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The Electric Company to the Rescue

By David J. Robinson

SAVING AMERICA'S INDUSTRIAL HEARTLAND THROUGH ELECTRIC RATE INCENTIVES

Success of America's industrial sector has always been dependent on power utilities. Regulation of these utilities and the use of electric rate incentives impacts how an electric utility operates in our economy. **Ohio offers an interesting model for the regulation of the electric industry and the use of electric rate incentives. Ohio created a hybrid system of regulation.** Electric utilities are permitted to use either a monopoly-based regulatory approach or jump into the marketplace. The state also created an aggressive electric rate incentive program. Ohio may be the proving ground that determines if electric companies can lead America's industrial heartland into economic recovery. If not, the electric companies will suffer along with everyone else.

the electric company

TO THE RESCUE

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Power utilities and economic development go hand-in-hand. Whether as regulated monopolies or competitors for major power customers, utilities often play a major role in the recruitment and retention of companies and economic development across the United States. Regional, state, and even our national economic recovery in many ways may depend on the role of power utilities in our economy. For America to remain a global economic power, we must remain a place that makes things. Whether it is cars or the next cure for cancer, America's standard of living cannot be based upon a purely service sector economy. The cost of electric power for manufacturing customers and the role these power utilities play in implementing economic development strategy both make America's power utilities a key to our economic future. In addition, power utilities often play a strong private sector role in retaining and recruiting major employers.

In states with regulated monopoly electric power utilities, the relationship between electric utilities and economic development is fairly simple. For states that joined the electric deregulation bandwagon, however, the decision to devote resources to economic development becomes much more challenging for electric utilities. States such as Ohio offer an interesting model for economic development through a hybrid regulatory model matched with an aggressive electric rate incentive program – a significant development since utilities are uniquely well-equipped to answer the call for economic development leadership.

W.C. Beckjord Station is a nominal 862-megawatt facility with six coal/steam units located in New Richmond, Ohio, approximately 20 miles east of Cincinnati.

THE UTILITY ECONOMIC DEVELOPMENT MODEL

The business case for regulated utilities to invest in economic development has existed for quite some time. However, the "deregulation" of the power industry in states across the U.S. puts that business case in jeopardy. Now many of those same states are exiting the deregulation experiment and time will tell whether the power companies jump back into economic development. Although there are a few policy pieces yet to be put in place, the future success of electric and natural gas utilities may well depend on a renewed program of economic development.

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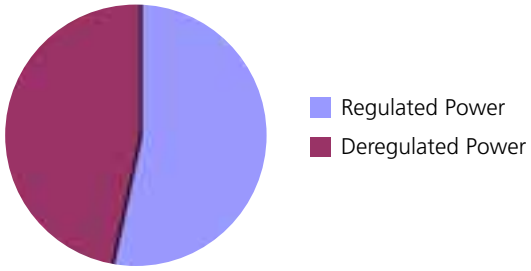
SAVING AMERICA'S INDUSTRIAL HEARTLAND THROUGH ELECTRIC RATE INCENTIVES

Success of America's industrial sector has always been dependent on power utilities. Regulation of these utilities and the use of electric rate incentives impacts how an electric utility operates in our economy. Ohio offers an interesting model for the regulation of the electric industry and the use of electric rate incentives. Ohio created a hybrid system of regulation. Electric utilities are permitted to use either a monopoly-based regulatory approach or jump into the marketplace. The state also created an aggressive electric rate incentive program. Ohio may be the proving ground that determines if electric companies can lead America's industrial heartland into economic recovery. If not, the electric companies will suffer along with everyone else.

Back in the day, customers knew who provided their power. When a problem arose, a solution was just a phone call away. In exchange, utilities charged a price – set by a government regulatory process – that was based on costs and allowed a profit. Utilities charged customers for the costs of moving power from the source to customers' homes and businesses. These costs included purchasing the power source, delivering power to customers, measuring customers' use, providing emergency service, and billing customers. Under this system, utilities hired an army of staff to sell their product and to promote economic development in their territories. The relationship between utilities and economic development was symbiotic: more factories, office parks, shopping malls, and housing developments meant more power users, a stronger economy, and better funding for schools and state and local governments. It was a unique social and economic compact.

