Individual Electric Utilities' Rate History and Rate Plans[1]

February 2014[2]

A Bit of Generalizing

The details in this year's edition of this summary of electric rate activity yield some general observations. Since last year's conference, wholesale electric prices have remained relatively low and have not exhibited much volatility (outside the recent period associated with the "Polar Vortex").

The results in the wholesale electric market have been influenced by a number of things including the shale play related downward movement in natural gas prices and slow recovery of the economy. Also since last year's energy conference, there has been greater use of a competitive bidding process ("CBP") to set default generation supply prices for retail customers not served by a competitive supplier. Where the CBP has been used for this purpose, the trend in the default electric supply price has followed the trend of wholesale prices. So, the default generation supply prices for retail customers of the FirstEnergy Corp. ("FirstEnergy") electric distribution utilities ("EDU") and of Duke Energy Ohio, Inc. ("DE-Ohio") declined or remained stable accordingly. For other electric consumers in Ohio, however, electric prices and bills have gone up or stayed at levels significantly above market largely as a result of reliance on "administratively determined" prices and actions by the Public Utilities Commission of Ohio ("PUCO" or "Commission"). In the cases of AEP-Ohio[3] and The Dayton Power and Light Company ("DP&L"), which serve customers in over 60 of the 88 counties in Ohio, the PUCO's actions sanctioned higher and more volatile prices accompanied by "now and later" non-bypassable barriers to the benefits otherwise available through "customer choice."

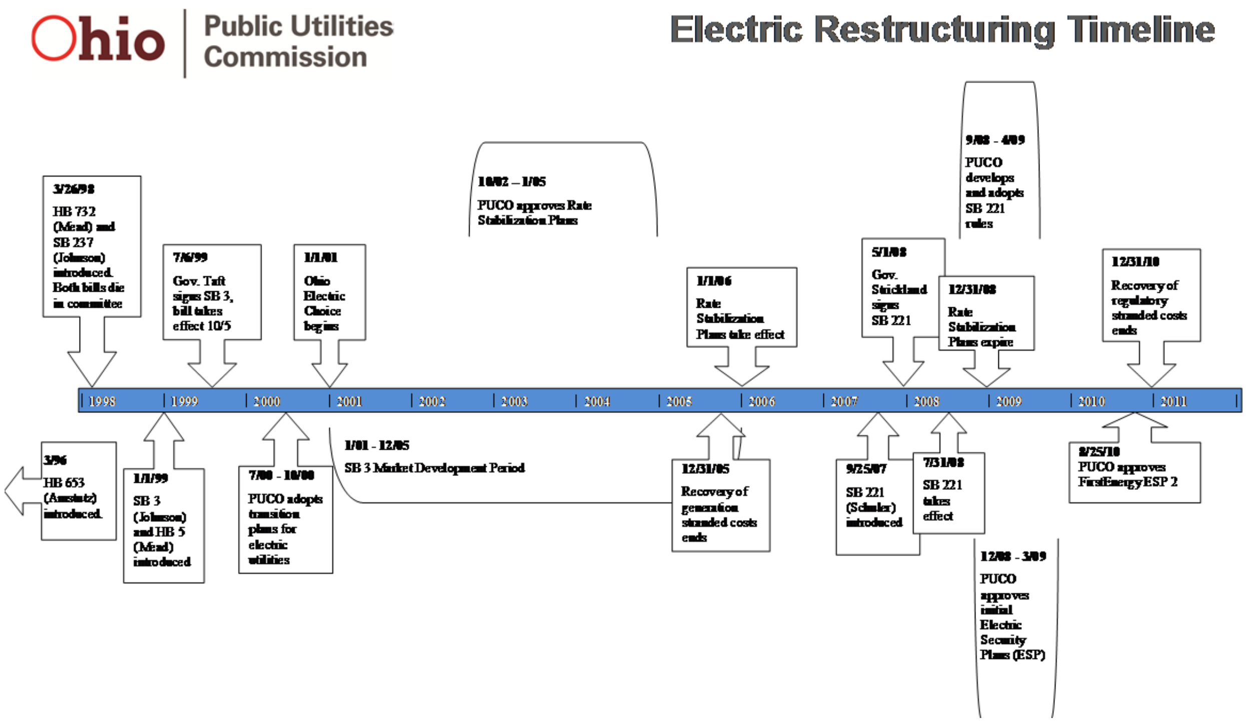
When Ohio changed the legal framework applicable to the electric utility sector to implement a "customer choice" vision, it provided an opportunity for incumbent electric utilities to obtain "transition revenue" (sometimes called "stranded costs") to help them

