BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Service Offer Pursuant to R.C. 4928.143, 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 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 IGS ENERGY
PUBLIC

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I. INTRODUCTION

In 1999 the General Assembly passed Amended Substitute Senate Bill 3 ("SB 3"), which restructured Ohio's electricity market. SB 3 left behind cost-based regulation and determined that Ohio's future lay with competitive electric markets and policies. After fifteen years of transition, Duke Energy Ohio ("Duke") is on the cusp of finally transferring its generating assets and operating as a fully separated electric distribution utility—as envisioned by SB 3.

Despite this progress Duke has proposed an electric security plan ("ESP") that, if approved, would take Ohio backward from the vison set forth in SB 3. Further, many of the proposals made in Duke's ESP violate State and Federal law and are contrary to the policies of the State set forth in Ohio Revised Code ("R.C.") 4928.02. For these reasons the Commission must not approve Duke's Application as proposed. Rather the Commission should modify Duke's ESP Application as recommended in the testimony filed by Interstate Gas Supply, Inc. ("IGS").[1] Specifically, the Commission should:

- Reject Duke's anticompetitive proposal to prohibit competitive retail electric service ("CRES") providers from placing non-commodity charges on the electric distribution utility ("EDU") bill. Duke already bills non-commodity charges for its affiliate; thus, Duke's proposal violates Ohio law which prohibits granting preferential treatment to an affiliate. Further, Duke's

[1] *See* IGS Ex. 10 (containing the Direct Testimony of Matthew White), Ex.12 (containing the Direct Testimony of Tim Hamilton), and Ex. 13 (containing the Supplemental Testimony of Joseph Haugen, which adopts the Testimony of Mr. Hamilton). Throughout this brief, IGS will refer to both Exhibits 12 and 13 as the Testimony of Joseph Haugen, as Mr. Haugen adopted Mr. Hamilton's testimony as his own.

proposal will stifle the development of innovative retail electric products in the Duke service territory;

- Modify Duke's proposed standard service offer ("SSO") to eliminate historical subsidies flowing from distribution rates to the SSO. Specifically, IGS recommends that the Commission follow the lead of other jurisdictions and further unbundle costs currently embedded in distribution rates that are more appropriately allocated to the SSO price;
- Reject Duke's deceptively named Price Stability Rider ("PSR"). The PSR is contrary to Ohio law, Federal law, and is unlikely to bring any actual price stability to customers. Rather, the PSR will merely serve to insulate Duke's shareholders against the risk of Duke's uneconomical generation and shift that risk to Duke ratepayers.

The extensive record in this case[2] demonstrates that Duke's proposal to establish the PSR and its other proposals that would materially inhibit competition should be rejected for legal, policy, and factual reasons. IGS also supports the positions in the Initial Brief of the Retail Energy Supply Association ("RESA").[3] IGS's silence on any issue should not be interpreted as acceptance or acquiescence.

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[2] The record in these proceedings contains both confidential and non-confidential information. Confidential exhibits include the designation "a" after their number. Throughout this brief, IGS references only the public version of exhibits, though confidential information may be cited (and redacted) in the brief.

[3] In furtherance of administrative economy, IGS will not rehash each of those positions in its Post-Hearing Brief.

II. ARGUMENT

A. The Commission Should Reject Duke's Proposal to Prohibit CRES Providers from billing Non-Commodity Charges on the Utility Bill

In its ESP Application Duke's witness Jones proposed to amend its tariff to prohibit CRES providers from using the bill-ready function to bill for non-commodity products and services.[4] Yet Duke is currently including non-commodity charges for its affiliated company on the EDU bill.[5] Duke's proposal to restrict CRES providers from billing non-commodity charges on the EDU bill (while granting its unregulated affiliate access to the EDU bill) is contrary to Ohio law and Commission rules that prohibit granting preferential treatment to an EDU affiliate. Moreover, customers in the Duke service territory are harmed by restricting CRES access to the EDU bill. If Duke's proposal is approved customers will have fewer innovative electric products and services made available to them by CRES providers.[6] For these reasons the Commission should reject Duke's proposal set forth in Witness Jones' testimony.

R.C. 4905.35(A) provides that "no public utility shall make or give any undue or unreasonable preference or advantage to any person, firm, corporation, or locality." OAC 4901:1-37-04(D)(10)(c) also states that an "electric utility *shall not*, through a tariff provision, a contract, or otherwise, *give its affiliates* or customers of affiliates *preferential treatment or advantages over nonaffiliated competitors*... to *any product and/or service* (emphasis added). Further, R.C. 4928.17(A)(3) prohibits a utility from extending any

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[4] Duke Ex. 13 at 8.

