

July 2015

# Electric Fuel Adjustment Clause Review in Ohio

Kevin F. Duffy

Please take a moment to share how this work helps you [through this survey](#). Your feedback will be important as we plan further development of our repository.

Follow this and additional works at: <http://ideaexchange.uakron.edu/akronlawreview>

 Part of the [Natural Resources Law Commons](#), [Oil, Gas, and Mineral Law Commons](#), and the [State and Local Government Law Commons](#)

---

## Recommended Citation

Duffy, Kevin F. (1979) "Electric Fuel Adjustment Clause Review in Ohio," *Akron Law Review*: Vol. 12 : Iss. 3 , Article 4.

Available at: <http://ideaexchange.uakron.edu/akronlawreview/vol12/iss3/4>

This Article is brought to you for free and open access by Akron Law Journals at IdeaExchange@UAkron, the institutional repository of The University of Akron in Akron, Ohio, USA. It has been accepted for inclusion in Akron Law Review by an authorized administrator of IdeaExchange@UAkron. For more information, please contact [mjon@uakron.edu](mailto:mjon@uakron.edu), [uapress@uakron.edu](mailto:uapress@uakron.edu).

# ELECTRIC FUEL ADJUSTMENT CLAUSE REVIEW IN OHIO

KEVIN F. DUFFY\*

**K**ING FAISAL ibn Abdul Aziz al Saud of Saudi Arabia was reported to have "exploded with rage" in late 1973 when President Nixon announced that he would ask Congress to send 2.2 billion dollars worth of arms to Israel.<sup>1</sup> The product of the King's rage, of course, was the Arab oil embargo, and very few single events in recent years have had as dramatic an effect on American life. The energy consciousness engendered by the embargo has left us with natural gas deregulation, the Department of Energy, the "double nickel" speed limit and dozens of other changes in our laws, institutions and life style.

One indirect result of the oil embargo was the Ohio General Assembly's passage of Amended House Bill 579, a law which requires the Public Utilities Commission of Ohio to periodically review the fuel adjustment charges of the state's electric utilities.<sup>2</sup> The law has been in effect for over three years now and its success, or lack thereof, has become the subject of public debate. This article will recount Ohio's experience thus far with fuel adjustment clause review and will address the question of whether the fuel adjustment clause should be abolished, which necessarily raises the issue of whether the experiment with fuel adjustment review has failed in Ohio.

A fuel adjustment clause is a mechanism that allows an electric utility to automatically raise or lower its rates, without prior regulatory approval, in response to fluctuations in the price it pays for fuel. Automatic adjustment clauses can and have been applied to other types of utility costs besides fuel. For example, all of Ohio's gas companies have purchased gas adjustment clauses<sup>3</sup> and other states have allowed automatic adjustment for such costs as taxes,<sup>4</sup> interest expense<sup>5</sup> and purchased power.<sup>6</sup> In fact, one state has even approved a "comprehensive" clause for a telephone company which

---

\*B.A., Ohio State Univ., 1967; J.D., Cleveland State Univ., 1972, with honors; currently is Asst. Chief of Public Utilities Section of the Ohio Attorney General's office. The views expressed herein are the author's and not necessarily those of the Public Utilities Commission of Ohio or the Ohio Attorney General's Office.

<sup>1</sup> TIME, Nov. 19, 1973, at 88.

<sup>2</sup> 1975 Ohio Laws.

<sup>3</sup> See OHIO REV. CODE ANN. § 4905.302 (Page Supp. 1978).

<sup>4</sup> E.g., Alabama Power Co., 83 P.U.R.3d 321 (Ala. Serv. Comm'n 1969).

<sup>5</sup> E.g., Rich Mountain Elec. Coop. Inc., No. U-2665 (Wis. Pub. Serv. Comm'n July 30, 1976).

<sup>6</sup> E.g., New England Power Co., 97 P.U.R.3d 41 (F.P.C. 1972).

allows adjustments for increased wages, taxes, depreciation and "other expenses."<sup>7</sup>

Regulatory commissions and legislatures have approved these adjustment clauses in response to the inability of traditional rate making procedures to accommodate sudden and constant changes (usually upward) in utilities' costs. Completion of the extensive investigation and approval process in an ordinary rate increase application case can take years. In the interim, rapidly rising costs, if uncompensated, could erode the utilities' financial position to the point that continued service to the public could be jeopardized. Further, proponents of the clauses argue that the automatic adjustment should obviate the need for frequent rate increase proceedings, thereby saving the utilities, and hence their customers, the considerable expense of such proceedings.<sup>8</sup>

Fuel adjustment clauses are not new; their use has been widespread since the mid 1920's.<sup>9</sup> They were little noticed by the general populace, however, until the 1974 Arab oil embargo caused fuel prices to skyrocket.<sup>10</sup> When customers, particularly those in the coal and oil dependent states, experienced substantial increases in their electric bills without any announced rate increase proceedings, a storm of public protest developed. For example, in Florida, the state Public Service Commission was sued for having "illegally" imposed the fuel adjustment clause without a public hearing;<sup>11</sup> in the District of Columbia, the local commission hired an accounting firm to study existing fuel adjustment surcharges;<sup>12</sup> and on the floor of the United States Senate, the clauses were characterized as "fool adjustment" clauses.<sup>13</sup>

In Ohio, most of the electricity sold is generated by coal and much of the remainder by oil, so the situation was much the same. Average fuel costs paid by Ohio's electric utilities rose 96% from mid 1973 to 1974 and an

<sup>7</sup> Adjustment Clause in Tel. Rate Schedules, 3 P.U.R.4th 298 (N.J. Bd. of Pub. Util. 1973); See also Public Serv. Co. of N.M., 8 P.U.R.4th 113 (N.M. Pub. Serv. Comm'n 1975).

<sup>8</sup> See Southern Cal. Edison Co., 94 P.U.R.3d 252 (Cal. Pub. Util. Comm'n 1972); F.P.C. Notice of Proposed Rulemaking, 40 Fed. Reg. 26,702, 26,703 (1975).

<sup>9</sup> Trigg, *Escalator Clauses in Public Utility Rate Schedules*, 106 U. PA. L. REV. 964 (1958).

<sup>10</sup> The cost of coal delivered to electric utilities in the United States remained stable at about forty cents per million BTU for most of 1973. By August, 1974, it had doubled. NAT'L ASSOC. OF REGULATORY UTIL. COMM'RS, *ECONOMIC DATA OF THE REGULATION OF UTILITY AND TRANSPORTATION COMPANIES*, p. 6-45 (1974).

<sup>11</sup> Schiffel, *Electric Utility Regulation: An Overview of Fuel Adjustment Clauses*, PUB. UTIL. FORT. 21, June 19, 1975, at 23.

<sup>12</sup> *Id.* at 24.

<sup>13</sup> *Id.* at 23.

additional twenty-eight percent by January, 1975.<sup>14</sup> The resulting fuel adjustment charges, coupled with the realization that such increases had not been subjected to regulatory scrutiny, produced public calls for reform. The mood at the time is typified by the statement of a state legislator who had just met with a citizens' group named "POWER" (People Outraged With Energy Rates): "All they can do is hope that the PUCO and the legislators can come to grips with the fuel clause problem before winter sets in."<sup>15</sup>

In mid 1975, a joint committee of the Ohio General Assembly chaired by State Senator Thomas Carney issued a report on the state's fuel adjustment clause as part of a larger study on energy matters.<sup>16</sup> The Carney Committee found no clear indication of improper activities by any Ohio electric utility and concluded that a fuel adjustment clause in some form was necessary. However, the committee also found that regulatory oversight of the existing clauses by the Public Utilities Commission had not been satisfactory and that information the utilities were required to file with the Commission was inadequate to evaluate the electric companies' fuel procurement practices. The Committee additionally criticized the lack of uniformity among existing fuel clauses, which had been approved over the years on a case by case basis for each electric company.<sup>17</sup>

The Carney Committee Report formed the basis for Amended House Bill 579, which was passed by the Ohio General Assembly as an emergency measure, effective immediately, on December 21, 1975. This new law replaced the then minimal scrutiny of fuel adjustment charges with a rather comprehensive mechanism for review. Basically, the legislative approach was three pronged: periodic reports, audits and hearings. House Bill 579 enacted Section 3905.66(A) of the Ohio Revised Code which requires each electric utility to file with the Public Utilities Commission an annual report detailing the company's fuel procurement practices and a monthly report of its fuel purchases, fuel quality, production statistics and the amount of its fuel adjustment charge on a cents per kilowatt-hour basis.<sup>18</sup> The statute further

<sup>14</sup> 111th OHIO GEN. ASSEMBLY, REPORT OF THE JOINT SELECT COMM. ON ENERGY (Oct. 15, 1975) [hereinafter cited as CARNEY COMMITTEE REPORT], Ex. 1.

