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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke)
Energy Ohio for Approval of a Market)
Rate Offer to Conduct a Competitive)
Bidding Process for Standard Service) Case No. 10-2586-EL-SSO
Offer Electric Generation Supply,)
Accounting Modifications, and Tariffs for)
Generation Service.)

VOLUME II

TESTIMONY

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DIRECT TESTIMONY OF

JAMES S. NORTHRUP

ON BEHALF OF

DUKE ENERGY OHIO, INC.

November 15, 2010

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I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is James S. Northrup, and my business address is 526 S. Church Street,
3 Charlotte, North Carolina, 28202.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by Duke Energy Business Services, Inc. (DEBS) as Director,
6 Project Analysis and Special Projects. DEBS provides various administrative and
7 other services to Duke Energy Ohio, Inc. (Duke Energy Ohio or Company) and
8 other affiliated companies of Duke Energy Corporation (Duke Energy).

9 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATION AND**
10 **PROFESSIONAL EXPERIENCE.**

11 A. I am a registered professional engineer in the state of North Carolina, having
12 received a Bachelor of Science in Civil Engineering from Queens University. I
13 began my career at Duke Power Company in 1979 and have held a variety of
14 responsibilities across the Company in the areas of electric system distribution
15 engineering, customer marketing, demand-side management program design and
16 implementation, generation business planning, generation expansion planning,
17 energy risk management, and integrated resource planning. After coordinating
18 the development of demand-side customer programs, I joined the Generation
19 System Planning Group in 1994 and coordinated the development of the
20 integrated resource plan filings for state regulatory agencies. I was promoted to
21 Manager, Generation Business Support in the Power Generation Group in 2000 to
22 lead the business case development and asset strategy for fossil/hydro generation.

1 In 2003, I was promoted to Director, System and Power Planning Group to guide
2 major investments for generation assets and develop expansion plans to maintain
3 system reliability. In 2006, I was promoted to Director, Project Analysis and
4 Special Projects where I continue work in integrated resource planning, new
5 generation investments, and maintaining system reliability.

6 **Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES AS DIRECTOR,**
7 **PROJECT ANALYSIS AND SPECIAL PROJECTS.**

8 A. As Director, Project Analysis and Special Projects, I am responsible for
9 developing the strategy for Duke Energy's operating utilities, including
10 commercial support for utility activities such as requests for proposal (RFPs) for
11 renewable and supply side resources and major project/initiative business case
12 analysis. Recently, I was responsible for the development of the Duke Energy
13 Ohio Resource Plan filed in the Company's 2010 Long Term Forecast Report.

14 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC**
15 **UTILITIES COMMISSION OF OHIO?**

16 A. I submitted written testimony in Duke Energy Ohio's Electric Security Plan
17 (ESP), Case No. 08-920-EL-SSO, *et al.*, but I have not testified before the Public
18 Utilities Commission of Ohio (Commission).

19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
20 **PROCEEDING?**

21 A. The purpose of my testimony is to discuss certain information regarding the
22 competitive bidding process (CBP) plan under Duke Energy Ohio's proposed
23 market rate offer (MRO). Specifically, I address elements of the CBP plan not

1 otherwise discussed by other witnesses in this proceeding and I support the draft
2 Master Standard Service Offer Supply Agreement (Master SSO Agreement).

3 **Q. WHAT IS THE ATTACHMENT FOR WHICH YOU ARE**
4 **RESPONSIBLE?**

5 A. I am sponsoring the Master SSO Agreement included as Attachment F to the
6 Application.

II. DISCUSSION

7 **Q. PLEASE SUMMARIZE THE PROPOSED CBP.**

8 A. The objective of the CBP is to secure suppliers to provide the most cost-effective,
9 full requirements standard service offer (SSO) supply for Duke Energy Ohio's
10 customers as the Company transitions from the current ESP to the proposed
11 MRO. Full requirements SSO supply will include energy, capacity, transmission,
12 ancillaries and resource adequacy services consistent with all reserve margin
13 requirements. Duke Energy Ohio's CBP plan is based upon staggered
14 procurements, with the first auction to be conducted in June 2011, for delivery
15 beginning January 1, 2012. The generation supply for the Company's SSO load
16 will be procured through descending-price clock, full requirements auctions.

