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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Staff Proposal for an Economic Development Tariff Template.	))	Case No. 11-4304-EL-UNC

COMMENTS OF THE INDUSTRIAL ENERGY USERS-OHIO

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August 5, 2011

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{C34911:2 }

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I. INTRODUCTION

On July 15, 2011, the Public Utilities Commission of Ohio ("Commission") issued an Entry (hereinafter cited to as "*July 15 Entry*") soliciting public comment on a "... proposed economic development tariff ...." *July 15 Entry* at 2. In addition to comments on the proposed template, the Commission requested comments on the "... issue of recovery of delta revenue." *July 15 Entry* at 2.

With regard to the proposed template, the Commission's *July 15 Entry* states that "... reasonable arrangements may involve significant transaction costs ..." (*July 15 Entry* at 1) and that these "... transaction costs would be significantly mitigated if utilities were to adopt a rate schedule to be used as an additional tool to promote economic development in certain situations." *July 15 Entry* at 1. With regard to the issue of delta revenue recovery, the *July 15 Entry* states:

> In light of the unbundling of generation and distribution rates pursuant to Am. Sub. Senate Bill 3, electric utilities do not accrue the same benefits with the expansion of the customer base as was the case under traditional rate-of-return regulation. Therefore, the Commission solicits comments on the proper amount of delta revenue which electric utilities should be permitted to recover under the proposed economic development tariff template.

> ... the Commission notes that all electric utilities in this state do not own generation assets. ... Therefore, the Commission requests comments on whether there should be a differential in the amount of delta revenue recovered by electric utilities, based upon whether they own generation assets or provide generation service through a competitive bid process. Would the absence of such differential create a disincentive to electric utilities to procure generation through a competitive bid process and stifle the further development of competitive markets in this state?

July 15 Entry at 2.

Below are the comments of the Industrial Energy Users-Ohio ("IEU-Ohio") on the items for which the Commission has requested comments. IEU-Ohio appreciates the Commission's interest in economic development and retaining or procuring jobs. IEU-Ohio also appreciates the Commission's interest in obtaining comments from stakeholders who are on the front line working to retain good jobs in Ohio and to beneficially expand the economy by promoting consumer-focused outcomes on issues that affect the price and availability of energy in Ohio.

II. THE COMMISSION'S FINDINGS

A. Transaction Cost Mitigation

In the *July 15 Entry*, the Commission finds that the transaction costs associated with reasonable arrangements "... would be significantly mitigated if utilities were to adopt a rate schedule to be used as an additional tool to promote economic development in certain situations." *July 15 Entry* at 1. The Commission did not identify the basis for this conclusion and it is not one that can be necessarily associated with the proposed template.

Also, issues regarding the Commission's legal authority to require utilities to adopt a rate schedule compliant with the proposed template are likely to bring their own transaction costs. As the Commission knows, the Commission has approved the current rate schedules of electric distribution utilities ("EDU") and those schedules are deemed to be reasonable unless and until shown to be otherwise. Section 4905.31, Revised Code, provides the Commission with authority to act upon an application by a public utility, including an EDU, a mercantile customer or a group of mercantile customers.

It is IEU-Ohio's position that the Commission's interest in reducing transaction costs, an interest shared by IEU-Ohio, can be best advanced by focusing on the process that the Commission has used in the case of applications for reasonable arrangements involving a mercantile customer and an EDU. In this context, the Commission has the ability to draw upon experience gained from the extensive use of reasonable arrangements involving the pricing and supply of gas or natural gas, as well as communications services.

B. EDU Benefits from Expansion of Retail Sales

In the *July 15 Entry*, the Commission states that unbundling of EDU services and prices has eliminated the benefits that EDUs obtained from customer additions during the era of "traditional regulation." The Commission did not identify the basis for this conclusion and it is not one that is necessarily correct in any or all cases.

Regardless of Ohio's electric restructuring legislation, traditional regulation still applies to the distribution services of EDUs. And, the benefit an Ohio EDU may derive from expanding its retail sales base in Ohio depends almost entirely on the level of the unbundled prices for competitive and non-competitive services, the design of the unbundled rates and the costs incurred by the EDU to supply the additional services. If for example, the standard service offer ("SSO") prices for unbundled services are above the actual cost to supply the unbundled services, the shareholders of an EDU may secure substantial benefits from an expansion of retail sales within its Ohio service area. These benefits are not theoretical; they are actual and observable.

