. S.B. 221, however, provides that the filing will be conducted according to "filing requirements the commission shall prescribe by rule." Chairman Schriber indicated to this Committee two weeks ago that electric security plans would be long enough in their durations that comparison with market rate options would not be easily accomplished, if feasible at all. That statement seems incompatible with the comparison of options that is intended by Sub. S.B. 221, but nonetheless appears to be within the Commission's discretion.

Utilities may file for increased rates under an electric security plan, and Sub. S.B. 221 provides, under Sec. 4928.14(D)(6), that the Commission's order "may provide a schedule and the procedural and substantive terms and conditions for periodic commission review of the approved offer." That provision, along with others such as those that permit the approval of the automatic adjustment of generation rates (Sec. 4928.14(D)(1)), provides the Commission with very broad authority that may prevent interested parties from being involved in rate-setting for prolonged periods of time. Further, the Commission has the ability to limit the amount of preparation time intervenors have to challenge costs that may be in the hundreds of millions or billions of dollars. Allowing approximately two and a half months from the time an application is filed to the time of a hearing – which is typically the amount of time granted in the rate stabilization plan cases - is insufficient for the purposes of reviewing an application, conducting discovery, hiring a consultant if needed, and preparing prefiled testimony which is usually due one to two weeks before the hearing.

Another source of troublesome PUCO discretion emanates from a less obvious source. Currently, Sec. 4928.05 limits the authority of the Commission over generation service, and its application in the rate plan cases has been a source of great controversy. Sub. S.B. 221 approaches this matter by providing the PUCO with authority, under Sec.

4928.05, “if the commission determines that supervision and regulation is necessary to implement the state policy specified in Section 4928.02 of the Revised Code.” Such broad authority could be wielded not only at times and over utilities as determined by the Commission, but might also be more broadly interpreted by the PUCO to limit the applicability of some statutes in a particular case that would provide consumer protections. Such broad PUCO discretion is too limiting to public participation in rate-setting, and may constitute an unlawful delegation of authority to an administrative agency.

Infrastructure Modernization

Under 4928.111, Sub. S.B. 221 provides that utilities with an SSO generation rate “shall” file an energy delivery infrastructure modernization plan pursuant to Section 4909.18 of the Ohio Revised Code. The important aspect of this reference is that it be tied to a full rate case process. To the extent that delivery infrastructure modernization involves an increase in *existing* rates, then a full rate case process which usually takes nine months and requires a staff report, is invoked. This process, favored by OCC, would provide intervenors the appropriate amount of time to prepare for rate increases that could go into the billions of dollars. If the matter is determined to involve a *new* rate, then a modified process can be substituted in which there is no guarantee of a hearing.

Because there have been significant problems with service quality and reliability compounded with insufficient expenditures, the cost of modernizing the infrastructure is estimated to be in the billions of dollars. To allow these kinds of increases outside of a rate case process would deprive intervenors of the opportunity to review costs in order to assure that the cost increases are verified and prudent. *Language should be inserted to set forth that infrastructure modernization is considered to be an increase in an existing rate subject to a full rate case.*

Some Additional Observations

There has been a lot of fear of the competitive market citing the 70 percent increases in Maryland. Yet what has not been considered is the impact on rates of the rate

stabilization plans, where generation rates have increased to at times by nearly 40 percent in the Duke service territory since 2005. The point is that the fear and drama around the competitive market is overstated. Rather than focusing on the *means* to the end, OCC proposes focusing on the *ends* – which should be the lowest generation rates possible.

This proposed legislation, with its preferential reliance on the electric security plan, does not protect customers. It starts with a baseline SSO generation rate that in most instances is too high and could result in double recovery at the expense of the customer. It subjects customers to paying for billions of dollars in increases for environmental costs, power plant construction and infrastructure modernization. It subjects them to these increases in a manner that does not provide the needed protections. Utilities can increase some costs *automatically* not only for the environmental costs and investments in construction, but also for a host of other costs including fuel and operation and maintenance. Add to that, residential customers will pay for subsidies of industrial customers' due to discounted rates through secret arrangements that total to an undisclosed amount.