Things began to change when industries such as airlines and others were deregulated in an effort to break the economic malaise of the 1970s. Deregulation eventually made its way to the power utility industry. Massive capital investments and the detailed logistics of serving millions of customers complicate deregulation in the power utility industry. By most counts, 19 of the 50 states now have deregulated electric power service but this constitutes 47 percent of the energy used in the U.S.[1]

US Percentage of Power From Electric Regulated v. Deregulated States



States such as Ohio, Pennsylvania, New Jersey, Illinois, Michigan, New York, Connecticut, Rhode Island, Maine, New Hampshire, California, Arizona, Nevada, Oregon, Maryland, Delaware, and Texas are considered "deregulated" for electric power purposes while Virginia and Montana recently enacted laws to "reregulate" after policy makers grew concerned about the price impact of deregulation.

As a result of deregulation legislation, power service marketers entered the game, placing different utility industry players in competition with one another. Although this approach offered many of Adam Smith's promised benefits of capitalism, it also killed the business case for utility industry economic development armies. In particular, the promise of competitors brought the threat of lost customers. Why, so the reasoning went, would an incumbent power company invest in a sales force when prospective customers could very well end up obtaining power from a utility marketer? As a result, most deregulated utilities scaled back economic development efforts to providing general support for a few, targeted economic development partners. The electric rider offers an interesting middle ground for keeping electric utilities in economic development business.

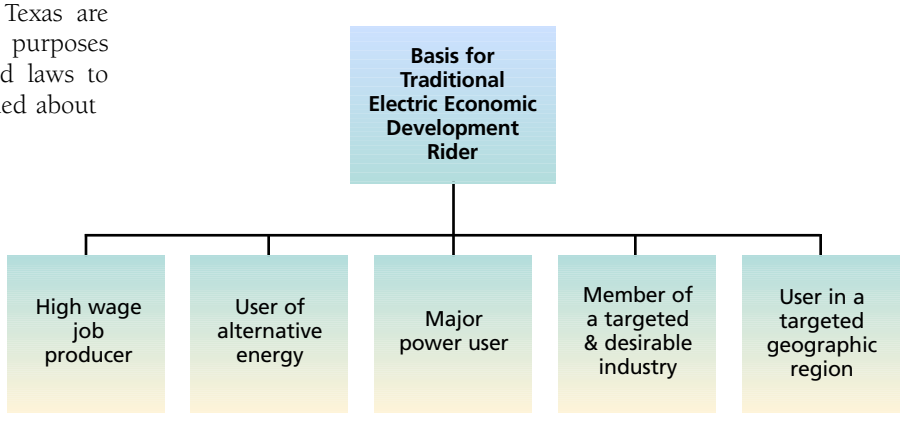
ELECTRIC ECONOMIC DEVELOPMENT RIDER TO THE RESCUE

An electric economic development rider has traditionally been defined as some form of special price provided for a user that policy makers determine deserves a unique rate for service. That "uniqueness" determination could be based upon economic factors such as production of jobs or capital investment, use of alternative sources of power, use of substantial amount of power, membership in a targeted industry or location in a targeted geographic location.

Power companies often focus electric economic development riders into targeted industries. Union County, Georgia, offers three ways for gaining electric load incentives from Blue Ridge Mountain Electric Membership Corporation:

- Companies in mining, manufacturing or bulk transportation with a minimal additional electric for new or existing customers of 100 kilowatts;
- Commercial or industrial customers with a minimal additional electric load requirement of 250 kilowatts with all electric HVAC systems, 50 percent or more floor space that is heated and cooled; and HVAC, interior lighting and /or cooking represent 50 percent or more of the customer's rated electric load; or
- Other qualifying customers that plan to add 250 kilowatts of electric load for all electric HVAC, water heating and/or cooking.[2]

Baltimore Gas & Electric (BGE) offers an economic development incentive rate program targeted within the company's central Maryland service territory that can provide electric rate reductions for up to five years.