[1] The law firm of McNees Wallace & Nurick LLC ("MWN") prepared this document to chronicle the evolution of Ohio's approach to the regulation of investor-owned electric utilities. It is MWN's hope that the information assembled in this report will facilitate efforts to obtain price and service quality outcomes that are customer-driven. This report and the activities we undertake on behalf of Ohio businesses are made possible thanks to the efforts of Kevin Murray, Executive Director of the Industrial Energy Users-Ohio, Debbie Ryan, Vicki Leach-Payne, Karen Bowman, Renee Gannon, Ed Hess, Joe Bowser, Matt Pritchard, Joe Oliker, Frank Darr and Scott Elisar, with assistance from Don Pesich, John McGough and Charles Willoughby.

[2] Author's Note – Information on the status of any PUCO case identified herein can be obtained *via* the PUCO's website using the menu item for the PUCO's Docketing Information System ("DIS") at http://dis.puc.state.oh.us/ by inserting the case number in the "Case Lookup" box.

[3] As used herein, AEP-Ohio refers to Ohio Power Company ("OP"), which has merged with Columbus Southern Power Company ("CSP").

prepare to compete based on merit. Below is an illustration from testimony presented by the PUCO to the Ohio House Public Utilities Committee on September 29, 2011.[4] The illustration shows the transitional electric restructuring timeline established by Ohio law.



The PUCO's timeline clearly indicates that the opportunity for incumbent utilities to recover generation "stranded costs" ended effective December 31, 2005. And, Ohio law states that once this opportunity ends, the generation business of each incumbent electric utility must be fully on its own in the competitive market.

But, neither the obvious implications of the above timeline nor the pronouncements of Ohio law have retarded the appetite of some incumbent electric utilities for yet another transition and more "transition revenue." For example, AEP-Ohio (the entity remaining from the merger of OP and CSP) has, since January 2011, prosecuted a successful campaign before the PUCO to insulate its competitive generation business from the discipline of the market and block customer access to the lower electric bills available from such market. AEP-Ohio's success at the PUCO inspired DP&L to file a "copycat" application with the PUCO which the PUCO approved, over the objections of all other parties, in 2013. DE-Ohio also has a "copycat" application seeking nine-figure, above-market, non-bypassable charges that DE-Ohio claims it must be paid based on the PUCO's decision in the AEP-Ohio cases.

The actions already taken by the PUCO in the AEP-Ohio and DP&L cases and their implications as they relate to the proposal by DE-Ohio effectively result in well over $2