<sup>15</sup> *Utility Costs Draw Ire*, Parma Sun-Post, July 31, 1975.

<sup>16</sup> CARNEY COMMITTEE REPORT, *supra* note 14.

<sup>17</sup> *Id.* Findings 1,2,4,5,7.

<sup>18</sup> OHIO REV. CODE ANN. § 4905.66(A) (Page 1977). This subsection of the statute provides:

(A) The public utilities commission shall require from each electric light company, the timely submission of any data, information, or evaluation pertinent to the fuel procurement practices of the company which the commission determines is necessary for it to judge the prudence and effectiveness of such practices and similar data for the years 1973, 1974, and any other preceding years that the commission may determine to

requires the Commission to conduct or cause to be conducted an annual audit of each electric company's fuel related policies and practices.<sup>19</sup> Ohio

be required for analysis of historical trends. The data, information, and evaluations required to be submitted shall include, but are not limited to:

- (1) A report that shall be filed annually, on a date to be established by the public utilities commission, for the prior fiscal year ending with the month prior to the filing and that shall state with respect to each contract that the company has entered into for the supply of fuel for the generation of electricity:
  - (a) The duration of the contract;
  - (b) To the extent it is available to the company through lawful means, the ownership of the fuel supplier;
  - (c) The type of fuel supplied and, where possible, the identification and location of the facilities at which it was extracted and processed;
  - (d) An estimate of the total and periodic amount of fuel to be supplied under the contract;
  - (e) The extent to which a contract for fuel, that is for a period longer than one year, is of the "cost plus profit" type. Such a contract is of such type, for purposes of this division, where it requires that an originally bargained price, in addition to determined pro rata increases, is paid by the company;
  - (f) The extent to which the electric light company has attempted to rectify any abridgement of any rights it may have to a supply of fuel under a fuel supply contract that is for a period of more than one year.
- (2) An annual report of the fuel procurement practices of the company, describing:
  - (a) The overall fuel procurement performance of the company in the preceding calendar year;
  - (b) A description of efforts the company has made to reduce overall costs of fuel supply and the success of those efforts.
- (3) A report that shall be filed each month for the prior calendar month and that shall state:
  - (a) The name and address of each supplier of fuel to the company for the generation of electricity;
  - (b) With respect to the cost of purchases made by the company in the period covered by the report, the invoice price of each weight or volume unit of fuel supplied to the company for the generation of electricity;
  - (c) With respect to the cost of deliveries made to the company in the period covered by the report, the applicable delivery costs of the company;
  - (d) The quantity of British thermal units consumed by the company in the generation of electricity;
  - (e) The cost to the company of each million British thermal units consumed by the company in the generation of electricity;
  - (f) The amount of net kilowatt hours generated by the company;
  - (g) The amount of fuel cost adjustment expressed in cents per kilowatt hour plus or minus the fuel cost adjustment so expressed for the previous month reported; . . . .

<sup>19</sup> *Id.* § 4905.66(B)(2). The review procedure provided by subsection (B) is as follows:

(B) (1) For the purpose of evaluating the fuel related practices and policies of each electric light company, the public utilities commission shall make a monthly review of all the data contained in the monthly report submitted by an electric light company, pursuant to division (A) (3) of this section, including whatever additional information is considered appropriate by the commission.

(2) At least annually, the public utilities commission shall conduct or cause to be conducted an audit of fuel related policies and practices of each electric light company.

(3) A report of the findings made by the public utilities commission pursuant to the audit required by division (B) (2) of this section, together with any orders that the commission may have made in the prior year relating to the fuel purchase activities of electric light companies shall be submitted by the commission to the general assembly with the submission of the commission's annual report.

Revised Code Sections 4905.301(B)<sup>20</sup> and 4909.191<sup>21</sup> mandate the Commission to conduct a hearing every six months at which each electric utility must demonstrate that during the subject time period its fuel adjustment charges were fair, just and reasonable.<sup>22</sup>

The review of fuel charges provided for in House Bill 579, is essentially an after the fact review. That is, the utilities are allowed to recover their fuel costs through the clause subject to readjustment or refund if the Commission finds either that the charges were mathematically incorrect after reviewing each company's monthly report<sup>23</sup> or that such charges were erroneous or unreasonable at the individual company's semiannual hearings.<sup>24</sup>

Additionally, House Bill 579 directed the Public Utilities Commission to promulgate a rule implementing the new law and the Commission re-

<sup>20</sup> *Id.* § 4905.301(B), which provides:

(B) Subject to sections 4909.19 and 4909.191 [4909.19.1] of the Revised Code, schedules of the type required by section 4905.30 of the Revised Code that contain a provision that authorizes any electric light company to continue to pass through any further amount of its acquisition and delivery costs shall be reviewed at a hearing by the public utilities commission once in every six months. The public utilities commission may, in its discretion, establish such staggered dates for the hearing on the fuel cost adjustment clause for each electric light company as provide for effective and efficient regulation of the fuel cost adjustment clause.

<sup>21</sup> *Id.* § 4909.191.

<sup>22</sup> *Id.* § 4909.191(C).

<sup>23</sup> *Id.* § 4905.66(E) and (F), which provide:

(E) The public utilities commission shall, within thirty days of the report filed in conformity with division (A) (3) of this section, examine and determine for the period covered by the report:

(1) Whether the payments made as a result of acquisition and delivery costs have been erroneously reported;

(2) The arithmetic accuracy of all amounts passed through to the customers of the company as reflected on bills to such customers mailed in the period covered by the report.

(F) (1) Where the public utilities commission determines, under division (E) of this section, that an error or inaccuracy exists, the commission shall immediately order the company to readjust equitably the rates charged all its customers accordingly or order a refund. The commission shall set a reasonable period for the company to comply with its order.

(2) Where the public utilities commission determines, as a result of the examination conducted under division (E) of this section, that an inaccuracy exists, the effect of which is that customers of an electric light company have been undercharged, the commission shall order the company to equitably adjust the rates charged to all its customers.

<sup>24</sup> *Id.* § 4909.191(D), which provides:

(D) The public utilities commission shall readjust the rates of the electric light company or order the company to refund any charges it has collected under its fuel cost adjustment clause which the commission finds to have resulted from:

(1) Errors or erroneous reporting;

(2) Imprudent or unreasonable fuel procurement policies and practices;

(3) Errors in the estimation of kilowatt hours sold;

(4) Such other practices, policies, and factors as the commission considers appropriate.

sponded by issuing Chapter 26 of its Rules and Regulations.<sup>25</sup> Rule 26, as it is now commonly called, fleshed out House Bill 579 by providing for a uniform fuel adjustment clause to be used by all regulated electric companies (as recommended by the legislation) and detailing the procedures to be used in the reports, audits and hearings mandated by the legislation.

The new uniform fuel adjustment clause differs from the then existing clauses in several important respects. First, fuel cost recovery under Rule 26 is zero based; that is, all of the companies' qualifying fuel costs are recoverable through the clause.<sup>26</sup> This makes it possible to separately identify

<sup>25</sup> OHIO ADMIN. CODE § 4901:1-11-01 to 09 (Banks-Baldwin 1978).

