**Before**

**The Public Utilities Commission of Ohio**

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| In the Matter of the Application of Duke Energy Ohio for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications and Tariffs for Generation Service. | )  )  )  )  )  )  )  ) | Case No. 14-841-EL-SSO |
| In the Matter of the Application of Duke Energy Ohio for Authority to Amend its Certified Supplier Tariff, P.U.C.O. No. 20. | )  )  )  ) | Case No. 14-842-EL-ATA |

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**Revised Memorandum of Industrial Energy Users-Ohio in Opposition to the application for Rehearing of**

**Duke Energy Ohio, Inc.**

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**May 14, 2015 Attorneys for Industrial Energy Users-Ohio**

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**Duke Energy Ohio, Inc.**

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# Introduction

In its application for an Electric Security Plan (“ESP”), Duke Energy Ohio, Inc. (“Duke”) sought authorization of the Power Stabilization Rider (“PSR”) that would assure that Duke recovers the difference between the costs it is contractually required to pay Ohio Valley Electric Corporation (“OVEC”) under a federally-approved wholesale contract and proceeds from the liquidation of the wholesale capacity and energy Duke may receive under that contract through June 30, 2040.[[1]](#footnote-1) In the Opinion and Order modifying and approving the application for an ESP issued on April 2, 2015 (“ESP Order”), the Public Utilities Commission of Ohio (“Commission”) concluded that the PSR could be authorized under R.C. 4928.143(B)(2)(d), but refused to allow Duke to bill and collect its above-market costs associated with OVEC because Duke failed to demonstrate that the rider would provide “rate stability” or that the “proposal would provide customers with sufficient benefit from the rider’s financial hedging mechanism or any other benefit that is commensurate with the rider’s potential cost.”[[2]](#footnote-2)

Duke filed an application for rehearing of the ESP Order on May 4, 2015.[[3]](#footnote-3) In its first two assignments of error, Duke requested that the Commission reverse its order denying recovery of the above-market costs of OVEC. The Commission should deny these two assignments of error because Duke incorrectly assumes that the PSR was lawfully authorized and Duke seeks to relitigate factual claims the Commission has resolved correctly.[[4]](#footnote-4)

# Duke fails to state grounds for rehearing of the Commission’s refusal to authorize recovery of the above-market generation-related wholesale costs of OVEC

## The PSR cannot be lawfully authorized

As many parties demonstrated in their applications for rehearing, the Commission erred when it concluded that the Commission could lawfully authorize a rider such as the PSR under R.C. 4928.143(B)(2)(d).[[5]](#footnote-5) Duke nonetheless assumes that the Commission acted lawfully when it made that finding that it could authorize the PSR as a placeholder rider and bases its first two assignments of error on the Commission’s erroneous finding.[[6]](#footnote-6) Because that assumption is incorrect, the Commission should reject Duke’s first two assignments of error.

Under Ohio law, the Commission’s authority to regulate electric services is limited to the regulation of retail electric service of public utilities.[[7]](#footnote-7) Retail electric service consists of retail service functions of transmission, distribution, and generation-related services,[[8]](#footnote-8) and the scope of the Commission’s authority to regulate retail electric service varies by service function.[[9]](#footnote-9) Although distribution service remains under the Commission’s traditional regulatory authority,[[10]](#footnote-10) Commission authority over generation service is restricted because retail electric generation service has been declared competitive.[[11]](#footnote-11) Under R.C. 4928.05(A)(1), the Commission has no authority to set prices for competitive services except as provided by R.C. 4928.141 to 4928.144 to establish the standard service offer. No provision of R.C. 4928.141 to R.C. 4928.144 carves out an exception permitting the Commission to establish as a term of the standard service offer the collection of above-market generation-related wholesale costs or a nonbypassable placeholder rider to do the same.[[12]](#footnote-12) Further, as to competitive services, the electric distribution company is “fully on its own.”[[13]](#footnote-13) Anticompetitive subsidies are prohibited, and the electric distribution company may not recover generation-related costs through distribution or transmission rates or generation-related transition revenue or its equivalent.[[14]](#footnote-14) Moreover, the Commission is field preempted by the Federal Power Act from increasing Duke’s compensation for wholesale generation-related services.[[15]](#footnote-15) Thus, authorization of the PSR to permit Duke to recover above-market generation-related wholesale costs would violate Ohio and federal law.[[16]](#footnote-16)