Further add to this the absence of language protecting customers with the guarantee of due process. Other than the initial electric security plan hearing which unlocks the golden gate to riches for the utility, there are no clear specified hearing requirements – not even for the billion dollar increases for environmental and construction costs and not even for the hundreds of millions of dollars in fuel increases. Nor is there any timetable set forth to guarantee intervenors the time they need to prepare their case. There are no audits of these huge costs to assure that expenditures are prudent. There is no clear offsetting of cost decreases throughout the utilities and no offsetting of excess profits against these increases because there are no rate cases. In sum, there is limited accountability and little confidence that the process will protect customers. If the rate stabilization plan process is to be used as the measure for setting future rates, then history tells us there will be a rush to hearings and a rush to settlements with incomplete discovery and insufficient time to prepare.

And the baseline SSO generation rate from which an electric security plans starts – from which rates get increased – is inflated to levels that obligate customers to pay costs that have been recovered and to pay charges that should be removed from customers' bills.

OCC poses the question: *Where is all this money going to come from?*

More and more, residential customers are struggling to make ends meet given increases in the prices of natural gas, electricity, gasoline, medicine and other commodities. Customers have to make choices as to what bills to pay and which can wait another week. Consider the following information about residential customers who will be burdened with huge cost increases to the benefit of the utilities:

- According to the Office of Strategic Research in the Ohio Department of Development, there are 807,345 households in Ohio at 150 percent of the poverty guideline. That is approximately 18 percent of all Ohio households that are eligible for assistance through the Percentage of Income Payment Plan program (PIPP), Home Energy Assistance Program (HEAP) or the Home Weatherization Assistance Program (HWAP).
- The number of households at 175 percent of the poverty guideline jumps to 1,066,618, nearly one quarter of all Ohio households. That translates into an additional 259,273 low-income Ohio households that do not have access to most of the programs and who must somehow find resources to pay rising energy bills.
- According to information from the Midwest Energy Efficiency Alliance, in 2004, energy bills for low-income Ohioans were \$740 million more than what is generally accepted as affordable. In 2006, actual low-income energy bills exceeded affordable energy bills by \$1.156 billion, an increase of 84.5% since 2002.

- The number of gas and electric company disconnections for the twelve-month period ending July 2007 was 382,786, a 10 percent increase over the previous year.
- Natural gas rates have more than doubled over the last five years, and electric rates have, or will, increase significantly during the period covered by the rate stabilization plans.
- Many Ohioans are struggling to keep their homes. As reported in the Dispatch on Nov. 14: “Ohio’s six biggest cities ranked among the 30 metropolitan areas in the U.S. with the highest foreclosure rates during the third quarter of 2007. Ohio ranked fifth (behind NV, CA, FL, MI) among the states for foreclosures in the third quarter with one filing for every 107 households.” (Source: RealtyTrac)
- Many Ohioans are struggling to feed their children. Also reported in the Nov. 15 Dispatch: In Ohio, nearly 20 percent of all children lives in food insecure households, which means they do not always know where they will find their next meal. Ohio has the 14th highest rate of child food insecurity in the nation. The states with the highest rates of child food insecurity are Texas and New Mexico, where more than 24 percent of all children are at risk for hunger. The other states with child hunger rates above 20 percent are: California, Idaho, Kentucky, Mississippi, North Carolina, Oklahoma, Oregon, Tennessee and Utah. Washington, D.C. also has a child food insecurity rate above 20 percent.

OCC is not opposed to utilities earning a reasonable return. The problem is that there is never an opportunity to evaluate and set that return. Under the electric security plan as designed, customers may have to wrestle with dramatic increases every year with no ability to offset a utility’s lower costs. What OCC does object to is excess utility profits at the expense of consumers.

As a final matter, OCC has heard it stated on more than one occasion that certain language in legislation is “not what is intended.” OCC has also heard representations of what is in the legislation, when it is simply not in the text.

First, the text of the legislation speaks for itself and what parties intended or represented about that language will not hold up in a court of law where the plain language will be subject to interpretation. If the text of the legislation is not what is intended, then it needs to be fixed.

Second, if someone represents something to be “in” the legislation, ask them to identify the text that states what they are representing. Many representations of what is in the bill or what the Commission may do are meaningless unless the language actually exists in the law to back up the claim. All of this points to ambiguity of currently proposed legislation and the need to clarify major portions.

