BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. 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, Inc. for Authority to Amend its Certified Supplier Tariff, P.U.C.O. No. 20	)))	Case No. 14-842-EL-ATA

INITIAL BRIEF OF THE CITY OF CINCINNATI

I. INTRODUCTION AND BACKGROUND

On May 29, 2014, Duke Energy Ohio, Inc. ("Duke" or "Company") filed its Application to establish a standard service offer ("SSO") in the form of an electric security plan ("ESP" or the "Plan"), along with a request for approval of certain accounting authorities. The Plan is to replace Duke's current ESP that is set to expire on May 31, 2015.

The proposed Plan is for a two-year period beginning on June 1, 2015 with an option (on the part of Duke) to extend the plan for an additional year. The SSO rate would be determined through a two-auction process for each year (June to May) of the ESP. The Plan also continues certain of the non-bypassable riders that are currently in place: Rider UE-Gen, Rider LFA, and Rider DC-ECF. The Plan as proposed introduces three new non-bypassable riders—Distribution Capital Investment Rider ("Rider DCI"), Distribution Storm Rider ("Rider DSR"), and Price Stabilization Rider ("Rider PSR").

While Duke's overall application is generally consistent with Duke's current plan, Rider PSR presents a glaring exception. The City of Cincinnati's ("City" or "Cincinnati") arguments in this Brief are limited to Rider PSR and the City's strong opposition to this poorly constructed assault on the public interest by Duke.

A. The City of Cincinnati

Cincinnati relies upon Duke to deliver the electric power necessary for various city-owned and/or operated governmental facilities. These facilities include the Greater Cincinnati Water Works, a department of the City, and the Metropolitan Sewer District of Greater Cincinnati, a sewer district owned by Hamilton County, but managed and operated by the City. The City has over 600 individual accounts and, collectively, the City consumes more than 267,000 MWh per year (approximately 1.3% of Duke's 20 million MWh retail sales). The City spends in excess of $14 million annually on electricity. In addition, the residents of the City rely upon Duke for the distribution of their electric services. The City's municipal electric aggregation program includes approximately 60,000 such distribution service customers. The City and the welfare of its residents will be greatly impacted by the outcome of this proceeding.

B. Rider PSR

Similar to the other Ohio electric distribution utilities ("EDUs"), Duke is a sponsoring company of the Ohio Valley Electric Corporation ("OVEC"), and it is a participant in the Amended and Restated Inter-Company Power Agreement, dated September 10, 2010 (the "ICPA"). See, IEU-Ohio Ex. 5. The ICPA entitles Duke to a 9% share of the capacity and energy output of the two OVEC generating facilities,[1] along with a proportionate share of the cost burden of the OVEC operations. Through its proposed Rider PSR, Duke is offering its share of its share of the capacity

[1] Ohio Valley Electric Corporation (OVEC) owns and operates two coal-fired baseload generating facilities, the 1,086 MW Kyger Creek plant, located in Cheshire, Ohio, and the 1,304 MW Cifty Creek plant, located near Madison, Indiana, both placed into service in 1955. IEU-Ohio Ex. 7, p. 1.

and energy from OVEC to its retail customers for the duration of Duke's entitlement. Duke is proposing to sell one hundred percent of its share of OVEC's energy and capacity into the PJM markets. Under Rider PSR, the difference between the revenue generated from such sales and the costs allocated from OVEC to Duke would flow through to customers. Duke Ex. 6, pp. 11-13. If revenues exceed costs, Duke's customers will see a credit; if, however, revenues are less than Duke's allocated share of costs under the ICPA, customers will see a surcharge.

Under any circumstance, Rider PSR will allow Duke to recover 100% of the costs associated with Duke's interest in OVEC. Currently and without Rider PSR, Duke is completely at risk for this cost recovery and Rider PSR serves no purpose other than to shift the financial risk of this power purchase contract on to captive customers. As proposed by Duke, it may request authority to include other power purchase arrangements in this rider mechanism at some point in the future. The "risk" is measured by netting the annual contract cost against the market value of the power from the OVEC, which is bid into the PJM market. As benignly described by Duke, Rider PSR is " simply a financial arrangement intended to act as a hedge against price volatility that exists in the PJM Interconnection, L.L.C. (PJM) power markets." Duke Ex 6, p. 12. However, the record in this case is devoid of any empirical evidence to support this claim. It has not been shown, nor can it be shown, that Rider PDR would do anything beyond adding an additional cost on customers' bills.

Under Rider PSR, Duke would remain the direct market participant and owner of the OVEC entitlement, but in place of the PJM market-based revenue streams for capacity and energy, Duke would instead receive 100% of its contract costs as compensation for that wholesale market participation. This is a fundamentally different outcome for Duke from the outcome otherwise dictated by the FERC approved wholesale marketplace. This indisputable fact must not be lost on the Commission.

II. ARGUMENT

A. <u>Rider PSR is Illegal</u>

Rider PSR changes the outcome of participation in the PJM marketplace for Duke – it does not matter what the motivation for that change may be, it is an intrusion into the authority of the FERC and it is illegal. The Commission is already considering the legality of this proposal: Duke's Rider PSR proposal is identical to that of AEP Ohio's Rider PPA now pending before the Commission in Case No. 13-2385-EL-SSO, with the exception of the amount of generation involved (Duke's 9% share vs AEP Ohio's 19.93% share) and the duration of the proposal, Duke is proposing the entirety of the entitlement (through 2040), while AEP Ohio only *alluded* to a desire to commit its entitlement for a longer period beyond its ESP. As with the AEP Ohio proposal, the idea has many fatal flaws from a public interest standpoint, but primary problem from the Commission's perspective is that it is facially illegal and the Commission lacks the authority to even entertain the idea.

There is no question that without Rider PSR, the financial outcome from Duke's participation in the PJM wholesale marketplace is totally dependent on the revenues available from the PJM market structure—compensation for capacity or energy, or both, as the case may be. This is the FERC-approved compensation arrangement, and Rider PSR would change this arrangement. See, Tr. Vol. III. p. 650, ln. 8-12.

As the Commission is by now likely aware, two recent federal circuit court decisions address state authority to influence the federal scheme of interstate wholesale electric rates. Both cases involve state efforts to provide incentives for the construction of new baseload generation facilities out of a concern that the PJM base residual auction ("BRA") process for setting capacity prices was not properly serving this function. Both of the state programs in question directed ratepayer funded subsidies to generation plants governed by the PJM tariff, and to this extent are identical to Rider PSR.

This past June, in *PPL Energy Plus, LLC v. Nazarian*, 753 F.3d 467, 2014 U.S. App. LEXIS 10155 (4th Cir. 2014), the Fourth Circuit Court of Appeals, in upholding the decision of the District Court below, found that the Maryland Public Service Commission was *field preempted* by the Federal Power Act from providing incentive compensation for new generation located in a specific PJM delivery zone based on the difference between market revenues and the "bid-in" per-unit embedded cost of that generation. *Id.* at 476. Wholesale generators are entitled to no more or less compensation than that permitted under federally approved tariffs. As the Court explained:

> …the federal markets are the product of a finely-wrought scheme that attempts to achieve a variety of different aims. FERC rules encourage the construction of new plants and sustain existing ones. They seek to preclude state distortion of wholesale prices while preserving general state authority over generation sources. They satisfy short-term demand and ensure sufficient long-term supply. In short, the federal scheme is carefully calibrated to protect a host of competing interests. It represents a comprehensive program of regulation that is quite sensitive to external tampering.

Id. at 473. The Court explained further:

> Furthermore, the [Maryland order authorizing the Contracts for Differences ("CfDs")] ensures that [the generator] receives a fixed sum for every unity of capacity and energy that clears (up to a certain ceiling). The scheme thus effectively supplants the rate generated by the auction with an alternative rate preferred by the state. The Order thus compromises the integrity of the federal scheme and intrudes on the FERC's jurisdiction.

Id. at 476 (internal footnote omitted).

Like the characterizations now being made by Duke and the other Ohio EDUs, the Court dismissed the attempts to put lipstick on a pig:

> Relevantly, appellants contend, the Order does not fix the rate that PJM pays to CPV for its sales in the auction; instead, it merely fixes the rate that CPV receives for such sales. On the basis of this asymmetry, appellants contend that the CfD payments represent a separate supply-side subsidy implemented entirely outside the federal market. We cannot accept this argument.

Id. Here, under Rider PSR, ratepayers will “fix” the rate that Duke receives for its federally regulated generation asset by paying Duke 100% of its costs under the OVEC ICPA. This plainly supplants the federal scheme of compensation for such wholesale generation transactions and denies full effect to the rates set by the FERC. Duke, as the owner of the market participating ICPA entitlement, must “feel” the price signals from the PJM marketplace in order for that compensation scheme to work as intended by the FERC.

More recently, in *PPL Energy Plus, LLC, et al., v. Lee A. Solomon, et. al.*, 766 F.3d 241, 2014 U.S. App. LEXUS 17557 (3rd Cir. 2014), the Third Circuit Court of Appeals found that the New Jersey Board of Public Utilities also was *field preempted* when it exercised state statutory authority[2] to set an “appropriate” rate for the provision of capacity serving the PJM markets. 766 F. 3rd. 241, 253. Just as with the Maryland example, the subsidy mechanism covered the difference between PJM market revenues and the administratively determined cost of operating the new facilities. *Id.* at 251.

Here again, the proponents of the subsidies argued that the payments did not intrude on federal rates, but rather such payments represent “ contract for differences, functioning like a hedge’ and, therefore [do] not transact in capacity.” *Id.* at 252. The Court responded: “True, LCAPP’s price assurance insulates LCAPP generators from market volatility and thus eliminates their risk. But the [Standard Offer Capacity] Agreements provide more than risk-hedging; they provide for the supply and sale of capacity, as well. LCAPP commands generators to sell capacity to PJM. In return, New Jersey’s statute ensures that generators will receive the Standard Offer Capacity Rate for each quantity of capacity offered at auction and not solely the auction price they would have otherwise received. *Id.* at 252-253.

