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

SIERRA CLUB'S INITIAL BRIEF

PUBLIC VERSION – CONTAINS REDACTED MATERIAL

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CONFIDENTIAL OR HIGHLY CONFIDENTIAL

Sierra Club urges the Commission to protect the best interest of electric customers and promote competition in the provision of electric service by rejecting Duke Energy Ohio's proposed Price Stabilization Rider ("Rider PSR"). Duke has failed to meet its burden to demonstrate that Rider PSR is better for its customers than the alternative (i.e., its denial). In fact, the record overwhelmingly demonstrates that, if approved, Rider PSR would harm customers by increasing costs and exposure to risk without providing any benefit, except to Duke itself, which would benefit by receiving guaranteed cost recovery for uneconomic coal units.

I. Background

In this proceeding, Duke seeks approval of an application for an Electric Security Plan ("ESP") for the period June 1, 2015 to May 31, 2018. The application includes a proposal for a new rider that Duke refers to as the Price Stabilization Rider. Through the Rider PSR, Duke is proposing that it bid 100% percent of the Ohio Valley Electric Corporation ("OVEC") energy

and capacity to which Duke is entitled into the PJM wholesale markets.[1] Duke would pass the costs allocated to it from OVEC on to its customers, less any market revenue generated from sales.[2] If market revenues from the sale of the OVEC generation are greater than the allocated OVEC costs, the amount would be credited to Duke's customers; but if the allocated OVEC costs are greater than market revenues, then customers would be charged the difference. Rider PSR would be non-bypassable, meaning that neither shopping nor non-shopping customer could avoid it.[3]

OVEC (and its wholly owned subsidiary) owns and operates two large coal-fired power plants as well as a transmission system that connects these generating facilities to the networks of other utilities. The Kyger Creek plant in Cheshire, Ohio can generate 1,086 megawatts ("MW") and the Clifty Creek plant near Madison, Indiana has capacity to generate 1,303 MW.[4] Along with other utility companies, Duke is a "Sponsoring Company" and shareholder under the Inter-Company Power Agreement ("ICPA") that governs OVEC management and operations.[5] As a "Sponsoring Company" under the ICPA, Duke is allocated a share of the capacity and energy provided by the OVEC plants and is charged a share of the fixed and variable costs for the plants. Duke's share of both costs and output is 9% of the total.[6] The PSR would remain in effect for the entire length of Duke's contractual obligation with OVEC,[7] which as of today goes through June 2040 and could be extended by agreement of the Sponsoring Companies without

[1] Duke Energy Ohio Application, Volume I, p. 13; Duke Exhibit 6, Wathen Written Testimony, p. 11.
[2] Duke Exhibit 6, Wathen Written Testimony, p. 13.
[3] Hearing Transcript, Vol. II at 415; 4-6 (Wathen Testimony) ("the PSR is going to be charged to customers regardless of whether they are taking power from CRES or SSO").
[4] IEU Exhibit 7, OVEC Annual Report – 2013, p. 1.
[5] IEU Exhibit 5, ICPA.
[6] *Id*. § 1.0117.
[7] Duke Exhibit 6, Wathen Written Testimony, p. 11.

Commission approval.[8]

II. Standard of Review

When presented with an ESP application, the Commission shall:

> approve or modify and approve [the ESP] application . . . if it finds that the [ESP] so approved, including its pricing and all other terms and conditions, including any deferrals and any future recovery of deferrals, is more favorable in the aggregate [than would be available through a Market Rate Offer].

Ohio Rev. Code § 4928.143(C)(1). This statute confirms that the Commission has authority to modify an ESP application by rejecting a proposed term or condition. *See id.; see also In the Matter of the Application of the Ohio Edison Co.*, Pub. Util. Comm. No. 08-935-EL-SSO, 2008 Ohio PUC LEXIS 782, at 21 (December 19, 2008) (modifying terms of ESP based on merits of the individual terms themselves and approving modified ESP); *In the Matter of the Application of Columbus Southern Power Co.*, Pub. Util. Comm. No. 11-346-EL-SSO, 2011 Ohio PUC LEXIS 1325, at 70-71 (December 14, 2011) (same). Further, the Commission has authority to approve only those provisions specifically listed in the ESP statute. *In re Application of Columbus S. Power Co.*, 128 Ohio St. 3d 512, 520 (2011) ("if a given provision does not fit within one of the categories listed 'following' (B)(2), it is not authorized by statute"). Thus, where an ESP term or condition is either i) unlawful or unreasonable (because, for example, it causes unfair prices or subjects customers to unreasonable risk) or ii) would cause the entire ESP to be less favorable than a MRO, the Commission should modify the ESP by removing the term or condition.

The Commission has recognized that it should use the state policy statements codified by the General Assembly in R.C. 4928.02 to "guide" its "implementation of [the ESP statute]." *In*

[8] IEU Exhibit 5, ICPA § 9.07.

the Matter of the Application of the Ohio Edison Co., Pub. Util. Comm. No. 08-935-EL-SSO, 2008 Ohio PUC LEXIS 782, at 21 (December 19, 2008). These codified policy statements include a duty to ensure "reasonably priced" electric service and to ensure effective market competition:

> (A) Ensure the availability to consumers of adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service;
>
> * * *
>
> (H) Ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa, including by prohibiting the recovery of any generation-related costs through distribution or transmission rates;

Ohio Rev. Code § 4928.02 (A), (H).