For example, the table below is from page 8 of a July 7, 2011 presentation by American Electric Power ("AEP") at the Boston Investor Meetings hosted by Barclays Capital.[1] The table shows the relative gross margin (revenue less fuel expense) of the various business divisions within AEP during 2010 (actual) and 2011 (estimated) and the relative contributions to earnings per share of common equity. The "Ohio Companies" are Ohio Power Company ("OP") and Columbus Southern Power Company ("CSP") and the "East Regulated Integrated Utilities" are the balance of AEP's operating companies providing service within AEP's traditional service area sometimes referred to as "AEP East." The table shows that the gross margin per megawatt hour ("MWH") achieved by OP and CSP from unbundled services and prices is stunningly higher than the per MWH margin that CSP's and OP's affiliated operating companies obtained in 2010 and are expected to obtain in 2011 even though they operate in areas that are more traditionally regulated than Ohio.

[1] The AEP presentation is available *via* the Internet at http://www.aep.com/investors/present/documents/BostonInvestorMeetings7-7-2011.pdf (last viewed August 1, 2011). Similar information is shown in the presentation materials that were issued by AEP in conjunction with its July 29, 2011 earnings call. The earnings call presentation materials are available *via* the Internet at http://www.aep.com/investors/webcasts (last viewed August 1, 2011).

2010A: $3.03

2011E: $3.00 - $3.20

American Electric Power
Financial Results for 2011 Guidance vs 2010 Actual

		Performance Driver	2010 Actual ($ millions)	Performance Driver	2011 Guidance ($ millions)
	UTILITY OPERATIONS:				
	Gross Margin				
1	East Regulated Integrated Utilities	68,761 GWh @ $ 41.9 /MWhr =	2,882	67,739 GWh @ $ 43.4 /MWhr =	2 940
2	Ohio Companies	49,465 GWh @ $ 56.6 /MWhr =	2,800	49,747 GWh @ $ 56 1 /MWhr =	2 793
3	West Regulated Integrated Utilities	42,131 GWh @ $ 31 4 /MWhr =	1,322	41,536 GWh @ $ 32 8 /MWhr =	1,361
4	Texas Wires	27 348 GWh @ $ 22 3 /MWhr =	611	27,870 GWh @ $ 22 0 /MWhr =	614
5	Off-System Sales	19,172 GWh @ $ 15.6 /MWhr =	299	21,786 GWh @ $ 12.0 /MWhr =	262
6	Transmission Revenue - 3rd Party		369		429
7	Other Operating Revenue		511		481
8	Utility Gross Margin		8,794		8,880
9	Operations & Maintenance		(3,427)		(3,529)
10	Depreciation & Amortization		(1,598)		(1,553)
11	Taxes Other than Income Taxes		(801)		(818)
12	Interest Exp & Preferred Dividend		(945)		(921)
13	Other Income & Deductions		154		211
14	Income Taxes		(758)		(787)
15	Utility Operations On-Going Earnings		1,419		1,483
16	Transmission Operations On-Going Earnings		10		17
	NON-UTILITY OPERATIONS:				
17	AEP River Operations		40		51
18	Generation & Marketing		25		6
19	Parent & Other On-Going Earnings		(43)		(61)
20	ON-GOING EARNINGS		1,451		1,496

Accordingly, Ohio's unbundling of EDU services and prices has not universally eliminated the benefits that EDUs obtained from customer additions during the era of "traditional regulation." Actual and forecasted data show that at least two EDUs in Ohio are achieving gross margins that are greatly in excess of the margins produced by other states that are more traditionally regulated.

C. Delta Revenue Differentiation as a Result of Generation Ownership or a Competitive Bidding Process

In the *July 15 Entry*, the Commission asks for comments on whether there should be a difference in the amount of delta revenue recovered by EDUs as a function of whether they own generation assets or provide generation service through a competitive bid process ("CBP"). The Commission also asks if the absence of such difference would create an EDU disincentive to procure generation through a CBP and stifle the further development of competitive markets in this state. The request for comments on these questions appears to be related to the provision in the proposed template that would require an EDU to absorb twenty percent (20%) of delta revenue.