[5] *Id.*

[6] IGS Ex. 10 at 7.

"undue preference or advantage to any affiliate." In short, the Ohio Legislature and the Commission have, under no uncertain terms, made clear that a utility *shall not* grant preferential treatment to its affiliate.

Duke is currently billing for non-commodity products and services for its affiliate Duke Energy One.[7] Specifically Duke is billing for StrikeStop service which is an insurance service that provides coverage for damage caused to the customer's home from electric surges. Duke is also billing for Underground Protection service which is an insurance service that covers damage to the customer's underground electric lines.[8] Thus, Duke is currently utilizing the billing assets of distribution customers to place non-commodity charges for its unregulated affiliate on the EDU bill.

In its ESP application Duke is seeking to prohibit CRES providers from billing for non-commodity charges such as the charges Duke now bills for its affiliate Duke Energy One. Further, there is evidence on the record that Duke does not, and has not, allowed CRES providers to place non-commodity charges on the EDU bill, such as the charges Duke bills for Duke Energy One.[9] As IGS witness Matthew White testified, it is a tremendous advantage for Duke's affiliate to be able to bill for its non-commodity charges on the EDU bill. Not only is there cost savings associated with utilizing the EDU bill, there is a great convenience given to the EDU affiliate customers to have a

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[7] *Id.* at 8.

[8] *Id.*

[9] IGS Ex. 11 (Int 40 and 41); Tr Vol. XIV 3929-28.

single bill for electric distribution and generation service, along with non-commodity charges.[10]

Duke's proposed changes to its tariff to restrict CRES from billing for non-commodity charges would constitute granting preferential treatment to its affiliate company. Given the directive of Ohio law to prohibit such preferential treatment, the Commission should not adopt changes to Duke's tariff that would prohibit CRES providers from utilizing the EDU bill the same way Duke allows its affiliate, Duke Energy One, to utilize the EDU bill.

Beyond granting an undue preference to Duke's affiliate, the Commission should not adopt Duke's proposed changes to its tariff because it is simply bad policy to do so.

As Mr. White notes in his testimony, "one of the major benefits of competition is that it encourages the development of innovative products and services that add value to customers beyond the electric commodity."[11] Mr. White also explains that in competitive electric markets throughout the country CRES providers are beginning to offer sophisticated products and services such as "electricity bundled with energy efficiency, demand response, direct load control, smart thermostats, distributed solar generation and other forms of on-site generation, micro-grids, battery storage technology, products bundled with loyalty rewards and products bundled with home protection, to name a few."[12]

[10] IGS Ex. 10 at 15.

[11] IGS Ex. 10 at 6.

[12] *Id.* at 6-7.

If Duke's proposal is adopted, the markets for bundled products and services that include CRES non-commodity products will be severely restricted. As Mr. White notes customer do not want separate bills for each individual component of a bundled electric product and customers often want a bundled all in price.[13] Thus, "in order for CRES providers to offer value added products and services that customers prefer it is important to have billing flexibility for electric service."[14]

Further, the State policy set forth in statute is to expand innovative product offerings to customers. Specifically, it is the State policy to "encourage innovation and market access for cost-effective supply- and demand-side retail electric service" R.C. 4928.02(D); "ensure effective competition in the provision of retail electric service." R.C. 4928.02(H); "recognize the continuing emergence of competitive electricity markets through the development and implementation of flexible regulatory treatment." R.C. 4928.02(G); "ensure diversity of electricity supplies and suppliers, by giving consumers effective choices over the selection of those supplies and suppliers." R.C. 4928.02(C).

All of the above policies support expanding the access of more electric products and services to customers through the competitive market—not restrict access to a diverse range of products and services as Duke would have the Commission do. Since it is the Commission's directive to ensure the State policies are effectuated the Commission must reject Duke's proposed tariff changes. See R.C. 4906(A).

[13] *Id.* at 15.

[14] *Id.*

1. Duke Can Still Allow CRES Providers to Bill for Non-commodity Charges and Exclude those Charges from the Purchase of Receivables Program

In his Testimony Duke witness Daniel Jones claims that it is necessary for Duke to prohibit CRES providers from billing for non-commodity charges because Duke does not wish to include such charges in the Purchase of Receivables ("POR") program.[15] Mr. Jones justification for Duke's proposed tariff changes is without merit.

