BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of **Duke Energy Ohio, Inc.**, for a Cost Recovery Mechanism and for Approval of Additional Programs for Inclusion in its Existing Portfolio.	: : : : :	Case No. 11-4393-EL-RDR

SECOND POST-HEARING BRIEF
SUBMITTED ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

Michael DeWine
Attorney General

William L. Wright
Section Chief

Devin D. Parram
Assistant Attorneys General
Public Utilities Section
180 East Broad Street, 6th Fl.
Columbus, Ohio 43215
(614) 466-4397
Fax: (614) 644-8764
william.wright@puc.state.oh.us
devin.parram@puc.state.oh.us

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INTRODUCTION

This Post-Hearing Brief summarizes Staff's position regarding the five issues set forth in the Paragraph 9 of the Commission's May 9, 2012 Entry. In addition, because this was issue raised by the Hearing Examiners throughout the June 7, 2012 hearing, Staff addresses whether or not a cap should be adopted by the Commission.

ISSUES FROM PARAGRAPH 9 OF THE MAY 9, 2012 ENTRY

I. Issues 9(a): Explain, in detail, why or why not Duke should be granted a waiver of the requirements established in Chapter 4901:1-39, O.A.C, including, but not limited to, Rules 490l:l-39-03(B), 4901:1-39-04, and 4901:1-39-05,0.A.C.[1]

Staff recommends that a waiver be granted in this particular case.[2] Although Staff does not typically support adding new programs in between Energy Efficiency Portfolio filings, Staff believes extenuating circumstances exist in this case.[3] Through data request, Staff determined that Duke Energy Ohio, Inc. ("Duke") may need additional energy efficiency programs in order to meet its annual energy efficiency statutory benchmarks for 2012 and 2013.[4] Duke also felt it was appropriate to present an application to replace its existing energy efficiency cost recovery mechanism while

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1 Although this issue may have been largely directed at Duke, Staff felt it was necessary to explain its position regarding why a waiver may be warranted in Duke's particular case. Staff's position on this "waiver" issue, however, may differ in the future based upon the particular circumstances of each case.

2 Staff Ex. 3 (Prefiled Testimony of Gregory C. Scheck ("Scheck Direct")) at 3.

3 *Id.*

4 *Id.*

seeking to introduce the additional energy efficiency programs.[5] Staff sees benefits in the proposed cost recovery mechanism. For these reasons, Staff believes a waiver would be appropriate in this case.

II. Issues 9(b): What is the range of revenue that could be earned via Duke's proposed incentive mechanism in this case?

Staff Witness Scheck testified that Duke could earn an average $8.5 million incentive per year on an after-tax basis and a maximum of $15 million.[6] The proposed shared savings incentive mechanism would be tied to the net avoided cost benefit of the program. Scheck Direct at 7. Net avoided cost is determined by subtracting the total avoided costs in a given year by total program costs.[7] The ultimate incentive amount would depend on the levels of customer participation in the program and the actual program costs. Although Duke could potentially earn up to $15 million dollars, Mr. Scheck believes the likelihood of Duke reaching this level of performance is small. [8]

III. Issue 9(c): Should Duke's incentives be limited to performance that exceeds statutory benchmarks?

Staff believes that Duke should earn an incentive on total energy benefits after Duke meets the statutory benchmark.[9] The signatory parties agree that Duke should only be allowed to share in the benefits of its energy efficiency programs after it reaches 100%

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5 *Id.*

6 *Id.* at 7; Tr. 133.

7 Scheck Direct at 7.

8 Tr. 133.

9 Scheck Direct at 8.

compliance with the statutory benchmark.[10] This would ensure that Duke is not rewarded for performing requirements that it is already statutorily mandated to perform. At the same time, the signatory parties believe it is important to incentivize Duke to go beyond the bare statutory minimum. In order to strike this balance, the signatory parties agree that Duke should be allowed to earn an incentive based on its total energy efficiency costs, but only after Duke has surpassed the statutory benchmark.

Staff Witness Scheck explained why this structure is consistent with the policy and purpose of SB 221. Mr. Scheck testified that the purpose of energy efficiency incentives is to motivate electric distribution utilities ("EDUs") to go beyond the bare minimum requirements of the statute.[11] He also explained what EDUs consider when deciding whether to invest in energy efficiency programs vs. investing in traditional, non-energy efficiency investment opportunities. When investing in non-energy efficiency investment opportunities, EDUs can earn a rate of return if the investment is determined to be used and useful.[12] The rate of return on this non-energy efficiency investment is calculated based upon total investment costs, not some subset of the total investment cost.[13] If the Commission were to allow Duke to earn an incentive on only a subset of its energy efficiency investment costs as opposed to its total costs, Duke would not be economically

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10 Joint Exhibit 1, Stipulation and Recommendation.

11 *Id.* at 8.

12 *Id.*

13 *Id.*

incentivized to invest in energy efficiency beyond the statutory requirements.[14] Rather, once it reached the statutory benchmark, Duke would be incentivized to invest in other non-energy efficiency investment opportunities that provide greater potential for economic return.[15]

Duke Witness Duff also explained why an incentive structure that only recognizes the net benefits of impacts that exceed the statutory minimum would not incentivize Duke to invest in energy efficiency beyond the statutory minimum.[16] For a $25 million dollar investment in energy efficiency programs, Duke would receive an incentive of only approximately $350,000.[17] This would be a 1.4% return on investment. Such a small return on investment may not incentivize Duke to go beyond the minimum requirements of the energy efficiency statute. Especially when Duke could invest the same amount of money in non-energy efficiency investments and potentially earn higher economic returns. NRDC Witness Sullivan echoed this point in his testimony.[18] Mr. Sullivan stated that limiting the incentive mechanism in such a fashion "would not create enough of an earnings opportunity to change Company behavior."[19] His also testified

[14] NRDC Exhibit 1, (Direct Testimony of Dillon Sullivan on Behalf of Natural Resources Defense Council ("Sullivan Direct")) at 6.

[15] *Id.*

[16] Duke Energy Exhibit 10, (Second Supplemental Direct Testimony of Timothy J Duff s on the Behalf of Duke Energy Ohio ("Second Supp. Duff Direct")) at 9.

[17] *Id.*

[18] Sullivan Direct at 6.

[19] *Id.*

that this would "put energy efficiency at a disadvantage compared to other opportunities for Company investment and ingenuity."[20]

IV. Issue 9(d): Should an incentive be equal to or greater than the return on investment that Duke could earn by investing the same sums in utility infrastructure?

Staff believes the incentive mechanism would need to be greater than the return on investment that Duke could earn by investing the same amount in utility infrastructure. [21] Mr. Scheck explained that this is necessary to encourage Duke to invest in energy efficiency beyond the statutory mandates.[22] Duke Witness Duff also testified that return on investment for energy efficiency programs should be greater than investments in traditional utility infrastructure.[23] He clarifies, however, that the incentive mechanism proposed in this case is not linked to return on investment, but tied to the Company's ability to meet and exceed the performance thresholds in an economically efficient manner.[24] This proposed shared savings mechanism helps to align the interest of Duke and its customers.[25]

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20 *Id.*

21 Scheck Direct at 9.

22 *Id.*

23 Second Supp. Duff Direct at 10.

24 *Id.*

25 *Id.*

V. Issue 9(e) How should the Commission view Duke's proposed incentive mechanism in light of Duke's significantly excessive earning threshold?

Staff determined that Duke's proposed energy efficiency incentive mechanism would not cause Duke to trigger the SEET threshold.[26] Staff Witness Scheck made this determination based upon Duke's "SEET case" filings in Case No. 12-1280-EL-UNC. Duke reported that it had a return on common equity including non-SSO sales and ESP deferrals of 5.84% for calendar year 2011.[27] This percentage number is quite below the 15% SEET threshold.[28]

VI. Proposed cap on energy efficiency incentive earnings

a. Staff believes that the SEET test serves as a cap and that any other cap may not properly incentivize Duke to invest in energy efficiency programs

It is Staff's position that the only cap on the energy efficiency incentive earnings should be the SEET test. The SEET test, in theory, already works to prevent Duke from earning significantly excessive earnings. Staff Witness Scheck testified that putting another cap on the incentive mechanism could cause Duke to stop investing in energy efficiency programs once it meets the cap. However, if the Commission chose to impose a cap in this case, Staff believes a number of factors should be considered in determining the appropriate cap level. Staff Witness Scheck testified that the Commission, if it chooses to impose a cap, should consider the total amount of sales of Duke, the make up

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26 Scheck Direct at 9.

27 *Id.*

28 *Id.*

of Duke's customer base (commercial, industrial, or residential) and the weather in Duke's particular service area (the warmer weather of Southern Ohio as opposed to other EDU's service areas). The Commission may also want to consider these particular factors if they choose to compare Duke to AEP, which currently has $20 million cap on its current incentive mechanism.

b. The cap proposed by OEG's Witness Kollen should not be adopted by the Commission

OEG Witness Kollen is opposed to the idea of any incentive mechanism.[29] He acknowledges, however, that they are allowed by Ohio law.[30] Mr. Kollen testified that if the Commission approves an incentive mechanism in this case, then the Commission should impose a cap.[31] Mr. Kollen suggests that the cap should be 3% of the total program cost.[32] He also suggests an absolute dollar cap of $1,000,000 annually. His proposed method would be calculated based upon project cost alone.[33]

The Commission should not adopt Mr. Kollen's proposed cap for a number of reasons. First, setting the cap based solely upon program cost would not ensure that Duke is implementing the most cost effective energy efficient programs. As explained by

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29 OEG Exhibit 7, (Direct Testimony of Lane Kollen on behalf of Ohio Energy Group ("Kollen Direct")) Kollen Direct at 4.