These rate reductions apply to BGE's distribution portion of the customer's bill, not the customer's commodity charges. Discounts may be as high as 15 percent to companies that meet the following qualifications:

- Price reduction influences companies' decisions to locate new operations or expand current operations;
- Other government economic development incentive offers involved;
- Qualifying power load of new or incremental power at a minimum of 500 kilowatts or 200 kilowatts if located in an Enterprise Zone or Empowerment Zone;
- Employment expansion of at least ten new jobs; and
- Retail establishments are excluded.[3]

The Duke Energy Envision Center, located just south of Cincinnati in Erlanger, Kentucky, is helping educate people on the potential of smart grid technology. The center features a "smart" home complete with solar panels and an electric vehicle, an apartment complex with advanced meters, and a power delivery control center with real-time monitoring.

New Jersey offers a utility rate program to provide incentives and rebates for the installation of high efficiency equipment as well as rate discounts for companies that locate in targeted urban centers.[4] Also, Indiana, through Duke Energy, offers an economic development rider to select customers that can reduce the maximum demand load charges by 60 percent over 12 months for existing or new customers who add at least 25 new employees per 1,000 kilowatts of new electric load or at least $10 million in capital investment per 1,000 kilowatts of new load. The maximum load to qualify for the rider is 10,000 kilowatts.[5]

Municipalities even get in the electric economic development rider game. New York City promotes a Business Incentive Rate energy discount program co-administered by the NYC Economic Development Corporation and Con Edison. NYC's program is designed to encourage economic growth in the manufacturing and industrial sectors by offering defined discounts off Con Edison's electric delivery charges for manufacturers and wholesale distributors with facilities in the five boroughs of New York. Retail establishments and governmental operations are excluded under this program and electric rate reductions range from 30-35 percent for a five-year term.[6]

Municipalities with their own publicly owned electric utility are often even more aggressive in linking economic development incentives with power discounts. City Water, Light & Power of Springfield, Illinois, offers an economic development rider to encourage new businesses to locate in its city. Focused on industrial customers, the program also offers incentives to non-retail businesses that are large users of power. Larger incentives are provided to "major expansions" which require a monthly demand increase of at least 125 kilowatts over the customer's average base period demand. Major expansion projects can gain discounts as large as 50 percent in year one that decline by 10 percent per year until they terminate after year five. Minor expansions, requiring a demand increase of 75 percent, may receive an incentive lasting just three years but still offering 50 percent off in year one, 30 percent in year two, and 10 percent in the final year.[7]

Ohio's roller coaster ride with electric deregulation offers an interesting national model for how the issue impacts economic development.

Electric economic development riders are nothing new to the scene. However, their use for states that try to escape the bonds of electric deregulation offers some interesting issues.

OHIO AS A MODEL: HYBRID ELECTRIC REGULATION

Ohio's roller coaster ride with electric deregulation offers an interesting national model for how the issue impacts economic development. Ohio's electric deregulation legislation, SB 3, was enacted in 1999.[8] SB 3 not only created a start date for competition but also created a "Market Development Period" that included an electric rate freeze. This rate freeze was scheduled to expire on December 31, 2008. As the date for the rate freeze expiration began to close in, the same industrial customers that pushed for deregulation became concerned that the "promises" of competition would not be delivered. In April of 2008, the Ohio General Assembly and Governor Ted Strickland responded to concerns regarding electric rate shock by enacting SB 221.[9] This legislation addressed two legal and policy goals:

1. It partially eliminated the deregulation framework established by SB 3 by creating a new pricing context; and
2. It promoted alternative energy by creating a goal for electric utilities to obtain 25 percent of their energy from alternative sources by 2025.

In essence, Ohio created a hybrid electric regulatory framework that permitted investor owned electric utilities to go to the marketplace or opt for a non-market based regulatory framework where regulators set rates.