<sup>26</sup> Fuel costs qualifying for inclusion in the fuel adjustment clause are calculated pursuant to OHIO ADMIN. CODE § 4901:1-11-01 (Banks-Baldwin 1978):

(A) Fuel Charge Calculation.

The allowable fuel charge per kilowatt-hour of the electric utility company in a given month equals the includable fuel cost for the preceding calendar month divided by the total number of includable kilowatt-hours for the preceding calendar month, except that the includable fuel costs, other than those attributable to purchased power, shall be reduced by multiplying by the ratio of the weighted average thermal efficiency achieved for the month to the target thermal efficiency whenever that ratio is less than one.

(B) Fuel Cost Determination.

Each electric utility shall determine its cost for fuel consumed during the month as a sum of the products of the weighted average unit cost for each type of fuel multiplied by the number of units of such fuel consumed during the month.

(C) Thermal Efficiency.

(1) Target Thermal Efficiency.

The target thermal efficiency shall be the reference measure of the electric utility's thermal efficiency. The target thermal efficiency, to be determined by the Commission pursuant to Chapter 4901:1-11 of the Commission's Rules and Regulations, shall be expressed in terms of net kilowatt-hours generated per million British Thermal Units (MMBTU) of fuel consumed.

(2) Weighted Average Thermal Efficiency Achieved for the Month.

The weighted average thermal efficiency achieved for the month is the net kilowatt-hours generated in the immediately preceding twelve months by the electric utility and its generating subsidiaries, and by all of their own and by their share of jointly owned or leased generating plants, divided by the amount, in million British Thermal Units, of fuel consumed in the same twelve months by the same plants. The weighted average thermal efficiency shall be determined each month for purposes of comparison with target thermal efficiency.

(D) Includable Fuel Costs.

Includable fuel costs are those direct and justifiable consumed fuel costs attributable to the includable kilowatt-hours. These costs shall equal the direct cost of fuel F.O.B. at the plant plus the fuel cost attributable to purchased power, less the fuel charges attributable to power sold for resale, and less the fuel charges attributable to any additional kilowatt-hours to be excluded that were sold within the State of Ohio, but outside the jurisdiction of the Public Utilities Commission.

(E) Includable Kilowatt-Hours.

Includable kilowatt-hours are the number of kilowatt-hours of system net generation plus the number of kilowatt-hours purchased less the number of kilowatt-hours sold for resale and less any additional kilowatt-hours to be excluded that are sold within the State of Ohio, but outside the jurisdiction of the Public Utilities Commission.

(F) Operating Procedure.

In procuring its fuel, and in operating its generation, dispatch, transmission, and distribution systems, each electric utility shall attempt to operate at a minimum overall

the fuel charge on customers' bills as required by the Rule.<sup>27</sup> Under prior practice, a portion of the fuel charge had been buried in the utilities' normal, or base, rates. Next, Rule 26 enables the utilities to recover, through the fuel adjustment clause, the fuel costs attributable to purchased power<sup>28</sup> and, under some circumstances, certain nonfuel purchased power costs.<sup>29</sup> Finally, Rule 26 introduces the concept of target thermal efficiency, a mechanism designed to serve as an incentive for the electric companies to efficiently operate their generating facilities.<sup>30</sup> The allowance of purchased power costs and implementation of target thermal efficiency have been the subject of much controversy and will be examined later herein.

Rule 26 coordinates the audit and hearing requirements of House Bill 579 by providing that at one of the two semiannual hearings for each company the Commission shall consider the findings of the financial and performance audits.<sup>31</sup> The rule outlines the scope of the required audits and provides that such shall be performed, unless otherwise ordered, by qualified independent auditing firms and paid for by the audited utility.<sup>32</sup> In practice, the audits have all been performed by the major accounting firms.

Thus far, the Commission has held fifty-six review hearings on the fuel adjustment clause, seven for each of Ohio's regulated electric utilities, which have encompassed three annual audits per company. The hearings have lasted anywhere from a few hours to fifteen days. Representatives of industrial, commercial and residential consumers of the utilities have intervened in these hearings and cross-examined the auditors and company officials. The state's Office of Consumers' Counsel, which is charged by statutory law to represent all residential consumers in proceedings before the Public Utilities Commission,<sup>33</sup> has participated extensively in the hearings. In fact, that Office considers its participation in the fuel adjustment clause hearings a high priority item.<sup>34</sup> Needless to say, few, if any, of the electric companies' practices that affect their fuel charges have remained unexamined. For the

---

cost, taking into consideration the utility's voltage, frequency, reliability, safety, environmental, and service quality requirements, as well as the utility's existing contractual obligations.

<sup>27</sup> *Id.* at -08.

<sup>28</sup> *Id.* at -01(A).

<sup>29</sup> *Id.* at -02(I).

<sup>30</sup> *Id.* at -01(C).

<sup>31</sup> *Id.* at -06(D)(4)(b), (c).

<sup>32</sup> *Id.* at -06(C).

<sup>33</sup> OHIO REV. CODE ANN. § 4911.15 (Page 1977). See also § 4911.01-17.

<sup>34</sup> [1978] CONSUMERS' COUNSEL GOVERNING BD. ANN. REP. 34; Goodman, *The Role of Consumer Advocacy Before the P.U.C.O.*, 8 CAP. U.L. REV. 213, 231 (1978).



most part, the Commission has found the companies' fuel charges collected through the fuel adjustment clause to be reasonable and proper. In a few instances, however, the Commission has exercised its statutory authority to order refunds of unreasonable charges. The following issues are some of the major areas of controversy which have arisen in the review hearings on the fuel adjustment charges.

#### A. *Target Thermal Efficiency*

One frequent criticism of fuel adjustment clauses is that they enable utilities to automatically pass on cost increases which removes any incentive for efficient operation. All of the fuel clauses in effect prior to the enactment of House Bill 579, however, did contain one efficiency incentive mechanism, the fixed heat rate translator. Under the old clauses, the companies' fuel adjustment charges fluctuated with variations in the cost of fuel computed on a cents per million British Thermal Unit ( $\text{¢/MMBTU}$ ) basis. The resulting fuel cost was then translated into the cents per kilowatt-hour amount that was ultimately charged to customers. The translation factor, or translator, used for this purpose was established in each company's rate case based upon that utility's heat rate, which is the number of BTU's needed during the time period to generate one kilowatt-hour of electricity. Since the translator was fixed, a company could, between rate cases, suffer a penalty or enjoy a premium depending upon the actual achieved heat rate. Thus, if a company's efficiency declined because more BTU's were needed to generate one kilowatt-hour than accounted for by the translator, the utility would underrecover fuel costs; whereas, if efficiency improved, it would overrecover those costs.

Because the fixed heat rate formula promoted efficiency, the Carney Committee recommended that the mechanism be retained.<sup>35</sup> House Bill 579, as adopted, mandated that the Commission promulgate a fuel adjustment rule establishing a formula by which utilities' efficiency may be measured<sup>36</sup> and establishing incentives for efficiency in terms of costs that may be recovered through the clause.<sup>37</sup>

Rule 26, however, simplified the computation of the fuel adjustment charge. Under the new uniform fuel clause, a utility's allowable fuel costs for a given month are spread across all of the allowable kilowatt-hours generated in that month, thus resulting in a direct cents per kilowatt-hour fuel charge.<sup>38</sup> Therefore, there is no more need for a translator, fixed or

<sup>35</sup> CARNEY COMMITTEE REPORT, *supra* note 14, at 9.

<sup>36</sup> OHIO REV. CODE ANN. § 4905.69(A) (Page 1977).

<sup>37</sup> *Id.* at (C).