As Mr. White notes in his testimony, "if the Commission does not wish Duke to include non-electric charges in the POR program, it could simply order Duke to file a modified tariff that excludes non-electric charges from its POR." [16] However, Duke does not have to exclude all CRES non-commodity charges from EDU bill to accomplish this objective. Further, as noted by Mr. White, since Duke already excludes the non-commodity charges of Duke Energy One from its uncollectible expense rider and utility disconnect we know that "Duke has the ability to differentiate between unregulated non-electric charges and electric commodity charges."[17]

Simply excluding CRES non-commodity charges from Duke's POR program is a less restrictive means to accomplish Mr. Jones' stated purpose than a blanket prohibition against CRES non-commodity charges on the EDU bill. Further, excluding CRES' non-commodity charges from POR would not run afoul of Ohio law and Commission rules that prohibit granting preferential treatment to an affiliate.

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[15] Duke Ex. 13 at 8.

[16] IGS Ex. 10 at 8.

[17] *Id.* at 9.

2. Duke is in Violation of Its Corporate Separation Requirements

Ohio's corporate separation statute prohibits a utility from extending any "undue preference or advantage to any affiliate."[18] Duke is allowing its affiliate Duke Energy, One to place its non-commodity Strike Stop and Underground protection charges on the EDU bill. Evidence on the record established that Duke currently will not allow CRES providers to bill for non-commodity charges such as those that Duke bills for Duke Energy, One.[19] Thus Duke is currently in violation of its corporate separation requirements.[20]

R.C. 4928.18 places the enforcement of Duke's corporate separation requirements within the Commission's jurisdiction. Further R.C. 4928.18(C) sets forth strict penalties that may apply to a utility that is in violation of its corporate separation rules. Finally R.C. 4906(A) requires that the Commission ensure that the policy of the State of Ohio is effectuated. Thus, it would be unreasonable for the Commission to approve a tariff that would place Duke in further violation of its corporate separation requirements given that it is the Commission that has been tasked with enforcing them.

Further, Rule 4901:1-35-03, OAC, requires that Duke demonstrate in is ESP Application that it is in compliance with Ohio's corporate separation statutes. The evidence on the record demonstrates that Duke is granting preferential treatment to its affiliate in violation of R.C. 4928.17(A)(3). Further, Mr. White notes in its testimony

[18] R.C. 4928.17(A)(3).

[19] IGS Ex. 11 (INT 40 & 41); Tr. Vol. XIV at 3927-28.

[20] R.C. 4928.17(A)(3).

there are already questions as to whether Duke is in compliance with its corporate separation requirements given the limited information that Duke has provided regarding how it allocates costs to Duke Energy One.[21] For these reasons the Commission should find that Duke has not demonstrated that it is in compliance with Ohio's corporate separation requirements.

3. The Commission Should Authorize CRES Suppliers to use the Bill-Ready Function on the EDU Bill to Bill for Non-Commodity Charges

As already noted the Commission should reject Duke's proposed tariff modifications recommended by Witness Jones. Further as recommended by witness White, "the Commission should also require that Duke update its tariff to explicitly allow CRES providers to use the bill-ready function to bill for non-electric charges. The Commission should also direct Duke to update its tariffs to treat CRES non-electric charges with respect to payment priority in the same manner Duke treats the non-electric charges for its affiliate Duke Energy One."[22]

These tariff changes are necessary so that Duke does not attempt to unlawfully discriminate against CRES provider non-commodity charges in the future and to ensure that Duke is in compliance with corporate separation. Further, as already noted, authorizing CRES providers to bill for non-commodity charges is consistent with the policies of the State to expand the innovative electric product offerings to customers. See R.C. 4928.02(D); R.C. 4928.02(H); R.C. 4928.02(G) and R.C. 4928.02(C). For

[21] IGS Ex. 10 at 13-14.

[22] IGS Ex. 10 at 10.

these reasons the Commission should require that Duke allow competitive suppliers to use the bill ready function to bill for non-commodity charges on the EDU bill.

4. The Commission Should Also Direct Duke to Develop the Systems Necessary for Supplier Consolidated Billing

IGS also proposed in its testimony that Duke's ESP Application be modified to require Duke to offer supplier consolidated billing to CRES suppliers. Thus not only should Duke take the immediate step of allowing CRES providers to use the bill-ready function to bill for non-commodity charges on the EDU bill, the Commission should direct Duke to move towards making the CRES providers the single billing entity for customers. "It is important the Commission adopt both recommendations because it may take time for Duke to implement supplier consolidated billing. In the meantime CRES providers should be able to use the Duke bill-ready option to bill for non-electric charges."[23]

As Mr. White testified, with supplier consolidated billing CRES suppliers purchase the receivables for the EDU distribution charges and then the CRES suppliers would be responsible for billing and collecting all of the charges (distribution and generation) from the customer.[24] Mr. White explains supplier consolidated billing enables CRES providers to offer electric customers a broader range of products and services. As Mr. White notes, granting customers billing flexibility and multiple billing options is extremely important if additional products and services are to develop in the competitive market.[25]

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[23] *Id.* at 16.

