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Embracing Electricity Markets and Quarantining the Monopoly

Good afternoon, Chairman Cupp and members of the committee. Thank you for the opportunity to testify before you today on House Bill 247. My name is Devin Hartman, and I am electricity policy manager and a senior fellow at the R Street Institute, a pragmatic free-market think tank. My perspective today reflects my experiences serving in my current capacity, but also as an economic analyst at the Federal Energy Regulatory Commission and the Indiana Utility Regulatory Commission. Those I offer today are my personal views.

Beginning in the 1990s, Ohio joined 12 other states and the District of Columbia in restructuring their electricity systems. This facilitated competitive wholesale markets for power generation and retail markets where customers can choose their electricity supplier. It also limited the scope of monopoly regulation to the distribution utility.

It took roughly a decade for wholesale and retail electricity markets to mature and most transition policies to phase-out. For example, Ohio utilities received over $9 billion in "stranded asset" and "regulatory transition" payments from 2000-2010.[1] Ohio's robust retail market did not emerge until 2011.[2] A joint study by Cleveland State University and Ohio State University found that this restructuring has resulted in $15 billion in Ohio consumer savings since 2011, and it projects comparable savings through 2020.[3]

Since the turn of this decade, competitive markets have unquestionably outperformed the monopoly model. From 2008 to 2016, the weighted-average price of electricity in monopoly states increased 15 percent and decreased 8 percent in restructured states.[4] In the mid-1990s, Illinois and Ohio had the first and third highest retail electricity rates in the Midwest, respectively.[5] Currently, Illinois and Ohio, the only Midwest states to restructure, have the lowest rates in the region.[6]

To date, the greatest economic gains from restructuring have occurred at the wholesale level. For Ohio, this has taken place in the PJM Interconnection, LLC, which administers wholesale markets. In fact, the Buckeye Institute and R Street Institute recently published an interview with the independent auditor of PJM's markets who identified that they:

1. Send efficient price signals for lower cost resources to enter the market (e.g., highly efficient natural gas turbines);
2. Signal higher cost resources to exit the market (e.g., retirement of over 20,000 megawatts of unprofitable coal plants since 2011);

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[1] "Senate Bill 155 Opponent Testimony of Kim Bojko, Partner Carpenter Lipps & Leland LLP, Energy Counsel to the Ohio Manufacturers' Association," Public Utilities Committee of the Ohio Senate, June 15, 2017, 3. http://search-prod.lis.state.oh.us/cm_pub_api/api/unwrap/chamber/132nd_ga/ready_for_publication/committee_docs/cmte_s_pubutil_1/testimony/cmte_s_pubutil_1_2017-06-15-0900_581/kbojkotestimonyoveclegislation.pdf.

[2] Andrew R. Thomas, et al., "Electricity Customer Choice in Ohio: How Competition Has Outperformed Traditional Monopoly Regulation," *Urban Publications*, November 2016, 1. http://engagedscholarship.csuohio.edu/cgi/viewcontent.cgi?article=2420&context=urban_facpub.

[3] Andrew R. Thomas, et al., "Electricity Customer Choice in Ohio: How Competition Has Outperformed Traditional Monopoly Regulation," Urban Publications, November 2016, 1. http://engagedscholarship.csuohio.edu/cgi/viewcontent. cgi?article=2420&context=urban_facpub.

[4] Philip R. O'Connor, "Restructuring Recharged: The Superior Performance of Competitive Electricity Markets 2008-2016," Retail Energy Supply Association, April 2017, 17. https://www.resausa.org/sites/default/files/RESA_Restructuring_Recharged_White%20Paper_0.pdf.

[5] See, e.g., U.S. Energy Information Administration, "Electric Power Monthly: Data for June 1996," U.S. Dept. of Energy, June 12, 1996, 68. https://www.eia.gov/electricity/monthly/archive/pdf/02269606.pdf.

[6] U.S. Energy Information Administration, "Electric Power Monthly: Data for July 2017," U.S. Dept. of Energy, Aug. 24, 2017. https://www.eia.gov/electricity/monthly/archive/september2017.pdf.

3. Provide incentives for innovation and risk management by placing investment risks and rewards on private capital rather than socializing it across captive ratepayers (the monopoly model); and
4. Maintain electric reliability at the lowest possible cost by facilitating competition to meet defined system reliability needs.[7]

However, many of these benefits of competitive wholesale electricity markets have not flowed through to Ohio consumers. Since 2008, Ohio has had the worst electric price performance of all restructured states.[8] The principal culprit is state regulatory intervention that subsidizes a parent company's competitive generation affiliate through its regulated distribution monopoly. The primary subsidy vehicle is electric security plans (ESPs) that have already cost Ohioans over one billion dollars this decade.[9]

These regulatory subsidies violate a cardinal rule of electric restructuring that is laid out in the economic literature. The injection of subsidies through a regulatory mechanism into a competitive marketplace creates deep anti-competitive concerns, raises consumer costs and distorts market outcomes. Instead, Ohio should isolate the regulated monopoly to prevent cross-subsidization within a parent company. Economists have long emphasized the need to "quarantine the monopoly" as the single most effective approach to create robust electric competition.[10]

New evidence highlights the consequences of Ohio failing to quarantine the monopoly. A study by Ohio State University researchers found that declining wholesale prices lowered earnings for generation companies and should have resulted in savings passed on to consumers.[11] However, utilities used

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[7] Joe Nichols and Devin Hartman, "Don't Short Circuit the Ohio Electricity Market: A Q&A with Dr. Joe Bowring on State Subsidies and Power Plant Bailouts," The Buckeye Institute and the R Street Institute, 2017, 2. http://2o9ub0417chl2lg6m43em6psi2i.wpengine.netdna-cdn.com/wp-content/uploads/2017/10/2017-10-16-Don-t-Short-Circuit-the-Ohio-Electricity-Market-By-Joe-Nichols-and-Devin-Hartman.pdf.

[8] O'Connor, 20. https://www.resausa.org/sites/default/files/RESA_Restructuring_Recharged_White%20Paper_0.pdf.

[9] Office of the Ohio Consumers' Counsel, "Subsidy Scorecard," Sept. 1, 2017. http://www.occ.ohio.gov/electric/subsidy-scorecard.pdf.

[10] Michael Giberson and Lynne Kiesling, "Vision for a clean, cheap, cutting-edge, customer-focused electric power business," Draft Working Paper, Nov. 1, 2016, p3. https://static1.squarespace.com/static/53c4b06fe4b03a89bfc573b3/t/5818e2108419c21ac8d34e5a/1478025745336/Vision+for+a+clean%2C+cheap%2C+cuttingedge%2C+customerfocused+electric+power+business+%28Nov+1+2016+Draft%29.pdf.

[11] Noah Dormady, Matthew Hoyt, et al., "Who Pays in Deregulated Energy Markets? A Panel Analysis of Cross-Subsidization from Ohio Complete Bill Data," IAEE/USAEE Annual Meetings, November 2017, 13.

regulatory-approved riders and surcharges to offset the losses of their generation affiliates in the wholesale market.[12] This complex system of subsidies has harmed consumers and could have been averted had policymakers and regulators thoroughly implemented restructuring consistent with longstanding academic literature.[13]

Indeed, restructuring was a wise policy decision, but Ohio did not fully implement it correctly. This has resulted in a hybrid, quasi-regulated paradigm with extensive utility subsidization at ratepayers' expense. In view of this, H.B. 247 provides a path to complete the full market transition, which will provide billions of dollars of benefits to Ohio's economy. It does so by accomplishing the following three recommendations from the joint Buckeye Institute/R Street Institute paper:[14]

1. *Quarantine the monopoly*. Ohio should have full corporate separation of competitive power generation and the regulated distribution monopoly. This is the case in Texas, which has witnessed the sharpest declines in customer rates since 2008.[15]
2. *Embrace market pricing.* Market pricing should determine charges to customers, not extra charges and subsidies such as those in ESPs. For this reason, Ohio should eliminate ESPs.
3. *Refund overcharged customers.* Ohio law should enable the Public Utilities Commission of Ohio to issue refunds to overcharged customers.

Thank you for your time today. I would be happy to take any questions at this time.

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http://www.usaee.org/usaee2017/submissions/Presentations/3_Dormady&Hoyt_USAEE_Houston_11-13-17_FINAL.pdf.

[12] Ibid.

[13] Noah Dormady, Matthew Hoyt, et al., "Who Pays in Deregulated Electricity Markets?: Quasi-Experimental Evidence of Inter-Class Subsidization From Ohio Complete Bill Data," IAEE/USAEE Annual Meetings, November 2017, 2. http://www.usaee.org/usaee2017/submissions/Abs/DormadyHoytRoahenriquez.pdf.

[14] Nichols and Hartman, 6.

[15] O'Connor, 20.
https://www.resausa.org/sites/default/files/RESA_Restructuring_Recharged_White%20Paper_0.pdf.