Summary of OCC’s 10 Key Recommendations:

1. The competitive bid price (through the market rate option) should be compared against the electric security plan price (including estimates for cost increases), with the lowest cost option selected in order to protect customers.
2. The baseline from which costs will likely increase and could theoretically decrease should be reduced to reflect costs already paid by consumers as a matter of fairness and affordability. Customers should not be made to subsidize a utility’s excess profits.
3. Clarification is needed throughout the legislation wherever increases in rates are sought to ensure that there is full due process and a fair and reasonable opportunity to review filings, conduct discovery and prepare for litigation or negotiation. As necessary, requirements for staff reports and audits should also be included.
4. The legislature should remove the windfall regulatory transition payments that act like a tax so that customers can put their hard-earned money to better use to buy food and pay for housing and medical needs.

5. Provisions allowing for automatic increases which amount to single-issue ratemaking should be removed in order to ensure that rates are prudent, just and reasonable and that customers are not overpaying for their electric utility service as a whole.
6. A prudence standard which was removed from the version of the bill which passed the Senate should be reinserted in order to assure accountability from the utilities of costs to be borne by captive ratepayers.
7. Without a clear review of all the subsidies contained in the secret contracts from the standpoint of whether every industrial recipient still needs or deserves the discount; what the cost is, in aggregate, for all these secret contracts; and, what impact socializing these industrial subsidies would have on working families in terms of affordability and the ability to avoid utility service disconnection, the subsidies should be removed.
8. In order to enable customers to switch to potentially lower retail rates in the competitive market or pursue distributed generation options, the entire generation rate needs to be bypassable so that the market rate is on the same footing as the utility's generation rate for comparison purposes and so that customers can have an exit strategy from high electric security plan rates.
9. Increases in rates for infrastructure modernization should be considered as an increase to existing rates and be subject to a full rate case process.
10. A standard of review and criteria that the Commission must consider in rendering decisions is critical in order to afford all parties the right of redress before the Supreme Court of Ohio of any decision judged to be unjust or unreasonable. Moreover, serious consideration needs to be given to how much discretion is granted to the Commission. Policy decisions ought to be made by the legislature.

I thank this Committee for the opportunity to testify and for its careful and thoughtful consideration of this legislation. Much work needs to be done to this proposed legislation in order to provide consumer protections and prevent runaway rates that will impose severe hardship to many residential customers. I urge you to restore balance and protect the small customers. I am ready to answer your questions.