[24] *Id.* at 15.

[25] *Id.*

Further, all of the consumer protection statutes and billing requirements would still be in place with the adoption of supplier consolidated billing. Non-commodity charges could not trigger disconnect and CRES suppliers would have to abide by the same billing rules and billing format as AEP is required to today.[26]

In short, with the adoption of supplier consolidated billing, the Commission will be taking an important step to ensure that customers are able to receive the diverse range of electric products and services that bring value to customers.

B. The Commission Should Require Duke to Unbundle the Costs from Distribution Rates Required to Support SSO Service

Ohio Revised Code ("R.C.") R.C. 4928.02(B) provides that it is the policy of the State of Ohio to "[e]nsure the availability of *unbundled and comparable* retail electric service" (Emphasis added). It is also the State policy to "ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies" R.C. 4928.02(B). Further, R.C. 4928.02(G) provides that it is the State policy to "[r]ecognize the continuing emergence of competitive electricity markets." These policy statements are not idealistic or aspirational; R.C. 4928.06(A) provides that the Commission "*shall* ensure that [Ohio's energy] policy . . . is effectuated." (Emphasis added.)

In its ESP Application, Duke claims that its proposed SSO is an unbundled price comparable to other products in the market. The evidence, however, demonstrates that the Duke's SSO product is anything but comparable or unbundled.

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[26] *Id.* at 17-18.

Currently, Duke's SSO price is simply a pass-through of wholesale capacity and electric costs.[27] However, Duke incurs significant *additional* costs to provide retail electric service to customers. But these costs are not recovered in the SSO price; rather these costs are recovered through Duke's distribution rates.[28]

Mr. White testified that there are non-commodity costs required to support SSO generation service that are currently being recovered through Duke distribution rates. And these costs are not insignificant. Those costs include but are not limited to:

> Duke employee costs for the time Duke employees work to make the SSO rate available to customers; Duke infrastructure costs, including IT costs used to support the SSO and SSO customers; the cost of working capital Duke incurs to purchase SSO supply up-front, but bill SSO customers later; customer call center costs incurred when customers inquire about their SSO generation service; and allocation of a portion of overhead expense, because the SSO could not be made available to customers without the use of Duke's overhead.[29]

CRES suppliers incur largely the same costs in addition to the wholesale electric costs in order to provide retail electric service to customers. But CRES providers *cannot* recover those costs through distribution rates. Rather all of CRES costs must be reflected in the electric generation price they charge customers.[30]

Moreover, because costs to provide SSO electric generation service are recovered through Duke's distribution rates, shopping customers are paying for these costs twice; once through the distribution rates, and once through the CRES generation prices. For these reasons the SSO service offered by Duke is anything but a

[27] IGS Ex. 10 at 22.

[28] *Id.*

[29] *Id.* at 23.

[30] Tr. Vol. XI at 3326.

comparable and unbundled retail electric product as required by the Ohio Revised Code. The SSO continues to be subsidized by Duke distribution rates.

Indeed other utilities commissions throughout the country including New York, Pennsylvania, Illinois and Maryland have recognized the need to ensure distribution rates are unbundled default service more closely reflects the true cost of providing retail electric service. [31] Ohio is far behind in this regard despite what is required in Ohio law.

The New York Public Service Commission ("NYPSC") has unbundled a number of costs from distribution rates and reflected those costs in the default price.[32] In so doing, the NYPSC determined that it was appropriate to allocate IT expenses, outside professional expenses, customer care expense and promotional expenses to default service (*see Id.* at 24 allocating $7.1 million in Information Resource and computer resource costs to the default supply rate); (*see Id.* at 30 "it seems clear that Con Edison's promotional and other advertising expenses, even if they are not designed to directly increase the company's profitability, nevertheless provide benefits associated with the ongoing exposure of the public to the corporate name. These corporate recognition and image benefits are contrary to the competitive interests of the ESCOs, and ESCO customers should be able to avoid at least a portion of those costs when they switch to ESCO commodity service.")

[31] R.C. 4928.02(A) and (B).

[32] NYPSC CASE 00-M-0504 – Unbundling Track (Aug. 25, 2004).

