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# **INDIVIDUAL ELECTRIC UTILITIES' RATE HISTORY AND RATE PLANS**

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# INDIVIDUAL ELECTRIC UTILITIES' RATE HISTORY AND RATE PLANS<sup>1</sup>

February 2017<sup>2</sup>

## **Do Not Forget About Restructuring Regulators (Federal, Regional, State & Local)**

This is the 21st year for this energy and customer-focused conference. Thanks to the hard work of the Manufacturers' Education Council ("MEC") and the energy conference planning group, this annual event is the best such conference in the Nation.

Each year, several hundred representatives of businesses, schools, local government, utilities and regulators, as well as other stakeholders, have assembled to improve our collective ability to act on opportunities and avoid problems.

When this conference started, Ohio had just adopted legislation that restructured the natural gas sector. Much of this restructuring work had been completed prior to the passage of this legislation as a result of reforms introduced by the PUCO to bring relief from natural gas supply shortages that were significantly harming Ohio. The gas restructuring legislation followed similar legislation focused on the communications sector where innovation and technology advances demanded change at the state and federal level. The effort to restructure the electricity sector loudly followed the reforms in the natural gas and communications sectors and implementing reforms in this sector continues to provide some very bumpy rides for the customers who were supposed to be better off as a result of the reforms.

There was and is a common origin to the reforms in the communications, natural gas and electricity sectors. In each case, courts, regulators or both looked at structure the of the then-existing network industry and concluded, without objection, that the vertically

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<sup>1</sup> 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 ("IEU-Ohio"), Debbie Ryan, Vicki Leach-Payne, Karen Bowman, Renee Gannon, Joe Bowser, Matt Pritchard, Frank Darr and Scott Elisar, with able assistance from John McGough. The views expressed herein are the views of the individual contributors to this report and not the views of IEU-Ohio or any other client which has been or will be represented by MWN.

<sup>2</sup> Author's Note – Information on the status of any Public Utilities Commission of Ohio ("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.

integrated industry structure was anticompetitive. More than anything else, initiatives directed at unbundling services and giving customers comparable and non-discriminatory access to non-competitive services and functions were part of the plan to remedy anticompetitive industry structures.

But many of the decisions that had to be made to remedy this unhealthy condition were left to regulators who were generally untrained in the science and art of transforming a vertically integrated industry structure so that the public interest might be served by effective competition. Too often, these regulators had become accustomed to completing tasks associated with implementing a static ratemaking formula. Too often, implementation of the tasks was disconnected from the purpose of economic regulation which is to “.. mimic a competitive market outcome, even when the underlying market is not competitive.”<sup>3</sup> The challenges of an aging regulatory workforce and inadequate attention to needed compensation levels and skill sets have also made it hard to replenish and improve the quality of the regulatory talent pool in ways that might allow regulators to better adapt to their new roles.

In years following the Civil War, railroads and communications technologies were very much the disruptive technologies of their day and our Nation and others seemed to wobble from one economic crisis to another. Many of the “panics” were a byproduct of corruption and government subsidies that resulted in uneconomic and unsustainable investment in railroads. There was no federal system of regulation so the states were left to their own devices.<sup>4</sup> And, because courts viewed railroads to be engaged in interstate commerce, they often ruled that the abusive and monopolistic practices of railroads were beyond the reach of states.

Nonetheless, state regulatory authorities were largely invented in the late 1800’s as a result of the abusive and monopolistic practices of railroads and other network industries. Ohio responded like many other states.

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<sup>3</sup> *Principles of Utility Corporate Finance*, Leonardo R. Giacchino, Ph.D. & Jonathan A. Lesser Ph.D., Public Utility Reports, Inc. 2011. In 1975, Bruce Mansfield, a witness testifying for Ohio’s electric utilities and a former CEO of Ohio Edison Company, described the purpose of economic regulation as follows: “... the process of fixing reasonable rates requires the application of standards which will substitute for free competition - methods which will assure that the service provided be adequate and satisfactory and permit the price to approximate that which would result from unrestrained, free competition.”

<sup>4</sup> Thanks mostly to the railroad troubles, the Interstate Commerce Act arrived in 1887. It was the first federal law regulating private industry in the United States and it created the Interstate Commerce Commission. The act required railroad rates to be “published” and to be “just and reasonable” (a throwback to the “common law”). It did not give government the authority to establish rates or compensation. Over the objections of “big business,” President Theodore Roosevelt led the charge to establish the first new executive department – the Department of Commerce and Labor – in February 1903. The Bureau of Corporations (becoming the Department of Commerce in 1913 and, in 1915, eventually becoming the Federal Trade Commission) was created within the Department of Commerce and Labor. The Bureau of Corporations mainly focused on monopolistic practices and functioned as an investigatory and reporting agency (much like Ohio’s Office of the Commissioner of Railroads and Telegraphs, created in 1867). In 1906, the Bureau of Corporations reported on the petroleum industry and made recommendations that were folded in to the Hepburn Act (1906); the Department of Justice used the Hepburn Act in 1911 to go after and break up Standard Oil.