House Public Utilities Committee Substitute Senate Bill 221

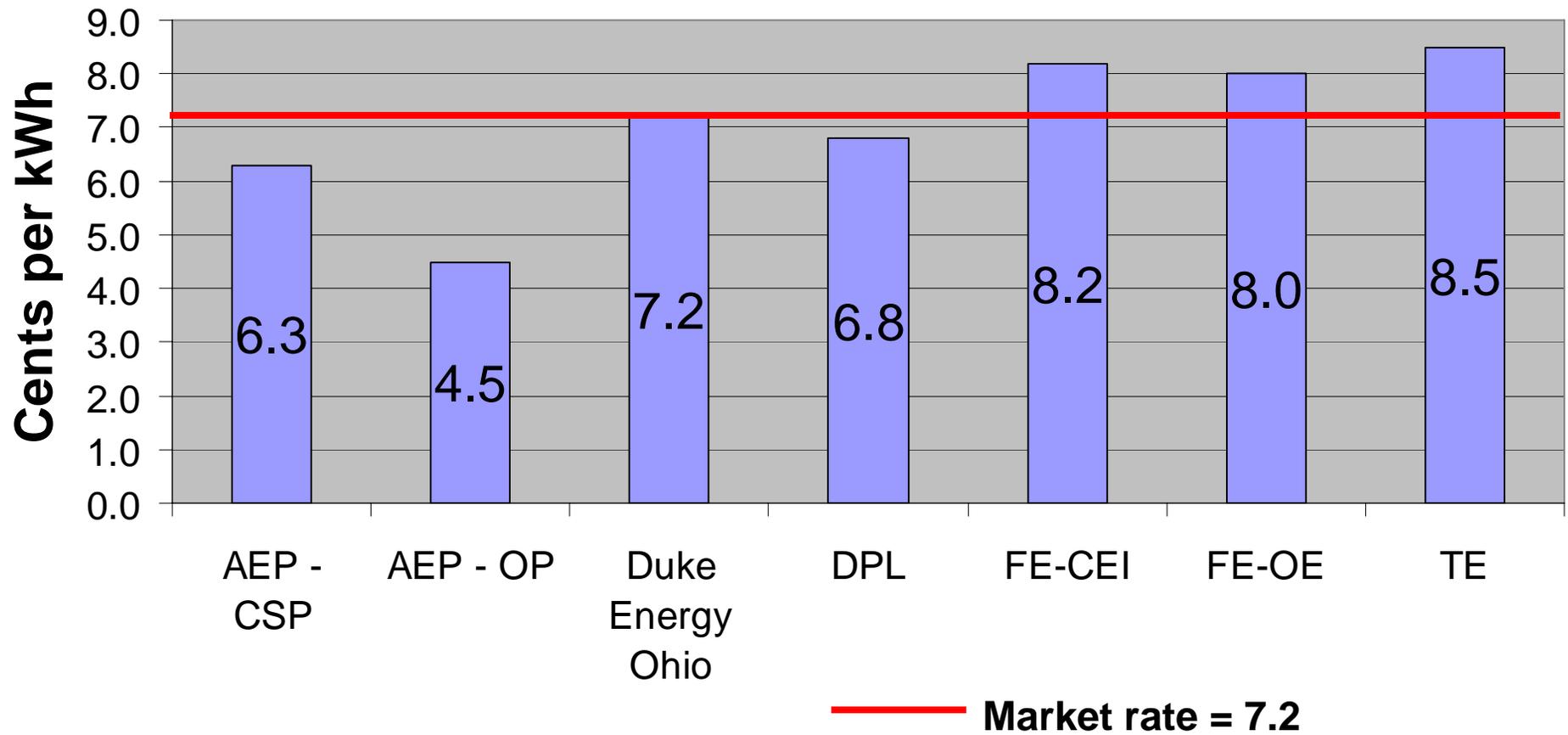
Prepared by:

Janine Migden-Ostrander
Consumers' Counsel
November 28, 2007

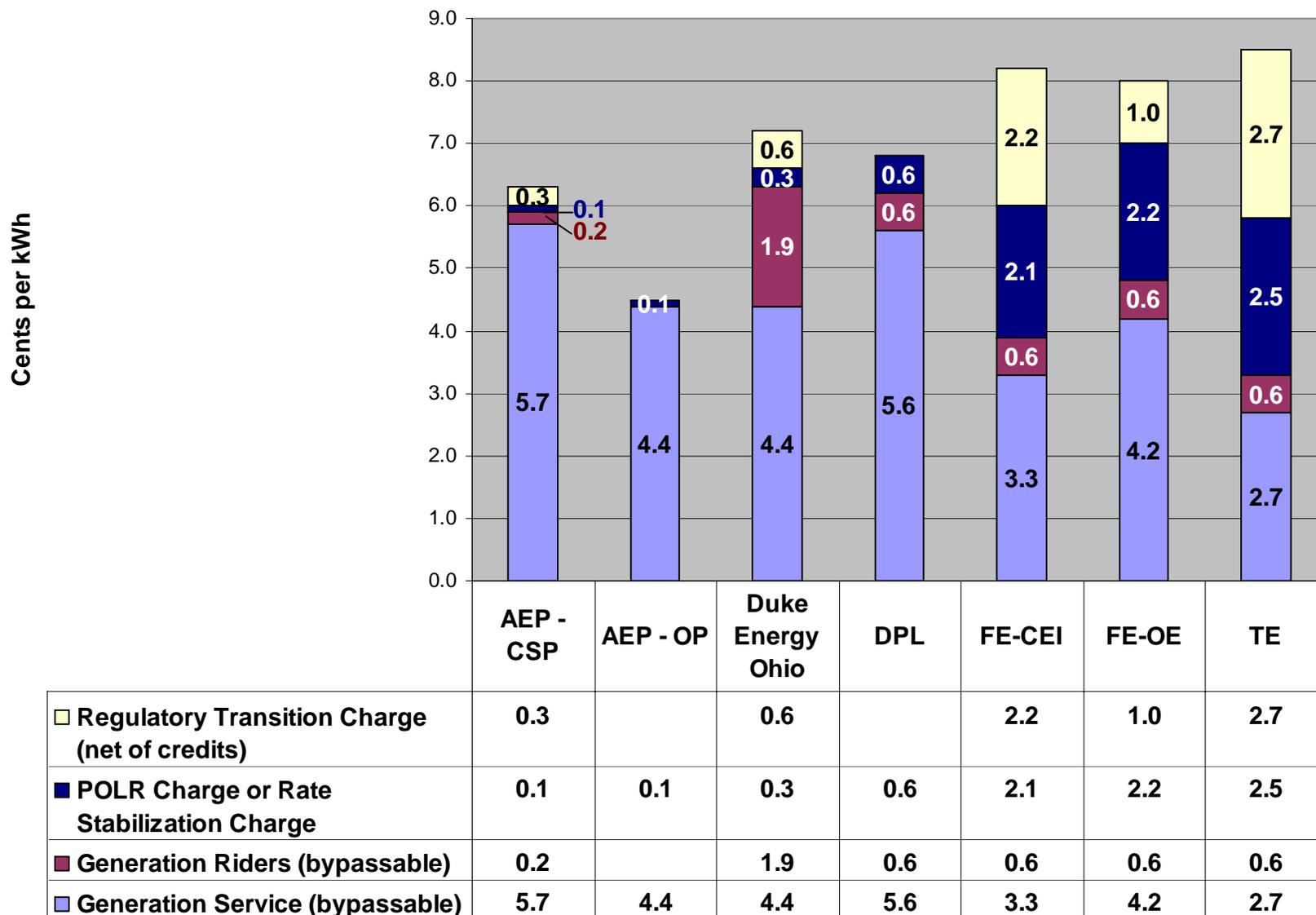


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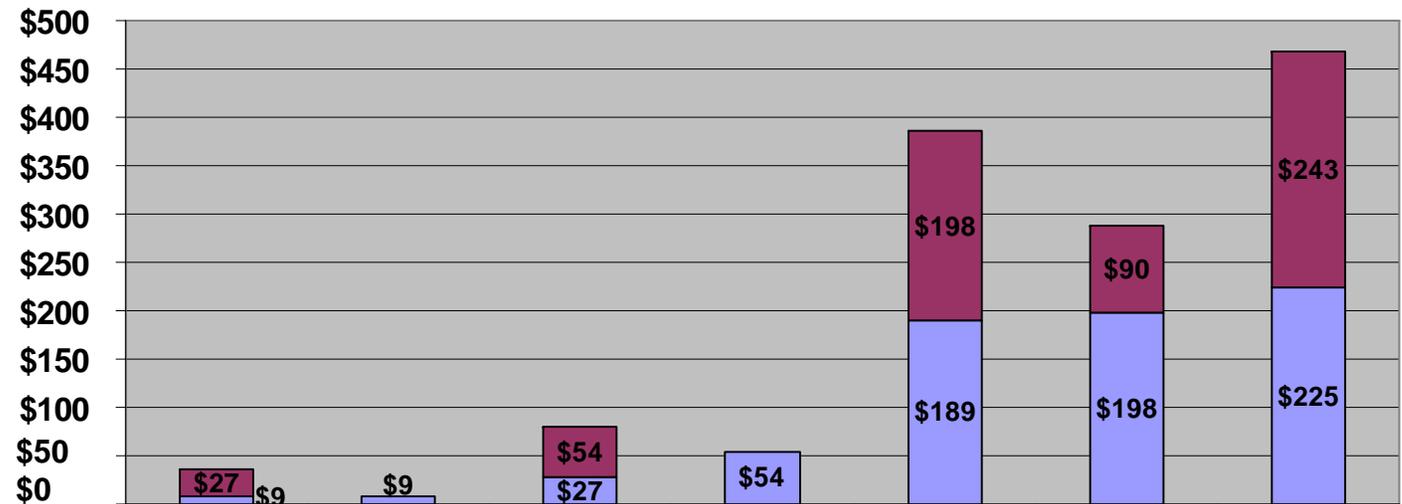
Estimated Generation Related Average Rates: Summer 2008