30 Duke Energy Exhibit 11, (June 5, 2012 Deposition of Lane Kollen ("Kollen Depo.")) at 26.

31 Kollen Direct at 5.

32 *Id.*

33 Kollen Depo at 37.

Duke Witness Duff, this proposed cap would incent Duke to stop investing in energy efficiency efficiently or, even worse, stop investing in energy efficiency completely once it hits the 3% cap.[34] Second, Mr. Kollen's "3%" or "$1,000,000" cap is not based upon any meaningful analysis.[35] He did not study any potential rate impacts or analyze any other incentive mechanisms in making his determination.[36] His only consideration was the potential cost to OEG's clients, not promoting energy efficiency or ensuring that the policy behind SB 221 is met. Third, he fails account for the fact that the statutory minimums increase over time, and whether this would affect Duke's need to increase its spending to meet the increasing mandates.

CONCLUSION

The incentive mechanism proposed by the signatory parties will help further the energy efficiency goals of SB 221 and align the interest of Duke and its customers. The signatory parties thoughtfully constructed the shared savings mechanism in order to accomplish a wide array of interest. With the additional evidence presented at the June 7, 2012 hearing, Staff believes that the record supports the Commission's adoption of the Stipulation and Recommendation.

34 Second Supp. Duff Direct at 10.

35 Kollen Depo. at 33-35.

36 *Id.*

Respectfully Submitted,

Michael DeWine
Ohio Attorney General

William L. Wright
Section Chief

/s/ Devin D. Parram

Devin D. Parram
Assistant Attorney General
Public Utilities Section
180 East Broad Street
Columbus, OH 43215-3793
(614) 466-4396
FAX: (614) 644-8764
devin.parram@puc.state.oh.us

PROOF OF SERVICE

I hereby certify that a true copy of the **Second Post-Hearing Brief** was served by electronic mail upon the following parties of record, this June 22, 2012.

/s/ Devin D. Parram

Devin D. Parram
Assistant Attorney General

PARTIES OF RECORD:

Duke Energy Ohio
Amy B. Spiller
Elizabeth H. Watts
155 East Broad Street, 21st Street
Columbus, Ohio 43215
Amy.Spiller@duke-energy.com
Elizabeth.watts@duke-energy.com

Office of the Ohio Consumers' Counsel
Janine L. Migden-Ostrander, Consumers' Counsel
Jeffrey L. Small, Counsel of Record
Melissa R. Yost
Assistant Consumers' counsel
10 West Broad Street, suite 1800
Columbus, Ohio 43215-3485
small@occ.state.oh.us
yost@occ.state.oh.us

People Working Cooperatively, Inc.
Mary W. Christensen
Christensen & Christensen LLP
8760 Orion Place, Suite 300
Columbus, Ohio 43240-2109
mchristensen@columbuslaw.org

Environmental Law & Policy Center
Tara C. Santarelli
1207 Grandview Avenue, suite 201
Columbus, Ohio 43212
tsantarelli@elpc.org

Natural Resources Defense Council
Christopher J. Allwein
Williams, Allwein and Moser, LLC
1373 Grandview Avenue, suite 212
Columbus, Ohio 43212
callwein@williamsandmoser.com

Ohio Energy Group
David F. Boehm
Michael L. Kurtz
Jody M. Kyler
Boehm, Kurtz & Lowery
36 East Seventh Street, suite 1510
Cincinnati, Ohio 45202
dboehm@bkllawfirm.com
mkurtz@bkllawfirm.com
jkyler@bkllawfirm.com

Ohio Partners for Affordable Energy
Colleen L. Mooney
231 West Lima Street
Findlay, Ohio 45839-1793
Cmooney2@columbus.rr.com

Vectren Retail
Joseph M. Clark
6641 North High Street, Suite 200
Worthington, Ohio 43085
jmclark@vectren.com

Ohio Environmental Council
Trent A. Dougherty
Nolan Moser
1207 Grandview Avenue, suite 201
Columbus, Ohio 43212-3449
trent@theoec.org
Nolan@theoec.org

The Sierra Club
Henry W. Eckhart
1200 Chambers Road, Suite 106
Columbus, Ohio 43212
henryeckhart@aol.com