Recently, the Illinois Commerce Commission ("ICC") ordered that $11 million in customer care costs be allocated to default supply service.[33] In doing so the ICC found that "allowing ComEd to recover these costs through distribution rates provides a subsidy to ComEd's supply rate."[34] Moreover, in Illinois, other non-electric costs required to support default service are allocated to default supply including outside legal expense and IT costs.[35]

Further, a Maryland proposed order recently approved an administrative charge to the default supply rate. "The Administrative Charge is the portion of SOS [Standard Offer Service] rates intended to recover the costs of providing SOS above and beyond transmission costs, taxes, and power purchase costs."[36] Moreover, the Proposed Order authorized recovery of costs "prudently incurred by the Companies as a direct result of providing SOS that are not included but are not limited to: retail settlement costs, regulatory costs, legal costs, consultants, procurements process costs, incremental system costs, and costs of educational bill inserts."[37]

Finally, the Pennsylvania Public Utilities Commission has unbundled other retail costs required to support default service and continues to further unbundle costs on a utility specific basis. For example, as recently as October 28, 2015, a recommended

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[33] *Commonwealth Edison Annual formula rate update and revenue requirement reconciliation under Section 16-108.5 of the Public Utilities Act, ICC Case No. 14-0312, Final Order* at 108-110 *(Dec. 10, 2014) ("Customer Care Cost Case").*

[34] *Id.* at 110.

[35] *Id.* at 108-110.

[36] *Id.*

[37] *Id.* at 9 (emphasis added).

decision approved a settlement that was filed in which Duquesne Power and Light Company agreed to propose to unbundle additional costs to support default service:

> In the earlier of its next general rate increase filing or its Default Service Plan filing for the period commencing June 1, 2017, *Duquesne Light will propose to unbundle from base rates costs associated with the provision of default service, including default service proceeding and procurement costs, and cash working capital with regard to default service procurements.* Duquesne Light will simultaneously propose a mechanism for recovery of such costs from default service customers.[38]

In short, Ohio is far behind other jurisdictions with competitive retail electric markets in unbundling costs from distribution rates that support SSO service—despite the clear directive in Ohio law to ensure that the SSO is an "*unbundled and comparable*" retail electric service. As any CRES supplier can attest to, the cost of providing retail electric service consists of more than just a pass-through of wholesale energy prices.[39] Because the Commission is required to ensure that the SSO price is unbundled and comparable to other retail electric products in the market, the Commission must unbundle the costs Duke incurs in distribution rates and charge those costs to the Duke SSO price, as proposed by Mr. White in this proceeding.

C. The Commission should reject Rider PSR

The PSR proposal relates to Duke's 9% ownership interest in the Ohio Valley Electric Corporation ("OVEC") and its two over a half-century old coal plants. As a sponsoring company of OVEC, Duke has entered into an Intercompany Power Agreement ("ICPA") with the other OVEC sponsoring companies that requires Duke to

[38] *Petition of Duquesne Light Company for Approval of Default Service Plan for the Period June 1, 2015 through May 31, 2017* – PPCU Docket No. P-2014-2418242, Recommended Decision at 15 and 34 (October 28, 2014) (emphasis added).

[39] IGS Ex. 10 at 23.

pay a traditional cost-based rate, including a rate of return and variable costs, to OVEC.[40] In exchange for these payments, Duke receives a pro-rata portion of the capacity and energy generated from the OVEC units.

The PSR proposal would shift the cost and risk of OVEC ownership to Duke ratepayers. Under the proposal Duke would sell the energy and capacity from the OVEC coal plants into PJM Interconnection, LLC's ("PJM") wholesale capacity and energy markets.[41] If the wholesale market revenues that Duke receives are less than the cost-based rate that Duke must pay to OVEC under the ICPA, then Duke would collect the difference from its distribution customers through the PSR.[42] Conversely, if the wholesale revenues are greater than the cost-based rate that Duke must pay to OVEC, then Duke would provide a credit to its distribution customers through the PSR. Under either of these scenarios, Duke is made whole for the amount of money it is required to pay OVEC.

As more fully explained in this brief, the Commission should not indulge Duke's PSR request. Specifically:

- The PSR is contrary to Ohio Law;
- The PSR is contrary to Federal Law;
- The PSR is contrary to the Stipulation and Order in Duke's prior ESP proceeding that requires Duke to transfer its interests in OVEC;

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[40] As a 9% owner of OVEC, Duke effectively pays a cost-based rate to itself under the ICPA.

[41] Duke Ex. 6 at 16.

[42] *Id.*

- The PSR provides no hedge to Duke customers; rather it insulates Duke's shareholders against market risk;
- Duke's internal projections of the impact of the PSR are flawed, causing Duke to dramatically overstate the benefits and understate the risk of the PSR to customers;
- The PSR would leave the Commission with limited oversight as to the OVEC costs that can be passed on to customers.

1. The PSR is Contrary to Ohio Law

The Supreme Court of Ohio has indicated that the Commission may approve only ESP provisions authorized by R.C. 4928.143. *In re Application of Columbus Southern Power*, 128 Ohio St. 3d 512, (2011). R.C. 4928.143 provides only two instances in which the Commission may authorize nonbypassable generation-related riders: divisions (B)(2) (b) and (c). Under those two divisions, a nonbypassable charge is available to recover costs associated with generating facilities *under construction or constructed after 2009* that meet additional statutory requirements. The General Assembly's specific directive that a non-bypassable generation-related charge may be authorized under these two sections indicates a lack of authority to authorize such a charge in any other circumstances. The Supreme Court has stated:

> As a general rule of statutory construction, the specific mention of one thing implies the exclusion of another. This principle is especially pertinent where, as in the cases *sub judice*, the statute involved is a definitional provision. Had the General Assembly intended to allow the utilities to recapture other types of expenses through this rate, it would have expanded the definitions.

Montgomery County Bd. of Comn'rs v. Pub. Util. Comm'n of Ohio, 28 Ohio St.3d 171, 175 (1986) (citations omitted). Because the PSR does not pertain to the construction of new generation or otherwise satisfy the criteria of divisions (b) and (c), it cannot be lawfully authorized in an ESP. Therefore, the Commission should reject it.

Further, the Commission must reject the PSR because it violates bedrock principles of Ohio law and policy, which prohibit subsidies to the generation portion of the business. "Pursuant to R.C. 4928.03 and 4928.05, electric generation is an unregulated, competitive retail electric service, while electric distribution remains a regulated, noncompetitive service pursuant to R.C. 4928.15(A)." *Industrial Energy Users-Ohio v. Pub Util. Comm'n*, 2008-Ohio-990 at ¶6. Thus, generation is no longer subject to the Commission's economic regulation.

Unbundling regulated and unregulated services "ensured that distribution service would not subsidize the generation portion of the business. In short, each service component was required to stand on its own." *Migden-Ostrander v. Pub. Util. Comm'n*, 102 Ohio St.3d 451. 453 (2004). These regulatory principles are codified in R.C. 4928.02(H). That section prohibits "the recovery of any generation-related costs through distribution or transmission rates." To that end, the Commission has held that R.C. 4928.02(H) prohibits nonbypassable charges that are designed to collect generation-related costs.[43]

[43] *In the Matter of the Application of Ohio Power Company for Approval of the Shutdown of Unit 5 of the Philip Sporn Generating Station and to Establish a Plant Shutdown Rider*, Case No. 10-1454-EL-RDR, Finding and Order at 19 (Jan. 11, 2012).

The PSR is undeniably linked to Duke's ownership interest in two generating assets. It would require Ohio customers to guarantee Duke's investment in these resources. As stated by IGS witness Haugen:

> If OVEC is uneconomic, the PSR would require Duke's distribution customers to subsidize Duke's out-of-market interest in OVEC and its associated purchased power agreement for wholesale generation service. Conversely, if the PSR were a credit, the PSR would require a competitive service to subsidize distribution customers . . . either of the above scenarios would run afoul of the law.[44]

In short, it is unlawful for the Commission to ensure that distribution customers provide out-of-market compensation to support Duke's uneconomic investment in generation resources.

2. The PSR is Contrary to Federal Law

The Commission should not approve the PSR because it would require the Commission to regulate the wholesale price of capacity and energy and undermine Reliability Pricing Model ("RPM") approved by the FERC. [45] The Federal Courts have struck down arrangements in other states that are very similar to the one Duke wishes to enter into under the PSR. The Federal circuit courts have held that such arrangements undermine FERC's authority to establish wholesale competitive pricing mechanism and thus are preempted by Federal Law.

PJM's RPM sets a uniform price for electric generation at various locations throughout PJM. Such prices are set by competitive processes. In the Order approving

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[44] IGS Ex. 12 at 7.