Finally, "[t]he burden of proof in [an ESP] proceeding shall be on the electric distribution utility." Ohio Rev. Code § 4928.143(c)(1).

III. Summary of Argument

The Commission should either deny the ESP outright or modify the ESP by removing Rider PSR. Information provided in discovery shows that Rider PSR will cause customers to incur a cumulative charge for at least the first ten years. This information likely understates Duke's share of OVEC costs and thus the impact on customers' rates would likely be even more negative than these projections show. Rider PSR also violates Ohio's competitive markets policy by tying customers to the economic fortunes of aging coal plants without the protections afforded in a regulated state. Even if Rider PSR were good for customers—which it is not—the Commission would still have no authority to approve a generation "cost tracker" like Rider PSR because such an automatic cost recovery mechanism is not authorized by any provision of the

ESP statute. Furthermore, by providing an out-of-market enhancement to the wholesale energy and capacity price that Duke would otherwise receive, Commission approval would encroach on an exclusive federal area of regulation in violation of the Federal Power Act. Because Rider PSR harms consumers, violates multiple provisions of Ohio law, and is preempted by federal law, the Commission must either deny the ESP or remove Rider PSR and approve the modified ESP.

IV. The Commission Should Deny the Proposed Rider PSR as its Costs Far Outweigh Any Benefits.

Cost and revenue projections that show a cumulative loss for customers over the next ten years and the massive uncertainty associated with Rider PSR, easily outweigh the qualitative "benefits" offered by Duke, which are not benefits at all. Rider PSR offers customers higher costs during the first several years on the uncertain hope of benefits appearing far down the road. In addition, customers bear the risk of essentially owning Duke's share of OVEC in the face of enormous uncertainty for these aging coal-burning. At a time when utilities around the country are shuttering coal units,[9] Duke asks for Commission approval to tie its customers to the economic fortunes of the aging OVEC units for two-and-a-half decades.

In accordance with the ICPA, Duke is responsible for OVEC costs regardless of market performance or cost recovery construct. Because all charges other than fuel will be paid regardless of whether Duke takes any energy from OVEC in a given year,[10] Duke's customers will cover the costs of the OVEC plants even if those units earn no revenue in a given year. Duke has stated that it will take power from OVEC only when its variable costs exceed PJM

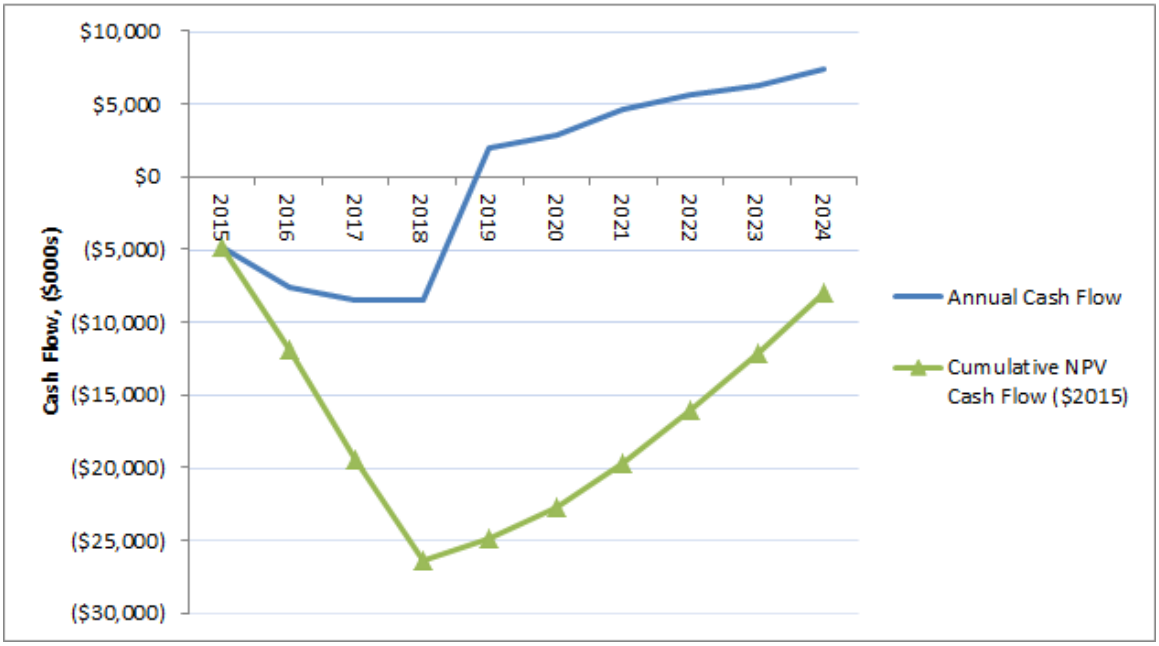
[9] Sierra Club Exhibit 5.
[10] Hearing Transcript, Vol. II at 488; 3-5 (Wathen Testimony) ("All of the charges independent of the fuel charge would be paid regardless of whether we take power or not.").

market prices.[11] Thus, at times when Duke's variable costs exceed PJM market prices, Duke's customers will be required to cover Duke's share of OVEC's fixed cost with no corresponding revenue offset.[12] Despite being faced with this exposure to risk, Duke's customers lack any control over OVEC operations or Duke's PJM bidding strategy, while the entity with such control, Duke, lacks any economic incentive to maximize revenues and minimize costs for customers.