Even more significantly, a little noticed provision of SB 221 may have a major impact on Ohio's economic development efforts. SB 221 creates an opportunity for electric utilities and their business customers to reach "reasonable arrangements" to facilitate Ohio's effectiveness in the global economy, promote job growth, ensure availability of reasonably priced energy, encourage energy efficiency, and provide incentives to develop technologies that address environmental mandates.

Under this provision, electric utility and mercantile customers may file an application for Public Utilities Commission of Ohio (PUCO) approval of an economic development arrangement – the PUCO's version of an economic development incentive. Rules adopted by the PUCO in September 2008 outline which mercantile customers may qualify for this incentive. Several economic development arrangements have been approved by the PUCO thus far.[10] The benefits of the incentives have ranged from $30 million to $60 million just in the first three years of the deals.

OHIO ELECTRIC RATE INCENTIVE OPTIONS
Job Creation
Job Retention
Energy Efficiency
Unique Arrangements

Job Creation

An Ohio electric rate incentive is available to non-retail projects that create 25 full-time jobs over three years with an annual average wage that is 150 percent of the federal minimum wage. In addition, participating companies must demonstrate economic viability and must identify any other local, state, or federal tax incentives being relied upon. Participating utility customers may also identify any secondary benefits of the project and must agree to maintain operations for the duration of the economic development arrangement.

Job Retention

In addition to fostering job creation, an economic arrangement may be granted to retain utility customers likely to cease or reduce operations or relocate them out of state. Many of the standards for retention projects are the same as for economic expansion projects, including the requirement that the project not involve retail activities and that at least 25 jobs be in doubt. Retention projects also require that the customer have an average billing load of at least 250 kilowatts and that the cost of electricity be identified as a major factor in the decision to cease, reduce, or relocate operations.

Energy Efficiency

Energy efficiency arrangements can also be proposed to provide an incentive for developing energy efficient production facilities that create 10 full-time jobs over three years and meet the same criteria as economic expansion arrangements. An energy efficient production facility includes projects that install energy saving products that increase the ratio of energy end-use services (heat, light and drive power) derived from a device or processes as compared to commonly installed energy services. In addition, projects qualify as energy efficient arrangements where any customer manufactures, assembles or distributes products that are used in the production of clean, renewable energy.

Unique Arrangements

Finally, the PUCO proposed rules permit utilities and companies to submit applications for unique arrangements under SB 221. These matters do not require job creation, threats of closure/relocation or energy efficiency but require the filing party to bear the burden of proof.

The PUCO adopted guidelines for how the level of incentives may be judged for all the reasonable arrangements, including:

- demand discounts;
- percentages of total bills or portions of bills;
- direct contributions;
- reflections of cost savings to electric utility;
- shared savings; and
- a combination of all the above.

One of the most important aspects of the PUCO's proposed reasonable arrangement rules is the ability for electric utilities to apply to recover some of the difference between the regular rate schedule and any economic development schedule, energy efficiency schedule, or unique arrangement. In short, the investors for the electric companies will not pay for the savings gained by companies awarded an electric rate incentive. The electric companies other customers will foot the bill for the costs from this PUCO program. This SB 221 legislative mandate is justified by the fact that growing or struggling companies need the economic help of Ohio utilities, rate payers, and state government.

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The PUCO's economic development arrangements give regulators the ability to hold a hearing to review applications for economic arrangements and to keep confidential any customer information provided under the application. Approved arrangements must be posted publicly, are subject to utility customer reporting requirements, and may be revised or modified by the PUCO.

These utility arrangements should have a positive impact on the retention and expansion of manufacturing and other jobs in states like Ohio. The rules governing the arrangements are, in many instances, modeled after Ohio's highly successful Ohio Job Creation Tax Credit and combined with electric load requirements for retention and relocation projects.