<sup>38</sup> OHIO ADMIN. CODE, § 4901:1-11-01(A) (Banks-Baldwin 1978). See note 26 *supra*.

otherwise. To replicate the effect of the fixed heat rate translator, Rule 26 introduced the concept of target thermal efficiency (T.T.E.). Thermal efficiency is the mathematic reciprocal of the heat rate; it expresses the number of kilowatt-hours generated from each million BTU's.<sup>39</sup> The rule provides that a target thermal efficiency, based on the utility's performance in a reference year and any anticipated changes, be set at each company's semiannual fuel hearing.<sup>40</sup> To the extent the company's monthly achieved thermal efficiency falls short of the target, recovery of that month's fuel costs is proportionally reduced.<sup>41</sup>

The utilities expressed strong opposition to target thermal efficiency, primarily because unlike the fixed heat rate translator, T.T.E. does not reward improving efficiency, but only penalizes declining efficiency. The Commission's Chairman noted in a dissenting opinion filed after the first round of fuel hearings that he agreed with the companies' criticism in this respect.<sup>42</sup> In addition, the utilities claimed that maximizing thermal efficiency is not always consistent with minimizing cost and that the T.T.E. formula imposed a penalty for factors beyond the companies' control, such as load growth, weather extremes and equipment outages.

Having failed to keep thermal efficiency out of Rule 26 the companies attempted to emasculate it in practice. Because the Rule is silent on the methodology for computing a target, several of the companies proposed using the lowest achieved target in a prior reference year. The Commission rejected this approach because it would remove any element of incentive and instead adopted the Commission staff's proposed methodology using an average of monthly thermal efficiencies for the reference year.<sup>43</sup>

Since Rule 26 has been in effect, several electric companies have exceeded their target thermal efficiencies and in one case the Commission raised the target despite protestations by the affected utility that uncontrollable declines in efficiency were expected.<sup>44</sup> Other companies, however, have experienced chronic inability to meet their targets and have suffered

---

<sup>39</sup> *Id.* at -01(C)(3).

<sup>40</sup> Target thermal efficiency can also be set in a rate case or at anytime there has been a significant change in circumstances, *id.* at -04(A)(1), (3).

<sup>41</sup> *Id.* at -01(A).

<sup>42</sup> Case Nos. 76-160-EL-FAC through 76-167-EL-FAC (P.U.C.O. Aug. 13, 1976) at 3, 4. (Heckman, Comm'r, dissenting and concurring).

<sup>43</sup> Ohio Power Co., No. 76-161-EL-FAC (P.U.C.O. June 9, 1976) at 2, 3; Cincinnati Gas & Elec. Co., No. 76-164-EL-FAC (P.U.C.O. Sept. 22, 1976) at 11-13.

<sup>44</sup> Cleveland Elec. Illum. Co., No. 76-532-EL-FAC (Subfile A) (P.U.C.O. June 15, 1977) at 3.

the resultant penalties.<sup>45</sup> One reason a company's thermal efficiency may steadily decline is the normal load growth occurring between the addition of new generating units. In other words, as kilowatt-hour sales grow yearly, an electric company usually relies more on relatively less efficient "peaking" units to meet the increased demand until a new, and normally more efficient, unit is built. In such cases, the use of that interim time period as an historical reference year for setting the target thermal efficiency may unfairly penalize the company. Consequently, the Commission's staff in some instances has recommended the use of partially or totally projected data for setting the target, which is contemplated by Rule 26. The Commission sanctioned this approach, but in early cases generally rejected the companies' suggestions that the lowest projected thermal efficiency be used as a target.<sup>46</sup>

Other significant factors affecting the use of target thermal efficiency have been nuclear generation and coal conservation. Nuclear power has somewhat lower thermal efficiency than coal and oil generation, but it is also significantly lower in fuel cost. Therefore, the Commission in *Toledo Edison* decided not to include nuclear generation in thermal efficiency computations, because to do so would discourage the company from making maximum use of its inexpensive nuclear power.<sup>47</sup> During the protracted United Mine Worker's strike in early 1978, thermal efficiency was a secondary consideration to coal conservation. One of several emergency measures implemented by the Commission to mitigate the strike's effect was the suspension of target thermal efficiency during the strike months, thus allowing more liberal use of thermally inefficient oil generation.<sup>48</sup> Following the strike, the Commission omitted the strike months from any calculation of the electric companies' achieved or target thermal efficiencies.

Meanwhile, the electric companies have continued to criticize target thermal efficiency and call for its abolition. In July, 1978, however, the companies gained an unlikely ally in their campaign against the concept of T.T.E. On behalf of the Office of Consumers' Counsel, Touche Ross & Company issued a comprehensive report reviewing fuel adjustment clauses in Ohio.<sup>49</sup> Among other things, the report sharply

<sup>45</sup> Cincinnati Gas & Elec. Co., No. 77-375-EL-FAC (Subfile A) (P.U.C.O. May 4, 1977) at 2; Monongahela Power Co., No. 77-376-EL-FAC (Subfile A) (P.U.C.O. Apr. 5, 1978) at 2-6.

<sup>46</sup> Cincinnati Gas & Elec. Co., No. 77-375-EL-FAC (Subfile A) (P.U.C.O. May 4, 1977) at 2; Monongahela Power Co., No. 77-376-EL-FAC (Subfile A) (P.U.C.O. Apr. 5, 1978) at 2-6.

<sup>47</sup> Toledo Edison Co., No. 77-379-EL-FAC (P.U.C.O. Mar. 10, 1978) at 6.

<sup>48</sup> Emergency Procedures of Elec. Utilities, No. 77-1139-EL-COI (P.U.C.O. Jan. 11, 1978).

<sup>49</sup> TOUCHE ROSS & CO., REVIEW AND ANALYSIS OF THE OHIO FUEL ADJUSTMENT CLAUSE (July, 1978).

criticized target thermal efficiency, primarily on the grounds advanced by the utilities.<sup>50</sup> The report pointed out that generating units with the highest thermal efficiency do not necessarily have the lowest fuel cost, or vice versa, and then concluded that the pursuit of high thermal efficiency may be inconsistent with the minimization of fuel costs.<sup>51</sup> Next, the report agreed with the utilities, and purported to represent by experience that the failure of T.T.E. to allow the companies a premium for improved efficiency results in a positive disincentive to improve efficiency above that required for meeting the target.<sup>52</sup> Because the targets have normally been set using historical data, the utilities have had no desire to attain too high an efficiency since that could lead to a higher target in the future.<sup>53</sup>

In light of such criticism from both industry and consumer representatives, some modification of current Rule 26 is likely. Even the Commission's staff, which developed target thermal efficiency, no longer adamantly defends it, but only states that any change should be made in a rulemaking proceeding and not in the individual companies' semiannual fuel hearings.<sup>54</sup> In the meantime, the Commission has considerably softened the application of the concept in practice. The Commission in recent cases has approved the practice, earlier rejected, of setting a target based upon the lowest projected thermal efficiency the company is expected to achieve.<sup>55</sup> If automatic adjustment of fuel costs is allowed to continue, some efficiency incentive formula is desirable. Hopefully a method can be developed which avoids some of the drawbacks of target thermal efficiency.

## B. *Contract Shortfalls*

In 1967, production per man-day in West Virginia underground coal mines was like in the popular song about sixteen tons; but by 1974, production had dropped to 9.3 tons per man-day, a decline of nearly forty-three percent.<sup>56</sup> This drastic decline in production was echoed nationally and

---

<sup>50</sup> *Id.* at IV-6 to 7.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at IV-6 to 7, IV-19 to 22.

<sup>53</sup> Surprisingly, CONSUMER REPORTS finds something sinister in an efficiency incentive formula that allows for positive incentives. *The Fuel Adjustment Capex*, 39 CONSUMER REPORTS 836, 838 (Nov. 1974).

<sup>54</sup> Cleveland Elec. Illum. Co., No. 77-377-EL-FAC (P.U.C.O. Dec. 7, 1977) at 6.

<sup>55</sup> Ohio Power Co., No. 77-380-EL-FAC (Subfile A) (P.U.C.O. Aug. 16, 1978) at 5; Cincinnati Gas & Elec. Co., No. 78-624-EL-FAC (P.U.C.O. Oct. 25, 1978) at 6.