A. Even Under Duke's Analysis, Customers Are Projected to Incur Significant Costs.

In its application and pre-filed testimony, Duke provided no data on the projected cost impact of Rider PSR. In discovery, Duke produced estimates of the OVEC plants' revenues and costs from 2015 to 2024.[13] This information shows that for the first four years of Rider PSR, customers would be charged a total of $26.4 million (cumulative net present value in 2015$ using a 6.4% discount factor) as OVEC costs would exceed revenues. After that, in years five through ten of Rider PSR, the Company projects that customers would receive credits totaling $18.4 million as Duke's OVEC revenues are projected to exceed costs in those years. Over this ten-year period, the cumulative net present value of the Rider PSR remains negative through at least 2024. This means that, according to the Company's own analysis, its customers will be required to pay more than $26 million and should expect to receive only $18 million—about 70 percent—of their money back. In terms of cumulative net present value, Duke's customers may never break even on their 'investment' in the OVEC generation:

[11] *Id*. at 413; 3-8.
[12] In recent years, Duke has taken significantly less energy that the amount of energy to which it is entitled: ranging from 800,000 megawatt-hours to about 1.5 million megawatt-hours in a given year. Id. at 462; 5-8.
[13] OCC Exhibit 4.



Sierra Club Exhibit 4, Jackson Written Testimony, Figure 1. Impact of Proposed PSR through 2024.[14] Duke's forecast is based on assumptions regarding future energy and capacity prices, future utilization rates of the units, and potential cost risks facing the plants. Yet, even if all of Duke's assumptions underlying the forecasted abrupt turnaround in cash flow in 2019 prove true, Duke's customers will still have to pay millions for this Rider PSR for at least the first ten years. And because short-term projections are more reliable than longer-term ones,[15] these near-term losses are more likely to materialize than any long-term gains.

B. Information In the Record Likely Understates Rider PSR's Costs to Consumers.

Duke makes a number of key assumptions that influence the projection of potential costs and benefits to customers. Together, these assumptions account for the sudden reversal in cash

[14] Sierra Club Exhibit 4, Jackson Written Testimony, p. 7; *see also* OCC Exhibit 43, Wilson Written Testimony, p. 7.
[15] Hearing Transcript, Vol. II at 375; 5-7 (Mullins Testimony) ("All forecasts have assumptions in them, but I would think the short-term would be more reliable based on those shorter-term assumptions."); *id.*, at 376.

flow that Duke projects after 2019. First, the Company assumes that energy prices [redacted][16] Duke also assumes that energy costs [redacted].[17] This contributes to the next assumption—[redacted][18] Finally, Duke assumes capacity prices in PJM will [redacted][19] Taken together, these assumptions suggest that, starting in 2019, total annual revenues will begin to exceed total annual costs, as shown in the blue line in Figure 1 above. These assumptions, however, are unlikely to bear out as Duke's projects. Several factors tend to indicate that Duke is both under-estimating costs and over-estimating revenues from OVEC.

1. Information in the record may overstate the revenue that Duke will earn from its share of OVEC energy and capacity.

Duke assumes that energy and capacity prices will [redacted] in the future. Its assumptions regarding future energy and capacity prices are important because they affect how much revenue Duke can expect to earn from selling its OVEC generation into these markets. If energy and capacity prices turn out to be lower than expected, Duke would have less total revenue available for pass-through to customers under Rider PSR.

There are myriad reasons why Duke's energy and capacity price forecasts might be too high. [redacted]

[16] OCC Exhibit 4a; *see also* OCC Exhibit 43a, Wilson Written Testimony, p. 18.
[17] *Id.*
[18] *Id.*
[19] *Id.*

[20]. [21]. [22]. .

[20] *See* Highly Confidential Response to SIERRA-INT-03-072(d).
[21] Sierra Club Exhibit 4, Jackson Written Testimony, p. 11.
[22] Regulatory Impact Analysis for the Proposed Carbon Pollution Guidelines for Existing Power Plants and Emissions Standards for Modified and Reconstructed Power Plants, U.S. EPA, June 2014, p. 3-38, available online at: http://www2.epa.gov/sites/production/files/2014-06/documents/20140602ria-clean-power-plan.pdf.
[23] *PPL EnergyPlus, LLC v. Hanna*, 977 F. Supp. 2d 372, 395 (D.N.J. 2013).

[redacted].[24] There simply is little reason to believe Duke's market forecast projections, and the data underlying those projections were not provided in discovery so a full assessment is not possible.[25]

In addition, Rider PSR itself, if approved, will work to decrease revenues as it eliminates Duke's incentive to optimally bid its OVEC entitlement into the PJM markets.[26] In the absence of Rider PSR, Duke would have a strong economic incentive to maximize revenues for itself. Basic economic theory holds that the elimination of this incentive would cause Duke to behave in a non-optimal manner that would reduce revenues.[27]

2. Information in the record likely understates the OVEC costs for which Duke is responsible.

If Duke has its way, for the 25-year term of Rider PSR, Duke's customers will be required to cover the entirety of its 9% share of OVEC costs, whatever those costs end up being in a given year. These costs are likely understated in at least three ways. First, the record does not account for all environmental compliance costs that will come to bear on the OVEC plants. There is great risk to Duke—more properly, Duke's customers if Rider PSR is approved—that these costs will increase above levels projected by OVEC. Second, much of the machinery and equipment of these plants has been in operation for nearly six decades and this machinery and equipment can be expected to fail more frequently over the next 25 years. Third, approval of Rider PSR would itself likely increase costs by decreasing Duke's—and the other Ohio public utilities'—incentive to ensure that cost are kept down.