The utility arrangements require much less in the way of job creation or retention than Ohio's Job Retention Tax Credit – which is limited to projects involving 1000 or more jobs. In contrast, unique arrangements do not discuss jobs at all, energy efficiency arrangements require just 10 jobs, and economic development arrangements require just 25 jobs. Overall, the PUCO's requirements for economic incentives are lower than those of the Ohio Department of Development, provide no restriction by geographic location on any of the programs, and even permit retail projects and low electric load projects in most likely limited circumstances.

Although the PUCO's standards will be easier to meet, it is not clear that the program process will facilitate successful deal making. The PUCO proposed an important confidentiality requirement, but the requirements for legal affidavits and the possibility of public hearings may create challenges for corporate site location projects on a fast track. Only time will tell if these programs will be evaluated and administered in a manner that is timely and efficient enough to appeal to national corporate site location lawyers, consultants, and Ohio companies in need.

SB 221 also encourages electric utilities to include a financial commitment for economic development in their rate filings but many of those economic development commitments fell by the wayside during the rate case negotiations with Ohio's four major electric utilities.

No doubt as a result of legislative compromise, Ohio electric utilities can choose either traditional regulation or the marketplace. Of the four investor owned electric utilities in Ohio, only First Energy has chosen the marketplace. However, this hybrid approach makes Ohio an innovator to determine if a hybrid approach can bring the best of both worlds- creation of a competitive electric marketplace or use of a regulatory model that has worked for nearly 100 years.

WHAT DISTINGUISHES OHIO?

Policy makers in Ohio may have created a unique approach to bring the electric industry back in as leaders in our economic revival. The Ohio approach is distinguishable in several ways.

Hybrid Regulation

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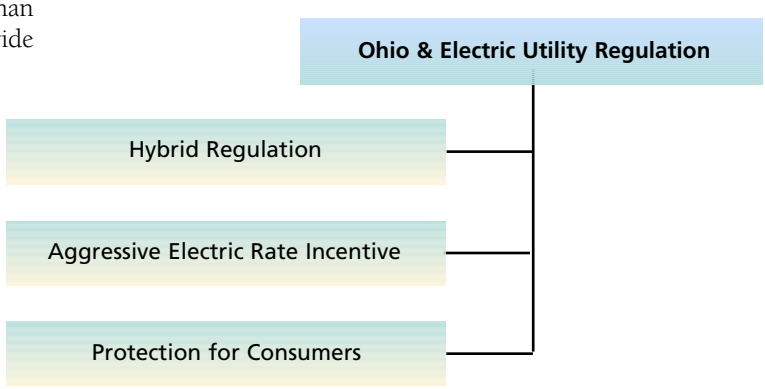


Aggressive Electric Rate Incentives

Ohio threw in the "kitchen sink" when it created its electric rate incentive program. While time will tell if the regulatory process permits its widespread application, the Ohio electric rate incentive program contains no geographic restriction, and creates specific programs for job creation, job retention and alternative energy but also creates a catch-all program that appears to potentially have no restrictions. Struggling industrial states may look to Ohio's electric rate incentive program as a model that can serve as a major strategy for economic recovery.

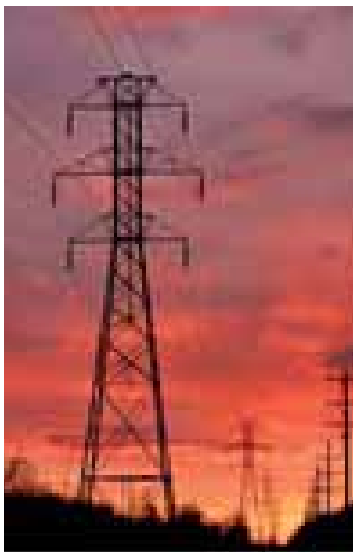
Protection for Consumers

The Ohio electric regulatory program also creates built in protections for consumers. While electric costs from electric rate incentives will be spread across the rate base, the process for awarding these incentives operates through normal PUCO regulatory procedures. This process will rarely move projects through as quickly as economic developers want but it does permit the public and other companies to participate in the administrative review process of the PUCO. The handful of

deals thus far approved in Ohio has been aggressively debated by representatives of residential consumers as well as competitor companies.