[45] "A wealth of case law confirms FERC's exclusive power to regulate wholesale sales of energy in interstate commerce, including the justness and reasonableness of the rates charged." *PPL Energy Plus v. Nazarian*, Case Nos. 13-2419, 13-2424 at 7 (4^{th} Cir. Ct. Appeals) (2014) (citing Schneidewind v. ANR Pipeline Co., 485 U.S. 293, 300 (1988)).

the RPM ("RPM Order"), FERC stated "in a competitive market, all suppliers will be paid the same price."[46] "In a competitive market, prices do not differ for new and old plants or for efficient and inefficient plants."[47] Thus, RPM rewards efficient sellers and drives inefficient sellers out of business.[48] The RPM Order also specifically holds that cost-of-service regulation is contrary to RPM because it does not provide incentives to minimize costs or maximize revenue, noting that "sellers (of cost based generation) have far weaker incentives to minimize costs under cost-of-service, because regulation forces a seller to reduce its prices when the seller reduces its cost."[49]

Moreover, the purpose of *uniform* locational electric pricing is to support infrastructure investment throughout PJM's footprint.[50] The uniform clearing price is intended to provide a transparent price signal three years in advance in order for market participants to respond.[51]

Indeed, Federal Courts have held that arrangements such as the PSR undermine the RPM construct and are preempted by federal law. The Third and Fourth Circuit recently determined state commissions cannot approve purchased power contracts between distribution utilities and wholesale generators that ensure that the generator receives a set amount of compensation that differs from that which the generator can

[46] ER05-1410-001 Entry 32 Order Denying Rehearing and Approving Settlement Subject to Conditions (Dec. 22, 2006).

[47] RPM Order at 57.

[48] *Id.*

[49] *Id.*

[50] Tr. Vol. XVI at 4276-77.

[51] IGS Ex. 14 at 3 (containing PJM Manual 18).

obtain from market-based wholesale revenues.[52] The Circuit Courts aptly named such arrangements "contracts for differences" because the contracts require the distribution utility to pay the difference between the wholesale market revenue and the cost-based revenue requirement.[53]

As the Third Circuit stated, a contract for difference is unlawful because it "supplements what the generators receive from PJM with an additional payment financed by payments from electric distribution companies . . . . Because electricity distribution companies do not participate in PJM's capacity auction, and because PJM still pays generators the auction clearing price [the contract for differences] artfully steps around the capacity transactions facilitated by PJM." *PPL Energy Plus v. Soloman*, p. 28 Case No. 13-4330 (3rd Cir.) (Sep. 11, 2014). The Court further stated that "[I]f FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject." *Id.* (quoting *Miss. Power & Light Co. v Miss. ex rel. Moore*, 487 U.S. 354, 377 (1988) (Scalia, J., concurring)).

The PSR is no different than the contracts for differences that were rejected by the Third and Fourth Circuits. The PSR compensates Duke for the difference between OVEC's market-based wholesale revenues and a cost-based revenue requirement. Such arrangements replace the amount of compensation that the market participant is intended to receive under RPM.

[52] *PPL Energy Plus v. Nazarian* at 7-10 ("The scheme thus effectively supplants the rate generated by the auction with an alternative rate preferred by the state . . . . The fact that it does not formally upset the terms of a federal transaction is no defense, since the functional results are precisely the same."); *PPL Energy Plus v. Solomon* at 24-29, Case No. 13-4330 (3rd Cir. Ct. Appeals) (2014).

[53] *PPL Energy Plus v. Nazarian* at 6; *PPL Energy Plus v. Soloman* at 24.

Moreover, Duke's witness, Ken Jennings, conceded that the PSR may impact the price of capacity produced by RPM.[54] By approving the PSR, the Commission would guarantee that Duke bids OVEC's capacity into PJM through 2040—regardless of the economics of that decision.[55] And, as IGS witness Haugen testified, the PSR provides no incentive for Duke to bid OVEC into the energy and capacity markets like a rational market participant because Duke is already guaranteed cost recovery.[56]

Accordingly, because the PSR would require the Commission to regulate wholesale prices exclusively within the jurisdiction of FERC, the Commission should reject it.

3. The ESP Order Requires Duke to Transfer its Interest in OVEC

Duke's proposal to guarantee cost recovery of the OVEC units is also in conflict with Duke's ESP Stipulation in case 11-3549-EL-SSO, *et al.* The Stipulation provides:

> that the Commission's approval of the stipulation will constitute approval of Duke's Third Amended CSP and **full legal corporate separation**, as contemplated by Section 4928.17(A), Revised Code, such that the transmission and distribution assets of Duke will continue to be held by the distribution utility and **all of Duke's generation assets** will be transferred to an affiliate.[57]

The OVEC generating assets (Clifty Creek and Kyger Creek) are not specifically identified in the Stipulation, as no specific assets were listed in the Stipulation. But Duke cannot deny that it was required to transfer those assets because the stipulation

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[54] Tr. Vol XVI at 4264, 4271, 4284-87.

[55] Tr. Vol. XVI at 4270-71. *See also id.* at 4268-69.

[56] Tr. Vol XV at 4080, 4088; 4094-96. *See also* RPM Order at 57.

