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Ohio's History of Regulation

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Historical Perspective: Why Regulation?

- Electricity has historically been considered a “natural monopoly.”
- Entry into this market required huge investments in infrastructure.
- Electricity was considered a “public good” and the concept of the “social compact” evolved.
- Very few people could make the investment to get into the electric business and those who did could take advantage of the monopoly.



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Ohio's Market Prior to Electricity Restructuring

- Ohio's investor-owned utilities accounted for 91% of electric sales
Six electric distribution utilities (EDU's):
 - Ohio Power
 - Dayton Power & Light
 - Duke Energy
 - FirstEnergy
 - Cleveland Illuminating
 - Ohio Edison
 - Toledo Power
- Utilities sold “bundled” services—owned and operated generation, transmission and distribution
- Utilities received cost recovery for generation investment
- Risk in generation investment borne by ratepayers, including cost overruns, expensive generating assets, *etc.*



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Turn of the Century System

- Unbundling of vertically integrated systems
- Customers served by generator of choice
- Transmission and distribution remained regulated
- For generation, the rate of return on rate base construct was replaced with a competitive model construct



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History of Ohio Electric Restructuring

In 1999, Am. Sub. SB 3, the Ohio Electric Restructuring Act, was passed. It authorized the restructuring of the electric industry in Ohio. At the same time, 23 other states also restructured their electric utility markets.

- Market development period. A five year period from 2001 through 2005 during which it was expected that the retail markets would emerge. Electric rates were frozen during this period.
- Rate stabilization period. A three year period from 2006 through 2009 resulting from the failure of the retail markets to develop.



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Issues Under Restructuring

- Unbundling
- Market Power
- Transitional Issues
- Independent System Operation
- Social Issues
- Environmental Issues



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Unbundling



**Generation (“or supply”)
Shop for this**

**Transmission
Remains regulated by FERC**



**Distribution
Remains regulated by PUCO
and provided by your local
utility.**





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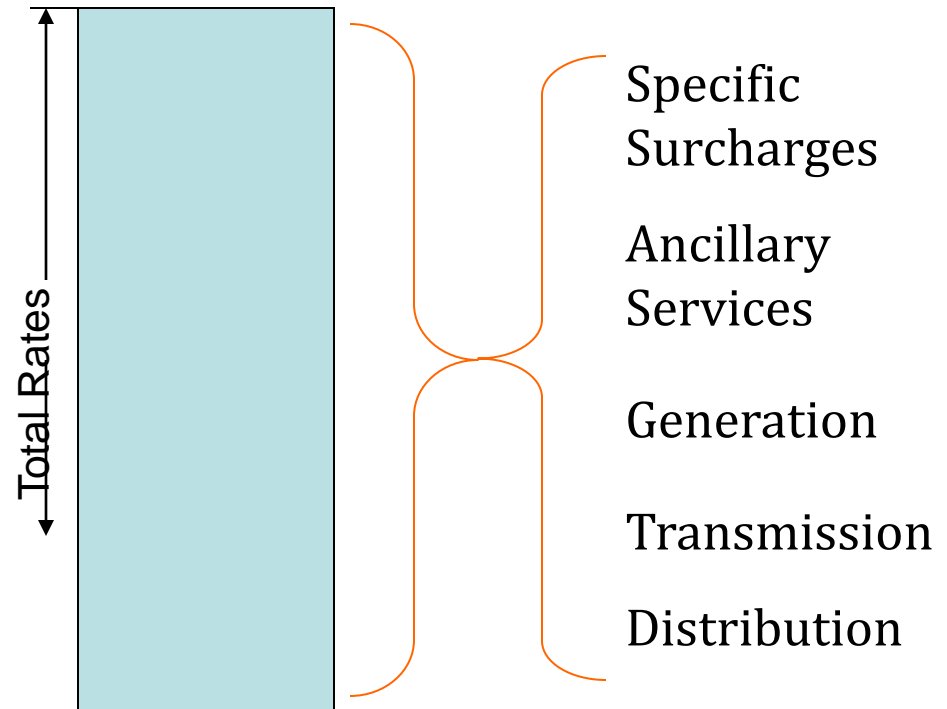
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“Bundled” Rates

- Rates were previously a “bundle” of costs for different services.
 - Generation
 - Transmission
 - Distribution
 - Ancillary Services
 - Specific Surcharges