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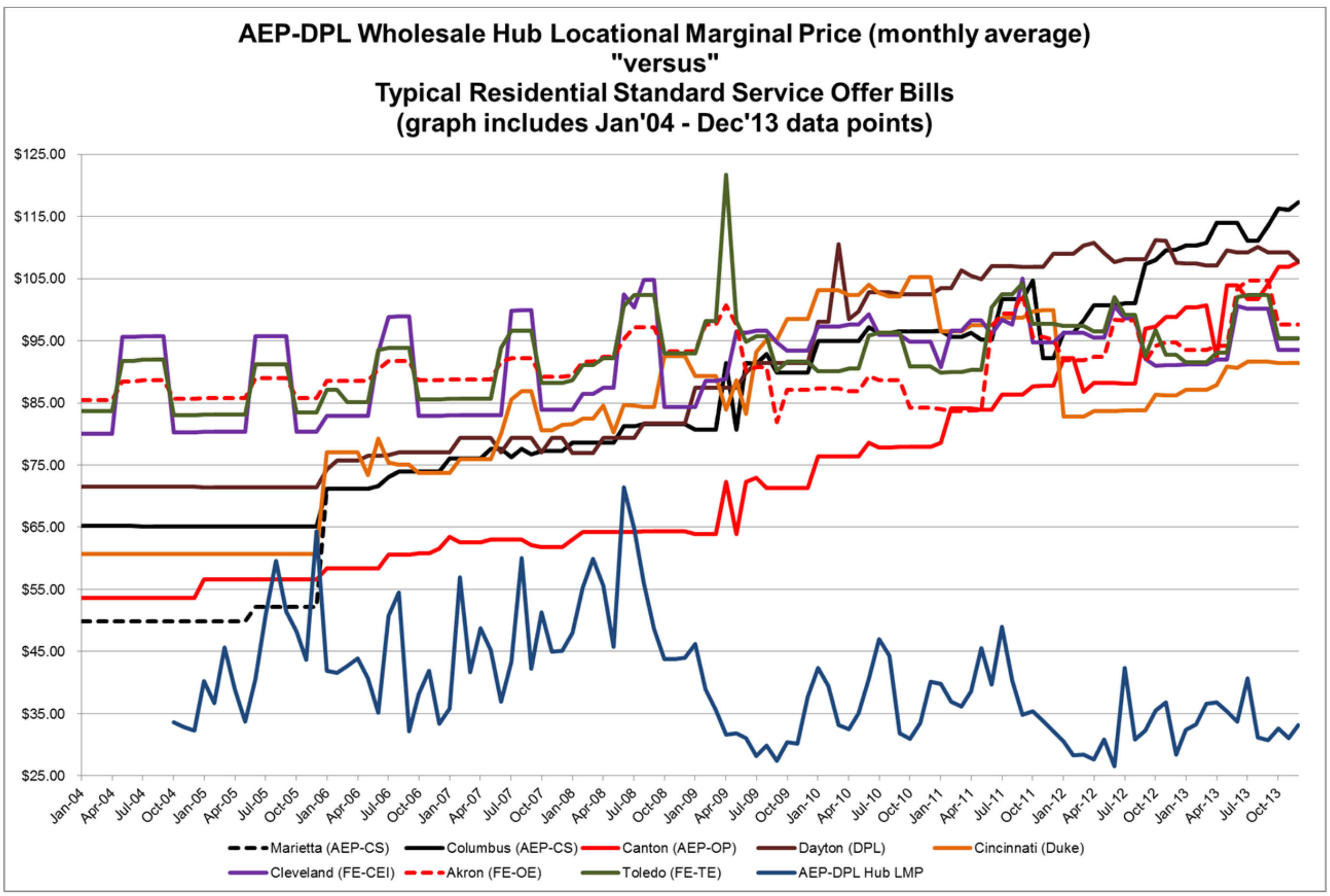
[4] The slides from the PUCO's September 29, 2011 presentation are available *via* the Internet at http://www.puco.ohio.gov/puco/index.cfm/consumer-information/consumer-topics/legislative-testimony/ (last checked February 10, 2014).

billion in above-market compensation for the incumbents' competitive generation business. This above-market compensation is provided through a confusing array of non-bypassable charges that work to increase the total bill for electricity while depriving customers of the full "choice" opportunity to reduce their electric bills by turning to a competitive retail electric service ("CRES") provider.

From a customers' perspective, there is something wrong with this picture. But this picture is the current reality for most of Ohio's electric consumers. Because of the electricity intensity of Ormet Primary Aluminum Corp. ("Ormet"), the anticompetitive and anti-consumer consequences of these PUCO decisions caused Ormet to "tap out" soon after the above-market prejudice arrived in Ormet's electric bill. While the Ormet situation has generated a lot of finger pointing, the erosive force of the PUCO-enabled electricity penalty on Ohio's economy continues to undercut Ohio's ability to compete successfully in our global economy.

The up/down conflicts in the default service retail electricity pricing trend lines have become more observable since last year's energy conference. These same conflicts have also caused the relative position of the default supply prices of Ohio's EDUs to change substantially.