<sup>56</sup> ERNST & ERNST, FINDINGS, CONCLUSIONS AND RECOMMENDATIONS FROM AUDIT OF FOSSIL FUEL ADJUSTMENT AND RELATED PROCEDURES FOR THE OHIO POWER COMPANY (1976); Ohio Power Co., No. 76-534-EL-FAC (P.U.C.O. Apr. 4, 1977).

is widely acknowledged to have resulted from the enforcement of the Federal Mine Health and Safety Act.<sup>57</sup>

Largely as a result of this phenomenon, many coal companies which supply Ohio's electric utilities have, in recent years, been chronically deficient in delivering the quantities and qualities of coal specified in their contracts with the utilities. For example, in 1975, the Ohio Power Company experienced an overall quantity shortfall of thirty-one percent under its long-term coal contracts.<sup>58</sup> The same year, another electric company's suppliers had aggregate quantity shortfalls of thirty-three percent.<sup>59</sup> Other utilities have experienced quality shortfalls; coal of lower B.T.U., sulfur or ash quality than contractually specified was delivered, thus forcing in some cases, the purchase of more coal to obtain the same heating effect.<sup>60</sup>

Contract shortfalls may cost electric consumers money because the utilities must ordinarily replace the nondelivered or inferior coal with coal purchased under a short-term contract on the spot market. Spot market coal prices are rather volatile and in periods of high demand spot coal producers command substantial premiums. Of course, the reverse is true: when the spot market price is below the prevailing market price of coal under long-term contracts, the electric companies and their customers save money as a result of the long-term coal suppliers' failure to perform.

The fuel shortage created by the Arab oil embargo, along with other factors, increased the demand for coal which pushed spot market prices quite high. Due to this high cost level being passed through the fuel adjustment clause, the Carney Committee perceived shortfalls as a serious problem. Amended House Bill 579 reflected the sentiment that it may be inappropriate for consumers to pay for the dereliction of the coal suppliers. The legislation authorized the Commission to promulgate rules which provide for "exclusion from fuel adjustment clauses of charges arising from . . . unfulfilled contractual obligations of fuel suppliers."<sup>61</sup> The Commission thus included in Rule 26 a provision to the effect that increased coal costs caused by shortfalls are not recoverable through the fuel adjustment clause unless the utility submits satisfactory evidence of its efforts to obtain performance or to recover damages for nonperformance.<sup>62</sup> Upon review, however, the Commission has generally been satisfied with the utilities' contract enforce-

---

<sup>57</sup> 30 U.S.C. §§ 801-962 (Supp. 1979).

<sup>58</sup> Ohio Power Co., No. 76-161-EL-FAC (P.U.C.O. June 9, 1976) at 4.

<sup>59</sup> Cleveland Elec. Illum. Co., No. 76-166-EL-FAC (P.U.C.O. Aug. 11, 1976) at 9, 10.

<sup>60</sup> See, e.g., Dayton Power & Light Co., No. 76-536-EL-FAC (P.U.C.O. Dec. 15, 1976) at 14.

<sup>61</sup> OHIO REV. CODE ANN. § 4905.69(D) (Page 1977).

<sup>62</sup> OHIO ADMIN. CODE, § 4901:1-11-07(B)(2) (Banks-Baldwin 1978).

ment posture. To date, no refund to a utility's customers has been ordered by the Commission as a result of contractual shortfalls, even though little litigation has been instituted against defaulting suppliers.

There are two basic reasons for this lack of contract enforcement. First, the utilities' long-term coal contracts typically contain a *force majeure* provision excusing nonperformance by either party for reasons beyond that party's control, such as strikes,<sup>63</sup> shortages of transportation facilities,<sup>64</sup> governmental regulation and environmental restraints.<sup>65</sup> Utility personnel<sup>66</sup> and independent consultants<sup>67</sup> have inspected defaulting suppliers' mines and have concluded that most contractual shortfalls result from declines in productivity attributable to the Federal Mine Health and Safety Act. The utilities' legal advisors then concluded that such shortfalls would most likely be excused by the contract's *force majeure* clause, rendering litigation futile.

In some cases, the shortfalls were due to problems with the utilities' own coal handling facilities.<sup>68</sup> In fact, very little culpable conduct by the coal suppliers has been uncovered by the Commission during the semiannual fuel hearings. In one instance, the Commission found that a coal supplier was diverting contract coal to another utility, and the contracting utility did file suit.<sup>69</sup> In another case, a utility arguably had a cause of action for minimal damages caused by quality deficiencies in one coal supplier's deliveries, but declined to sue because it desired to maintain a dealing relationship with the coal company which had access to abundant coal reserves.<sup>70</sup> The Ohio Supreme Court upheld the Commission's determination that the utility's abstention from legal action was reasonable.<sup>71</sup> The Court delineated the proper role of the Commission in assessing utilities' contractual enforcement policies by stating, "[i]t is not the province of third parties to compel lawsuits by a utility concerning the utility's rights where reasonable business justification exists to support abstention."<sup>72</sup> This language, of course, is merely a specific application of the larger principle that it is not the function of regulatory bodies to second guess management deci-

---

<sup>63</sup> Toledo Edison Co., No. 76-531-EL-FAC (Subfile A) (P.U.C.O. July 20, 1977) at 8.

<sup>64</sup> Cincinnati Gas & Elec. Co., No. 76-164-EL-FAC (P.U.C.O. June 23, 1976) at 7.

<sup>65</sup> Dayton Power & Light Co., No. 76-536-EL-FAC (P.U.C.O. Dec. 15, 1976) at 13.

<sup>66</sup> Cleveland Elec. Illum. Co., No. 76-532-EL-FAC (P.U.C.O. Jan. 31, 1977) at 4.

<sup>67</sup> Dayton Power & Light Co., No. 76-162-EL-FAC (P.U.C.O. June 9, 1976) at 6.

<sup>68</sup> Toledo Edison Co., No. 76-531-EL-FAC (Subfile A) (P.U.C.O. July 20, 1977) at 10.

<sup>69</sup> Ohio Power Co., No. 76-534-EL-FAC (P.U.C.O. Apr. 4, 1977) at 13.

<sup>70</sup> Ohio Edison Co., No. 77-373-EL-FAC (Subfile A) (P.U.C.O. Mar. 15, 1978).

<sup>71</sup> Consumers' Counsel v. Pub. Util. Comm'n, 56 Ohio St. 2d 319, 384 N.E.2d 245 (1978).

<sup>72</sup> *Id.* at 325, 384 N.E.2d at 249.

sions, but only to assure that those decisions were reasonable, lawful and rationally developed.<sup>73</sup>

The second reason why contractual shortfalls have not given rise to customer refunds is that the spot market prices for coal have moderated somewhat since the days of the Arab oil embargo. As a result, comparatively low spot prices have rendered contractual shortfalls a benefit to utilities and customers. Ohio Edison Company's auditor, for example, noted that for two consecutive years the utility replaced contractual shortages with spot coal, cheaper, on the average, than the contract coal.<sup>74</sup> At one Ohio Edison fuel hearing, the Consumers' Counsel urged the Commission to grant refunds for those specific months during which the price of spot market coal exceeded the price of coal purchased pursuant to the long-term contracts. The Commission soundly rejected that contention because if the company had enforced the long-term contract, it would have had to accept the contractual coal throughout the year regardless of spot market prices and the overall price of coal would have been higher.<sup>75</sup>

It thus far appears that shortfalls in the delivery of contract coal have not had the serious consequences envisioned by the General Assembly. In the near future, as contracts signed prior to the Federal Mine Health and Safety Act expire or are renegotiated to reflect more realistically attainable coal quantities, there will be no more significant contractual shortfalls.

### C. *Purchased Power*

Modern electric utilities typically rely substantially on power purchased from other utilities for satisfying the electric load of their customers. Reliance on purchased power is beneficial because it moderates the need to build additional generating plants to meet peak electric demands, assures continued service during emergencies and enables a utility to purchase power at a cheaper cost than self-generation.