THE CASE FOR UTILITY INVOLVEMENT IN ECONOMIC DEVELOPMENT

Great thinking regarding the best electric regulatory framework and electric rate incentive programs falls by the wayside unless the electric utilities themselves can be convinced it makes economic sense for them to aggressively participate in America's economic revival. Whether from a regulated or deregulated state and both from a business and a regulatory incentive standpoint, utilities benefit from substantial engagement with economic development. If a utility operates under a traditional rate-of-return monopoly framework, the benefits of economic development are readily apparent: economic development equals marketing and sales.



Power companies build relationships with manufacturers looking to expand operations in the power companies' service territory. By helping manufacturers with such expansions, power companies sell more power. A competitively deregulated power market, on the other hand, somewhat dampens incentives for utility involvement in economic development but the overall health of the service territory's economy impacts the distribution market. A hybrid market – one that has partial deregulation – offers a mix of opportunities and risks.

For a utility to devote substantial resources to economic development, it must have a strong business case for investment. In a competitive world, contributions for the sake of community relations and brand promotion are generally small in scale and scope. The business case for utilities to make substantial investments in economic development makes sense for the national economy and the electric utility. Consider these factors:

1. Credit Markets Are Looking for Direction from Utilities.

An October 1, 2008, *Wall Street Journal* headline says it all:

> **Turmoil in Credit Markets Sends Jolt to Utility Sector**
>
> The chaos of the financial sector affects all sectors of public finance and private investments. Utilities have not been spared this pain. The capital-starved economy has forced many utilities to delay new borrowing or, alternatively, to devise new and more costly methods of raising funds. Historically, utilities have been a safe haven for stock market investments. Deregulation and other factors are now creating momentary volatility. Ohio utilities would benefit from sending a message to Wall Street that conveys their aggressive plan to market for new customers and redevelop the territories they serve with billions in capital investment and employees.

2. Electric Rate Incentives Can Create Win-Wins for Utilities and Their Customers.

Electric rate incentives provide a reduction of a major expense for industrial customers struggling to survive in a global recession. In addition, electric rate incentives also may lock in a major power customer for a long term electric service contract. Companies that close up their shop are not good customers for electric companies in either a regulated or deregulated marketplace. Customers who sign long term power agreements with an electric utility at reduced rates are more likely to not only remain a customer but remain a customer for a longer period of time in any sort of regulatory environment.

Electric rate incentives provide a reduction of a major expense for industrial customers struggling to survive in a global recession. In addition, electric rate incentives also may lock in a major power customer for a long term electric service contract.

3. State Government Can Create Incentives for Utilities to Lead Economic Development.

States all over the U.S. are starting to create major incentives for utilities to re-engage in economic development. Many electric rate incentive programs offer electric utilities the chance to partner with other industries to foster growth in their service territory and to pass on the expense of the incentives to ratepayers. If properly implemented from a regulatory standpoint and effectively promoted by utilities, these programs could be an important tool for retaining and attracting manufacturers and building research parks and downtown office towers.

In the past, natural gas and electric utility monopolies often competed for customers. Deregulation shifted the intensity of that focus. Electric utilities re-engaged in economic development may renew some of the old market pressures for natural gas utilities, which should give them an incentive to care about economic development.

4. Utilities Are in the Service Business.

Unlike an auto assembly plant, a power utility cannot simply leave a community. Fixed capital investments and myriad government regulations make that option impossible. More importantly, although utilities generate power, up to two-thirds of their business model is centered on providing distribution or retail services to customers in a defined geographic territory.

Utilities are tied to their customers much like lawyers, retailers, hospitals, and accountants are dependent on geographically proximate customers. That geographic tie dictates that business success depends on the economic success of the region. This concept is amplified with power utilities.

The collapse of a manufacturing-based economy has meant lower business revenues, a declining residential base and, consequently, fewer economic opportunities for utilities. Conversely, reinvigoration of a region's economic health – through new-economy jobs such as technology and research – spells growth and development that creates ample opportunities for utilities. In the simplest terms, what's good for the economic health of a region is good for utilities.