17 Duke Energy Ohio has retained CRA International, d/b/a Charles River
18 Associates (CRA) to act as the independent Auction Manager to implement a
19 CBP plan to procure SSO supply for delivery beginning in 2012. As I understand,
20 CRA has performed numerous competitive bidding processes in a range of
21 industries, including the power sector, and has recently conducted structured
22 procurements for FirstEnergy Ohio electric distribution utilities (FirstEnergy

1 Companies) in 2008 and 2010. Duke Energy Ohio retained CRA to design an
2 open, fair, and transparent competitive solicitation with clear product definition
3 and standard bid evaluations. Specific Auction Manager activities include widely
4 publicizing the auctions to prospective bidders, conducting information sessions
5 and responding to bidder questions, managing the CBP auction, and
6 communicating with the Commission on the progress and results of the
7 competitive solicitation. Duke Energy Ohio will provide the Commission, on a
8 real-time basis, with access to Company employees and CRA to assist the
9 Commission in its review of the CBP, including data, information and
10 communications relevant to the bidding process.

11 In the first two years of the MRO, the Company will auction 10% and
12 20% of its SSO load, respectively, as required by R.C. 4928.142(D). There will
13 be a single product offered in the first two years. In the first year of the MRO, a
14 seventeen-month contract for service will be offered. And a twenty-four month
15 contract for service will be offered in the second year. The Company seeks to
16 auction its entire SSO load beginning in year three of the MRO and continuing
17 every year thereafter. Consistent herewith, it will offer multiple auction products
18 beginning in year three.

19 The auction timeline proposed under the Company's CBP plan does make
20 provision for its forthcoming realignment to PJM Interconnection, LLC (PJM).
21 The Federal Energy Regulatory Commission (FERC) recently approved, with
22 some conditions, this realignment to occur on January 1, 2012. As explained by
23 Company witness Kenneth J. Jennings, the PJM planning year auction calendar

1 runs June through May, as opposed to a conventional January through December
2 calendar year. But, in order to enable prospective participants in Duke Energy
3 Ohio's load auctions to benefit from PJM's forward-looking capacity prices, the
4 Company is proposing here that year one of its MRO be defined as the period
5 from January 1, 2012, through May 31, 2013. Thereafter, the auctions will follow
6 the PJM planning year term.

7 As required by the Commission's rules, the Company submits, as part of
8 this filing, the draft documents integral to the CBP plan. Duke Energy Ohio
9 witness Robert J. Lee of CRA elaborates on the documents relevant to the pre-
10 auction period. More specifically, Mr. Lee discusses the Application Process, the
11 Information Website, Bidder Rules, the Communications Protocol, and Glossary.
12 I will discuss below the Master SSO Agreement to be executed by Duke Energy
13 Ohio and the respective successful bidders, after the auction concludes. A copy
14 of the Master SSO Agreement is Attachment F to the Application.

15 **Q. HOW DOES REALIGNMENT WITH THE PJM AUCTIONS BENEFIT**
16 **AUCTION PARTICIPANTS IN YEARS ONE AND TWO OF THE**
17 **COMPANY'S MRO GIVEN THAT PJM HAS ALREADY CONDUCTED**
18 **THE CAPACITY AUCTIONS FOR THAT PERIOD?**

19 **A.** The goal in extending only the first year of the MRO to a seventeen-month
20 contract, and thereafter aligning with the PJM calendar, is to achieve timely
21 coordination of Duke Energy Ohio's CBP plan with the PJM auction cycle. It
22 would be disruptive to the auction process to seek to extend or shorten a year
23 under the MRO after the auction format has been approved and certain auctions

1 conducted. The Company is seeking certainty with regard to how and when its
2 auctions will occur and the time periods over which supply will have to be
3 provided.

4 Extending year one of the MRO and proceeding thereafter to match the
5 PJM calendar is consistent with the Company's fixed resource requirements
6 (FRR) plan that the FERC already approved. The FRR plan concerns the same
7 period of time that Duke Energy Ohio has used to define the first two years of its
8 MRO and it is thus prudent to coordinate the inception of Duke Energy Ohio's
9 load auctions with impending realignment to PJM.

10 **Q. WHAT IS THE PRODUCT THAT WILL BE PROCURED IN THE**
11 **AUCTIONS UNDER THE CBP PLAN?**

12 **A.** The product in Duke Energy Ohio's CBP plan is an hourly, load-following full
13 requirements tranche of the Company's SSO load. For purposes of this
14 description, a tranche is defined as 1.0 %, or a slice, of the Company's total SSO
15 load obligation.