Estimated Generation Related Average Rates: Summer 2008 By Component

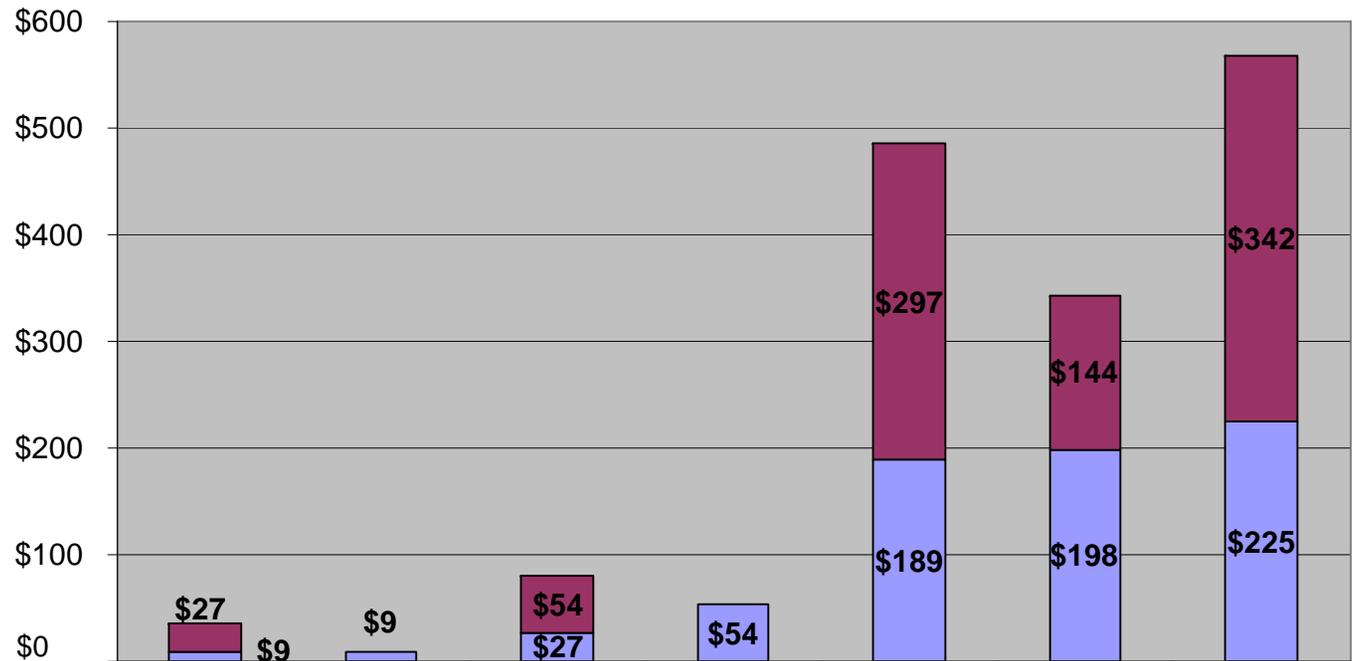


Annual Residential Impact of (1) Regulatory Transition Charges (net of credits) and (2) Rate Stabilization or POLR Charges



	AEP - CSP	AEP - OP	Duke Energy Ohio	DPL	FE-CEI	FE-OE	TE
■ Regulatory Transition Charge (net of credits)	\$27		\$54		\$198	\$90	\$243
■ POLR Charge or Rate Stabilization Charge	\$9	\$9	\$27	\$54	\$189	\$198	\$225

Annual Residential Impact of (1) Regulatory Transition Charge (without credits) and (2) Rate Stabilization or POLR Charges



	AEP - CSP	AEP - OP	Duke Energy Ohio	DPL	FE-CEI	FE-OE	TE
Regulatory Transition Charge (net of credits)	\$27		\$54		\$297	\$144	\$342
POLR Charge or Rate Stabilization Charge	\$9	\$9	\$27	\$54	\$189	\$198	\$225