Ordinarily in purchased power transactions, the purchasing utility pays the selling utility an energy charge which is intended to compensate the seller for variable costs. Approximately ninety percent of the energy charge is the fuel charge. The remainder is the net energy charge which is designed to cover other variable expenses and return on investment.

In Ohio, Rule 26 designates the fuel charge portion of purchased power as an includable fuel cost that may be recovered through the fuel adjustment

<sup>73</sup> *Mount Vernon Tel. Co. v. Pub. Util. Comm'n*, 127 Ohio St. 556, 189 N.E. 650 (1934).

<sup>74</sup> *Ohio Edison Co.*, No. 78-622-EL-FAC (P.U.C.O. Oct. 18, 1978) at 14.

<sup>75</sup> *Id.*

clause.<sup>76</sup> Ohio thus joined the majority of states which allow some or all purchased power costs to be automatically recovered either through fuel adjustment clauses or separate purchased power adjustment clauses.<sup>77</sup> Rule 26 follows the Federal Energy Regulatory Commission's approach,<sup>78</sup> allowing the purchasing utility to recover through the fuel adjustment clause the total energy charge for purchased power if that total charge is less than the fuel cost of self-generation.<sup>79</sup> The obvious purpose of the provision is to avoid or minimize the disincentive the utility would otherwise have to purchase the cheaper power and thereby minimize fuel costs.

In some instances, a utility reserves the generating capacity of another utility for a period of time. The reserving utility pays a capacity or demand charge for the availability of that capacity in addition to an energy charge for energy actually purchased. Original Rule 26 prohibited the inclusion of demand charges in the fuel adjustment computation, but the Commission in *Cleveland Electric Illuminating Co.*<sup>80</sup> modified the Rule to allow such inclusion if the total purchased power charge, including the demand charge, is less than the fuel costs of self-generation. Again, the Commission sought to discourage a utility from passing up economical purchases because it could otherwise recover its own higher fuel costs through the fuel adjustment clause.

The Commission's decision to allow the recovery of purchased power costs, and particularly the nonfuel costs, through the fuel adjustment clause has engendered a great deal of controversy. At least three bills have been introduced in the Ohio General Assembly to reverse this policy.<sup>81</sup> The Office of Consumers' Counsel challenged the Commission's statutory authority to allow automatic adjustment of such costs in the Ohio Supreme Court.<sup>82</sup>

The position of the Consumers' Counsel in that case was that a fuel adjustment clause, as defined in House Bill 579, contemplates only the recovery of "acquisition and delivery costs" of fuel and not purchased power costs.<sup>83</sup> The Commission countered arguing that the fuel component of purchased power charges represents acquisition and delivery costs of fuel and that nothing in the legislation limits the recovery to those fuel costs

<sup>76</sup> OHIO ADMIN. CODE, § 4901:1-11-01(A) (Banks-Baldwin 1978).

<sup>77</sup> TOUCHE ROSS & CO., REVIEW AND ANALYSIS OF THE OHIO FUEL ADJUSTMENT CLAUSE, *supra* note 49, at II-27.

<sup>78</sup> F.P.C. Order No. 517, No. R-479 (F.P.C. Nov. 13, 1974); *see also* Public Serv. Co. of N.H., 8 P.U.R.4th 573 (F.P.C. 1975).

<sup>79</sup> OHIO ADMIN. CODE § 4901:1-11-02(I) (Banks-Baldwin 1978).

<sup>80</sup> Cleveland Elec. Illum. Co., No. 76-166-EL-FAC (P.U.C.O. Aug. 11, 1976) at 14-17.

<sup>81</sup> H.1167, H.1173, Sub. S. 451 (112th Gen. Assembly, Regular Sess. 1977-78).

<sup>82</sup> Consumers' Counsel v. Pub. Util. Comm'n, 56 Ohio St. 2d 319, 384 N.E.2d 245 (1978).

<sup>83</sup> OHIO REV. CODE ANN. §§ 4905.01(E),(F),(G) (Page 1977).



attributable to the utility's own generation. With respect to the nonfuel demand and net energy costs allowed in certain instances, the Commission pointed out that its authority to approve automatic adjustment clauses was established a long time before and independent of House Bill 579 in *City of Akron v. Public Utilities Commission*<sup>84</sup> and *City of Cleveland v. Public Utilities Commission*.<sup>85</sup> Since it is clear from those cases that the Commission had the authority to adopt a purchased power adjustment clause, the fact that the same result was reached under the aegis of a fuel adjustment clause, the Commission argued, is a matter of form rather than substance. In addition, the Commission pointed to language in the Bill requiring it to establish incentives promoting efficient fuel procurement practices.

The Supreme Court upheld the Commission by relying on the statutory incentive language, rather than the Commission's independent authority,<sup>86</sup> to authorize the inclusion of nonfuel purchased power costs in the fuel adjustment clause. Two dissenting justices argued that while the Commission's policy on the recovery of nonfuel costs might be reasonable, it is not statutorily permitted.<sup>87</sup>

Just as a utility may include the fuel component of purchased power costs in the fuel clause, it must exclude fuel cost recovery attributable to sales of power to other utilities.<sup>88</sup> In *Ohio Power Co.*,<sup>89</sup> the Commission ordered a substantial refund to customers because of the company's failure to exclude such recoveries from its pre-Rule 26 fuel clause. Ohio Power engages in substantial wholesale sales of electricity, nearly half of the electricity generated in 1975 was sold on a wholesale basis. The company computes its fuel charges to some of its wholesale customers on an incremental cost basis. That is, the most expensive fuel is assumed to have generated the electricity sold wholesale to the other utilities and they are billed accordingly. In computing the average cost of fuel which determines fuel charges to retail customers, however, the company included all fuel costs, including the cost of the higher priced fuel already billable to wholesale customers. This practice was changed by the uniform fuel adjustment clause imposed by Rule 26, but since Ohio Power's previous fuel clause remained in effect for a time subsequent to the effective date of House Bill 579, the company's fuel charges under that clause were, during the

<sup>84</sup> 5 Ohio St. 2d 237, 213 N.E.2d 182 (1966).

<sup>85</sup> 3 Ohio St. 2d 82, 209 N.E.2d 424 (1965).

<sup>86</sup> 56 Ohio St. 2d at 322-23, 384 N.E.2d at 247.

<sup>87</sup> *Id.* at 327, 384 N.E.2d at 251 (Locher, J. and Brown, J., dissenting).

<sup>88</sup> OHIO ADMIN. CODE § 4901:1-11-01(E) (Banks-Baldwin 1978).

<sup>89</sup> Ohio Power Co., No. 76-534-EL-FAC (P.U.C.O. Apr. 4, 1977).

interim, subject to Commission review. The Commission determined that the company's inclusion of fuel costs attributable to wholesale sales in the computation of retail fuel charges resulted in an overcharge to retail customers. A refund in excess of eight million dollars was consequently ordered by the Commission.

Ohio Power appealed the Commission's refund order to the Ohio Supreme Court on a variety of grounds. Its central contention, however, was that the challenged practice of including wholesale fuel costs in the retail calculation had been allowed in the former fuel clause as approved by the Commission. Having once approved the clause, the company argued, the Commission could not now complain that charges thereunder were unreasonable. The Court unanimously affirmed the Commission by stating that a fuel clause does not give carte blanche authority to pass through costs other than those fairly attributable to service provided customers charged under the clause.<sup>90</sup>

The subject of purchased power has thus far produced the most significant appellate decisions under the implementation of House Bill 579 and has been the most fertile area of litigation and controversy. Although the Commission's policies in this area as recognized by the Ohio Supreme Court, have been in the public interest, they are largely misunderstood and may well be changed by legislation.

#### D. *Captive Coal*

One controversial aspect of the fuel procurement policies of Ohio's electric companies is their substantial and increasing reliance on captive coal suppliers, coal companies owned by or financially affiliated with the utilities. In 1976, thirty-one percent of the coal burned to generate electricity in Ohio came from captive sources<sup>91</sup> and this percentage is projected to reach thirty-six percent by 1985.<sup>92</sup> The degree of affiliation between the utilities and coal suppliers ranges from outright ownership to the guarantee of financial obligations.