16 As I briefly mentioned, the Company is subject to blending requirements
17 and can auction 10% of its load in the first year of the MRO and no more than
18 20% in year two. So as not to dissuade bidders or lessen competition, the
19 Company's CBP plan contemplates a contract for seventeen months of service in
20 year one and twenty-four months in year two, in contrast to contracts that would
21 be for less than one year. Thereafter, the Company will include different products
22 of varying contract durations necessary to meet all of its SSO load via a
23 competitive process. To achieve consistent, price-smoothing benefits for

1 customers over the long term, Duke Energy Ohio is planning for an equal
2 distribution of one-, two-, and three-year contract durations in the third year of the
3 MRO, with each contract term equaling 30% of the total SSO load requirement.
4 Duke Energy Ohio anticipates holding a single procurement auction in June of
5 each year. Regardless of the length of time to which a supplier commits, each
6 successful supplier will provide full requirements SSO supply, including energy
7 and capacity, transmission ancillaries, and other transmission services as defined
8 in the Master SSO Agreement.

9 **Q. WHAT CUSTOMER LOADS WILL BE SERVED BY THE WINNING**
10 **BIDDERS?**

11 A. As discussed above and in the Direct Testimony of Company witness Lee, the
12 CBP plan uses a slice-of-system approach. Consequently, the winning bidders
13 will serve a share of each customer's SSO load in proportion to the share of the
14 overall load won in the auction.

15 **Q. WHAT INFORMATION WILL BE MADE AVAILABLE TO BIDDER?**

16 A. As described in the Bidding Rules provided as Attachment C to the Application,
17 Duke Energy Ohio will make available to prospective suppliers the following
18 information: load data for a historical three-year period, historical hourly load
19 data for its total retail load and SSO load, historical switching statistics, and
20 historical load profiles. This information will be available on the Information
21 Website prior to qualification. The Company's retail electric tariffs are available
22 on its public website, <http://www.duke-energy.com/rates/ohio/electric.asp>.

1 Duke Energy Ohio witnesses Andrew S. Ritch and Dr. Richard J. Stevie
2 discuss the Company's plans for meeting the alternative energy resource, energy
3 efficiency, and peak demand reduction requirements, respectively, under
4 Amended Substitute Senate Bill 221 and several alternative pricing options
5 available to customers, two of which are awaiting Commission approval.

6 **Q. WHAT OPTIONS WILL A SUPPLIER HAVE TO DELIVER ENERGY TO**
7 **THE PJM DUKE ENERGY LOAD ZONE?**

8 A. Suppliers will have several options to deliver energy to the PJM Duke Energy
9 Load Zone. Options include the purchase of energy directly from PJM at the PJM
10 Duke Energy Load Zone as well as scheduling energy from a source in PJM to be
11 delivered to the PJM Duke Energy Load Zone. PJM energy sources examples
12 may be a specific generator in PJM or a commercial trading hub inside PJM, such
13 as AEP/Dayton Hub. Energy delivered to the PJM Duke Energy Load Zone from
14 generating sources located within contiguous regional transmission organizations
15 outside of PJM, such as from MISO or New York Power Pool, are also
16 acceptable.

17 **Q. DID DUKE ENERGY OHIO CONSIDER ANY OTHER TYPES OF**
18 **PRODUCTS FOR INCLUSION IN THE AUCTIONS?**

19 A. In developing its CBP plan, the Company evaluated the products that should, or
20 should not, be included in the auction. In doing so, the Company concluded that
21 its proposal detailed in this filing would be familiar to prospective bidders and
22 this Commission, particularly given the success of the FirstEnergy Companies in
23 utilizing this same framework over the past two years. For the reasons that follow,

1 Duke Energy Ohio also believes that the product offerings here better enable an
2 open, fair, and transparent competitive solicitation process.

3 The Company did not find it beneficial to exclude capacity from the
4 product definition. With the realignment to PJM and the approved FRR plan,
5 prospective auction participants will benefit from knowledge of the capacity costs
6 sufficiently in advance of the Company's load auctions. Each supplier is
7 obligated to obtain capacity from Duke Energy Ohio in accordance with the FRR
8 plan, as approved by the FERC. This knowledge of the capacity costs enables
9 prospective bidders to better manage price risk, which should produce more
10 competitive prices for customers.