Rather than focusing on the amount of delta revenue that has to be paid by consumers compared to the amount that the Commission might require EDUs to absorb, and regardless of the differentiation that may be appropriate based on generation ownership or SSO generation prices based on a CBP, IEU-Ohio urges the Commission to first focus on opportunities to advance beneficial economic development and retention objectives without creating delta revenue.

The Commission's current framework defines delta revenue as the difference between the revenue produced by the EDU's otherwise applicable SSO rate and the reasonable arrangement rate approved by the Commission. In other words, delta revenue is measured by reference to a revenue stream from the SSO rate that is incapable of advancing the economic retention or development objective. There would be no delta revenue if the SSO rate was capable of getting the job done. And, it is unreasonable to provide an EDU with the opportunity to receive the amount of revenue that it would otherwise receive at the SSO rate for purposes of determining how much, if any, revenue shortfall should become the responsibility of other customers or the EDU's shareholders.

In present circumstances, the Commission should consider how "shopping" and competitive sourcing of generation supply can and should be leveraged to advance economic development and retention objectives and either bypass completely or mitigate significantly any delta revenue related wealth transfer. Rather than reverting to a command and control model for economic development and retention that uses government regulation to compel EDUs to adopt a standard tariff, the Commission could and should be focusing on the flexibility provided by Section 4905.31, Revised Code. Section 4905.31, Revised Code, provides Ohio with the ability to enable long-term, customized electricity, natural gas and communications arrangements (price, service quality, reliability) that respond to specific opportunities. By leveraging a market-based approach, Ohio can exploit an advantage that it has as a result of the structure of Ohio's law.

The use of market-based pricing to advance Ohio's economic development and retention objectives is not a new idea. Indeed, in *In the Matter of the Complaint of Ormet Primary Aluminum Corporation and Ormet Aluminum Mill Products Corporation v. South Central Power Company and Ohio Power Company*, Case No. 05-1057-EL-CSS, Supplemental Opinion and Order (November 8, 2006) (hereinafter cited as "*Ormet Order*"), the Commission authorized delta revenue collection to be calculated based on the difference between the generation price specified in the customer-specific contract ($43 per MWH) and the Commission-approved market rate for generation supply.[2] Similarly, in *In the Matter of the Transfer of Monongahela Power Company's Certified Territory in Ohio to the Columbus Southern Power Company*, Case No. 05-765-EL-UNC, Opinion and Order (November 9, 2005) (hereinafter cited as "*Mon Power Order*"), the Commission permitted CSP to collect the difference between the

[2] The *Ormet Order* was issued at a point in time when the market rate for generation supply was in excess of the otherwise applicable SSO rate. In present circumstances, there is good reason to believe that the market rate for generation supply is less than the otherwise applicable SSO rate.

SSO generation supply price and a higher market-based price as part of a transaction through which the Ohio customers of Monongahela Power Company were acquired by CSP.[3]

Using competitive bidding and market-based pricing to advance Ohio's economic development and retention objectives in present circumstances can provide the Commission with an opportunity to address any leaks in the delta faucet. And, competitive sourcing can avoid the tug-of-war that what will certainly commence if the Commission continues to rely on a comparison to the otherwise applicable SSO rate to advance Ohio's economic development and retention objectives. This approach also avoids the need to differentiate between EDUs based on their degree of vertical integration (something that should be irrelevant anyway as a result of corporate separation requirements) or the extent to which SSO generation supply prices are based on a CBP. Additionally, the use of a market-based approach may help to avoid undue discrimination in favor of newly arriving mercantile customers and those mercantile customers that have paid their dues in Ohio for decades. It is imperative that the Commission avoid this type of discrimination. Finally, the use of a competitive bidding approach could also provide a means to address the price and service quality needs of mercantile customers located in the service areas of Ohio's electric cooperatives and municipal electric utilities that elect to participate in a statewide economic development and retention program. Even if the Commission had the authority to require EDUs to adopt the proposed tariff template, the Commission's jurisdiction is limited to EDUs.