Some consumer representatives have evidenced suspicion that the utilities' dealings with their affiliate coal suppliers may not be at arms length. As *Consumer Reports* magazine stated: "[o]n the surface, it seems

<sup>90</sup> *Ohio Power Co. v. Pub. Util. Comm'n*, 54 Ohio St. 2d 342, 344, 376 N.E.2d 1337, 1338-39 (1978).

<sup>91</sup> BAKER, AN ANALYSIS OF THE FACTORS DETERMINING COAL PRICE FORMATION AND SUPPLY RESPONSE IN THE CONESVILLE MARKET, EXECUTIVE SUMMARY (June 1978) at V [hereinafter cited as BAKER REPORT].

<sup>92</sup> BATTELLE MEMORIAL INSTITUTE, FINAL REPORT ON TECHNICAL ECONOMIC RESEARCH ON OHIO ELECTRIC UTILITY COAL PROCUREMENT PRACTICES AND PRICES (Oct. 1978) at III-27 [hereinafter cited as BATTELLE REPORT].

odd that a utility can raise the price its right hand charges its left hand for coal or gas and then pass the price increases right on to consumers without a rate hearing."<sup>93</sup> Proponents of captive coal, on the other hand, argue that the arrangements will assure a reliable long-term coal supply, act as a competitive force to keep independent suppliers' prices low, insulate the utility from demand induced price increases and provide expertise in mining which will enable the utilities to better evaluate independent suppliers' price escalation requests.<sup>94</sup>

The Carney Committee Report recommended that the Public Utilities Commission directly regulate utility owned fuel suppliers.<sup>95</sup> A minority of the Committee, however, questioned the wisdom and legality of such regulation because the profits of the fuel supplier subsidiaries are already regulated by the Federal Securities and Exchange Commission<sup>96</sup> pursuant to the Public Utility Holding Company Act of 1935.<sup>97</sup> House Bill 579, as finally adopted, contained no provision authorizing Commission regulation of captive coal suppliers, but did guarantee Commission access to affiliated coal companies' business records.<sup>98</sup>

Five of Ohio's eight regulated electric companies rely in varying degrees on captive coal suppliers. The performance of these affiliated suppliers, as revealed in the fuel hearings thus far, has not been encouraging.

The Columbus and Southern Ohio Electric Company, through its subsidiary Simco Inc., entered the mining business in a joint venture with Peabody Coal Company, an independent supplier. Simco-Peabody coal has historically been competitive in price, but has been generally more expensive than coal from unaffiliated sources in recent years.<sup>99</sup> Fortunately for consumers, Simco-Peabody last year closed its underground mines which had mainly contributed to the joint venture's higher costs.<sup>100</sup> Further, Columbus and Southern Ohio Electric Company abandoned plans to have Simco-Peabody supply a future coal fired generating station.<sup>101</sup>

The Ohio Power Company relies heavily on captive coal through

<sup>93</sup> *The Fuel Adjustment Caper*, *supra* note 53, at 838.

<sup>94</sup> *BATTELLE REPORT*, *supra* note 92, at III-4; *BAKER REPORT*, *supra* note 91.

<sup>95</sup> *CARNEY COMMITTEE REPORT*, *supra* note 14, at 9.

<sup>96</sup> *Id.* at 7 (Minority Report).

<sup>97</sup> 15 U.S.C. § 79(m) (1971).

<sup>98</sup> OHIO REV. CODE ANN. § 4905.67 (Page 1977).

<sup>99</sup> *BATTELLE REPORT*, *supra* note 92, at III-17; Columbus & Southern Ohio Elec. Co., No. 76-535-EL-FAC (P.U.C.O. Jan. 5, 1977) at 16.

<sup>100</sup> Testimony of John Apel, Vice-President, Environmental, Columbus & Southern Ohio Elec. Co., No. 78-627-EL-FAC (P.U.C.O.) at 10.

<sup>101</sup> *C&SOE Curtails Involvement in Actual Mining Operations*, Columbus Citizen-Journal, Apr. 13, 1978, at 2, col. 3.

ownership or other interest in four coal companies. In an early fuel hearing, the Commission found that the coal costs resulting from these arrangements were reasonable because such were comparable with the price of reasonably available independent coal.<sup>102</sup> This decision was sharply criticized by the staff of the Federal Energy Regulatory Commission which is engaged in a massive investigation of the captive coal and transportation activities of Ohio Power's parent, American Electric Power Company.<sup>103</sup> In any event, Ohio Power's affiliated coal costs have recently been substantially in excess of the independent suppliers' prices due largely to the commercialization of some major affiliated mines. The Ohio Power Company and its independent auditor, however, project that the company's captive coal costs should decline below the price of independent coal by the early 1980's.<sup>104</sup>

As part of a larger power pool, the Cleveland Electric Illuminating Company, the Ohio Edison Company and the Toledo Edison Company have entered into a complex arrangement involving the guarantee of the captive coal company's financing. Unfortunately, the mines being developed under this arrangement have experienced productivity problems and development costs far in excess of those originally anticipated.<sup>105</sup>

A pleasant but insignificant exception to the general trend of captive coal costs is represented by Ohio Edison Company's two wholly owned strip mines which consistently produce coal at a very low cost, albeit in very small quantities.<sup>106</sup>

Despite these problems, with the costs of captive coal, neither the independent auditors nor the Public Utilities Commission have found any captive coal supply arrangement unreasonable. Clearly, the prudence of a captive coal arrangement cannot reasonably be determined by a short run comparison of prices. A recent study on the subject, commissioned by Ohio Consumers' Counsel, notes that whether captive mine operations are being managed in an efficient or appropriate manner cannot be judged "in a simplistic, quick or easy fashion."<sup>107</sup> Furthermore, the Commission has recognized certain nonprice related advantages to captive coal arrange-

---

<sup>102</sup> Ohio Power Co., No. 76-534-EL-FAC (Subfile A) (P.U.C.O. Sept. 7, 1977).

<sup>103</sup> McDowell County Consumers Council, Inc. v. American Elec. Power Co., No. E-9206 (F.E.R.C.) COMMISSION STAFF PRELIMINARY REPORT OF INVESTIGATION, at 54-57.

<sup>104</sup> ERNST & ERNST, FINDINGS, CONCLUSIONS AND RECOMMENDATIONS FROM AUDIT OF FOSSIL FUEL ADJUSTMENT AND RELATED PROCEDURES FOR THE OHIO POWER COMPANY (1978), at III-15, 16.

<sup>105</sup> BATTELLE REPORT, *supra* note 92, at III-19; see GATES ENGINEERING CO., IN-DEPTH STUDY OF THE DEVELOPMENT OF POWHATAN NO. 7 MINE QUARTO MINING COMPANY (1977).

<sup>106</sup> Ohio Edison Co., No. 76-533-EL-FAC (P.U.C.O. Nov. 22, 1976) at 13.

<sup>107</sup> BATTELLE REPORT, *supra* note 92, at III-23.

ments, such as reliability of supply and competitive pressure on independent prices.<sup>108</sup>

On the other hand, certain drawbacks to affiliated coal arrangements have become apparent. Production at captive mines must be maintained at optimum levels to assure the best price; this might deprive the utility of the flexibility to purchase the lowest priced coal available at the time.<sup>109</sup> During periods of curtailed production, a captive mine's fixed costs must still be recovered from its utility customer, while independent suppliers absorb these costs,<sup>110</sup> at least in the short run.

Hopefully, captive coal arrangements assure reasonable fuel costs. If it becomes apparent that they cannot, however, the Commission has the statutory authority to insulate customers from any adverse effects.