11 As explained by Company witness William Don Wathen Jr., the Company
12 is separating its transmission charges into market-based and non-market-based
13 categories. The non-market-based FERC costs have been removed from the
14 product, which should make the CBP more transparent to all by disaggregating
15 transmission from the generation product and should also benefit competitive
16 retail electric service providers participating in the retail market for the same
17 reasons.

18 **Q. DID THE COMPANY CONSIDER INCLUDING ITS ALTERNATIVE**
19 **ENERGY OBLIGATION IN THE AUCTIONS UNDER ITS CBP PLAN?**

20 **A.** Yes. Duke Energy Ohio did explore including renewable energy certificates
21 (RECs) in the auction for its generation supply but has opted to not pursue that
22 tactic for multiple reasons. Some of the key reasons for this include the greater
23 transparency of actual costs of alternative energy compliance under the proposed

1 plan as compared to auctioning the alternative energy requirement combined with
2 other full requirements SSO supply in one price; greater assurance that the
3 compliance targets will be met if we retain this component as opposed to potential
4 alternative compliance payments being paid by bidders; and because the auction
5 is considered to be more straightforward to bidders if the REC requirement is not
6 included, in part because the REC obligations are based upon the Company's
7 historical sales and the load auction is prospective in nature.

8 **Q. WHY DID DUKE ENERGY OHIO SELECT A SLICE-OF-SYSTEM**
9 **PRODUCT?**

10 A. Again, the auction structure proposed here is familiar to prospective bidders.
11 Furthermore, the full requirements, slice-of-system product better enables
12 prospective bidders to mitigate costs and financial risks, which should result in
13 more competitive prices for customers.

14 **Q. DID THE COMPANY CONSIDER PROCURING LOAD USING OTHER**
15 **GENERATION SERVICE OPTIONS?**

16 A. Consideration was also given to managing the SSO obligation through use of
17 RFPs and other portfolio optimization methods. However, as I understand, the
18 law expressly requires the use of a competitive solicitation to procure generation
19 supply under the MRO structure. As such, having the Company circumvent this
20 requirement by employing other procurement alternatives was not a viable
21 consideration.

22 **Q. HOW DID THE COMPANY SELECT THE TIMELINE AND NUMBER**
23 **OF TRANCHES PROPOSED FOR THIS COMPETITIVE BID PROCESS?**

1 A. The auction timeline was influenced by the planning year concept used by
2 Regional Transmission Organizations, including PJM, which is also consistent
3 with the timing of PJM's annual base residual auction, as well as the Company's
4 effective date of its MRO. The numbers of tranches were, in the first two years, a
5 function of the amount of load that the Company is permitted to auction. As
6 explained by Mr. Wathen, the Company is proposing that its transition to market
7 conclude on May 31, 2014, such that beginning in the third year of the MRO, and
8 continuing every year thereafter, the Company will auction its entire SSO load.
9 The timeline and number of tranches offered annually reflects this transition to
10 full market.

11 I will further note that the staggered timeline and varying contract
12 durations from one to three years serve to smooth out potentially volatile market
13 prices, provide for longer-term price stability, and encourage efficient pricing of
14 the products.

15 **Q. HOW CAN A POTENTIAL BIDDER TAKE INTO CONSIDERATION**
16 **THE COMPANY'S PROGRAMS FOR MEETING PEAK DEMAND**
17 **REDUCTION BENCHMARKS?**

18 A. Duke Energy Ohio's programs for meeting peak demand reduction benchmarks
19 are publicly available through the Commission's docketing information system.
20 Notwithstanding this readily available source of information, I reference the
21 testimony of Company witness Stevie, which addresses this topic.

22 **Q. PLEASE DESCRIBE THE MASTER SSO AGREEMENT.**

1 A. The Master SSO Agreement sets forth the contractual obligations of successful
2 suppliers and the Company in respect of each auction. The Agreement expressly
3 details the terms and conditions that will govern the relationship between the
4 Company and successful suppliers. The Master SSO Agreement must be
5 executed by each successful supplier in the prescribed period of time; otherwise,
6 Duke Energy Ohio has the right to consider the agreement void and to retain any
7 pre-bid security provided by the successful supplier.