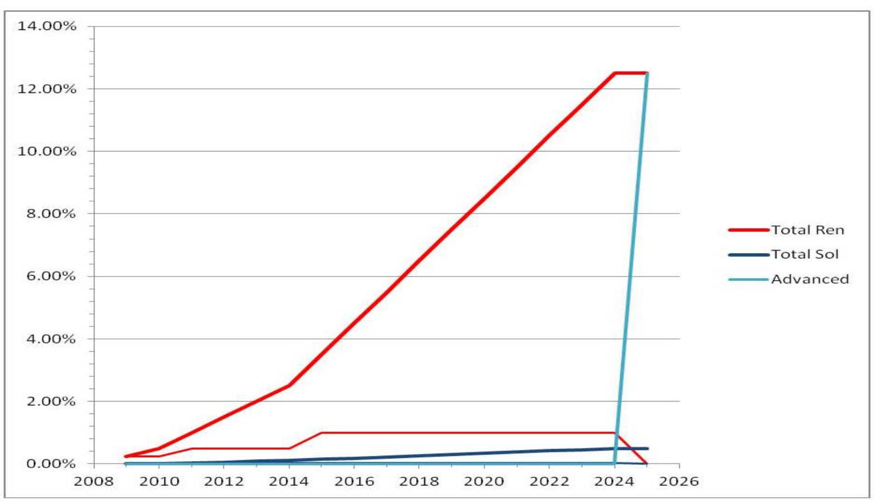


Contrary to the situation that existed when Ohio's law was changed to provide consumers with the opportunity to select their electricity supplier, customers in the distribution service area of AEP-Ohio now pay some of the highest electric bills in Ohio. The graph above shows the relative changes in the "typical" standard service offer ("SSO") electric bill for residential customers based on information published by the PUCO. And, this change in relative position of Ohio's EDUs can be traced directly to differences in the extent to which a CBP is used ***or not used*** to set default supply prices and the extent to which the PUCO has approved above-market, non-bypassable generation related charges. The above graph also shows a wholesale electric price trend line for the AEP-DPL zone to illustrate the disconnect between retail electric prices in Ohio and the "market-based" wholesale prices relevant to much of Ohio.

These real-world competitive bidding results are very different than the rate shock predictions that some stakeholders and elected officials associated with "competition" in 2007 and 2008. Instead of "competition" driving up electric bills, it is lowering electric bills. Indeed, the administratively determined prices that are the byproduct of the PUCO's current version of economic regulation are the source of the rate shock that has occurred over the last two years and will continue to occur at an escalating level in the years ahead unless the PUCO's decisions are overturned by the Ohio Supreme Court.

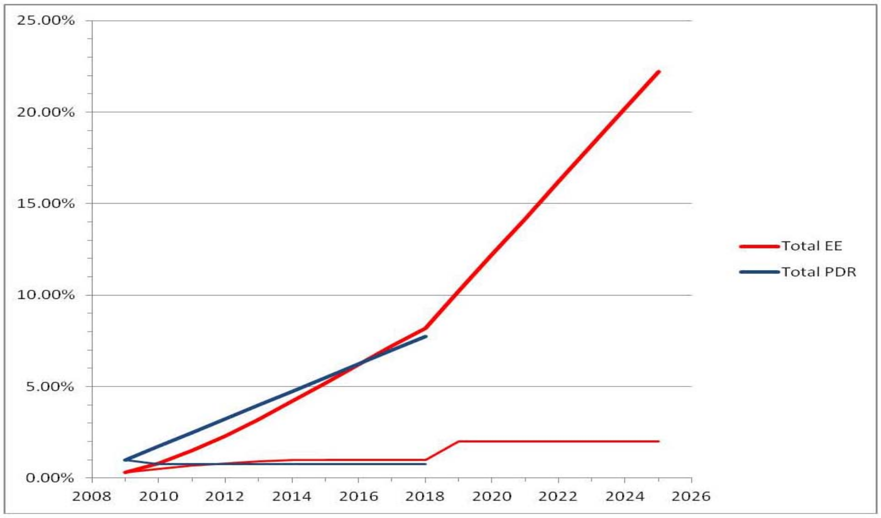
The same fundamental forces that have produced a decline in wholesale electric prices are also compelling an examination of government mandates that dictate supply-side and demand-side behavior of consumers and suppliers. Here again, 2008's expectations about what the future would bring stand in stark contrast to our current reality.