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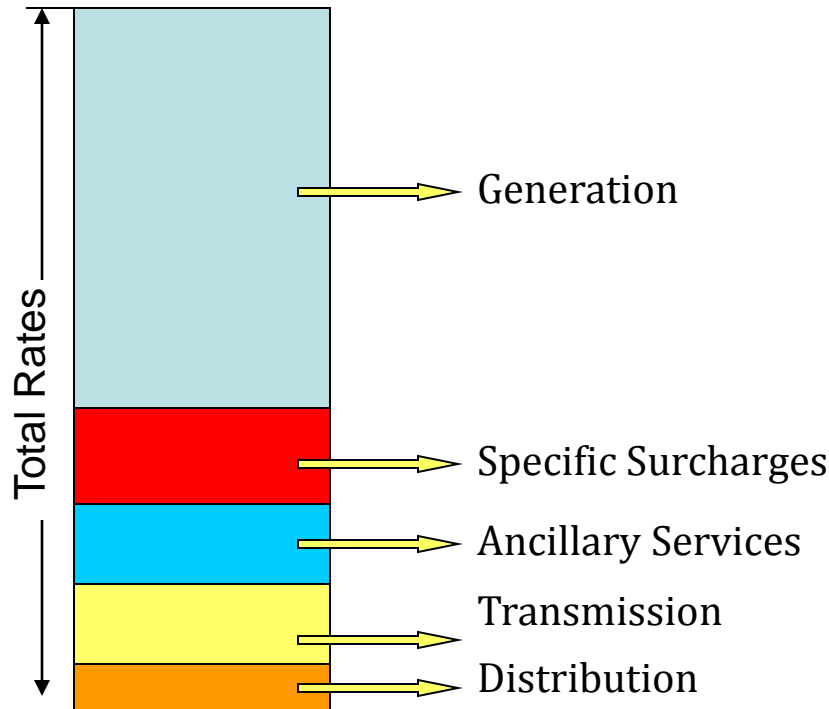
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“Unbundled” Rates



Electric Restructuring would “unbundle” the rates so the generation component could be shopped for, and priced at “market.” The bill anticipated that market rates would be lower than regulated rates.



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Transitional Issues

Temporary issues pertaining only to the period of transition from a regulated to a competitive industry.

- **Timing**
 - How soon full competition can begin
- **Stranded Costs**
 - Production
 - Regulatory

Social Issues

- Universal Service
- Provider of Last Resort
- Low Income Programs
- Consumer Education
- Metering & Billing
- Unfair & Deceptive Practices



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Regulatory Focus Shifted to Market Monitoring and Development

The ability to control prices and product quality

Vertical

A vertically integrated company favors its own or an affiliate's generation over alternatives through non-price barriers.

A single supplier or group of suppliers has a strategic advantage in terms of access to customers relative to other suppliers.

Horizontal

A single supplier or group of suppliers has undue influence on the price of the product due to concentration of market share that can be used strategically.



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Suppliers must be certified for consumer protection

- PUCO certifies all electric suppliers
- Suppliers are reviewed for:
 - technical capabilities
 - financial capabilities
 - managerial capabilities
- Ensures these companies are qualified to do business in Ohio



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Governmental Aggregation: The power of group buying

Ohio Electric Choice allowed for local governments to join all of the customers in a community into a single buying group.

- Most cases “opt-out” is used
- Community passes a ballot issue
- Everyone in community *automatically* enrolled and a supplier is chosen for the group
- Everyone is given a chance to “opt-out” or to not participate



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What happened during the Market Development Period?

- Initial results early during the period showed significant “switching” in some service territories primarily due to high costs in the northern part of Ohio.
- Governmental aggregation was the success story in Ohio.
- The moderate-to-low priced utilities experienced little, if any, customer switching.
- With the success of government aggregation aside, it was apparent that a fully competitive market had not developed as quickly as envisioned by lawmakers in Senate Bill 3.



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PLUS...

Many other events occurred during the
5-year Market Development Period

- The California crisis and the Enron scandals
- Extreme volatility and upward movement of market prices (due to rising gas prices, rising coal prices, and construction facilities not matching the projected increases in demand)
- And the slower than expected development of Independent System Operators for providing transmission services



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Ohio Electric Choice

The move to Rate Stabilization Plans

- As the end of the market development period neared, there were a limited number of competitive electric suppliers and a low degree of market activity. Therefore, there was concern that an immediate shift to market-based rates in 2006 would not be in the best interest of customers .
- To avoid rate “sticker shock” and gradually transition customers to market-based rates, the PUCO worked with Ohio’s electric utilities and stakeholders to develop Rate Stabilization Plans (RSPs).
- Rate Stabilization Plans lasted through 2008.