### PROSPECTS FOR CHANGE

There is currently considerable public sentiment in favor of abolishing or changing Ohio's fuel adjustment clause. The Democratic candidate for governor, for example, made abolition of the clause a major plank in his 1978 campaign platform;<sup>111</sup> his Republican opponent, who won the election, reportedly said he would sign such a measure.<sup>112</sup> In the current session of the Ohio General Assembly, some modification of fuel adjustment procedure under House Bill 579 appears inevitable.

Implicit in the latest abolition proposals are the assumptions that the review procedure under House Bill 579 has failed its essential purpose and that the only answer is to terminate automatic adjustment of fuel costs. It is doubtful, though, that these assumptions, and particularly the latter, evidence the certitude with which they are advanced. The advantages to the current procedure and disadvantages to abolishing the fuel clause should not be overlooked in fashioning new remedies.

An objective evaluation of House Bill 579 must start with an analysis of the legislation's direct benefits and costs. One benefit has been the refunds of fuel charges ordered by the Commission under the statutory authority established by House Bill 579. Thus far some twelve million dollars has been refunded to customers through reconciliation adjustments

<sup>108</sup> Ohio Power Co., No. 76-534-EL-FAC (Subfile A) (P.U.C.O. Sept. 7, 1977) at 12.

<sup>109</sup> Columbus & Southern Ohio Elec. Co., No. 76-535-EL-FAC (P.U.C.O. Jan. 5, 1977) at 15-19.

<sup>110</sup> BATTELLE REPORT, *supra* note 92, at III-5 to 11.

<sup>111</sup> *Celeste Campaigns Here on Utility Fuel Charges*, Cleveland Plain Dealer, Oct. 11, 1978, at 6A, col. 5.

<sup>112</sup> *Sweet, Abolish Fuel Adjustment Clause*, Cleveland Plain Dealer, Dec. 18, 1978, at 33A, col. 1.

to future fuel charges. A relatively small amount (about one million dollars) has been returned to the utilities due to underrecovery of allowable fuel costs.

The costs of regulation under House Bill 579 have admittedly been substantial: utilities' legal and other related costs incurred in connection with the semiannual fuel hearings can approach one hundred thousand dollars for a single proceeding<sup>113</sup> and each annual audit costs nearly twenty thousand dollars. In addition, the Public Utilities Commission incurs costs in reviewing the required reports and conducting the hearings, and the Office of Consumers' Counsel devotes considerable resources to participation in fuel adjustment review.<sup>114</sup> All of these costs are eventually paid by the utilities' customers, including the costs of the Commission and Consumers' Counsel because both agencies are funded by assessments against the utilities.<sup>115</sup> The Commission's staff has estimated that the utilities and the Commission incur approximately one million dollars per year in combined costs under House Bill 579.<sup>116</sup> Consequently, the direct cost to consumers for administering fuel adjustment review has been thus far outweighed by refunds of unreasonable fuel charges otherwise undetected. Moreover, any alternative to the current procedure will no doubt entail similar regulatory costs, unless all regulatory review of fuel adjustment is terminated which is highly unlikely.

Of course, a comparison of direct costs and benefits offers only a superficial evaluation of fuel adjustment review. The value of any regulatory scheme is its ability to act as an effective, yet realistic, cost control mechanism. In this respect, House Bill 579 has been of value through the close scrutiny of fuel expenditures thereby implemented. Utility executives now operate in a fishbowl environment with respect to fuel procurement and the calculation of fuel charges. Every decision made is subject to review by the fuel auditors, Commission staff and intervening consumer advocates.

The benefits of such scrutiny, of course, are not easily detected in every instance and the overall results are subject to differing interpretations. The Consumers' Counsel has alleged that fuel adjustment increases have been uncontrolled under House Bill 579,<sup>117</sup> while statistics compiled by the Com-

<sup>113</sup> In *Ohio Power Co.*, No. 76-534-EL-FAC (P.U.C.O. Apr. 4, 1977), counsel for the company proposed, probably in jest, that the utility's external costs of that proceeding, estimated at eighty to one hundred thousand dollars, be passed through the fuel adjustment clause. The request was denied, at 16.

<sup>114</sup> [1978] CONSUMERS' COUNSEL GOVERNING Bd. ANN. REP., *supra* note 34.

<sup>115</sup> OHIO REV. CODE ANN. §§ 4905.10, 4911.18 (Page 1977).

<sup>116</sup> UTILITIES DEPT., PUB. UTIL. COMM'N OF OHIO, REFERENCE MANUAL FOR RATE CASE TRAINING PROGRAM (Dec. 1978) at 107.

<sup>117</sup> Letter from William A. Spratley, Consumers' Counsel, to members of the General Assembly, July 25, 1978.

mission's staff indicate that those increases have been reasonably comparable with the general rate of inflation.<sup>118</sup> Regardless of the facts, the more important political reality is the great deal of frustration among the electorate over rising utility rates in general. Consequently, some change in fuel adjustment review is likely.

If the fuel adjustment clause is abolished, utilities will recover their fuel costs through base rates. Proponents argue this is now feasible because the two or three year regulatory lag in processing rate cases which had necessitated a fuel adjustment clause has been considerably reduced.<sup>119</sup> The supporters of the clause's abolition additionally contend that if fuel costs are not automatically adjusted, but are fixed for the period between rate cases, the utilities will have more incentive to bargain for lower costs which will force the remaining regulatory lag to operate in favor of consumers. Furthermore, extraordinarily high fuel costs and purchased power costs, such as those experienced during the 1978 coal strike, will be absorbed by the utilities, rather than consumers.

Several potential problems exist, however, with recovery of fuel costs through the base rates. Unless projected cost levels rather than the historical cost levels traditionally used are adopted for setting rates,<sup>120</sup> more frequent rate increase filings are certain. New applications may be filed during the pendency of a prior rate case, thereby severely taxing the regulatory process. Furthermore, frequent rate increases will serve to keep all the utility's costs, not just fuel costs, more currently adjusted than does the present system. Thus, if regulatory lag is beneficial to consumers, that benefit will be reduced for nonfuel costs and if projected cost levels are used, overrecovery of costs may occur until the projected levels are reached. The utilities argue that the cash flow aberrations resulting from abolition of the fuel clause would weaken their financial position, thereby leading to higher capital and borrowing costs to the ultimate detriment of consumers.

Another significant problem with abolishing the fuel clause is that such action would probably lead to less careful scrutiny of fuel expenditures than under current procedure. The only relevant question in a rate case is whether test year levels of expense are sufficiently reasonable for setting rates. Under House Bill 579, individual expenditures may be challenged

---

<sup>118</sup> UTILITIES DEPT., PUB. UTIL. COMM'N OF OHIO, REFERENCE MANUAL FOR RATE CASE TRAINING PROGRAM, *supra* note 107, at 122.

<sup>119</sup> In April, 1976, the Ohio General Assembly passed Am. Sub. S.B. 94, a law which substantially changed utility rate making procedures. It enacted OHIO REV. CODE ANN. § 4909.42 (Page 1977) which allows proposed rates to go into effect, subject to refund, nine months following a utility's application therefor. Concurrently, the Commission considerably streamlined its rate case processing procedures to meet the nine month deadline.

<sup>120</sup> See, e.g., Welch, PREPARING FOR THE UTILITY RATE CASE, (1954) at 135.

even though a utility company's overall performance has been reasonable. In short, regulation under House Bill 579 is more precise and detailed than normal rate case procedure.

Given the current climate of public opinion, any measure perceived of as pro-consumer is assured easy passage by the Ohio General Assembly. Nevertheless, as opponents of the fuel adjustment clause acknowledge,<sup>121</sup> consumers should not expect dramatic results from any new statutory scheme. Electric utilities incur huge fuel costs in providing electric service. These costs will be passed on to consumers in some fashion and they will inevitably increase. Hopefully, all alternatives will be rationally analyzed and any new legislation will result in improved regulation.

---

<sup>121</sup> Amatos, *Fuel Adjustment Clause Faces Action for Repeal*, *Youngstown Vindicator*, Dec. 17, 1978, at 3A, col. 4.