Although Ohio and federal law do not permit the Commission to authorize the PSR, Duke nonetheless assumes that the Commission may authorize the rider and then challenges the Commission’s adverse findings on the merits of the PSR.[[17]](#footnote-17) Because Duke’s legal assumption regarding the Commission’s authority to authorize the PSR is wrong, there is no reason for the Commission to address Duke’s attempt to relitigate the merits of the PSR. Rather, the Commission should find that it is without authority to authorize the PSR and deny Duke’s first two assignments of error.

## Duke’s attempt to relitigate the Commission’s findings do not provide grounds for rehearing

Based on its faulty assumption that the Commission can authorize the PSR, Duke makes two arguments to support authorization to collect above-market generation-related wholesale costs of OVEC. First, Duke claims that the Commission should not have focused on the uncertainty in wholesale markets as part of its rationale for denying cost recovery.[[18]](#footnote-18) According to Duke, “inability to foretell the future has not been a justification to refuse to act.”[[19]](#footnote-19) Second, it asserts that the Commission “misunderstood” the difference between a financial hedge and the laddering and staggering of auction results. The Commission, however, correctly assessed the record and determined that collection of OVEC’s above-market generation-related wholesale costs was unlawful and unreasonable.

### The Commission correctly determined the PSR could not be authorized under R.C. 4928.143(B)(2)(d) based on the record in this case

Pointing to the Commission’s finding that wholesale electricity prices are subject to uncertainty due to pending regulatory changes, Duke claims that the Commission should authorize cost recovery under the rider because the Commission “routinely approves riders [such as its rider to recover bypassable energy costs] based upon forecasts or projections” and this approach is an “established regulatory practice.”[[20]](#footnote-20) As part of this same assignment of error, Duke also claims that the Commission failed to account fully for the “benefits” of the rider when it denied cost recovery.[[21]](#footnote-21) Neither claim warrants rehearing.

Duke’s first claim that the Commission should follow “established regulatory practice” ignores that the Commission found that Duke failed to demonstrate that the PSR would meet the requirements of R.C. 4928.143(B)(2)(d) on much broader grounds than Duke admits. Duke sought authorization of the PSR under R.C. 4928.143(B)(2)(d). Under that division, Duke had the burden of proof[[22]](#footnote-22) to demonstrate that the PSR would have the effect of stabilizing retail electric rates, but it did not offer any evidence of the PSR’s cost as part of its direct case. Based on the efforts of intervenors, the Commission correctly rejected authorization of cost recovery because the Commission was “not persuaded that the PSR proposal put forth by Duke in the present proceedings would, in fact, promote rate stability, as Duke claims, or that it is in the public interest.”[[23]](#footnote-23) As part of its reasoning, the Commission identified the uncertainty created by market changes, pending environmental rules, and federal litigation.[[24]](#footnote-24) The Commission, however, further found “the evidence of record reflects that the rider may result in a net cost to customers, with little offsetting benefit from the rider’s intended purpose as a hedge against market volatility”[[25]](#footnote-25) and that Duke had failed to demonstrate “that Duke’s PSR proposal would provide customers with sufficient benefit from the rider’s financial hedging mechanism or any other benefit that is commensurate with the rider’s potential cost.”[[26]](#footnote-26) Based on Duke’s failure to carry its burden to show that the rider would satisfy the statutory requirements and was in the public interest, the Commission “conclude[d] that Duke has not demonstrated that its PSR proposal, as put forth in these proceedings, should be approved under R.C. 4928.143(B)(2)(d).”[[27]](#footnote-27) As the Commission’s findings demonstrate, the denial of authorization was based on detailed findings that collection of the above-market generation-related wholesale costs of OVEC was neither lawful nor reasonable. “Established regulatory practice,” therefore, required the Commission to deny authorization of the billing and collection of the above-market generation-related wholesale costs of OVEC.