Advanced Energy Resources (including "Renewables" Mandate)[5]



[5] The two illustrations of the portfolio mandates are taken from the PUCO's materials associated with the September 29, 2011 presentation to the House Public Utilities Committee. The materials are available *via* the Internet at http://www.puco.ohio.gov/puco/index.cfm/consumer-information/consumer-topics/legislative-testimony/ (last checked February 10, 2014).

Energy Efficiency and Peak Demand Reduction Mandate



When the portfolio requirements were first proposed as part of the Ohio legislative process in 2007, the beneficial supply and price effects of shale resources were not anticipated. Conventional wisdom and expert opinion at the time held that our domestic natural gas supply was in sharp decline and that the Nation would be increasingly dependent on imported liquefied natural gas ("LNG") to reliably satisfy natural gas demand. The expected natural gas supply and price consequences of this pre-shale scenario manifested itself in projections of much higher and volatile electric prices. Domestic shale resources are now responsible for about 30% of the flowing gas supply, natural gas prices have declined significantly and policymakers are looking for ways to prudently develop and utilize this abundant non-conventional energy resource.

When the portfolio mandates were adopted, the debilitating effects of the Great Recession on Ohio's economy and its citizens were not anticipated. The conventional wisdom and expert opinions that existed in 2007 promoted the portfolio mandates as a means to help consumers by mitigating upward pressure on prices and managing reliability-related risks. Since utility charges tend to make up a larger portion of spending by lower-income consumers (a regressive effect), these risks took on added significance as the Great Recession ended many jobs and reduced incomes.

Current realities show that market forces have worked to reduce utility bills (where the PUCO has not authorized above-market "shopping taxes"). The cost of compliance with the portfolio mandates is actually either reducing the market-based advantage that would otherwise be flowing to consumers or increasing the above-market disadvantage imposed on customers by the PUCO's actions.

When the portfolio requirements were adopted, the amount of retail customer shopping for competitive electric services had declined and there were fears that the pace of electric market development was moving too slow to effectively serve the public interest in reasonable prices and reliable service. Now, about 62 percent of Ohio's retail customer load is "shopping" for competitive electric services and the use of competitive bidding to establish default service generation supply prices has (as discussed above) worked to significantly reduce electric bills for many more Ohio electric consumers.

When the portfolio requirements were placed into Ohio law, the owners of electric transmission assets in Ohio had effectively divided Ohio by their regional transmission organization ("RTO") choices with some participating in the Midcontinent Independent System Operator ("MISO") and some participating in PJM Interconnection, LLC ("PJM"). These different RTO choices created a commercial and reliability "seam" that ran through Ohio and complicated efforts to harness the beneficial effects of competition in the wholesale market to meet retail price and reliability objectives. Today, all of Ohio's transmission owning entities are within PJM's reliability control and function within PJM's organized supply-side and demand-side regional markets. Today, PJM effectively controls reliability and dispatches supply-side and demand-side resources throughout the PJM footprint, including Ohio, to maintain real time reliability. PJM also engages in planning required to identify and address future reliability-related challenges. PJM operates the Generation Attributes Tracking System ("GATS") to facilitate the issuance, assignment and trading of Renewable Energy Credits ("RECs") that are available under Ohio law (Section 4928.65, Revised Code).

In 2007 and 2008, proponents of the portfolio mandates asserted that the "Advanced Energy Resource" sector would not develop on its own in Ohio without government intervention that imposed arbitrary technology preferences and their cost on to consumers. Today the picture is very different. Since 2008, the General Assembly has authorized local government to establish a revolving loan fund to help property owners finance, among other things, alternative energy technologies, energy efficiency and demand reduction through capital markets.[6] Investment firms are actively engaged in providing financing for solar, wind, and energy efficiency projects. Goldman Sachs has a $40 billion target for such financing and investing.[7] Bloomberg New Energy Finance has indicated that Internet–based "crowdfunding" options may help to raise more than $90 billion in "clean energy" investment.[8] Danbury, Connecticut-based FuelCell Energy raised $34.5 million from a public stock offering in the first quarter of 2012.[9] In 2012 alone, voluntary choices by hundreds of Ohio citizens have produced over 33 megawatts ("MW") of new solar electricity generating capacity. On December 12, 2012, the American Wind Energy Association announced its support for a six-year phase-out of the federal tax credit, also called the production tax credit or PTC and suggested that the work ahead should focus on developing cost-saving technologies that make wind

[6] Section 717.25, Revised Code, became effective in June 2010.

