



## MEMORANDUM

**TO:** Rick Sites, OHA  
**FROM:** Tom. O'Brien  
**DATE:** November 14, 2007  
**RE:** **Summary of Amended SB 221 as Passed by the Senate**

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This memo summarizes the key rate-impacting provisions of amended Sub S.B. 221, as passed by the Senate on October 31, 2007.

### Overall Impressions

The strength of this bill is that it will provide price stability at the expiration of the current rate stabilization plans, including a continuation of existing special contracts that have been approved by the Commission (for example, the FirstEnergy contracts preserved under its "rate certainty" plan). A further, and perhaps more significant strength is that the bill provides a stable process enabling the construction of new baseload generation, the lack of which is the single greatest threat faced by electric consumers. The addition of needed baseload capacity will moderate the price of electricity over the longer term.

The bill also addresses Ohio's over-dependence on conventional coal-fired generation. While Ohio's existing fleet of aging coal fired plants have enabled rates in Ohio to remain low relative to other parts of the country, these plants are nearing the end of their useful lives and their environmental costs continue to escalate. The bill's advanced energy program has the virtue of moderation in calling for an achievable goal over a reasonable timeframe without arbitrary triggers or technology mandates. The bill contains a cap on the relative price of advanced energy resources as a safeguard against runaway cost increases.

For consumers having on-site generating resources, such as hospitals, the bill increases the emphasis on the importance of distributed generation to the overall mix of sources of electricity. The bill does not go so far as to provide specific relief from the specific issues faced by self-generators, such as burdensome standby rates or interconnection costs and procedures, but those cost-specific issues do not lend themselves to legislative fixes, but rather require a regulatory fix due to their complexity. The PUCO continues to examine the barriers to self-generation in the proceedings spawned by Case No. 05-1500-EL-COI.

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The bill is by no means perfect. Each of the Ohio electric utilities are earning very healthy returns under the rate stabilization plans. It is possible that some rates would actually go down if Ohio were to make a complete return to traditional regulation. But such a move does not appear to be possible, politically or legally. So as an inducement to the utilities, the bill does “lock-in” the returns currently earned by the utilities, to be reviewed only upon a request for a significant addition to rate base.

The bill’s primary detractors consist of FirstEnergy, which appears to be irrevocably committed to the marketplace despite the recent downgrading of its debt stemming from this commitment, electricity marketers, who, despite the bill’s preservation of the legal right to shop will in all probability continue to be frozen out of the state due to the continuation of the RSP rates, and a portion of the environmental lobby that is unhappy with the flexibility in the bills advanced energy provisions. While the remaining utilities may publicly criticize the bill, this is most likely a tactical position only. The bill’s advantages to all of the utilities, including FirstEnergy, far outweigh its negatives.

#### **R.C. 4928.02 State Policy**

The “policy” provisions of a bill typically are not considered “substantive” provisions of the law. An appeal of a Commission decision based upon state policy arguments would be exceedingly difficult to win. Nevertheless, policy provisions are intended to influence administrative rules and decisions. For this reason, the changes to R.C. 4928.02 are noteworthy. The bill expands state policy to:

- Ensure that transmission and distribution systems are available to distributed generation for marketing and sales of power;
- Preclude imbalances of knowledge and expertise among parties in proceedings under Chapter 4928;
- Provide coherent, transparent means of giving appropriate incentives to technologies that can adapt successfully to potential environmental mandates; and
- Encourage implementation of distributed generation across customer classes through regular review and updating of rules governing critical issues such as interconnection standards, standby charges, and net metering.

#### **R.C. 4928.14 Standard Service Offer Provisions**

The key provision of the bill as it affects the price of electric generation service involves a “retooling” of the standard service offer (“SSO”) provisions in the bill’s predecessor,

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SB 3. The bill reintroduces cost-based concepts back into the SSO, where SB 3 had determined that the SSO should be purely market based. Note that significant changes were made to the rate-setting provisions of the bill between the date of the release of the bill as amended by the Senate Energy and Public Utilities Committee on October 25, and its passage by the Senate on October 31. The following summarizes the key provision, 4928.14(B), as passed by the Senate.

The SSO now comes in three varieties: the “default” SSO, which will take effect automatically upon the expiration of the existing RSP rate; the modified standard service offer (“MSSO”), which will replace the default SSO if the utility decides that it needs additional revenues not available under its default SSO; and the market based SSO (“MBSSO”) option, which is largely unchanged from prior iterations of the bill.

### **The “Default” SSO**

A “default,” SSO is created as follows: As of January 1 of the calendar year that follows the scheduled expiration of an electric distribution utility’s rate plan, the “base rate” component of the SSO shall consist of all of the following:

- The total charges for each customer class under the rate plan in effect on the first day of February of that year of expiration, exclusive of charges for transmission and distribution services;
- Adjustments to costs as incurred by the utility, the recovery of which are pursuant to any application authorized by the Commission under the rate plan, and that go into effect on or after the first date of February and before that first day of January;
- Any other deferred costs, as authorized by the Commission; and
- Special contracts or prices approved under 4905.31 prior to October 28, 2007. (note that the agreements stemming from DE-Ohio’s RSP, Case No. 03-93-EL-UNC likely will not be preserved by this provision, while agreements with the FirstEnergy Companies traceable to the pre-SB 3 era, will be preserved)

### **The “Modified” SSO (Rate Security Plan)**

The default SSO is not subject to a specific time limitation. It is of indefinite duration. If, however, a utility seeks to change this rate structure or seek rate increases that are not provided for above, then it must file for an MSSO. The Commission is required to

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prescribe a rule governing a filing requirement for an MSSO, and such applications are subject to a hearing process.

An MSSO (also called an electric security plan):

...shall adjust a utility's standard service offer relative to changes in one or more costs incurred by the utility to serve jurisdictional load in this state and specified in the application. An adjustment for a change in a capitalized cost shall also include a just and reasonable return on that cost. The amount of any adjustment under this section shall be offset by any decrease in costs, excluding reductions in amortization relating to costs recovered through a regulatory transition charge authorized by the commission as of February 1, 2008, and by any change in [kWh] sales associated with jurisdictional load.

Such costs may include, but are not limited to:

- Environmental compliance costs;
- The cost of fuel for specified generating facilities or purchased power;
- The cost of construction of one or more new, generating facilities, based upon need and resource planning procedures proscribed by rule;
- Environmental retrofits in excess of \$250 million, consistent with both 4909.15 and 4909.18;
- Operating, maintenance, and other costs, including taxes;
- Costs of investments in one or more specified generating facilities; and
- The cost of providing default or standby services.

This MSSO may provide for automatic adjustment clauses, except as to the cost of new plants or major retrofits, and operating and maintenance costs that are within the control or responsibility of the utility.

The costs attributable to advance energy technology under R.C. 4928.142 shall be bypassable only to the extent that the alternative supply contains a comparable mix of advanced energy technology.

The adjustment for a particular cost shall be determined using a baseline measure of that cost as of the first day of February of the calendar year in which the utility's rate plan is scheduled to expire. For subsequent applications, the baseline shall be that used to determine the prior rates.

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The MSSO provision appears to incorporate traditional cost-based ratemaking principles. However, without knowing the process and procedure for the rate review that will be conducted, it is difficult to assess how meaningful this rate review will be. We can be certain that it will be something short of the full nine-month process that is used under R.C. 4909. A shorter timeline means that intervening parties will be required to conduct their investigations of the filing much sooner after an application is made. This change should be manageable if the complete process for treating these applications is known in advance. The legislation does specify that the Commission is required to issue such a rule.

### **Market Based SSO (Market Rate Option)**

A utility may offer an MBSSO whereby rates are determined “periodically” through an open, competitive bidding process if:

The offer and the prices established are just and reasonable to each customer class and are consistent with the policy specified in section 4928.02 and the utility is in compliance with section 4928.141 (disclosure of contracts).

The relevant markets are subject to effective competition, as determined under R.C. 4928.06(D).

In addition, the offer price must be more favorable, or at least comparable to a “price-to-compare” for each class. The “price-to-compare” shall be the price that the Commission shall determine for the comparable time period and in the manner of an electric security plan.

Finally, once a utility has successfully implemented a market rate option SSO, the Commission cannot order that utility to file a rate security plan.

### **Section 4928.142 Advanced Energy**

As it has from its initial introduction, the bill calls for at least 25% of a utility’s jurisdictional SSO supply to be “advanced energy.” This advanced energy is, in turn, to be made up of at least 12.5% (“half”) to be generated from “sustainable” resources, as defined in R.C. section 3706.01,<sup>1</sup> and “shall include solar power.” The remainder shall be supplied from “advanced energy facilities,” as defined in R.C. 3706.01.<sup>2</sup>

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<sup>1</sup> “‘Sustainable resources’ includes, but is not limited to, solar, wind, tidal or wave, biomass, including, but not limited to biomass involving the utilization of trees or any part thereof, landfill gas,

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(B)(1) If the commission determines, after notice and hearing, that the utility has failed to comply with division (A) of this section, the commission shall issue an order requiring the utility to comply fully within such time as shall be specified in the order and shall specify in the order the process and schedule for verifying to the commission the utility's compliance with the order.

(2) Full compliance shall not be mandated under division (B)(1) of this section to the extent that the ratio between the blended advanced energy and nonadvanced energy price under this section in 2025 and the portion of that price attributable to nonadvanced energy exceeds one and three-hundredths.

This last provision only applies if the Commission determines that the utility has failed under division (A).

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biofuel, hydro, or geothermal resources that are used in the generation of electricity and includes fuel cells powered by sustainable resources.”

<sup>2</sup> “‘Advanced energy facility’ means any method or any modification or replacement of any property, process, device, structure, or equipment that meets any of the following:

(1) With regard to clean coal technology, technology that includes the design capability to control or prevent the emission of carbon dioxide, which design capability the commission shall adopt by rule and shall be based on economically feasible best available technology, or in the absence of a determined best available technology, shall be of the highest level of economically feasible design capability for which there exists generally accepted scientific opinion; (2) With regard to advanced nuclear energy production, consists of generation III technology as defined by the nuclear regulatory commission, other later technology, or significant improvements to existing facilities; (3) With regard to fuel cells used in the generation of electricity, consists of, but is not limited to, a proton exchange membrane fuel cell, phosphoric acid fuel cell, molten carbonate fuel cell, or solid fuel cell; (4) With regard to cogeneration technology, consists of a technology using a heat engine or power station to generate electricity and useful heat simultaneously;....”