Duke also complains that the Commission erred because it “focused solely on the term of the ESP” in assessing the “benefits” of the PSR. According to Duke, the Commission also should have considered the benefits that might accrue over the life of the proposed rider.[[28]](#footnote-28)

Contrary to Duke’s assertion, there is no finding in the ESP Order supporting Duke’s claim that the Commission “solely focused on the term of this ESP”[[29]](#footnote-29) when it rejected Duke’s unlawful request. To the contrary, the Commission expressly recognized that Duke was proposing a twenty-five year term for the PSR and that Duke was committing “the net benefits” of the rider to customers.[[30]](#footnote-30) However, Duke failed to persuade the Commission that customers would benefit from the rider.

With regard to Duke’s first assignment of error, therefore, Duke has failed to demonstrate that the Commission erred when it refused to authorize cost recovery under the PSR based on findings that the PSR did not satisfy statutory requirements of R.C. 4928.143(B)(2)(d). Further, as IEU-Ohio demonstrated in its application for rehearing, established regulatory practice requires the Commission to grant rehearing and reverse its authorization of the PSR because Duke did not carry its burden of proof.[[31]](#footnote-31)

### Duke mischaracterizes the PSR as a “hedge” customers may exercise to reduce retail price changes

As a separate basis for reversing its decision to deny Duke authority to bill and collect its above-market generation-related wholesale costs, Duke asserts that the Commission misunderstands the difference between a financial hedge and a general smoothing of price changes.[[32]](#footnote-32) To support this argument, Duke provides an example of a hedge based upon a farmer entering into a future or forward contract for the farm’s annual production. Based on this example, Duke claims that the PSR would operate similarly as a hedge for retail electric customers.[[33]](#footnote-33) Duke then argues “laddering and staggering of auctions [in contrast to the supposed benefits of the PSR as a hedge] can only smooth price changes.”[[34]](#footnote-34) Based on this alleged distinction, Duke concludes that the “Commission’s rejection of [Duke’s] Rider PSR proposal on the ground that laddering and staggering of auction products and the availability of fixed-price retail contracts already provide a ‘significant hedge against price volatility’ is fallacious.”[[35]](#footnote-35) Although Duke provides a useful demonstration of what a real hedge is, its example demonstrates the PSR is not what Duke purports it to be.

In Duke’s example of a hedge,[[36]](#footnote-36) a farmer locks in the price for his or her production before planting and thereby hedges the risk of changes in market prices when the farmer delivers the crop to the market. By contracting the delivery price of the crop through the future or forward contract, the farmer’s risk of rising or falling market prices several months in the future is shifted to the buyer of the crop. The farmer, however, would retain the risk that planting may not yield a sufficient crop to satisfy the delivery requirement and be forced to cover at market prices.

The PSR, however, is not a future or forward contract that hedges future market prices for customers since it would not establish a price for retail generation services.[[37]](#footnote-37) The price of retail generation will be the “market price” for retail generation supply, and whatever volatility occurs will be reflected in customers’ electric bills subject to whatever measures (including substituting natural gas for electricity) they may implement to reduce the risk. Unlike the farmer’s future or forward contract, the PSR will only increase electric bills through another rider that will make electric bills more volatile and harder to predict.

