



**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Commission                    )  
Investigation of the Financial Condition        )    Case No. 02-2627-AU-COI  
of Ohio’s Regulated Public Utilities.            )

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**COMMENTS OF THE  
INDUSTRIAL ENERGY USERS-OHIO**

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On October 10, 2002, the Public Utilities Commission of Ohio (“Commission”) issued an Entry initiating this proceeding and requesting comments and suggestions. More specifically, the Entry solicits input on the type of information the Commission should seek to limit the exposure of regulated entities from the adverse consequences of unregulated parent or affiliated company operations. The Industrial Energy Users-Ohio (“IEU-Ohio”) offers the following comments and suggestions for the Commission’s consideration.

As noted below, IEU-Ohio’s comments are predicated on the explicit assumption that utilities regulated by the Commission will continue to be provided with an opportunity to secure reasonable compensation for the goods and services consumed by the public. As IEU-Ohio understands the October 10, 2002 Entry, the Commission is interested in suggestions on how it can better ensure that the cash flow and other value derived by a regulated entity is applied to satisfy the obligations of the regulated firm and that the regulated firm’s access to capital or credit is not compromised by related firms or its parent company.

## Unfortunately, We Have Been Here Before

During his presidential campaign in 1932, Franklin Delano Roosevelt (“FDR”) spoke often of the disconnection between the performance of private electric utilities and the public interest. In a Portland, Oregon speech on September 21, 1932, he stated:<sup>1</sup>

Speaking in the language of the Navy, with which I was associated for many eventful years, I want at the outset of this discussion to take my bearings, to know my destination, to chart my course. In discussing electrical power, the speaker, like a ship sailing in dangerous waters, must avoid not only unseen shoals and rocky reefs, he must also be on his guard against false lights on the shore. His only protection against all of these dangers is to set squarely and fairly before him the course that he must steer.

He went on to describe the common law’s concept of a public utility (quoting Lord Hale<sup>2</sup>) and society’s search for a means to assure that services were “... satisfactory and cheap enough while ... making possible safe investment of private capital.” President Roosevelt described the “... subtle, deliberate and unprincipled campaign ...” of “misinformation,” “propaganda” and “lies and falsehoods” “... bought and paid for by certain great private utility corporations” and his commitment to returning government to its position as a regulator driven proactively by the public interest.

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<sup>1</sup> Reprinted in *The Public Papers and Addresses of Franklin D. Roosevelt*, Vol. 1, 1928-32 (New York City: Random House, 1938), p. 727. The speech is available via the Internet at <http://newdeal.feri.org/texts/60.htm>. The speech will be referred to as the Portland Speech for the balance of IEU-Ohio’s comments.

<sup>2</sup> “The greed and avarice of some of the ferry-boat owners were made known by an outraged people to the King himself, and he invited his great judge, Lord Hale [Sir Mathew Hale], to advise him. The old law Lord replied that the ferrymen’s business was quite different from other business, that the ferry business was, in fact, vested with a public character, that to charge excessive rates was to set up obstacles to public use, and that the rendering of good service was a necessary and public responsibility. ‘Every ferry’ said Lord Hale, ‘ought to be under a public regulation, to-wit: that it give attendance at due time, keep a boat in due order, and take but a reasonable toll.’” *Id.*

The views of President Roosevelt,<sup>3</sup> right or wrong, help to highlight the nature, duration and scope of the provocation required before government will rise to the challenges presented by businesses affected with the public interest. The present circumstances suggest that government has again escalated its inquiries in reaction to problems that obviously offend the public interest.

One of the things we might hope to learn here is that when typically reactive government agencies announce efforts to address problems similar to those identified in the Commission's Entry, it is generally an indication that the industry's public interest battery has run dangerously low perhaps with assistance from a government that has failed to notice the warning signs. When this battery runs low, there is greater potential for a mismatch between the performance of "great private utility corporations" and the evolving public interest. The mismatch makes reconciliation difficult. Implicit in the efforts of the Commission in this proceeding and other state and federal regulators working on numerous fronts are questions about how the public interest can be better served.