[7] See the information at the following link http://www.goldmansachs.com/our-thinking/focus-on/clean-technology-and-renewables/index.html?mediaIndex=video1&cid=PS_01_28_06_00_00_00 (last visited February 10, 2014).

[8] "Crowdfunding allows early-stage companies, projects and artistic ventures in the U.S. to attract financing from the masses over the Internet and provides developing world microfinance initiatives a new avenue to secure capital." See information at the following link http://about.bnef.com/2012/06/18/extraordinary-popular-solution-funding-from-crowds/ (last visited February 10, 2014).

[9] See the information at the following link http://www.ctpost.com/news/article/FuelCell-Energy-stock-issuance-raises-34-5-3439449.php (last visited February 10, 2014).

competitive without government subsidies.[10] Meanwhile, Ohio's portfolio mandates are proceeding as though we are oblivious to the opportunity for market-based approaches to let consumers and investors act on their preferences without intervention by government mandates.[11]

In 2007 and 2008, the mercantile customer options in Ohio's portfolio mandates were expected to help utilities satisfy compliance requirements, reduce the cost of compliance, streamline compliance and also help Ohio's businesses reduce their energy intensity. The experience since the portfolio mandates became part of Ohio law includes: (1) repeated efforts by some stakeholders to bypass safeguards adopted by the General Assembly; (2) efforts to rewrite the law so as to increase the actual amount of compliance required; (3) audits in which the PUCO's "independent auditor" asserted that a utility should have refused to comply with the mandates because the penalty for non-compliance was less than the cost of compliance; (4) regulatory actions that have contributed to confusion regarding the amount of compliance that is required and how compliance should be measured; and, (5) an administrative burden for utilities that has essentially doubled the cost of compliance passed on to consumers. In some cases, some utilities have been permitted to charge consumers for "shared savings" and "lost revenues" and this has further increased the cost passed on to Ohio consumers.

While each of these examples of the mismatch between prior expectations and current portfolio mandate realities is significant in its own right, the year-to-year escalation of the compliance level specified by Ohio's portfolio requirements suggests that the combined effect of all these expectations/realities conflicts will, if not addressed, significantly distort the ability of the market to efficiently allocate resources and increase consumers' electric bills.[12]

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[10] See information at the following link http://www.greentechmedia.com/articles/read/Wind-Industry-Calls-for-6-Year-Phase-Out-of-PTC-Subsidy (last visited on February 10, 2014).

[11] See, for example, the recent report issued by the Center for Energy Policy and the Environment at the Manhattan Institute available *via* the Internet at http://www.manhattan-institute.org/pdf/eper_10.pdf (last visited February 10, 2014); *The Economic Impact of Missouri's Renewable Energy Standard*, The Beacon Hill Institute at Suffolk University available *via* the Internet at http://www.beaconhill.org/BHIStudies/RPS/MO-RPS-BHI-2012-1115.pdf (last visited February 10, 2014); the Heritage Foundation's list of failing or at-risk taxpayer energy ventures (34 companies, $7.5 billion and counting available *via* the Internet at http://blog.heritage.org/2012/10/18/president-obamas-taxpayer-backed-green-energy-failures/ (last visited February 10, 2014) and the Institute for Energy Research's recent study detailing the "rebound effect" (more efficient appliances promote increased energy use) of energy efficiency requirements available *via* the Internet at http://www.instituteforenergyresearch.org/wp-content/uploads/2012/07/NJI_IER_MichaelsStudy_WEB_20120706_v5.pdf (last visited February 10, 2014).

[12] In some cases, the electric bill increases that have occurred as a consequence of the portfolio mandates have come about indirectly through the interplay between the portfolio requirements and utility proposals to increase prices and erect barriers to customer choice. For example, one utility has used its discretion and control over the energy efficiency program funding to reward a stakeholder for withdrawing opposition to the utility's request for above-market compensation for default generation supply service. We doubt that the General Assembly intended that utilities would be able to use the portfolio mandates to exercise this type of power.

