

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke)
Energy Ohio, Inc. for Recovery of)
Program Costs, Lost Distribution)
Revenues, and Performance Incentives)
Related to its Energy Efficiency and)
Demand Response Programs.)

Case No. 18-0397-EL-RDR

APPLICATION FOR REHEARING OF DUKE ENERGY OHIO, INC.

Pursuant to Section 4903.10, Ohio Revised Code (R.C.), and Rule 4901-1-35, Ohio Administrative Code (O.A.C.), Duke Energy Ohio, Inc. (Duke Energy Ohio or the Company) respectfully submits this Application for Rehearing of the Public Utilities Commission of Ohio's (Commission) July 31, 2019, Finding and Order (Order). The Commission's Order is unreasonable and unlawful in the following respects:

1. Paragraphs 17-18 of the Commission's Order are unreasonable and unlawful in two regards:
 - a. That the Commission adopts the Staff of the Commission's (Staff) evaluation insofar as it inappropriately and unlawfully excludes incentive pay from recovery based on mere "correlat[ion] with Duke's bottom line and meeting shareholder interests," contrary to Commission precedent and Ohio law.
 - b. That the Commission adopts Staff's conclusion that the Company did not provide the full information required to isolate non-financial incentives from financial incentives, in order for Staff to determine whether these expenses were incremental, prudent, reasonable, and appropriate for recovery.

A memorandum in support of this Application for Rehearing is attached.

Respectfully submitted,

DUKE ENERGY OHIO, INC.

/s/ Elizabeth H. Watts

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MEMORANDUM IN SUPPORT

Pursuant to R.C. 4903.10 and O.A.C. 4901-1-35, Duke Energy Ohio seeks rehearing of the Order issued by the Commission on July 31, 2019. The Order uncritically adopted the Staff's recommendation to exclude all of the Company's claimed incentive pay from cost recovery, a recommendation that appeared to be based in part on the erroneous notion that all incentive pay "correlated with Duke's bottom line" was a financial incentive and therefore required to be excluded.¹ While Duke Energy Ohio does not believe that the Staff or the Commission intended to change the longstanding standard for recovery of incentive pay, the Staff's reliance on overbroad language in a recent order in a related case confuses the matter considerably. If the Commission does not firmly clarify its position in this proceeding, the Order threatens to erase the established

¹ Staff Review and Recommendations at pg.2.

and crucial distinction between “incentive pay tied to financial goals”² and “non-financial incentives.”³

I. THE ORDER CONTRADICTS THE EXISTING DISTINCTION BETWEEN FINANCIAL AND NON-FINANCIAL INCENTIVES.

In response to Duke Energy Ohio’s application in this case for 2017 energy efficiency and demand response-related costs, the Commission adopted Staff’s exclusion of all incentive compensation.⁴ Staff recommended excluding the entire claimed amount of \$314,219 in incentive compensation, comprised as follows:

- \$246,987 incentives allocated
- \$ 7,781 performance awards
- \$ 35,776 restricted stock units
- \$ 23,675 executive short-term incentives⁵

Although Staff reached its recommendation primarily on factual grounds, Staff’s reasoning (seemingly upheld in full by the Commission) could be interpreted as adopting the overbroad position that any incentive pay merely “correlated with” a utility’s “bottom line” must be excluded. Such a standard would destroy any possible distinction between financial and non-financial incentives and lead to virtually all incentive pay being excluded—contrary to Commission precedent.

Earlier this year, when the Commission issued orders in Duke Energy Ohio’s applications for recovery of program costs, lost distribution revenue, and performance incentives related to Duke Energy Ohio’s energy efficiency and demand response programs for 2015 and 2016,⁶ the Commission adopted Staff’s recommendation to exclude all incentive compensation from cost

² Order at pg. 5.

³ Staff Review and Recommendations at pg. 3.

⁴ Order at pg. 5.

⁵ Staff Review and Recommendations at pg. 3.