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<sup>3</sup> In the Portland Speech, FDR described his findings upon becoming Governor of the State of New York:

When I became Governor, I found the Public Service Commission of the State of New York had adopted the unwarranted and unsound view that its sole function was to act as an arbitrator or a court of some kind between the public on one side and the utility corporations on the other. I thereupon laid down a principle which created horror and havoc among the Insulls and other magnates of that type. I declared that the Public Service Commission is not a mere judicial body to act solely as an umpire between complaining consumer or the complaining investor on the one hand, and the great public utility system on the other hand. I declared that, as agent of the Legislature, the Public Utility Commission had, and has, a definitely delegated authority and duty to act as the agent of the public themselves; that it is not the mere arbitrator as between the people and the public utilities, but was created for the purpose of seeing that public utilities do two things: first give adequate service; second, charge reasonable rates; that, in performing this function, it must act as agent of the public, upon its own initiative as well upon petition, to investigate the acts of public utilities relative to service and rates, and to enforce adequate service and reasonable rates.

The business and financial missteps of energy and communications firms have added significantly to the growing lack of public confidence in corporate America.<sup>4</sup> The broad public impact of communications and energy industry failures mean that their misdeeds often have broader implications. The recent accident or crime scene statistics have legendary proportions. Retirement accounts and public pension funds balances show the scars of unfortunate corporate preferences for being overleveraged, betting on the success of high growth illusions, entering businesses without sufficient core competence often in foreign lands and misreading market trends.<sup>5</sup> To make the mix more toxic, the opportunity for early warning and intervention was compromised by accounting ‘mumbo jumbo’ fed to oblivious guard dogs serving in the roles of “independent” board members, audit committees, “independent” accounting firms, investment analysts on Wall Street and Main Street, fund managers, shareholders, and state and federal<sup>6</sup> regulatory authorities charged with the duty to promote the public interest.

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<sup>4</sup> According to Gallop Poll results released in July 2002, 23% of the U.S. population believes that corporate CEOs can be trusted while 73% believe that you can’t be too careful when dealing with CEOs. The poll indicated that public confidence in CEOs has fallen below the level for lawyers and stockbrokers while remaining just above HMO managers. Car dealers ranked lowest while teachers ranked highest. See, <http://www.gallup.com/poll/releases/pr020717.asp>.

<sup>5</sup> See *What Really Ails US Power Companies*, Cambridge Energy Research Associates Discussion Brief (November 2002).

<sup>6</sup> About two years ago, the Securities and Exchange Commission (“SEC”) issued a controversial regulation mandating fair corporate disclosure (called regulation FD). Some observers believe that compliance with this regulation in conjunction with the efforts of an awakened SEC and very unhappy shareholders have helped to address selective disclosure practices. As a positive side effect of regulation FD, investment analysts may no longer be able to rely on selectively disclosed information thereby becoming more dependent on gaining insight from discussions with a firm’s suppliers, competitors and, last but not least, customers. The regulation may affect the opportunity for utilities to provide the Commission with material, non-public information in a private setting. The recently enacted Sarbanes-Oxley corporate reform bill may have removed the opportunity for corporations to comply with regulation FD by simply saying nothing to anybody. It reads in part: “Each issuer ... shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer ...”. Timely disclosure of material information should help the Commission identify trends that may increase customers’ risks. It will also better equip shareholders to protect their interests.

To be clear, IEU-Ohio is not suggesting that all or even most regulated firms, their affiliates and parents have crossed the line of acceptable behavior. Thankfully, the eligible Ohio candidates for membership in the public interest-challenged population appear to be few. In this context, IEU-Ohio also urges the Commission to not escalate regulation simply to escalate regulation. Most businesses, utilities included, have quite enough rules and regulations to comply with at the moment and the warranted fear generated by the above-mentioned misdeeds has already exerted a powerful influence on corporate America.

In the wake of so many unfortunate consequences, there is a risk that rightfully agitated and perhaps outraged branches of government will lunge at the problems more highly motivated because the events occurred on their watch. There is, perhaps, a greater risk that the separate branches at the state and federal level will proceed independently of each other adding the cost of duplication and inefficient jurisdictional conflicts to the public's invoice. As the Commission proceeds with its evaluation, IEU-Ohio urges the Commission to not cast its net so wide that it acts to discourage or frustrate those utilities that understand their public interest responsibilities as evidenced by their day-to-day behavior. As the Commission proceeds, IEU-Ohio urges the Commission to consider the information that is already available and the actions that are already underway at other state regulatory authorities, the SEC, the Federal Energy Regulatory Commission ("FERC") or the Federal Communications Commission ("FCC")

and to coordinate efforts with these agencies.<sup>7</sup> Transactions between related companies are the subject of much discussion on a number of fronts and it may be that through discussions with the SEC, FERC, FCC and other state commissions within the region, federal reporting requirements can be structured to provide data that will better permit the Commission to identify problems that may affect regulated family members resident in Ohio (and, of course, their customers). This type of coordination will also help to increase transparency, avoid pancaked and, perhaps, conflicting reporting requirements, reduce the risk of litigation over subject matter jurisdiction, and overcome selective disclosure problems.