Issue Ratemaking

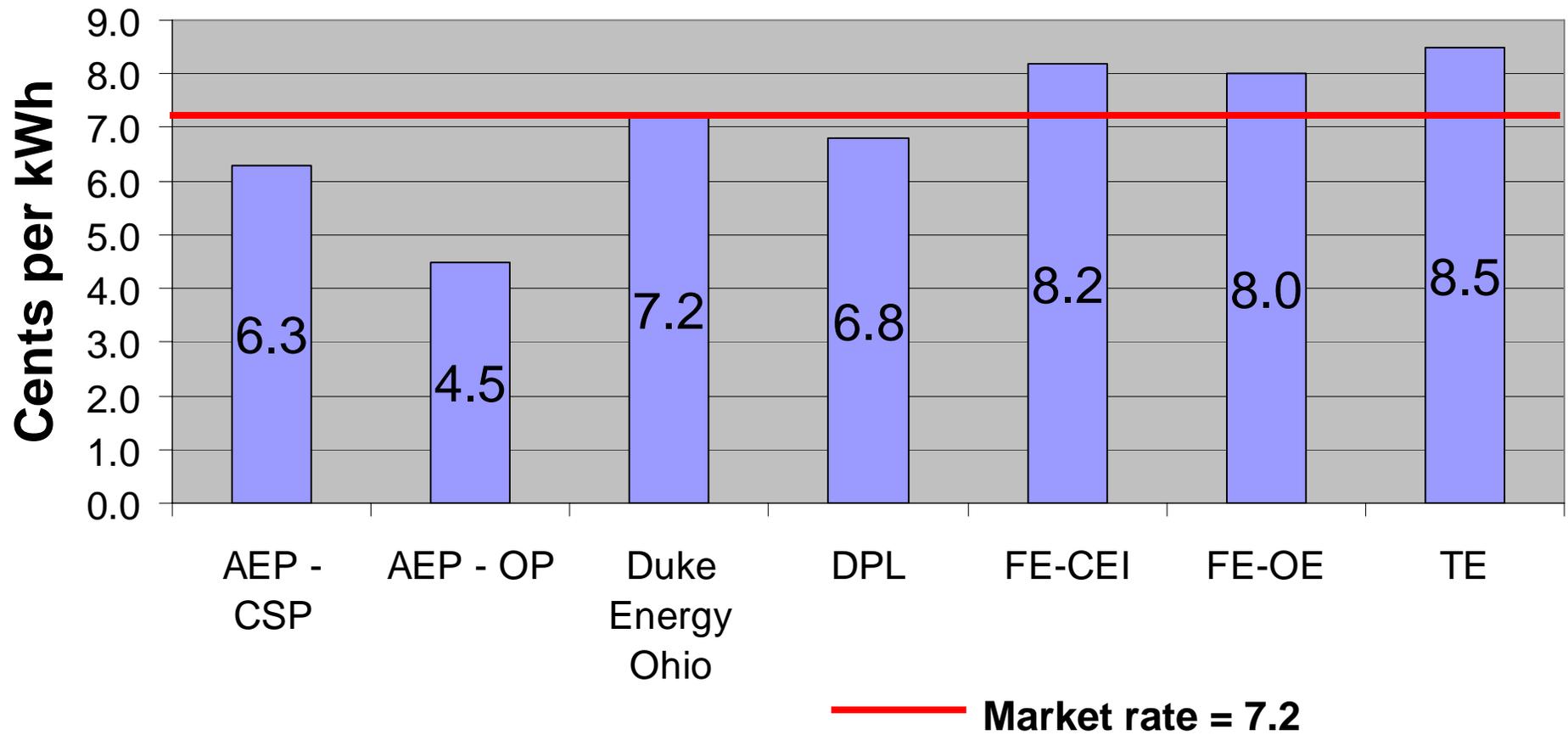
Including, but not limited to:

- Environmental Costs
- Fuel Costs
- Operating, maintenance, & other costs including taxes
- Cost of investment in specified generation
- Cost of providing standby & default service
- Infrastructure modernization



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Estimated Generation Related Average Rates: Summer 2008



Summary of OCC's Recommendations

1. There should be a required comparison between the electric security plan price and the market rate option.
2. The baseline of the RSP is too high and results in customers repaying for costs already recovered by the utility.



Summary of OCC's Recommendations

3. Consumers need a fair process with ample time to prepare.
4. Customers should not continue paying for the RTC.



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Summary of OCC's Recommendations

5. There should be no automatic rate increases.
6. We need a prudence standard to assure accountability.



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Summary of OCC's Recommendations

7. Subsidies to large customers at the expense of small customers should not be permitted.
8. Customers who switch should only pay their electric utility for transmission and distribution. The generation rate should be 100% bypassable.