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[3] CSP's witness Baker testified that CSP did not have adequate generation capacity to serve its current load and the Ohio load of Monongahela Power Company. *Mon Power Order* at 16.

III. THE PROPOSED TEMPLATE

The proposed tariff template contains two categories of rate options that may be available to mercantile customers satisfying certain criteria. The first category is the Economic Development Incentive ("EDI") and the second is the Energy Intensive High Load Factor Provision ("EIHLFP"). Both categories are subject to the terms and conditions listed on page 2 of the proposed tariff template that contains definitions, the requirement that EDUs absorb twenty percent (20%) of delta revenue (defined by reference to the EDU's otherwise applicable rate) and language reserving the Commission's authority to terminate or suspend, at any time, the tariff.

Any mercantile customer benefit that might be available under the EDI category (subject to the Commission's power to suspend or terminate the tariff) cannot be identified from the information provided by the proposed tariff template. Assuming a customer satisfies the minimum payroll, new employee, capital investment hurdles and other support requirements (funding and incentives), the customer will be billed a price that is equal to some percentage less than the otherwise applicable SSO rate. Since the SSO rate is not fixed, known or measureable, the economic development or retention inducement that the EDI might provide to a mercantile customer is also not known or measurable.

The EIHLFP is only available to a new economic development mercantile customer that satisfies the new jobs, minimum monthly demand, annual average load factor and electricity cost intensity relative to operation and maintenance expense requirements. Under the EIHLFP option, a new economic development mercantile customer pays the lower of the unknown and unknowable EDI option or the EIHLFP option. The term of the EIHLFP option shall not exceed ten years and, as indicated previously, the Commission reserves the right to terminate or suspend the EIHLFP option at any time.

The EIHLFP total kilowatt-hour ("kWh") rates are arrayed in a matrix that relates load factor to electric cost intensity. The electric cost intensity threshold requirement [electric cost must be at least four percent (4%) of total operating and maintenance costs] will likely preclude eligibility of certain types of businesses and impose a bias against energy-intensive operations that do not rely on electricity. For example, the natural gas supply and pricing opportunities that are presently available as a result of unconventional natural gas exploration and development could tilt a mercantile customer's decision towards the use of natural gas rather than electricity and thereby bring larger economic development benefits to Ohio. It is unclear how the electric cost intensity requirement will be applied in circumstances where a customer generates all or a portion of its electricity requirements. Beyond the details associated with the EIHLFP option, the rates displayed in the matrix are unlikely to provide Ohio with any competitive advantage relative to prices that are readily available in the marketplace or the indicative prices provided by other states and nations interested in economic development and retention.

IV. SUGGESTIONS

The Commission can do much to improve the attractiveness of Ohio for economic development and retention before resorting to tools that require the Commission to create or allocate delta revenue. Below (in no particular order) are some examples of areas where the Commission can act to facilitate Ohio's efforts to compete in the global economy.

A. Remove Distribution Costs from Rates that Apply to Customers Taking Service at Transmission Voltage Levels

Larger energy-intensive electric customers typically take electric service at higher voltage levels for price and service quality reasons. Current electric rates often have distribution service revenue requirements in the rates for customers taking service at transmission voltage levels. The Commission should urge electric utilities to reform their current rates and charges to remove distribution-related revenue requirements from the rates that apply to customers receiving service at transmission voltage levels.

B. Assist the General Assembly by Developing an Alternative kWh Tax Rate Design

Taxes or electric rates and charges that rely on a kWh collection mechanism tend to impose greater revenue responsibility upon larger, higher load factor electricity users. This works against Ohio's economic development and retention objectives. The Commission should assist the General Assembly by suggesting modifications to Ohio's kWh tax (a tax that applies to customers of municipal, customer-owned and investor-owned electric utilities) so that it does not work against Ohio's economic development and retention objectives.

C. Improve the Universal Service Fund Charge Rate Design

The Universal Service Fund ("USF") was created as part of Ohio's electric restructuring legislation which was enacted in 1999. The USF provides bill-payment assistance to eligible residential customers with funds provided by charges on all customers of investor-owned electric utilities. Like the kWh tax, USF funding occurs through a kWh-based collection mechanism which imposes substantial revenue responsibility on large, higher load factor customers. USF funding has increased significantly since 1999 and, statewide, it is now in excess of $200 million per year.