If Duke’s example demonstrates anything relevant to this proceeding, it is that Duke, rather than its retail customers, is the “farmer” in its example. Under the PSR, Duke, like the farmer, would transfer its price risk associated with OVEC to the buyers, Duke’s retail customers. Thus, the “hedge” the PSR would provide is an assurance that Duke would be free of the business risk of its interest in OVEC.[[38]](#footnote-38)

Duke’s example of a hedge also highlights an important difference between the farmer who elects to hedge and the Duke retail electric service customer. The former chooses to shift the market price risk to a third party, but could also elect to retain the market price risk. Under Duke’s PSR proposal, however, the Duke retail customer would be denied that choice. Instead, the retail customer will pay a nonbypassable rider. (As long as the retail customer remains on the Duke system, the customer would remain liable for the PSR. Even if the customer reduces consumption, Duke would still recover its above-market costs from customers through the true-up built into the proposed rider.) Thus, Duke’s example ignores a fundamental difference between a hedge and the PSR. A hedge reflects choice, a policy outcome the Commission is required to ensure when it approves an ESP[[39]](#footnote-39); the authorization of the PSR would require the customer to pay for something it may neither want nor value.

Through its faulty analogy, Duke has not provided a reason for the Commission to authorize Duke to shift the business risk associated with its retained interest in OVEC to retail customers. [[40]](#footnote-40) The PSR will not “hedge” price changes that will occur in the retail generation market; its only effect is to shift Duke’s above-market costs of OVEC to Duke’s retail customers. Further, customers already have a means to address retail price volatility. To the extent that a customer seeks to reduce retail generation price fluctuations, the customer may contract for retail generation service under fixed price term contracts that reflect a tradeoff of term and price for up to the term of the ESP.[[41]](#footnote-41)

# Conclusion

For the reasons discussed above, the Commission should deny Duke’s first and second assignments of error. The Commission properly found that the PSR does not satisfy a statutory requirement for authorization of the rider, and nothing in Duke’s application for rehearing provides a lawful and reasoned basis to reverse that finding. To bring the ESP Order into compliance with Ohio law, however, the Commission should reverse authorization of the placeholder PSR and the “future filing” because their authorization violates Ohio and federal law and is unreasonable.

Respectfully submitted,

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**Certificate Of Service**

In accordance with Rule 4901-1-05, Ohio Administrative Code, the Commission’s e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing *Memorandum of Industrial Energy Users-Ohio in Opposition to the Application for Rehearing of Duke Energy Ohio, Inc.* was sent by, or on behalf of, the undersigned counsel for IEU-Ohio to the following parties of record this 14th day of May 2015, *via* electronic transmission.

