HB 6 AND THE ROAD BACK FROM CORRUPTION

December 2020

Ohioans are rightly shocked by the recent reports of corruption in the state regarding energy legislation. Central to the current scandals is HB 6, passed in 2019, which will give over $1 billion to two nuclear power plants and another $400 million to two aging coal plants owned by the three major electric utilities in Ohio.

HB 6 was always controversial. But recent events have questioned the legitimacy of the law. Both the Speaker of the Ohio House and the head of Ohio's Public Utilities Commission (which regulates electric utilities) have had their homes raided in connection with a $60 million bribery scheme to pass HB 6. FirstEnergy Corp. has fired its CEO, and two individuals have already pled guilty to participation in the scheme.

The revelations have understandably led to calls for the repeal of HB 6.

While repealing HB 6 is a necessary first step, Ohioans should also look at the deeper factors that have made corruption like this more likely.

THE DANGER OF RENT-SEEKING

Whenever government plays a decisive role in the success or failure of a business, that business will have a strong incentive to manipulate government action to its own advantage. This is known among experts as "rent-seeking."

In the electric sector, government meddling has created the perfect breeding ground for both legal and illegal forms of rent-seeking. Situations where a regulated organization comes to control effectively or manipulate their own regulators is called "regulatory capture."

In addition to money, electric companies can use their control over information about electricity use and the electrical system, as well as their technical expertise, to manipulate regulators or legislators in their favor.

OHIO'S ELECTRIC SYSTEM FOSTERS RENT-SEEKING

Before 1999, Ohio operated under a monopoly electric model, with a single company or group of affiliated entities providing generation, transmission and distribution exclusively within their territory. Electric utilities in these states are subject to intensive government oversight and must get approval for the electric rates they charge from a state regulator.

In 1999, Ohio took the step of partially restructuring its electric system to allow for more competition with respect to electric generation. Utilities retain monopoly control over the transmission and distribution (delivery) of electricity.

While this change has reduced generation costs for Ohio electric consumers, it left dangerous connections between the monopoly and the competitive segments of the electric grid. Companies that owned monopoly distribution utilities were not required to sell off all of their generation power plants. These plants had been built under the old non-competitive system, and in many cases were simply unprofitable under competition.

When a single parent company is able to operate in both the monopoly and competitive sectors, the parent company can leverage its distribution monopoly holding to benefit its competitive generation holding, either by securing regulatory subsidies or by harnessing the lobbying advantage held by incumbent utilities relative to new companies. This does not foster an incentive to innovate or reduce expenses.

It is easy for states to get into a vicious cycle, where government subsidies to an industry create powerful interest groups which advocate still greater subsidies for itself.

HOW TO PREVENT UTILITY RENT-SEEKING

To minimize the risk of rent-seeking, policymakers and regulators should prioritize the following:

Restructure properly: isolate monopolies to distribution services only.
Experts have increasingly realized the importance of keeping monopoly and competitive businesses separate. Known as "quarantining the monopoly," this means requiring utilities to sell off generation and remove the distribution utility from providing default retail service. Quasi-restructured states like Ohio need to finish the job.

Regulate distribution monopolies properly. Ohio should clarify that regulators should seek to encourage competition wherever possible. Regulators should improve the transparency of distribution system planning and operations and lay the groundwork for an emerging distribution-level market that fosters distributed resource integration. They should attempt to shift the business risks from the customer to the monopoly.

Knowledge is power. Utilities can use their technical knowledge and access to data as a way to bend regulation in their favor. Improving the quality of information available to industry stakeholders and policymakers can also help overcome the lobbying asymmetry and deters rent-seeking.

Remain disciplined. The legislature and regulators should have a bias against intervening in electric markets to steer toward a certain outcome. Such interventions can be habit forming and allow for corporate manipulation.

CONTACT US

For more information on this subject, contact the R Street Institute, 1212 New York Ave. NW, Washington, D.C. 20005, 202-525-5717.

Josiah Neeley
Senior Resident Fellow
Energy and Environmental Policy
jneeley@rstreet.org
512-415-2012

Michael Haugh
Senior Fellow
Energy and Environmental Policy
mhaugh@rstreet.org