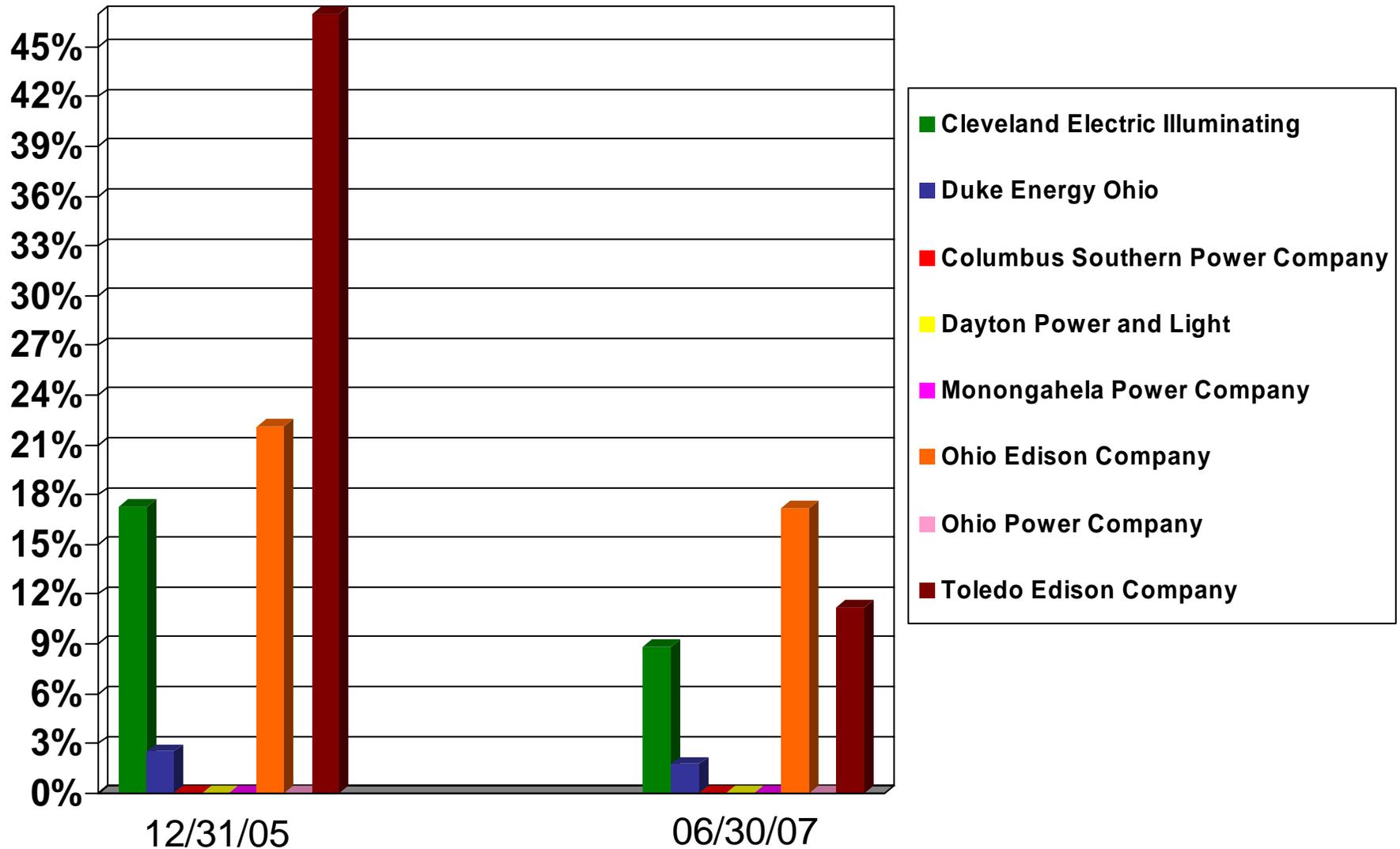


Summary of OCC's Recommendations

9. No rate increase for infrastructure modernization should be permitted without a full rate case review by the Commission.
10. The legislature should establish criteria that the Commission must consider in rendering a decision.



Summary of Switch Rates from EDUs to CRES Providers in Terms of Customers



Duke Energy Ohio: Residential Generation Rates Under the RSP Compared to December 2005