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[2] The Long Term Capacity Pilot Program Act (“LCAPP”) See, 766 F. 3rd 241, 246

To complete the analogy of the New Jersey LCAPP arrangement to Rider PSR, one needs to only switch the LCAPP contract amount of generation with Duke's 9% OVEC interest, and the LCAPP contract price with the ICPA costs that Duke will recover. There is no material difference that would affect the reasoning of the Court.

Both of these decisions clearly spell-out the legal principle that the states may not intrude into the compensation scheme for wholesale electric rates put into place by the FERC, either directly or through an RTO, because the Federal Power Act gives this authority to the FERC alone—the entire subject of wholesale generation is field preempted. Rider PSR substitutes the compensation provided by the PJM markets with a blanket assurance of full ICPA cost recovery for Duke. Rider PSR is functionally identical to the "contract for differences" (Maryland) and the "Standard Offer Capacity Agreements" (New Jersey) that have been struck down as unconstitutional in both the Fourth and Third Circuit Courts of Appeals, respectively. This fact should end the Commission's consideration of Rider PSR.

The following arguments are offered only as an aside, since the Commission does not have the authority to consider Rider PSR for the purposes of either Ohio law or Ohio public policy.

B. <u>Rider PSR Has No Basis In Ohio Law</u>

Duke's Application in this case was filed pursuant to Ohio Revised Code Sections ("R.C.") 4928.141 and 4928.143. Neither section contains any provisions that would authorize Rider PPA—there is no relationship between the Rider and the provision of electric service, regulated or otherwise. See, Tr. Vol. II, pp. 464-466. Having no relationship to either generation *or* distribution service, it is completely outside the scope of either R.C. 4928.141 or 4928.143.

C. <u>Rider PSR Is Bad Public Policy</u>

Even though the Commission does not have the jurisdiction to consider Rider PSR under either federal or state law, Rider PSR remains a bad idea in any event.

While the record reflects that Duke expects the OVEC plants to operate until at least 2020 (Tr. Vol. III, p. 726), the Commission has no assurance that the OVEC plants will operate through the duration of the contract. If the plants are retired before that time, the participating companies (Duke) will likely incur significant decommissioning costs. See, IEU-Ohio Ex 5, Article 7. If the Commission were to approve Rider PSR, this liability would become the responsibility of captive ratepayers. The same holds true for any of the myriad possible unforeseen costs associated with the OVEC plants. This is no idle speculation when the pending federal efforts to limit greenhouse gasses are considered.

The Commission's lack of firm legal authority over the OVEC assets raises still another problem with this idea. If at some point in the distant future the OVEC plants *were* to become profitable in the PJM marketplace—and anything is possible—the Commission would be without authority to prevent a divesture of the OVEC assets by either Duke individually, or the OVEC Participating Companies collectively, so that the financial windfall of "low cost" OVEC generation inures to the benefit of shareholders. As discussed below, the Commission may be very confident that Duke would make every effort to capture for its sole shareholder any economic benefit from the OVEC entitlement.

The request for Rider PSR is another "me too" by Duke, similar to Case No. 12-2400-EL-UNC, wherein Duke attempted to back out of prior commitments to its customers because AEP Ohio had received a "better deal" for its capacity obligations. Even in the instant case, Duke is not hesitating to toss aside its prior commitments to the Commission. This is evident in Duke's bizarre position that its interest in the ICPA and its 9% equity stake in OVEC are not "generation assets" as contemplated by the Commission's corporate separation rules or the stipulation Duke signed in Case No. 11-3549-EL-SSO, et al. Duke claims that because it does not directly own or control the operation of the OVEC plants, its OVEC interests are not generation assets. Duke takes this position notwithstanding the fact that it is trying to sell the value of the OVEC "hedge" on the basis that it is an entitlement, "which is a physical asset, dependable, reliable energy, and capacity… ." Tr. Vol. III, p. 613. If this isn't a generation asset, it is difficult to imagine what is. Duke's position is, to put it charitably, silly. Here again, Duke has been disadvantaged by its fellow EDUs that have taken a more sober approach to the question, and sought Commission authority to retain their OVEC assets. See, Case No. 12-1126-EL-UNC. Unlike with its current ESP stipulation, or as in Case No. 12-2400-EL-UNC, the Commission had a clear statutory footing to force Duke to keep its commitments. With Rider PSR, Duke will have any number of ways to circumvent its promise to pass surplus revenues to ratepayers, and instead capture that benefit for its parent, and the Commission can be confident that Duke will do so.

III. CONCLUSION

Just as in Case No. 13-2385-EL-SSO, the Commission's Staff is recommending that Rider PSR be rejected for a number of compelling reasons. See generally, Staff Ex. 1, pp. 6-11. For all the foregoing reasons, the City requests that this Commission adopt the position of the City on the issue set forth above.

Respectfully submitted on behalf of,
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing INITIAL BRIEF was served upon the following parties via electronic mail this 15th day of December 2014.

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