### **Suggestion No 1 – Restate the Objective**

IEU-Ohio's first suggestion is designed to secure a restatement of the Commission's objective. The Commission's Entry seeks comments and suggestions for the purpose of protecting a regulated firm from the adverse consequences of the regulated firm's dysfunctional family. There is room to be concerned about these adverse consequences and perhaps some family counseling may be warranted. But, the Commission's first and highest priority should be to ensure that the price and service objectives of ultimate customers are not placed at risk by the acts or omissions of any regulated firms, their respective parent companies or affiliates. Stated in positive terms, the Commission's first and highest priority should be to ensure that the business,

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<sup>7</sup> There are also a number of organizations that have assembled to address issues related to the erosion of public confidence in corporate America. For example, the 12-member Conference Board Commission on Public Trust and Private Enterprise was formed to address widespread abuses, which led to recent corporate scandals and declining public trust in companies, their leaders and capital markets. This Commission is in the process of examining a number of issues including governance, compensation and auditing and issuing a series of best-practices guidelines. The Commission is co-chaired by Peter G. Peterson, Chairman of The Blackstone Group, former Secretary of Commerce and Chairman of the Federal Reserve Bank of New York, and John W. Snow, Chairman, CSX Corporation and former Chairman, Business Roundtable. Information on the Commission is available via the Internet at <http://www.conference-board.org>.

financial and cultural aspects of each regulated firm's capacity are predisposed to the timely satisfaction of the price and service objectives of ultimate customers.<sup>8</sup>

This suggested restatement of the Commission's expression of interest should be highly visible and made conspicuous by the Commission's prompt adoption. After all, this is the attitude mandated to the Commission by the Ohio General Assembly through the communications and energy policy statements in Sections 4927.02, 4928.02 and 4929.02, Ohio Revised Code. It is also the orientation that mimics that of a dynamically efficient market and the Commission should strive to be a good substitute for market forces where and when the market can or will not do the job directly.

### **Suggestion No. 2 – Plan to Address the Worst Case and Work Proactively to Produce the Best Case**

It is not clear if the last two years have provided us with revelations that warrant the establishment of new rules or if the parade of misfortune has made it more difficult to deny reality. It is clear that the administration and scope of the current system of checks and balances were not robust enough to prevent unconscionable abuse practiced on a wide scale. The understandable reaction by regulators, lawmakers, and insightful business leaders is to seek to rebalance the rules of the road to better manage the forward risk (in light of the images in the rear view mirror) and try to regain the confidence that is a necessary (not sufficient) condition for efficient markets.

IEU-Ohio suggests that the Commission assume, for planning purposes, that its rules perfectly applied will not be sufficient to prevent bad people from doing bad things. The above-suggested restatement of objective implicitly makes this assumption and shifts the emphasis to functional outcomes that are not dependent on any particular

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<sup>8</sup> At the risk of stating the obvious, this restatement of objective assumes that all regulated firms will be fairly compensated for their goods and services.



regulated firm, its affiliate or parent company. Management by the objectives useful to customers will preserve the flexibility of the Commission to address any bad apples, yet not make satisfaction of the objectives dependent on the cooperation, discretion or voluntary compliance of a particular firm. Doing things like establishing excellent service standards<sup>9</sup> rather than setting low expectations expressed in the form of minimum service standards will help to make the physical and service capability of the utility system useful to paying customers in any event.<sup>10</sup>

If the physical and service capability of the distribution network is useful to paying customers, it is more likely that the market will efficiently supply a caring regulated owner should there be a change in ownership (needed due to offense of public interest standards or otherwise). If the physical and service capability of the distribution network is being neglected and the Commission assists in making the condition visible by an objective measure, it is more likely that shareholders and the investment community will be able to protect their interests by confronting corporate managers with questions about behavior that is likely to erode the earning power of the firm's physical and human assets.