Portfolios, properly formed, are a means to prudently and cost-effectively manage risk. Prudent energy portfolio designers and managers continuously evaluate their choices in light of current realities and expectations about the future to make sure that their choices are managing the right risks, avoiding unnecessary government intervention and avoiding involuntary transfers of consumers' wealth through the revenue collection capabilities of utilities.

For the reasons described above, we have previously suggested that it would be prudent for Ohio to promptly initiate a review of Ohio's mandatory portfolio requirements. The mismatch between past expectations and current realities indicates that the current portfolio mandates are not a sustainable means of advancing the public interest in reasonable prices and reliable service. And recent events indicate that this needed review is about to commence.

On February 1, 2013, Senator William J. Seitz, Chair of the Ohio Senate's Public Utilities Committee announced that a "placeholder" bill would be introduced to "…begin a meaningful review of the energy efficiency and renewable portfolio standard…". While sensible reform of Ohio's mandates was strongly supported by hundreds of businesses, business organizations and labor groups, 2013 ended like it began. There was no vote on any legislation introduced to reform the mandates. In part, the lack of meaningful action can be traced to the efforts of the Ohio Manufacturers' Association ("OMA") to block **any** reform notwithstanding the OMA's findings that Ohio's mandates are hurting Ohio's larger manufacturers.

The OMA's success (and the mandate penalty inflicted on its members) rests mainly on its claim that the current mandates are working to suppress wholesale electric prices and that this suppression effect is flowing into retail electric prices on a dollar-for-dollar basis. The above graph showing the retail electric prices in Ohio relative to what has happened in the wholesale electric market shows that the OMA's claim is contrary to what is actually happening in Ohio. But the mistakes made by the OMA go well beyond this fundamental error. Accordingly, the large and diverse group that is supporting sensible reform of Ohio's current portfolio mandates is pushing forward to secure passage of Senate Bill 58 and its counterpart in the House of Representatives, House Bill 302.

The success of the pro-reform effort will depend on how well more consumers are educated about the mandates and the fact that the mandates are increasing their electricity bills. To this end, the pro-reform coalition is launching a web-based mandate tax calculator that will allow all customers – residential, commercial and industrial – to easily identify how much their monthly electricity bill is being increased by the Ohio portfolio mandates. In addition, the pro-reform group is releasing a study that finds that the OMA's wholesale price suppression claim is contrary to both theory and reality. More specifically, the study shows that: (1) about 80% of any wholesale price suppression that may exist is actually being exported by Ohio to benefit customers that don't pay the Ohio mandate tax; and (2) the Ohio mandate tax requires Ohio customers to pay $5 to $10 to get $1 in any wholesale price suppression benefit that they might receive as a result of the Ohio mandates.

The new and bigger burdens which the PUCO has added to utility bills paid by consumers are not confined to electricity. In 2013 and on the natural gas side, the PUCO sanctioned a DE-Ohio proposal to make natural gas consumers responsible for environmental remediation expense associated with property that once hosted a long-ago obsolete manufactured gas process. As a result of this PUCO precedent-breaking decision, natural gas consumers served by DE-Ohio will pick up a tab of about $60 million in remediation expense associated with property that has nothing to do with the natural gas distribution service these consumers receive from DE-Ohio.

Historically, the business and financial risk and reward associated with non-utility property or lines of business have been reserved for utility owners (shareholders). The PUCO's decision in the DE-Ohio case effectively places the business and financial risk on natural gas consumers while preserving any reward (proceeds from the sale of the property, for example) for the utility owners.

As in the case of the PUCO's AEP-Ohio decisions, it is reasonable to expect that the PUCO's DE-Ohio decision will result in other utilities asking the PUCO to do to their customers what the PUCO has already done to DE-Ohio's customers. For this and other reasons, the Ohio Supreme Court will be asked to overturn the PUCO's decision.

During 2013, the General Assembly attempted to change Ohio law and give the PUCO authority to require consumers to foot the bill for remediation expense. The effort fell short because Governor Kasich vetoed the measure. However, there appears to be a renewed effort to pass the same or similar legislation in 2014.

The rest of this report is located on the Manufacturers' Education Council's website at: www.mecseminars.com.