Contrary to Duke's claims that OVEC costs are relatively stable, in recent years, OVEC

[24] OCC Exhibit 43, Written Wilson Testimony, p. 19.
[25] *Id*., p. 9.
[26] Hearing Transcript, Vol. VII at1887; 6-8 (Taylor Testimony) (Duke has "No incentive to maximize because the cost is guaranteed to be recovered? A. Correct.").
[27] OCC Exhibit 43, Written Wilson Testimony, p. 11.

costs for operating the plants, and therefore, Duke's obligation to pay 9 percent of those costs, have increased significantly. Duke's OVEC costs have increased by 52.9% over the past five full years from $46.18 MW/hour (2009) to $70.61 MW/hour (2013).[28] OVEC's fuel costs alone increased 32% from 2009 to 2013.[29] Indeed, in 2012 and 2013, Duke lost money on its OVEC entitlement as costs exceeded total market revenues.[30] If these trends continue, the costs Duke is proposing to pass on to customers may continue to outstrip market revenues into the foreseeable future.

a) Environmental compliance costs will likely be higher than projected by Duke.

As Sierra Club witness Sarah Jackson observes, the cost of compliance with environmental regulations could increase significantly:

> [T]he cost of power from the OVEC assets could increase significantly in the coming years as regulations addressing carbon and other environmental regulations lead to increased compliance obligations for coal-fired power plants like OVEC's Kyger and Clifty Creek plants.[31]

One major driver of costs for coal plants such as these units will be U.S. EPA's Clean Power Plan and others measures intended to reduce carbon emissions from existing electric generation units. *See* "Carbon Pollution Guidelines for Existing Stationary Sources: Electric Utility Generating Units," 79 Fed. Reg. 34,830-34,958 (June 18, 2014). Those costs remain uncertain at this time, but coal plants are the most carbon intensive source of electric

[28] IEU Exhibit 13.
[29] Hearing Transcript, Vol. II at 581; 2-6 (Wathen Testimony).
[30] Hearing Transcript, Vol. III at 624; 14-19 (Wathen testimony).
[31] Sierra Club Exhibit 4, Jackson Written Testimony, p. 4.

generation,[32] and as such, any plan to reduce carbon pollution from the electric sector would involve requiring increased capital expenditures for coal-burning units, less utilization of coal-burning units, or both. EPA's proposed rule, while not requiring any specific measures, calls for capital expenditures at coal-fired units to improve efficiency (Building Block 1) and increased utilization of gas, renewable energy, and energy efficiency (Building Blocks 2, 3, and 4). *See* 79 Fed. Reg. 34,858 (summary of building blocks). All of these measures will work to decrease the profitability of coal-burning units like the OVEC plants either by driving up costs or by decreasing utilization (or both).[33] The capital expenditure envisioned by U.S. EPA's Building Block 1 is not included in OVEC's environmental capital cost projections.[34] And the likelihood of even more stringent carbon regulation after 2030 would work to further erode the economic value of these plants during the last decade of Rider PSR.[35]

Coal-burning units also produce enormous volumes of "traditional" air pollutants like sulfur dioxide and nitrogen oxides. Air quality standards, such as the national ambient air quality standards ("NAAQS") for ozone and sulfur dioxide, are likely to require additional emission reductions from the OVEC plants over the lifetime of the Rider PSR.[36] OVEC has already sunk nearly $2 billion in capital expenditures to reduce air pollution, including selective catalytic reduction ("SCR") units and flue gas desulfurization ("FGD") units, in order to meet standards that the U.S. EPA will likely revise over the next 25 years. Further, OVEC's cost estimates do not account for the cost of an additional SCR unit at Clifty Creek unit 6. OVEC has

[32] Hearing Transcript, Vol. V at 1274; 21-24 (Brodt Testimony); Vol. V at 1166; 8-10 (Higgins Testimony) ("it will likely have a greater impact on coal plants than on other plants."); Vol. VIII at 2294-97 (Jackson Testimony).
[33] Hearing Transcript, Vol. VIII at 2294-97 (Jackson Testimony).
[34] Hearing Transcript, Vol. V at 1268; 18 (Brodt Testimony).
[35] Sierra Club Exhibit 4, Jackson Written Testimony, p. 15.
[36] *Id*., p. 16-22.

recognized the need for an SCR unit at Clifty Creek unit 6,[37] though such a capital expenditure was not included in the cost summaries provided in discovery.[38] Sierra Club Witness Jackson estimates a capital expenditure of $136 million (including 15 years financing) for this project.[39] While FGD and SCR units are necessary to reduce harmful air pollution, these units also increase O&M costs, [40] while decreasing total available output of coal-fired units.

Several major Clean Water Act rules will also drive costs higher at the OVEC units in coming years. U.S. EPA will soon publish final coal combustion residual ("CCR") and effluent limitation guideline ("ELG") rules that will likely cause the OVEC plants to incur capital costs and increased O&M costs. Sufficient evidence was not provided in discovery to assess the reasonableness of OVEC's estimates of CCR and ELG rule compliance costs.[41]

b) Old coal plants are bad investments.

Both OVEC plants began operating in 1955.[42] They will be 60 years old in 2015. If the OVEC units were to continue to operate until 2040— the length of Duke's OVEC entitlement— they would be 85 years old. According to the U.S. Department of Energy, the average age of retirement for coal-fired units has been 58 years, 63 years, and 51 years for units that retired in 2010, 2011, and 2012, respectively.[43] Operation and maintenance costs for coal plants tend to increase with age.[44] The turbines at the units have never been replaced.[45] Boiler tubes

[37] IEU Exhibit 7, OVEC Annual Report – 2013, p. 29.
[38] Hearing Transcript, Vol. V at 1270; 1-2 (Brodt Testimony).
[39] Sierra Club Exhibit 4, Jackson Written Testimony, p. 19.
[40] Hearing Transcript, Vol. V at 1267; 18-20 (Brodt Testimony).
[41] Sierra Club Exhibit 4, Jackson Written Testimony, p. 16.
[42] IEU Exhibit 7, OVEC Annual Report – 2013, p. 1.
[43] Sierra Club Exhibit 5.
[44] Hearing Transcript, Vol. V at 1272; 4-6 (Brodt Testimony).
[45] *Id*. at 1271; 2-4.

replacement projects are ongoing continuously.[46]

Age plays an important role in the reliability of power plants. These OVEC plants are today older than many plants that have been retired in recent years. Every OVEC unit failed to perform for at least one day during the January 2014 cold weather events.[47] The performance of these aging plants will likely continue to decline over the course of the Duke's contract with OVEC. The costs resulting from equipment failures, forced outages, and increased maintenance requirements may be difficult to predict, but under the Rider PSR, Duke's customers would have to bear them for the next 25 years.

c) If approved, Rider PSR itself could drive up costs.

If approved, Rider PSR itself could increase costs. Like the manager of a Soviet-era factory, Duke would have no incentive to exercise its influence over OVEC operations to keep costs down.[48] Moreover, a rational actor with "skin in the game" would retire an uneconomic asset, while Rider PSR would remove the incentive to look critically at a potentially uneconomic coal plant. This will especially be the case if the similar OVEC riders proposed by Ohio Power Company and FirstEnergy Corporation's Ohio public utilities are approved. If all three riders

[46] *Id*. at 1270; 15-24.
[47] Hearing Transcript, Vol. VIII at 2290; 8-15 (Jackson Testimony); Duke Exhibit 23.
[48] Hearing Transcript, Vol. XI at 3172; 14-19 (Wilson Testimony) ("they would have no particular incentive to pressure OVEC management to reduce costs or to operate efficiently, and they would have no particular incentive to call on the output when the output is valuable and not call on it when it's not valuable"); OCC Exhibit 43, Written Wilson Testimony, p. 33 ("by providing for the collection of costs from customers without the traditional regulatory process, a cost tracker results in even weaker incentives for cost control than are provided by traditional regulation.").

were approved, customers will be stuck with these plants for decades while the owners of a full third of the output would have no incentive to maximize revenues or keep costs down.[49]

* * *

In short, Duke has been losing money on its OVEC contract and the economic outlook is not promising. Uncertain market revenues together with rising costs due to environmental requirements and aging equipment make Rider PSR a bad deal for Duke's customers.

C. Rider PSR is Anti-Competitive, Exposes Duke's Customers to Tremendous Risk, and as such Violates Ohio Law.

Rider PSR violates Ohio codified policy by subjecting customers to unfair prices and reversing work to move Ohio toward competitive electric markets. *See* R.C. 4928.02(A), (H). At a time when the Commission has almost finished transitioning its four largest utilities to a fully competitive retail energy market, approval of Rider PSR would reverse this transition to competition in at least three ways: First, it requires customers to subsidize potentially uneconomic generation and, correspondingly, guarantees income to generation regardless of market performance. Second, Rider PSR unfairly subjects customers to the risk of owning generation over the long term without any control over decisions that affect costs and revenues. Third, Rider PSR is an inappropriate mechanism to manage volatility in a competitive environment.

Customers would be forced to subsidize specific generation units—essentially making these customers merchant generation owners—while providing them no control over Duke's bidding strategies and offering none of the regulatory oversight that would be found in a

[49] IEU Exhibit 5, ICPA § 1.0117.

regulated environment.[50] Further, there is an opportunity cost to Duke's customers, who are being forced to 'invest' in the OVEC units for at least 25 years, whether or not they are economic. This shifting of risk and the subsidy flowing from Duke's customers to Duke and OVEC, violates Ohio electric policy which provides that generation is to be a competitive service.[51] Under this policy, customers should not be forced to take supply from specified generation units that do not have to compete in the market. Tying customers to these particular plants for decades thus violates the competitive market principles that generation be provided by sources that must compete in the marketplace.

Further, in a competitive marketplace, risk and decision-making authority should be placed on the same entity in order to assure optimal performance. As Sierra Club witness Jackson observes, the Rider PSR inappropriately shifts risks to Duke's customers:

> This type of rate adjustment mechanism is inappropriate in a competitive retail market environment, as it seeks to effectively shift all of the risk from Duke's contractual obligations with the Ohio Valley Electric Corporation (OVEC) to customers, who will essentially become owners of generation they are not directly using.[52]

As noted above, Section IV.B., the risk associated with the OVEC plants is substantial and impossible to quantify over the 25-year term of this proposal. Duke is proposing that customers be locked into owning generation from these plants till 2040, while, at the same time, recognizing the reality that predicting complex markets over anything beyond the near term is extremely difficult. In fact, the data provided in discovery attempt only to assess costs through 2024, despite the fact that Duke has proposed Rider PSR to remain in place through 2040.[53] The

[50] Jackson Written Testimony, p. 5.
[51] *See* Ohio Revised Code § 4928.03.
[52] *Id*., p. 3.
[53] OCC Exhibit 43, Wilson Written Testimony, p. 7.

Commission should not permit Duke to gamble with its customers' money in this way. As OCC witness Wilson observes, "Forecasts of costs and revenues necessarily rely on multiple unknown inputs, including energy and capacity price, fuel prices, environmental and other regulations" and therefore are "necessarily highly uncertain."[54]

Lastly, the proposed PSR is not an appropriate mechanism to manage potential price volatility in a competitive market environment. Duke is already required to purchase electricity for its SSO customers through Commission-administered competitive auctions. These auctions are designed to insulate customers from price volatility through elements such as the use of staggered procurement and multiple products of varying durations (1-year, 2-year, 3-year, etc.). The resulting rates represent a blending of these various auctions, plus a markup, and are, therefore, more stable than market-based prices.[55] In essence, the proposed PSR would turn Duke's customers into unwitting merchant generators, forcing them to take on substantial market risk without allowing them any control over costs, strategic decisions, or bidding strategies. [56]

The proposed PSR would shift all costs (net of any market revenues) from Duke's portion of the OVEC generation to customers for the next twenty-five years and would require customers to pay for generation that is not competitively bid in the SSO auction. If there were any doubt that Rider PSR is worse for consumers than the alternative (i.e., its denial), it should be put to rest by examining the "guid[ance]" provided by the codified policies of R.C. § 4928.02.[57] These Ohio policy statements, which guide Commission implementation of the ESP statute, all favor rejection of Rider PSR.

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[54] OCC Exhibit 43, Wilson Written Testimony, p. 8-9.
[55] Sierra Club Exhibit 4, Jackson Written Testimony, p.5.
[56] *Id*.
[57] *In the Matter of the Application of the Ohio Edison Co.*, Pub. Util. Comm. No. 08-935-EL-SSO, 2008 Ohio PUC LEXIS 782, at 21 (December 19, 2008).

D. Rider PSR Will Not Work as a Hedge Against Volatility, and Duke's Other Claimed Benefits Are Not Benefits At All.

Duke has asserted that Rider PSR provides customers three qualitative benefits: a hedge against volatility; a mechanism that is "competitively neutral"; and "steel in the ground."[58] The latter two of these "benefits" are plainly not benefits of Rider PSR at all and Duke has not shown that Rider PSR would in fact work to reduce price volatility as experienced by its customers. In fact, the more persuasive testimony indicates that Rider PSR would actually exacerbate price volatility. Accordingly, there is *no* benefit at all to offset the tremendous harm Rider PSR would cause if approved.

Duke has provided no analysis to show the Rider PSR would actually work as a hedge.[59] Nor did Duke quantify any price volatility that has occurred for its customers.[60] Duke did not forecast SSO prices that its customers would be charged if the Rider PSR were approved or not.[61] Duke did not analyze the value of any hedge to its customers at all.[62] Aside from using "intuition," Duke has performed no analysis to demonstrate that Rider PSR would work to achieve any anti-volatility effect at all. Duke concedes that Rider PSR may in fact have no anti-volatility effect,[63] and that the market could achieve stability in prices even without the PSR.[64]

To the extent that Duke's Ohio customers genuinely are concerned about price volatility—a showing that Duke has not made—the proposed Rider PSR imposes long-term cost

[58] Duke Exhibit 6, Wathen Written Testimony, p. 12-15.
[59] Hearing Transcript, Vol. II at 590; 3-4 (Wathen Testimony).
[60] *Id*. at 582; 21-25.
[61] *Id*. at 583; 1-7.
[62] *Id*. at 589; 14-24 ("I did not do a quantitative analysis" of value to customers.)
[63] *Id*. at 722; 21-23.
[64] Hearing Transcript, Vol. I at 151; 18-21 (Henning Testimony).

risks on customers that will limit their ability to take advantage of other, potentially less expensive means of mitigating market price volatility in the future.[65] Duke did not analyze an alternative mechanism for promoting price stability.[66] Duke never, for example, issued a request for proposal for alternative hedge mechanisms.[67] Nor did Duke ever consider entering into an agreement with any other source of generation.[68]

Several witnesses explained that Rider PSR would worsen volatility for customers. Sierra Club witness Jackson and OCC witness Wilson observes that the SSO auctions are staggered, in part, to reduce volatility.[69] Wilson observes that SSO customers are not "exposed to substantial market price volatility" and that the Rider PSR would "add a potentially volatile element" to customers' bills.[70] Direct Energy witness Ringenbach testified that Rider PSR is not a hedge at all, but instead will "move with the market."[71] And for shopping customers (non-SSO customers), Rider PSR will work to eliminate any anti-volatility mechanisms for which they may have contracted.[72]

The other purported qualitative "benefits" of Rider PSR are not benefits at all and do not merit serious consideration. Even if it were true that approval of Rider PSR would not violate competitive market principles—which is not the case—this observation would not be a "benefit" of Rider PSR since there is no doubt that denial of Rider PSR would adhere to competitive market principles as well (and Duke has not argued to the contrary). Finally, Duke's observation

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[65] Sierra Club Exhibit 4, Jackson Written Testimony, p. 5.
[66] Hearing Transcript, Vol. III at 627; 17-22 (Wathen Testimony).
[67] Hearing Transcript, Vol. II at 471; 1-3 (Wathen Testimony).
[68] Hearing Transcript, Vol. III at 627; 13-16 (Wathen Testimony).
[69] Sierra Club Exhibit 4, Jackson Written Testimony, p. 5; OCC Exhibit 43, Wilson Written Testimony, p. 12.
[70] OCC Exhibit 43, Wilson Written Testimony, p. 12.
[71] Hearing Transcript, Vol. IX at 2604; 1-3 (Ringenbach Testimony) ("I don't view the PSR as a hedge at all. It doesn't protect from anything in the market. It moves with the market.").
[72] *Id*. at 2633; 1-7.

that that the OVEC plants are "steel in the ground," provides no benefit related to the Rider PSR because Duke has repeatedly confirmed that the OVEC plants would not retire if Rider PSR were disapproved by the Commission.[73]

* * *

In sum, against the tremendous economic harm and risk imposed on customers, Duke offers nothing but the "intuition" that Rider PSR might work a hedge. But the more persuasive testimony (that of Jackson, Wilson, and Ringenbach) indicates that even the hedge benefit is unlikely to accrue to customers.

V. The Commission Lacks Authority to Approve Rider PSR Because No Provision of the ESP Statute Authorizes It.

Rider PSR is not authorized by any provision of R.C. 4928.143(B)(1) or (2), the ESP statute, and thus the Commission lacks authority to approve it.[74] The statute authorizes inclusion of an automatic cost recovery mechanism in an ESP in limited instances only.[75] Rider PSR provides Duke with automatic recovery for its entire OVEC ownership share, does not involve the costs specified in the ESP statute, and therefore must be denied.

Rider PSR is best characterized as a "cost tracker" that allows Duke automatic recovery of all costs associated with its ownership of the OVEC plants.[76] OCC witness Wilson describes such a "cost tracker" as a "regulatory mechanism through which the actual costs of a function performed or undertaken by a utility are periodically passed through to customers, outside a rate

[73] *E.g.*, Hearing Transcript, Vol. III at 612; 13-14 (Wathen Testimony).
[74] *See In re Application of Columbus S. Power Co.*, 128 Ohio St. 3d 512, 520 (2011); *see also* 138 Ohio St. 3d 448, 449-50 (2014) ("We remanded the matter to allow the commission to specifically determine whether any of the nine categories of cost recovery under R.C. 4928.143(B)(2)(a) through (i) authorized the recovery" of specified costs.).
[75] *See* R.C. 4928.143(B)(2)(a).
[76] OCC Exhibit 43, Wilson Written Testimony, p. 10-11, 32-39.

case."[77] Such a mechanism is appropriate, according to Wilson, where certain costs are "largely outside the control of the utility" and are highly volatile (both conditions apply to fuel).[78] Applying a "cost tracker" to Duke's entire ownership share of OVEC is inappropriate because Duke, as an owner, *does* have some control over OVEC and its costs, while unpredictable, are no more unpredictable than any other aspect of its business (unlike fuel costs, for example, which tend to very widely).[79]

Ohio's ESP statute, on the other hand, allows automatic cost recovery for certain specifically enumerated costs only: fuel used to generate electricity supplied under the SSO offer; power purchased to supply the offer; emission allowances; and federally mandated carbon or energy taxes.[80] Rider PSR does not seek to recover these enumerated costs: Duke will not use the electricity supplied by OVEC to serve its SSO customers and Rider PSR is not limited to emission allowances or carbon or energy taxes.[81] Therefore, Rider PSR is outside the scope of allowable automatic cost recovery under the ESP statute and must be denied.

VI. Commission Approval of Rider PSR Would Violate the Federal Power Act.

Commission approval of Rider PSR would be preempted under the Federal Power Act ("FPA") because Rider PSR, if approved, would supplant the rates that Duke would otherwise receive in the PJM wholesale markets. The Federal Energy Regulatory Commission ("FERC") oversees PJM's operation of wholesale energy and capacity markets. Rider PSR, if approved, would encroach on FERC's and PJM's exclusive control in this area by providing an out-of-market supplement to the wholesale energy and capacity prices that Duke would otherwise

[77] *Id*., p. 10.
[78] *Id*.
[79] *Id*., p. 34.
[80] *See* R.C. 4928.143(B)(2)(a).
[81] Hearing Transcript, Vol. II at 464-65 (Wathen Testimony).

receive for its share of OVEC. Such out-of-market supplement effectively supplants the PJM wholesale price for Duke and, accordingly, Rider PSR is preempted by the FPA.

Congress, in enacting the FPA, gave FERC exclusive jurisdiction over wholesale sales of electricity in interstate commerce.[82] In this area, "if FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject."[83] The federal scheme thus "leaves no room either for direct state regulation of the prices of interstate wholesales of [energy], or for state regulations which would indirectly achieve the same result."[84] "Even where state regulation operates within its own field, it may not intrude indirectly on areas of exclusive federal authority."[85]

Here, the Commission cannot lawfully approve Rider PSR "because it functionally sets the rate that [Duke] receives for its sales in the PJM auction."[86] Like the Maryland program at issue in *PPL EnergyPlus, LLC*, the Rider PSR "scheme thus effectively supplants the rate generated by the auction with an alternative rate preferred by [Duke and the] state."[87] And it is no defense, that Rider PSR scheme does not directly upset any PJM market transaction as, under the FPA, each "state [is] required to treat the utility's FERC-mandated payments as 'reasonably

[82] *FPC v. S. Cal. Edison Co.*, 376 U.S. 205, 215-26 (1964); *see also Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 300 (1988) (internal quotation marks omitted) ("The [FPA] long has been recognized as a comprehensive scheme of federal regulation of all wholesales of [energy] in interstate commerce.").
[83] *Miss. Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 377 (1988) (Scalia, J., concurring).
[84] *N. Natural Gas Co. v. State Corp. Comm'n of Kansas*, 372 U.S. 84, 91 (1963).
[85] *Pub. Utils. Comm'n v. FERC*, 900 F.2d 269, 274 n. 2 (D.C.Cir.1990) (internal quotation marks omitted).
[86] *See PPL EnergyPlus, LLC v. Nazarian*, 753 F.3d 467, 476 (4th Cir. 2014).
[87] *Id*.

incurred operating expenses for the purpose of setting' the utility's retail rates."[88] Ohio may not therefore determine by fiat that Duke should always be made whole in the PJM marketplaces.

These out-of-market subsidies provided by Rider PSR have the potential "to seriously distort the PJM auction's price signals" thus interfering with FERC's chosen method to achieve federal policy goals.[89] PJM's price signals are intended to "promote a variety of objectives," especially price-driven construction of new generation and expansion of existing generation. As the *PPL EnergyPlus, LLC* court explained, "Market participants necessarily rely on these signals in determining whether to construct new capacity or expand existing resources. The signals appear to be serving their purpose; according to FERC, the evidence 'suggests that [Reliable Pricing Model] has in fact succeeded in securing sufficient capacity to meet reliability requirements for the PJM region.'"[90]

Signals intended to incentive new construction may break down if new entrants are forced to compete against existing generation that is immune from price signals. Rider PSR upsets the PJM scheme and nullifies these price signals by removing the effect of PJM prices on any decision to continue to operate the OVEC units. As OCC witness Wilson has observed, the information in the record "calls into question whether the OVEC plants are economic, and suggests that perhaps the plants (or some units) should instead be retired."[91] Commission approval of Rider PSR would eliminate the price signal sent by PJM's market prices that tend to indicate retirement is the best economic choice for these units. Such price signals are a fundamental aspect of FERC's and PJM's regulation of the wholesale markets.

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[88] *Id.*; *see also California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 851 (9th Cir.2004) (internal quotation marks omitted) ("Wholesale energy prices 'fixed by FERC must be given binding effect by state authorities' even 'in areas subject to state jurisdiction.'").
[89] *PPL EnergyPlus, LLC v. Nazarian*, 753 at 478-79 (4th Cir. 2014).
[90] *Id.*
[91] OCC Exhibit 43, Wilson Written Testimony, p. 25.

Generation units receiving compensation like that provided by Rider PSR could continue to participate in PJM's wholesale markets without an incentive to behave competitively. In fact, Duke's bidding strategy itself may distort the PJM clearing price given that the company will no longer have an incentive to bid based on traditional economic logic. This result plainly encroaches on federal control over wholesale markets and as such Rider PSR is preempted by the FPA.

VII. Conclusion

The Commission should not take at face value Duke's claim that Rider PSR has been proposed for the primary purpose of achieving price stability. If Duke's true overriding goal were to reduce price volatility for its customers, then it likely would have analyzed alternative mechanisms to achieve such stability, instead of just proposing Rider PSR. At the very least, Duke would have analyzed the problem of volatility as experienced by its customers and the quantitative effect Rider PSR would have to counter such volatility. Duke's perfunctory approach to analyzing the purported volatility problem, and the cost and revenue projections for OVEC, tend to indicate another purpose behind Rider PSR: providing cost recovery for uneconomic units. In a similar filing now pending at the Commission, the FirstEnergy public utilities have directly indicated that a subsidy for uneconomic units is the overriding purpose of the similar rider proposed in Case No. 14-1297-EL-SSO.[92] Here, Duke appears to be attempting to dump responsibility for its own uneconomic units on its customers, under the guise of a hedge

[92] Direct Testimony of Donald Moul, p. 2 ("The economic viability of the [Sammis and Davis-Besse plants] is in doubt. Market-based revenues for energy and capacity have been at historic lows and are insufficient to permit FES to continue operating the Plants and to make the necessary investments. Near-term forecasts for energy and capacity prices are unfavorable. While Company witness Rose forecasts that market prices for energy and capacity will increase over time, the Plants may not survive to see these better days.").

against volatility. If Duke truly believed that its OVEC contract was valuable in the long term, is there any doubt that it would not be proposing to essentially transfer its share of the OVEC plants to its customers?

The Commission should reject Rider PSR because the record overwhelmingly demonstrates that, if approved, Rider PSR would harm customers by increasing costs and their exposure to risk without providing any benefit. Approval of Rider PSR would violate Ohio law, including by reversing 15 years' of the Commission's work to transition Ohio to a competitive market for electricity. For all these reasons, the Commission should reject Rider PSR.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Sierra Club's Initial Brief—either a Highly Confidential or a Redacted version—was served via electronic transmission upon the parties this 15th day of December, 2014.

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