Focusing on the physical and service capability of utility infrastructure requires an inventory of current capabilities as well as forward-looking projections on what modifications are likely to be useful to meet the future needs of customers. Increasingly, this inventory requires integration across political boundaries as well as

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<sup>9</sup> As in the case of the Commission's minimum service standards, excellent service standards would be useful for benchmarking purposes. The suggestion is not intended to define the obligation to serve.

<sup>10</sup> Focusing on the service capability of utility networks may also provide the Commission with a better legal foundation and opportunity to reduce litigation risk as compared to an approach that depends on securing data to measure risks confronted by the regulated firm as a result of the demands of its affiliate or parent. The Commission's power to ensure that all utilities provide adequate services and facilities may be better and more reliably applied to promote the public interest.

industry sectors.<sup>11</sup> It also presupposes an ability to make good judgments about how the existing network architecture should be modified to allow these needs to be better met by new technology even where reliance on this new technology means that a legacy technology or particular firm relying on the legacy technology will fail. Care must be taken to guard against the risk that protection of the service and physical capability of utility infrastructure will be translated into uneconomic protection of uneconomic technology or suppliers.<sup>12</sup>

There is a subtle form of service quality erosion that comes from utilities that see their future as dependent on getting big quickly through acquisitions that involve payments of substantial premiums to book or as requiring a fundamental shift in market focus.<sup>13</sup> If the utility becomes overleveraged on the way to capturing its future and the future turns bleak, there is a risk that the utility will seek to enhance the margins from its cash producing retail business to address the financial demands of the market. Margins are improved in this context by such things as reducing capital programs devoted to retail market service, placing capital formation responsibilities more significantly on customers through modified line extension requirements that require customers to pay significant contributions in aid of construction to obtain service, reductions in human resources available to address service needs of ultimate customers, closing of local

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<sup>11</sup> For example, the electricity generation capacity recently added in the Midwest is mostly dependent on natural gas to commence and continue operations. To this point, Ohio's efforts to evaluate proposals to construct new generating plants and proposals to retire or transfer such facilities have not significantly considered the locational effects of these facilities on the price or availability of electricity and natural gas. At a minimum, these changes must be robustly evaluated to assess the potential effects on physical reliability of both natural gas and electric networks. This evaluation must be coordinated within the Midwest region to ensure that the full dynamic, cross-border effects of changes that impact the performance of the network are fully appreciated.

<sup>12</sup> The failure of telegraph and manufactured gas companies occurred because of the entry of telephone and electric companies and the new technology they sought to apply to meet the public's communication and lighting needs.

<sup>13</sup> A shift in market focus occurs, for example, when the utility seeks to disinvest in retail markets so that it can direct its resources to merchant, wholesale or trading activities.

offices, allowing service complaints to grow while denying a decline in service quality, seeking recovery of the same costs in multiple regulatory jurisdictions, curtailing service (through operational flow orders or interruptions) to enhance opportunities to put freed-up commodities into higher priced markets without a causal relationship between the curtailment and physical system risks, and demanding “incentives” from captive customers to do the things that regulated utilities are obligated to do in exchange for reasonable compensation.

A systemic cash extraction orientation and the subtle form of service erosion that follows are the early predictors of growing risk of higher prices, reduced service value and lower service quality for ultimate customers. These early predictors are observable in Ohio in specific utility cases from information that is readily available and frequently submitted to the Commission. To this point, the adverse real world regulatory consequences of engaging in practices designed to free-up regulated business cash so that it may be applied to other purposes is ambiguous at best. Where there are no adverse consequences for injurious but profitable behavior, the behavior is likely to continue. It appears that the challenge for the Commission may not be as much related to data collection as it is to data application.

Respectfully submitted,

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Samuel C. Randazzo, Esq.  
McNees Wallace & Nurick LLC  
21 East State Street, 17<sup>th</sup> Floor  
Columbus, OH 43215-4228  
(614) 719-2840 (Direct Dial)  
(614) 469-4653 (Facsimile)  
[srandazzo@mwncmh.com](mailto:srandazzo@mwncmh.com)

**General Counsel for Industrial Energy  
Users-Ohio**