⁶ *In re Duke Energy Ohio, Inc.*, Case Nos. 16-664-EL-RDR and 17-781-EL-RDR, Finding and Order (May 15, 2019) (2015 and 2016 cases).

recovery.⁷ In those cases, the Commission noted in passing that “[w]hile not all of the performance goals may be explicitly tied to financial objectives, they are correlated with Duke’s bottom line and meeting shareholder interests.”⁸

Although it used broad-sounding language in the 2015 and 2016 cases, the Commission gave no indication that it was (1) discarding its long-held practice of carefully evaluating the extent to which incentive pay was tied to financial goals or (2) adopting a new practice of excluding cost recovery for any expense “correlated with [a utility’s] bottom line.” The Commission did not cite, distinguish, or abrogate any prior cases on the subject of incentive payment recoverability as it surely would have if it sought to depart from past practice. But, as this case makes clear, the phrasing of the order in the 2015 and 2016 cases is susceptible to overbroad interpretation and therefore the Commission should clarify the appropriate definition of financial incentive.

In this case, Staff acknowledged that “non-financial incentives” were recoverable, but excluded the Company’s claimed expenses solely on factual grounds. Staff said that it had “requested information from Duke to trace, verify, and separate non-financial incentives from financial incentives within the employee pay incentives,” but that the Company had “not provide[d] the full information required” to distinguish between the two types of expenses.⁹ Thus, Staff was not recommending a blanket exclusion of incentive payments; it merely recommended excluding what it viewed as inadequately substantiated incentive payments.

Moreover, Staff’s statement that the Company did not provide the full information required is inaccurate. The Company did provide, in discovery, the financial versus non-financial allocation percentages for each of the components of its incentive plans.¹⁰ Applying these percentages to the total incentives of \$314,219 at issue would result in financial performance-related incentives of

⁷ *Id.*

⁸ *Id.* at pg. 6. These cases dealt with Duke Energy Ohio’s applications for recovery of program costs, lost distribution revenue and performance incentives related to Duke’s energy efficiency and demand response programs for 2015 and 2016. In this case, Duke Energy Ohio has applied to recover costs related to the same programs for 2017.

⁹ Staff’s Review and Recommendations at pg. 3.

¹⁰ See Confidential Responses to Staff-DR-01-14-01 and Staff-DR-01-14-02 and accompanying attachments.

only \$98,872 excluding restricted stock units (RSUs), which are rewarded as retention incentives, or \$134,648 if RSUs are included. Additionally, Staff incorrectly assumed performance rewards are entirely financial related. However, performance incentives include non-financial performance-related goals such as customer satisfaction.

Staff's recommendation and the ensuing Order are susceptible to misinterpretation because Staff repeated the language from the 2015 and 2016 cases regarding performance goals "correlated with Duke's bottom line and meeting shareholder interests," and the Commission uncritically adopted Staff's recommendation.¹¹ Readers might perceive that the Commission requires exclusion of all incentive pay that is merely "correlated" with a utility's "bottom line."¹² Accordingly, Duke Energy Ohio seeks rehearing and clarification that, while incentive pay conditioned solely on achieving financial goals may be excluded, incentive pay conditioned on other types of improved performance (safety, operational, etc.) is recoverable under both Commission precedent and Ohio law, even when it "correlate[s]" with shareholder benefits. A threshold for recovery that turns on whether or not an expense impacts the utility's bottom line is unreasonable. Any expense the utility incurs, whether labor, publication expense, even the Commission's own annual assessment, will impact the utility's "bottom line." These are all expenses that should be eligible for recovery through rates.

II. EXCLUDING OTHERWISE RECOVERABLE INCENTIVE COMPENSATION FOR MERE CORRELATION WITH A UTILITY'S BOTTOM LINE CONFLICTS WITH BOTH COMMISSION PRECEDENT AND SOUND POLICY.

Until the past few months, the Commission has maintained an established record of permitting recovery of incentive pay that is tied to operational goals and other non-financial goals, such as safety. This is because the Commission has determined recoverability based on whether an expense benefits the customer, *i.e.*, whether the utility incurred the cost in order to provide

¹¹ Order at pg. 5.

¹² Staff's Review and Recommendations at pg. 2.

service under R.C. 4909.15. Whether or not the shareholder also benefits as a side effect, *i.e.*, correlation, is immaterial.