As a result of IEU-Ohio's recommendations, the design of the USF collection mechanism is currently based on a two-block rate that has mitigated some of the impact of the USF charge on larger, higher load factor customers. But, representatives of residential customers have periodically attacked the current USF rate design and these attacks are anticipated in the future.

The Commission should assist the General Assembly by suggesting modifications to the design of USF charges so that USF funding does not work against Ohio's economic development and retention objectives.

As part of the larger effort to bring down rates and charges for all customers, the Commission should also urge the Ohio Department of Development to use its authority to competitively source generation supply for customers receiving USF assistance. Current market conditions suggest that the USF revenue requirement could be reduced significantly through competitive sourcing.

D. Encourage Regional Transmission Organizations to Establish Rates and Commercial Rules that Facilitate Economic Development and Retention

Regional transmission organizations ("RTOs") typically establish rates and rate designs that are not friendly to large, high load factor customers. The use of marginal loss factors, uniform clearing prices and marginal pricing by RTOs tends to significantly overstate the revenue requirement which drives the rates and charges of RTOs. RTOs have also taken to cost allocation schemes that socialize funding for investment in new facilities and this socialization approach tends to disadvantage energy-intensive economies like the Ohio economy. Generation and transmission charges make up the bulk of the electric bill for larger, high load factor customers and these charges are particularly sensitive to the pricing and rate design determinations of RTOs.[4]

The Commission should urge RTOs to adopt rates, services and practices that will facilitate (not hinder) Ohio's economic development and retention efforts.

E. The Commission Should Modify Portfolio Compliance Baselines and Ensure that Charges that Collect Compliance Costs Do Not Work Against Economic Development and Retention Goals

Sections 4928.64 and 4928.66, Revised Code, contain supply-side and demand-side portfolio requirements expressed as a percentage of a defined baseline. The performance percentages escalate over time. IEU-Ohio suggests that the Commission consider options for excluding the sales, peak demand or other mercantile customer load and usage characteristics from the baseline specifications in cases where mercantile customers are advancing Ohio's economic development and retention efforts. Additionally, IEU-Ohio urges the Commission to similarly exempt such customers from portfolio compliance costs so long as the customers are, individually or jointly, engaged in a plan of continuous improvement that is focused on reducing energy intensity.

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[4] The General Assembly has recognized the role of RTOs and has given the Commission ample authority to seek RTO rates and services that complement Ohio's economic development and retention objectives. In 2008, the General Assembly enacted Section 4928.24, Revised Code, directing an examination of RTOs to determine if RTOs are providing adequate value to consumers. This work remains incomplete.

F. The Commission Should Expand The Use of Market-Based Tools to Advance Economic Development and Retention Goals

As indicated above, the evolution of the electric market, the depressed economy and the beneficial effects of an abundant supply of reasonably priced natural gas are finally working to provide significant opportunities for Ohio customers to reduce their electric bills through shopping. Because shopping can and has reduced electric bills and it does so without producing any delta revenue, IEU-Ohio urges the Commission to consider economic development and retention tools that make the best use of market forces.

Customer-driven competitive retail electric services ("CRES") suppliers like IEU-Ohio are ready and willing to work with the Commission to facilitate the formation of competitive sourcing programs designed to provide customer-specific and aggregated customers with generation supply and other services (including value enhancing demand response services). There are market-based opportunities to produce pricing results superior to the results that occur by reference to the otherwise applicable SSO rate and avoid delta revenue at the same time.

In present circumstances, there is no good reason to start an economic development or retention effort by turning to the otherwise applicable SSO rate.

V. CONCLUSION

The *July 15 Entry* highlights the Commission's interest in actions the Commission might take to facilitate economic development and retention. IEU-Ohio hopes the comments and suggestions provided above help the Commission to identify opportunities to make Ohio a better home for new and expanding businesses.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Comments of the Industrial Energy Users-Ohio* was served upon the parties of record this 5th day of August 2011 *via* electronic transmission, hand-delivery, or ordinary U.S. mail, postage prepaid.

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ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO