



1145 Chesapeake Ave, Suite 1
Columbus, Ohio 43212

(614) 487-7506
www.theOEC.org

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Please find **COMMENTS ON THE SPECIAL ARRANGEMENT AGREEMENT BY THE OHIO ENVIRONMENTAL COUNCIL, NATURAL RESOURCES DEFENSE COUNCIL, ENVIRONMENTAL LAW & POLICY CENTER, AND ENVIRONMENTAL DEFENSE FUND** to be filed in Docket No. ~~14-2304~~-EL-EEC In the Matter of the Joint Application of Ohio Power Company and Kraton Polymers U.S., LLC for Approval of a Special Arrangement Agreement.

Thank you

Trent A. Dougherty, Esq. | Managing Director, Legal Affairs
Ohio Environmental Council
1145 Chesapeake Avenue, Suite 1, Columbus, 43212
(614) 487-7506 OEC
(614) 487-5823 direct

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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Joint Application of Ohio) Case No. 14-2304-EL-EEC
Power Company of Kraton Polymers U.S.)
LLC for Approval of a Special Arrangement)
Agreement.)

**COMMENTS ON THE SPECIAL ARRANGEMENT AGREEMENT BY
THE OHIO ENVIRONMENTAL COUNCIL, NATURAL RESOURCES DEFENSE
COUNCIL, ENVIRONMENTAL LAW & POLICY CENTER, AND ENVIRONMENTAL
DEFENSE FUND**

I. INTRODUCTION

On December 22, 2014, Ohio Power Company (AEP or the Company) and Kraton Polymers U.S. LLC (“Kraton”) filed a joint application (Application) for approval of a special arrangement wherein Kraton has agreed to commit the resources from its planned combined heat and power (CHP) system to AEP for its compliance with the energy efficiency benchmarks set forth in Section 4928.66, Revised Code.

The Ohio Environmental Council, along with Natural Resources Defense Council, Environmental Law & Policy Center, and Environmental Defense Fund (collectively “Environmental Advocates”) are each long-time proponents of cogeneration technologies due to the significant benefits that cogeneration provides to customers, the resiliency of the overall power grid and the environment. Combined heat and power (CHP) systems¹, when designed and engineered appropriately to the facility in which they’re installed, improves fuel efficiency, reduce emissions by up to fifty percent, and significantly reduce on-site emissions of carbon dioxide and other pollutants such as nitrogen oxides (NOx) and sulfur oxides (SOx).² As such,

¹ As defined in Section 4928.01 (A)(40) of the Ohio Revised Code

² Midwest CHP Technical Assistance Partnership, Energy Resources Center, University of Illinois at Chicago, Cuttica, John.

ENVIRONMENTAL ADVOCATES support the policy enacted by Ohio Senate Bill 315 (129th General Assembly) that allowed CHP and Waste Energy Recovery (WER) systems to qualify as energy efficiency measures under Ohio's Energy Efficiency Resource Standard (EERS).³

Because of Ohio's large manufacturing base, we are ranked 5th in the nation for technical potential of energy captured through CHP and WHR. But we lag far behind – 44th -- in taking advantage of the technologies. According to the most recent analysis of Ohio's potential, Ohio could realize up to 9 gigawatts of power generated through CHP and WHR, and with that, massive economic, environmental, and reliability benefits⁴. While the project proposed in this application represents a significant step toward reaching Ohio's CHP potential, and AEP's foresight should be commended, Ohio will continue to lag and Ohioans will continue to miss out on the benefits of CHP unless and until the state puts its full effort into encouraging investment into such projects. Commission staff and intervening parties have put significant effort into developing uniform rules for CHP projects across Ohio in Case No. 12-2156-EL-ORD, but the Commission has yet to issue any final rules in that docket even though public comment was completed more than a year ago. We believe that in order to facilitate projects such as this, the Commission needs to move forward on finalizing rules on CHP and WER as energy efficiency resources to provide the certainty that the CHP development industry and Ohio's manufacturing base needs to move forward on these projects.

Therefore, ENVIRONMENTAL ADVOCATES, with the proposed modifications and considerations outlined below, support this CHP project, and offers the following comments on the Application for the Commission's consideration.

II. COMMENTS

³ Per Section 4928.66 of the Ohio Revised Code

⁴ *Snapshot of Ohio CHP Market*, ICF International, 2011

The ENVIRONMENTAL ADVOCATES respectfully submit these comments, and generally supports this joint application by the Company and Kraton. However, the ENVIRONMENTAL ADVOCATES urge the Commission to consider improving the Application in a number of ways, as detailed below, prior to approving the Application.

1. **The per-kilowatt-hour incentive offered by the Company is woefully low, does not align with other states' incentive programs for CHP and/or WER, and would set a precedent that may unfairly undervalue the savings yielded by future projects.**

Despite the apparent agreed-to incentive between the Company and Kraton, the Commission should consider increasing the per-kilowatt incentive offered to Kraton in this Application because it is exceptionally low and would not set an adequate precedent for future CHP and WER projects incentivized under utility efficiency programs.

There is no doubt that the intent of the Governor's 21st Century Energy Policy, as enacted by Ohio Senate Bill 315 (129th GA), to include CHP and WER as energy efficiency resources, aligned well with the policy of the State of Ohio to "[e]ncourage implementation of distributed generation across customer classes...,"⁵ and "[e]ncourage the education of small business owners in this state regarding the use of, and encourage the use of, energy efficiency programs...."⁶

Given that CHP systems stabilize energy costs for the end-user and increase the electric grid's reliability, and since CHP is explicitly qualified as an energy efficiency resource, any incentive offered by the Company to encourage the development of CHP or WER under the state EERS should reflect the intent of the policy set forth in Ohio Senate Bill 315, which was to increase the deployment of new CHP systems in Ohio.

⁵ Section 4928.02 (K) of the Ohio Revised Code

⁶ Section 4928.02 (M) of the Ohio Revised Code

The discussion of legislative intent is necessary to consider because the per-kwh incentive level of this Application is not particularly substantial, and because this Application is likely to set a precedent for future CHP projects. Despite the Company's claims to the contrary, to describe this agreement as just an agreement between the Joint Applicants, and that each future agreement between each customer is unique to the circumstances, is to ignore the likelihood that this Agreement will set a precedent to customers interested in developing future CHP projects across the state.

Incentive levels should be high enough to encourage cost-effective CHP projects that would not otherwise be built without the incentive. The Utility Cost Test (UCT) value for this project is 36.1, with total net benefits of \$26.3 million in avoided transmission and generation costs, a substantial amount of savings which indicates this project would likely have occurred without the .005kw hour incentive the Company is offering. Since these projects will set a precedent for future CHP incentives, in order to create a substantial incentive for energy efficiency savings gained via CHP projects, and to fulfill the intent of encouraging energy efficiency resources such as CHP, the Commission should increase the per-kilowatt-hour incentive to at a minimum what the Ohio Manufacturers' Association Energy Group (OMAEG) recommends in their comments on this Application at .008/kwh. At a maximum, the Commission should examine and possibly adopt other states' and utilities' incentive levels. For example, the production incentives offered in Maryland and Illinois range from \$0.07 to \$0.08/kwh.

2. **The Company's Incentive Rate is Based on the Incorrect Assumption that the Operation of CHP Systems are akin to Behavioral Energy Efficiency**

The .005/kwh incentive offered by the Company is similar to the level of incentive proposed in the Commission's five-year rule review of the EERS (Case Nos. 13-651-EL-ORD,

13-652-EL-ORD, and 12-2156-EL-ORD, which are still pending, as well as the incentive level approved in at least one other application (13-2440-EL-EEC). Such an incentive level indicates that the Company views this project as a behavioral energy efficiency program, rather than an installed energy efficiency measure as one would find under a prescriptive or custom energy efficiency program. While the definitions of what precisely constitutes an energy-efficiency behavior program vary, at its heart, behavioral measures encourage the energy user to shift how they use energy, either by using energy at non-peak hours, or by taking certain actions which reduce energy usage during non-operational periods. By their nature, the energy savings coming from an energy-efficiency behavioral program can be uncertain and dependent on the energy user following a prescribed series of actions for the life of the energy efficiency program. Low incentives for energy efficiency behavior programs are justified where there is a lack of certainty that energy users will follow an energy use pattern over a sustained period of time.

If the operation of a CHP system were similar to a behavioral program with unreliable efficiency benefits, a low incentive level would be justified. But it is not. The typical operation of a CHP system yields energy savings at a reliable and consistent rate. First, the installation of a CHP system is very expensive, and takes several months (if not years) to design/engineer, permit and construct. Such a large capital investment alone is motivation enough to ensure reliable operation of the system, and maximization of its use. Second, the available CHP turbines and engines available in the market have well-established efficiencies and 24/7 operating protocols. When designed appropriately for the facility, and well maintained, CHP systems are highly reliable and typically only experience an average downtime of 4%, and only 2% downtime reliable operation during peak hours.⁷ The ENVIRONMENTAL ADVOCATES are unaware of

⁷ "The Legal Case against Stand-By Rates", Casten and Karegianes, The Electricity Journal, November 2007, Vol. 20, Issue 9, pp. 37-38. http://www.recycled-energy.com/_documents/articles/sc_electricity_journal11-07.pdf

any other state or utility that treats CHP systems as if they could be arbitrarily turned on and off, or as if their reliability is intermittent. Lastly, unlike energy efficiency behavioral programs, the Kraton Agreement indicates these systems will run almost continuously through the year and cannot be turned off by the whim of the operator.

The permanent nature of a CHP system and its guaranteed savings means this CHP project should receive a much higher incentive than a typical energy efficiency behavioral program, taking into consideration the intense capital investment these projects need and the significant 24/7/365 benefits they provide.

3. The Commission should Align the Incentive to Reflect the Efficiency of the CHP System

If approved without modification to the per-kilowatt hour incentive level, this Application may set a precedent that would attract CHP projects to seek an incentive under utilities' efficiency programs, but the projects attracted by the incentive may not be the most efficient CHP projects. Because of this Application's precedent-setting nature, the Commission should consider modifying the incentive Kraton in order to ensure the maximum amount of cost-effective CHP projects are encouraged and developed. To achieve this, ENVIRONMENTAL ADVOCATES recommend incentivizing CHP systems that achieve higher efficiencies, and provide for greater upfront incentives.

Incentivizing CHP Systems that Achieve Higher Efficiencies

Instead of offering a one-sized fits all incentive for all CHP projects which reach a certain amount of efficiency, the Commission should encourage a tiered incentive approach that determines incentive levels based on the actual demonstrated efficiency of a CHP system, and not just give a kwh incentive. Under this incentive scheme, the portion of the electricity

produced by the CHP system allowed as qualified savings increases as the efficiency of the CHP system increases.

In their own comments on the Commission's five-year rule review of the EERS (Case Nos. 13-651-EL-ORD, 13-652-EL-ORD, and 12-2156-EL-ORD), the Company proposed a tiered incentive based on a CHP system's efficiency performance. In future stakeholder engagement regarding these rulemakings, the Commission should further consider tiered incentives based on achieved system efficiencies, such as the Company's own recommended model:⁸

"...THE PAYMENT PER KWH GENERATED SHALL BE FURTHER SUBJECT TO THE FOLLOWING ADJUSTMENTS:

FOR CHP/WER PROJECTS:

LHV = 80% OR MORE: 100% OF THE CALCULATED PAYMENT.

LHV = 70% UP TO 80%: 75% OF THE CALCULATED PAYMENT.