In 1867, the Ohio General Assembly established the Office of the Commissioner of Railroads and Telegraphs (hereinafter referred to as the “Office”). There was one commissioner (two-year term) appointed by the Governor with the advice and consent of the Ohio Senate. The Office was a fact-finding agency for the Ohio General Assembly, providing reports to the General Assembly. In 1906, additional legislation (the Railroad Act) was enacted and the Office became the Railroad Commission - with three commissioners<sup>5</sup> and with authority to set reasonable and non-discriminatory rates. In 1911, the Ohio General Assembly established the Public Service Commission (“PSC”) to deal with public concerns resulting from the practices of gas, telephone, electric and water companies and to standardize accounting practices. In 1913, the PSC became the Public Utilities Commission of Ohio. <sup>6</sup>

It has been about 45 years since Ohio was the first state in the Nation to unbundle natural gas commodity supply, transmission and distribution services and give retail customers comparable and non-discriminatory access to delivery systems, irrespective of their choice of commodity supplier. While the Ohio General Assembly has bolted new Chapters of the Ohio Revised Code onto the portfolio of older laws delegating authority and imposing duties on the PUCO, decades have gone by without a serious look at how this authority and these duties need to be restructured to better serve the public interest.

The consequences of not undertaking a serious look at the structure, role and purposes of the PUCO are observable if you know where to look.

In the last seven years, there have been five different PUCO Chairmen. Each Chair arrived with individual preferences that have impacted the agency, promoted litigation or caused regulatory volatility.

While the PUCO is an agent of the Ohio General Assembly, it is increasingly run as though it is part of the Executive Branch.

Despite being directed by the Ohio General Assembly to do so in 2008, the Ohio Power Siting Board, a division of the PUCO, has failed to promulgate rules related to the siting of wind farms. In some areas of the state, local property owners are battling against well-funded wind farm developers. These local property owners increasingly feel as though the Ohio Power Siting Board is unwilling or incapable of addressing legitimate concerns.

In 2008, the Ohio General Assembly created the position of Federal Energy Advocate within the PUCO and charged the Federal Energy Advocate with the responsibility of

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<sup>5</sup> In the 1970’s, a period of energy supply shortages and large retail rate increases, the number of PUCO commissioners was expanded to five. Despite the significant restructuring in the communications, natural gas and electricity sectors in favor of market-based approaches that has occurred since the 1970’s and a shift in control from state to federal or regional control, the number of PUCO commissioners has remained at five.

<sup>6</sup> See <http://www.puco.ohio.gov/be-informed/consumer-topics/100-years-and-counting-the-history-of-the-puco/#sthash.c9xKNQy2.dpbs>, last visited February 15, 2017.

monitoring the activities of the Federal Energy Regulatory Commission (“FERC”) and other federal agencies and advocating on behalf of the interests of retail electric service customers in Ohio. Since 2008, various people have been appointed to this position but there has been little or no advocacy.

For a few years now, newspapers like the Columbus Dispatch have featured articles about residential customers and complaints of high utility bills received from “submetering” companies. Some of these customers have filed complaints at the PUCO alleging that the submetering company is a “public utility” that is violating the law by billing and collecting charges that have not been authorized by the PUCO. Rather than addressing the complaints through its traditional litigation process, the PUCO delayed the complaints so that it could conduct an investigation. The investigation remains incomplete. And even if it is completed, the issues raised in the complaints will remain unresolved.

We live and work in a market economy where the tugs and pulls of capitalism play essential roles. Instead of planning economic decisions through centralized political methods, as with socialism or feudalism, economic planning under capitalism occurs *via* decentralized and voluntary decisions made with due regard to the rule of law and property rights.

But, “...markets are economic systems that, unlike other kinds of systems, actually depend on confidence. They depend upon trust, they depend upon credibility, they depend on the quality of markets and how they work.”<sup>7</sup> And any regulation that may be capable of effectively mimicking a competitive market outcome will only do so if it also enjoys the credibility and confidence that are essential to an efficient and effective economic system. When the design of a regulatory system is blocking or inhibiting the ability of government to intervene through regulation in ways that mimic a competitive market outcome, the regulatory system will lack essential credibility and confidence. Markets fail and so does regulation.

These observations are ***not*** offered to directly or indirectly point fingers at the PUCO or at any branch of government. They are offered to identify the kind of things that happen in the real world when an outdated regulatory design is repeatedly placed under stress by disruptive events (ranging from too little to excessive energy supply), corruption of the type deployed by Enron (and others) or legal reforms that direct the regulator to delete comfortable traditional economic regulation and relationships with monopolies and insert a foreign market-based approach and relationships with new entrants.

In the many pages that follow, you will find details of what has happened in important cases dealing mostly with electricity. Here, you may notice the tension and conflict that is occurring (unnecessarily, in my view) because we have attempted to restructure the relationship between utilities or competitive suppliers and customers without giving much

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<sup>7</sup> Dan Yergin, Federal Trade Commission Conference in 2007, *Energy Markets in the 21<sup>st</sup> Century*.

attention to the fact that our regulators are using an operating system or software that is obsolete and, in some cases, no longer supported. The more we continue to ignore this problem, the greater the risk that the system will fail to "... mimic a competitive market outcome..." and work in a public interest sense.

The rest of this report is located on the Manufacturers' Education Council's website at: [www.mecseminars.com](http://www.mecseminars.com) and can also be located on the IEU-Ohio's website at: <http://ieuohio.org/education.aspx>.