Commission precedent demonstrates that mere correlation with the bottom line is no obstacle to recovery. Thus, for example, in a rate case submitted by The Cincinnati Gas & Electric Company in 1996, the Commission rejected OCC's attempt to exclude all incentive compensation from recovery. The Commission explained that a utility's "burden" should be to "demonstrat[e] that incentive compensation plans tend to improve operating results," and requested only that the utility "work to more closely tie such incentives to the performance of employees' specific operational areas."¹³ Similarly, in a rate proceeding, in an Entry on Rehearing, the Commission upheld the recovery of the sixty percent of the claimed incentive compensation that was "tied to operational and individual employee achievement," even though employee eligibility for these incentive payments depended on the company meeting certain prerequisite "financial health goals."¹⁴ The Commission properly recognized that this sixty percent "was a benefit to ratepayers and thus recoverable."¹⁵

In instances where the Commission has excluded financial incentives, the excluded amounts were tied to financial goals, not merely "correlated" with the "bottom line." Thus, in a 2009 rate proceeding, Staff found that twenty percent of the incentives "were paid for achieving financial goals" and the Commission adopted the recommendation to exclude only that twenty percent, stating that "Staff has struck the proper balance regarding incentive compensation."¹⁶

¹³ *In the Matter of the Application of The Cincinnati Gas & Electric Company for an Increase in Its Rates for Gas Service to All Jurisdictional Customers*, Case No. 95-656-GA-AIR, Opinion and Order, (Dec. 12, 1996) at pg. 19.

¹⁴ *In the Matter of the Application of Ohio American Water Company to Increase its Rates for Water and Sewer Services Provided to its Entire Service Area*, Case No. 09-391-WS-AIR, Entry on Rehearing, (June 23, 2010) at pg. 11-12.

¹⁵ *Id.*

¹⁶ *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices, and For Tariff Approval*, Case No. 07-551-EL-AIR, *et al.*, Opinion and Order, (Jan. 21, 2009) at pg. 17.

In this area, the Commission’s past practice aligns with that of other states, which likewise permit recovery where compensation is properly tied to corporate goals aligning with safety and reliability. For example, the Massachusetts Department of Public Utilities has allowed financial performance as a “threshold component” of variable pay, so long as the metrics used to determine the amount of payout focus on customer interests.¹⁷ The California Public Service Commission has allowed recovery in rates of fifty percent of short-term incentives.¹⁸ The Illinois Commerce Commission has identified as acceptable goals for incentive compensation, including “OSHA Recordable Injuries, Energy Efficiency, Gas Leak Response Objectives and Gas Compliance.”¹⁹

Not only would denying cost recovery to all measures that improve a utility’s “bottom line” eliminate virtually all incentive payments from cost recovery, but it would turn shareholders and customers into adversaries in areas where they could and should be allies. Both customers and shareholders benefit when a utility reduces the number of workplace injuries or environmental incidents. Likewise, both customers and shareholders benefit when customer response times are reduced or when cost-savings measures are implemented. Measures that benefit customers should correlate favorably with the bottom line for shareholders—such correlation is beneficial and the Commission should foster it whenever possible.

For the reasons above, the Commission’s disallowance of incentive compensation cost recovery in this case threatens to upend Commission precedent, contrary to both Ohio law and prudent policy. The Company respectfully requests that the Commission clarify its Order to make clear that utilities may recover incentive compensation that relates to safety, operations, reliability, and other non-financial goals, regardless of whether it “correlate[s]” with the utility’s “bottom line,” consistent with prior Commission precedent.

¹⁷ *Boston Gas Co.*, 2010 WL 4391332 (Mass D.P.U. Nov. 2, 2010).

¹⁸ *Southern California Edison Co.*, 2009 WL 801553 (Ca. PUC Mar. 12, 2009).

¹⁹ *Central Illinois Light Co.*, 2010 WL 1868345 (Ill. Comm. Comm’n. April 29, 2010).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Application for Rehearing of Duke Energy Ohio, Inc. was served upon the below listed parties this 30th day of August, 2019.

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