LHV = 60% UP TO 70%: 50% OF THE CALCULATED PAYMENT.⁹"

Such a tiered incentive structure would encourage CHP project developers to create and install only the highest-efficiency CHP systems and operate those CHP systems at the highest efficiency levels for as long as possible; and incentivize all prime mover technologies. It is based on the performance of real CHP systems, no matter the size, configuration and technology. Finally, it is simple to administer and implement, and we believe, will stand as a precedent foster continued innovative CHP projects that save energy and money.

Greater Upfront Incentives

⁸ Initial Comments by Ohio Power Company, In the Matter of the Amendment of Ohio Administrative Code Chapter 4901:1-40, regarding the Alternative Energy Portfolio Standard, to Implement Am. Sub. S.B. 315. Filed 3/3/13, Page 12.

⁹ Citing the Company's tiered incentive model recommendation is by no means an endorsement of the Company's model.

The current incentive structure of the proposal also does not offset the substantial upfront costs a CHP project will entail. The more incentives given upfront to a CHP developer, the more likely the initial costs of design and construction of a CHP project will not be a barrier to the development of that project. And the greater upfront costs will lead to a faster payback on a CHP system, and the faster the payback, the more likely customers will look to CHP projects as a viable option for their facilities. But the current incentive structure ensures projects that can be done won't be done because the incentives offered, and the way those incentives are offered, will not support most economically viable CHP programs.

CHP projects always entail substantial upfront costs in order to establish a CHP system. So an incentive which is designed to accrue during the later years of a CHP systems lifespan will not alleviate one of the main barriers to installing CHP projects. The only CHP systems that will be developed are those whose savings are overwhelmingly substantial. For example, in this Joint Agreement the Kraton CHP project has a **UCT value of 36.1**; even given the substantial savings most CHP projects cause, the UCT value of the CHP project subject to this Joint Agreement is above and beyond any savings a typical CHP system can be reasonable expected to produce. Any incentive program which does not provide substantial upfront payments will inhibit many economically viable CHP projects from being developed because the incentives are not structured to mitigate the substantial upfront costs of those projects.

4. The Company Should Seek Approval to Bid the Energy Efficiency Savings into the PJM Capacity Markets

For a number of years AEP has, on its own accord, bid energy efficiency resources into the PJM Base Residual Auctions. Bidding CHP capacity into PJM's market has and will continue to lower overall energy costs to all Ohioans, and make the electric grid more reliable.

Therefore, the Commission should modify the Agreement to require the Company to put forward a viable plan for qualifying CHP as a capacity resource for PJM's capacity auctions.

By bidding energy efficiency savings into PJM's capacity markets, PJM will pay for the energy efficiency savings accomplished by this CHP project at the same price as any other energy efficiency capacity resource. Energy efficiency has a lower cost than other capacity resources, so requiring the Company to seek approval from PJM to allow the CHP energy efficiency resources to be bid into the capacity market would lower the overall cost of electricity for consumers, providing price suppression benefits to all the Company's customers. In addition, by bidding CHP into PJM's capacity market, the revenue generated could increase the incentives available for other industrial customers to install and operate CHP systems.

As mentioned previously, given the authorizing legislations explicit intent to encourage and ensure affordable energy is available to all Ohioans, and because CHP projects reduce overall wholesale prices while increasing electric grids reliability, AEP should be required to bid its excess CHP capacity into PJM's interconnected market.

Response to AEP Comment-Amendment or Not an Amendment

In the Company's recent comments filed in response to comments by the OMAEG and the Industrial Energy Users (IEU), the Company indicated that coming up with a plan to qualify CHP as a capacity resource would constitute an amendment to the portfolio, thereby allowing industrial consumers in AEP's territory to opt-out of any energy efficiency requirements. However, bidding excess CHP capacity into PJM's market does not constitute an amendment because AEP has, in the past, bid energy efficiency into the auction on its own even when it was not required to by the current approved energy efficiency portfolio plan. Therefore, bidding CHP into the PJM auction would not modify the Company's plan, but will help facilitate fulfillment of

the Company's efforts to optimize its bid into PJM. The Ohio Environmental Council is willing and able to assist the Company in its efforts to seek approval from PJM to allow the Company bid its CHP energy savings into PJM's capacity market.