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Middle-ground Approach to Electricity Regulation

- Evidence demonstrated few competitive options existed at the retail level.
- Action was necessary to secure Ohio's energy future.
- A plan was needed for a comprehensive, long-term approach to the challenges of supplying reliable and affordable power.
 - Address the approaching expiration of the Rate Stabilization Plans.
 - Attract energy jobs of the future through an Ohio advanced energy portfolio standard.
 - Ensure affordable and stable energy prices to protect Ohio consumers and existing Ohio jobs.



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The Next Phase of Ohio Electric Restructuring

Senate Bill 221 in 2008 authorized the restructuring of the electric industry in Ohio and included an energy efficiency requirement and a renewable portfolio standard.

The law required electric utilities to file either an Electric Security Plan (ESP) or a Market Rate Option (MRO) to supply energy to customers.

Did not close the door on market pricing, but required a demonstration that competition is effective.

- The ESP is similar to a traditional rate plan for the supply and pricing of electric generation service.
- An MRO is a rate plan that utilizes a competitive bidding process to set generation prices and gradually transition customers to full market-based pricing.

S.B. 221 Policy Principles

- Availability of adequate, reliable, safe, efficient, nondiscriminatory and reasonably priced retail electric service
- Diversity of electricity supplies and suppliers
- Encourage innovation and market access for cost-effective supply- and demand-side retail electric service
- Transmission and distribution availability
- Recognize continuing emergence of competitive electricity market through the development and implementation of flexible regulatory treatment
- Provide coherent, transparent means of giving appropriate incentives to technologies that can adapt successfully to potential environmental mandates



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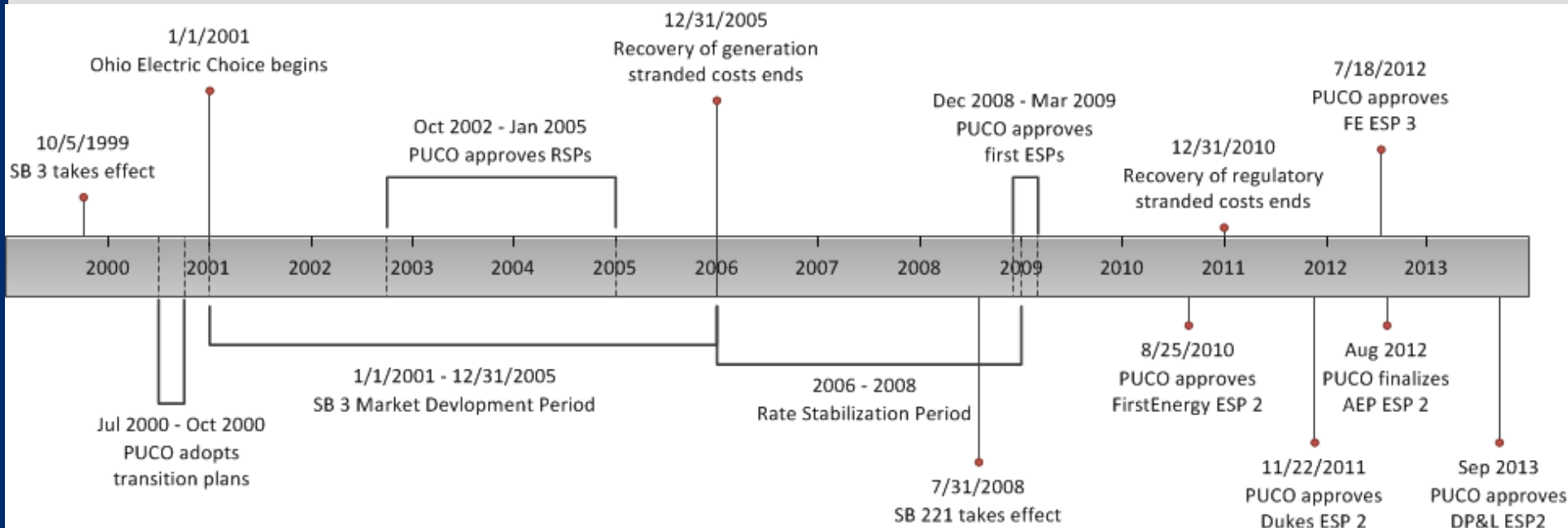
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Electric Restructuring Timeline



In Conclusion...

- Markets are continuing to evolve and market participation is growing
- There will be obstacles and difficulties
- Allows consumers more choices
- Over time, we hope for greater diversity in product offerings and additional consumer options



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THANK YOU!