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1. Opinion and Order at 42 (Apr. 2, 2015) (“ESP Order”). [↑](#footnote-ref-1)
2. *Id*. at 46. [↑](#footnote-ref-2)
3. Application for Rehearing of Duke Energy Ohio, Inc. (May 4, 2015) (“Duke Application for Rehearing”). [↑](#footnote-ref-3)
4. Failure to address any of the issues raised by Duke’s Application for Rehearing does not indicate any agreement with Duke. [↑](#footnote-ref-4)
5. *See, e.g.,* Application for Rehearing of Industrial Energy Users-Ohio at 8-54 (May 4, 2015) (“IEU-Ohio Application for Rehearing”); Sierra Club’s Application for Rehearing at 2-7 (May 4, 2015); Application for Rehearing and Memorandum in Support of the Ohio Manufacturers’ Association at 4-11 (May 4, 2015); Application for Rehearing of IGS Energy at 17-30 (May 4, 2015); Application for Rehearing by the Office of the Ohio Consumers’ Counsel at 16-37 (May 4, 2015); Application for Rehearing by the Environmental Law and Policy Center and the Ohio Environmental Council at 3-9 (May 4, 2015); Application for Rehearing of the Retail Energy Supply Association at 17-26 (May 1, 2015); Ohio Partners for Affordable Energy’s Application for Rehearing at 7-21 (May 1, 2015). [↑](#footnote-ref-5)
6. Duke Application for Rehearing at 6-7. [↑](#footnote-ref-6)
7. R.C. 4905.02, 4905.03, & 4928.01(A)(6) & (7). [↑](#footnote-ref-7)
8. R.C. 4928.01(A)(27). [↑](#footnote-ref-8)
9. R.C. 4928.05(A). [↑](#footnote-ref-9)
10. R.C. 4928.05(A)(2). [↑](#footnote-ref-10)
11. R.C. 4928.03. [↑](#footnote-ref-11)
12. In this case, the requirements of R.C. 4928.143 are controlling since Duke is seeking authorization of an electric security plan. The Commission may authorize only the terms of an ESP provided by R.C. 4928.143(B). *In re Columbus S. Power Co*., 128 Ohio St.3d 512 (2011). [↑](#footnote-ref-12)
13. R.C. 4928.38. [↑](#footnote-ref-13)
14. *Id*. & R.C. 4928.02(H). [↑](#footnote-ref-14)
15. IEU-Ohio Application for Rehearing at 35-44 (May 4, 2015) (the Commission is without authority to increase Duke’s compensation for wholesale generation-related services). [↑](#footnote-ref-15)
16. For the full development of these arguments, see *id*. at 8-54. [↑](#footnote-ref-16)
17. Duke Application for Rehearing at 6-11. [↑](#footnote-ref-17)
18. *Id*. at 8. [↑](#footnote-ref-18)
19. *Id.* [↑](#footnote-ref-19)
20. *Id.* [↑](#footnote-ref-20)
21. *Id*. at 8-9. [↑](#footnote-ref-21)
22. R.C. 4928.143(C)(1). [↑](#footnote-ref-22)
23. ESP Order at 46. [↑](#footnote-ref-23)
24. *Id*. [↑](#footnote-ref-24)
25. *Id*. [↑](#footnote-ref-25)
26. *Id.* [↑](#footnote-ref-26)
27. *Id.* [↑](#footnote-ref-27)
28. Duke Application for Rehearing at 8. [↑](#footnote-ref-28)
29. *Id*. [↑](#footnote-ref-29)
30. ESP Order at 46. [↑](#footnote-ref-30)
31. *See* IEU-Ohio Application for Rehearing at 23-24. [↑](#footnote-ref-31)
32. Duke Application for Rehearing at 9. [↑](#footnote-ref-32)
33. *Id.*at 9-10. [↑](#footnote-ref-33)
34. *Id.* at 10. [↑](#footnote-ref-34)
35. *Id.* at 11. [↑](#footnote-ref-35)
36. *Id*. at 9-10. [↑](#footnote-ref-36)
37. As part of its argument that the PSR would operate as a hedge, Duke assumed that the PSR will move in the opposite direction of prices. To support that assumption, Duke asserted that OVEC’s costs are stable, Duke Ex. 6 at 14, but the record demonstrated otherwise. OVEC’s average cost of generation moved from $52 to $62 from 2011 to 2012, and Duke’s average cost of its OVEC interest likewise increased considerably. IEU-Ohio Ex. 5 at 2, IEU-Ohio Ex. 7 at 2, & IEU-Ohio Ex. 13. The demand portion of Duke’s average cost of electricity from OVEC rose by 71% between 2009 and 2012. IEU-Ohio Ex. 13. Based on the record, the Commission does not have a basis to find that Duke’s OVEC-related generation costs are “stable.” [↑](#footnote-ref-37)
38. The business risk of OVEC is significant. Duke recorded a pretax impairment charge of $94 million related to OVEC. Duke Energy Ohio, Inc., FERC Form No.1 at 123.22 (Apr. 17, 2015), viewed at <https://www.duke-energy.com/pdfs/Q4_2014_DE_Ohio_Form_1.pdf> (May 13, 2015). An impairment is recognized to the extent the net book value of an asset exceeds the present value of future revenues discounted at the incremental borrowing rate. *Id*. at 123.9. [↑](#footnote-ref-38)
39. R.C. 4928.02(A) & R.C. 4928.06(A). [↑](#footnote-ref-39)
40. ESP Order at 46. [↑](#footnote-ref-40)
41. *Id. See* Tr. Vol. II at 472-73 & Tr. Vol. X at 2697. *See, also*, the Commission’s Apples to Apples Chart applicable to Duke, viewed at: http://energychoice.ohio.gov/ApplesToApplesCategory.aspx?Category=Electric. [↑](#footnote-ref-41)