Response to AEP Comment-Will PJM Allow CHP

AEP also argues in recent comments that PJM explicitly prohibits CHP from being bid into the market by quoting the PJM manual which states "The EE Resource must be fully implemented at all times during the Delivery Year, without any requirement of notice, dispatch, or operator intervention." The manual goes on to further indicate that CHP projects which require significant operation and maintenance would not qualify as an energy efficiency resource. But the joint application between Kraton Polymers and AEP indicated that the system will operate at "normal operation firing gas for approximately 95% utilization throughout the year" – hardly an operation mode that requires significant maintenance. Additionally, the CHP system that is the subject of the agreement will run throughout the year. It is unlikely PJM would consider the few times the system is shut down as significant maintenance or operation to the point that PJM would not let CHP be considered a capacity resource.

Most importantly, working with PJM to achieve market recognition of the efficiency benefits of CHP projects will benefit Ohio customers by monetizing those benefits to provide additional incentives for the implementation of cost-effective CHP. There is no reason for AEP not to pursue this issue with PJM.

III. CONCLUSION

The application submitted by Kraton and Ohio Power Company is unique because it provides for a first of its kind arrangement that harnesses and supports new energy efficiency savings projects. It is precisely this type of program that is contemplated by the statute and

code—and the type of program that the ENVIRONMENTAL ADVOCATES and the manufacturing and industrial community of Ohio can enthusiastically support. The ENVIRONMENTAL ADVOCATES believe that the application is just, reasonable, and will advance the economic and environmental goals of S.B. 221, S.B. 315, and the energy policies of this state. Therefore, the ENVIRONMENTAL ADVOCATES urge the Commission to promptly approve this application with the proposed amendments and considerations expressed in the comments above. Furthermore, it is also imperative that the Commission finalize its proposed CHP and WER energy efficiency rules, which have been languishing far too long, and seize the opportunity to capitalize on the enormous potential of cogeneration.

Respectfully Submitted,

/s/ Trent A. Dougherty

Trent A. Dougherty

Ohio Environmental Council
1145 Chesapeake Avenue, Suite I
Columbus, Ohio 43212-3449
(614) 487-7506 - Telephone
(614) 487-7510 – Fax
tdougherty@theoec.org

Samantha Williams
Natural Resources Defense Council
20 N. Wacker Drive, Suite 1600
Chicago, IL 60606
(312) 651-7930
swilliams@nrdc.org

Madeline Fleisher
Environmental Law & Policy Center
21 W. Broad St., Suite 500

Columbus, OH 43212
P: 614-488-3301
F: 614-487-7510
mfleisher@elpc.org

John Finnigan
Environmental Defense Fund
128 Winding Brook Lane
Terrace Park, Ohio 45174
(513) 226-9558
jfinnigan@edf.org

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing has been served upon the following parties by first class and/or electronic mail this 13th day of April, 2015.

/s/ Trent A. Dougherty

Steven T. Nourse
Senior Counsel
American Electric Power
1 Riverside Plaza
Columbus, Ohio 43215
stnourse@aep.com

Frank Darr
McNeese, Wallace & Nurick
21 East State Street., 17th Floor
Columbus, Ohio 43215
fdarr@mwncmh.com

William Wright
Assistant Attorney General
Public Utilities Commission of Ohio
180 East Broad Street, 6th Floor
Columbus, Ohio 43215
william.wright@puc.state.oh.us

Rebecca L. Hussey
Carpenter, Lipps & Leland
280 Plaza, Suite 1300
280 N. High Street
Columbus, OH 43215
hussey@carpenterlipps.com