8 **Q. WHAT TOPICS ARE INCLUDED IN THE MASTER SUPPLY**
9 **AGREEMENT?**

10 A. The Master SSO Supply Agreement addresses the following topics: (1)
11 Definitions; (2) Term and Termination; (3) General Terms and Conditions; (4)
12 Scheduling, Forecasting and Information Sharing; (5) Credit and Performance
13 Security; (6) Billing, Payment and Netting; (7) Breach and Default; (8)
14 Representations and Warranties; (9) Risk of Loss; Limitation of Liability, (10)
15 Indemnification; (11) Dispute Resolution; and (12) Miscellaneous Provisions.

16 **Q. WHAT IS THE CONTINGENCY PLAN IF ONE OR MORE OF THE**
17 **SUPPLIERS DEFAULT PRIOR TO OR DURING THE DELIVERY**
18 **PERIOD?**

19 A. The Master SSO Agreement makes provision for default and the remedies
20 available to Duke Energy Ohio should a supplier default on its contractual
21 obligations. To summarize, should a supplier default and not timely cure that
22 default, Duke Energy Ohio may terminate the contract with no remaining
23 contractual obligations owing to that defaulting supplier and may also seek

1 monetary damages from the defaulting supplier. The recovery of financial
2 damages may include, but is not limited to, withholding payment for prior
3 supplier performances and/or pursuing our rights under any credit support
4 provided by a supplier such as a guaranty of letter of credit. Duke Energy Ohio
5 will fill the tranches of the defaulted supplier by purchasing the necessary supply
6 through the PJM administered markets. Open tranches made available by
7 defaulting suppliers will be offered to current SSO suppliers as soon as
8 practicable consistent with current auction procedures.

9 **Q. WHAT ARE CREDITWORTHINESS STANDARDS AND WHY ARE**
10 **THEY NEEDED?**

11 A. It is typical of commercial power transactions to include standards around
12 creditworthiness. This serves to ensure that the contracting entity that does
13 perform under the contract is not financially disadvantaged should the other
14 contracting party default. In other words, the creditworthiness requirements under
15 the Master SSO Agreement are intended to allow the Company to recover
16 monetary damages from the supplier where that supplier is responsible for
17 causing damages to the Company. Duke Energy Ohio thus believes it is
18 commercially reasonable to include these provisions in the Master SSO
19 Agreement, as without these provisions its customers would likely have a higher
20 risk of absorbing the costs associated with a supplier's default. As discussed by
21 Mr. Wathen, should the Company have unreimbursed costs as a result of
22 procuring power in the spot market due to a supplier's default, it will seek to
23 recover those costs through Rider SCR. But it will first enforce the Master SSO

1 Agreement and exhaust all available remedies before seeking recovery through
2 the Rider SCR.

3 **Q. WILL THE MRO PLAN AS PROPOSED ENSURE REASONABLE**
4 **GENERATION PRICING?**

5 A. Yes. The CBP plan designed and administered by an independent auction
6 manager promotes competitive pricing through a transparent and standardized
7 market-based procedure. The staggered procurement timeline and multi-tiered
8 contract durations of slice-of-system load enables the supplier market to offer the
9 most cost-effective supply proposals available providing customers more stable
10 market based prices.

11 **Q. DOES THE MRO CREATE BARRIERS TO COMPETITION?**

12 A. The MRO eliminates any barrier to competition by allowing open access to
13 alternative retail suppliers supplying market based energy products to customers.
14 Under the MRO, Duke Energy Ohio will procure supply at the lowest prices
15 available in the market. This provides generation providers a new purchaser and
16 avenue to sell their resources. The MRO allows customers to continue to make
17 individual "choice" decisions on their preferred generation supplier based on their
18 own price, and reliability preferences.

19 **Q. HOW DOES THE MRO ENCOURAGE DIVERSITY AND INNOVATION?**

20 A. The Company has in place a number of programs that encourage diversity and
21 innovation and all of which will continue to exist after the implementation of the
22 MRO. For example, Duke Energy Ohio is a leader in the industry with respect to
23 its deployment of SmartGrid. The Company is engaged in a SmartGrid

1 collaborative with stakeholders and Commission Staff, which meets monthly and
2 provides an opportunity for creative input from all participants. The
3 Collaborative encourages a diversity of viewpoints and incorporates those views
4 into the process of designing and implementing the utility of the future.
5 SmartGrid, itself, is an innovative product that is piloting communications
6 hardware as well as billing hardware and software and their interactions.
7 Numerous outside vendors are actively interested in the development of the
8 SmartGrid as it might relate to their business interests. This demonstrates the
9 level of innovation that is taking place.

III. CONCLUSION

10 **Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

11 **A. Yes.**