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5. Government Cannot Do It Alone.

Successful economic initiatives are led by the private sector but are often the product of a public-private partnership. Private-sector companies, such as utilities, possess the flexibility, independence, and long-term commitment that can be lacking in a political world of term limits, outdated regulatory frameworks, and influential interest groups.

Aggressive leadership from the private sector is a proven catalyst for regional economic success. Research Triangle Park and other successful economic clusters gained strength when private-sector leaders charged ahead with a regional strategy. These leaders leveraged relationships at world class universities, fostered public sector development of essential infrastructure, and otherwise facilitated public sector support and commitment of resources to implement growth strategies.

Struggling industrial states working to transition to the new economy must follow a similar path. To put it simply, these states will not successfully transform into a vibrant information-age economy without private-sector leadership and their utilities are in a prime position to take on this responsibility. Indeed, in a globalized economy, few have the same strategic reach to make a difference.

The manufacturing base of most industrial states has been globalized, leaving it ill-equipped to lead the charge for the new economy because:

- Ownership is residing less and less in those states;
- Companies have typically grown more outside of these states than in; and
- Pressure from competitors matched with technological advances has substantially reduced most companies' community profile, headcount, and overall political strengths.

The new leader in state and regional employment is usually health care institutions. Unfortunately, health care institutions, although large employers, have an intensely complicated public policy agenda. Not only are these institutions large recipients of state funds, government funding of health care constitutes 46 percent of America's health care spending but, with millions left uninsured, health care institutions often have higher policy priorities than economic development and are often stuck in battles among hospitals, insurance health plans, and doctors. In many cases, their political priority will continue to be directing government funding through Medicaid and Medicare rather than spurring economic development.

Retailers, like manufacturers, have been completely changed by the global marketplace, and few of these companies possess the reach or incentive to commit to long-term regional economic development. In fact, most retailers' business strategies involve moving from challenged economic geographies into greener economic pastures. Financial service companies care deeply about regional economies. However, the current financial crisis has focused the industry on short-term survival rather than long-term investment.

So what industry can lead the private-sector economic development charge? Power utilities are it. Economic development cannot happen without affordable and reliable power provided by utility companies. Utilities also have expansive property databases and an ability and reputation for handling economic leads in a confidential nature. Other industry sectors either lack incentives or are disabled by the current economy. Utilities must become economic leaders.

CONCLUSION

The business case for utility economic development leadership is clear. For better or worse, power utilities are in the service business in specific and defined geographic markets. Government alone is incapable of redeveloping struggling regions, and the utility industry is uniquely positioned to lead a private sector economic development initiative. State law and regulations in states such as Ohio create substantial incentives for utilities to re-engage in economic development and can serve as a national model. Finally, states such as Ohio are a market worthy and capable of economic rejuvenation. Private-sector leadership and commitment from the utility industry can start that rejuvenation now.

FOOTNOTES

1 See http://www.electricitybid.com/electricity/index.php/2008/05/05/list-of-electricity-deregulated-states-in-the-usa/

2 See http://www.ucda.net/utilities.html

3 See http://www.bge.com/vcmfiles/BGE/Files/Rates%20and%20Tariffs/Rates%20and%20Tariffs%20Electric/RiderIndex%20-%20All%20Files/Rdr_15.pdf

4 See http://www.njcleanenergy.com/

5 See http://www.duke-energy.com/indiana-large-business/energy-efficiency/incentives-assessments.asp

6 See http://www.nyc.gov/html/sbs/nycbiz/html/incentives/relocation_new.shtml

7 See http://www.cwlp.com/electric_division/electricdiv.htm

8 See http://www.legislature.state.oh.us/BillText123/123_SB_3_10_N.htm

9 See http://www.legislature.state.oh.us/bills.cfm?ID=127_SB_221

10 See http://www.puco.ohio.gov/PUCO/Rules/Rule.cfm?id=8602.