[57] *In the matter of the application, motion for protective order and memorandum in support of Duke Energy Ohio 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 Nos. 11-3549-EL-SSO, *et al.*, Opinion and Order at 45 (Nov. 21, 2011) (emphasis added).

also required Duke to achieve full legal corporate separation, as required by R.C. 4928.17(A). R.C. 4928.17(A)(1), states that Duke's corporate separation plan provide at a minimum "**provision of the competitive retail electric service** or the nonelectric product or service **through a fully separated affiliate** of the utility (emphasis added)."

Thus, the Stipulation required Duke, the EDU, to cease providing competitive retail electric services and to operate solely as a distribution utility in the business of providing non-competitive service. The PSR does not relate to non-competitive service—it relates to generation service, which is a competitive service under Ohio law.

Moreover, the Stipulation required Duke to implement "separate accounting requirements" for services other than Duke's non-competitive service. The PSR would, however, allow Duke to avoid that requirement by continuing to account for OVEC-related costs and revenues on the books of the EDU.

Duke's understanding of the 11-3549-EL-SSO Stipulation is further reinforced by statements attributed to it in OVEC Board of Directors Meeting Minutes which evidence that Duke (among other Ohio utilities) represented to OVEC that they were required to transfer their entitlement or otherwise request permission to further alter their corporate separation plans.[58]

Finally, the record and the language of the ICPA indicate that Duke has three avenues through which it could transfer its interest in its OVEC entitlement. Specifically, under the ICPA Duke can transfer its interest in OVEC either 1) to an affiliate with a proper credit rating, 2) to a third party with a proper credit rating and 3) to any party

[58] OCC Ex. 16.

without a proper credit rating, if approved by the other owners of OVEC.[59] And, under two of these avenues, the other sponsoring companies are powerless to stop Duke from transferring its entitlement, so long as the identified transferee has a sufficient credit rating.[60] OVEC's CFO, John Brodt, confirmed the same during his testimony.[61]

In summary, Duke is obligated to transfer its generating assets and entitlements out of the EDU to achieve full legal corporate separation as contemplated by R.C. 4928.17(A). And Duke cannot identify any legitimate obstacles that would prevent it from complying with its obligation.

4. The PSR is Not a Hedge for Customers

In addition to the various legal concerns identified above, the PSR simply will not provide any value for customers. Duke claims that the PSR is a hedge for customers against volatile electric prices. In reality, the PSR is a hedge to guarantee Duke's earnings.

Although there is an entire division within Duke Energy Corporation devoted to managing Duke's portfolio of generating assets,[62] Duke chose to not file projections of the rate impacts of the PSR. Rather, it simply made the blanket statement within the testimony of witnesses Wathen and Henning that the PSR is a hedge—claiming that when energy prices are low, it will be a charge, but when they are high, it will be a

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[59] IGS Ex. 12 at 16-18; Tr. Vol. V at 1194-1195; *see also* IEU-Ohio Ex. 5 at sections 1.0115, 9.181, 9.182, and 9.183 (containing the Amended and Restated Intercompany Power Agreement).

[60] IGS Ex. 12 at 16-18.

[61] Tr. Vol. V at 1208-10, 1234-1235.

[62] See Tr. Vol. IX at 2498.

credit. But neither witness performed any analysis to test their claim.[63] Thus, Duke has provided no evidence to justify its claim. And as the Supreme Court of Ohio has stated, "[r]uling on an issue without record support is an abuse of discretion and reversible error."[64]

Given the lack of evidence in Duke's case to identify the potential impact of the PSR or to support Duke's hedge theory, Interveners attempted to pull this information out of Duke through discovery. Not surprisingly, Duke produced a PSR cash flow analysis which projects that PSR will be a significant charge to customers until at least 2019.[65] Indeed, even Duke's projections (which as discussed below overstate the cash flow from OVEC) reveal that the net present value of the PSR would be negative through at least 2024.[66]

In addition to the PSR being a cash flow drain to customers, Duke's cash flow analysis indicated that the PSR is not in fact a hedge. Indeed, Mr. Henning conceded that the PSR would only be a hedge if market prices rise faster than OVEC's cost of production.[67] But, if market prices rise at the same pace, or slower, than OVEC's cost of production, then the PSR would cause customers to experience even more price volatility.[68]

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[63] Tr. Vol. II at 643.

[64] *In re Application of Columbus Southern Power v. Pub. Util. Comm'n Ohio*, 128 Ohio St. 3d 512, ¶ 29 (2011).

[65] IGS Ex. 12 at TH-4.

[66] Sierra Club Ex. 4 at 7-8.

[67] Tr. Vol. I at 223.

[68] Tr. Vol. I at 225-226; see also Tr. Vol. XII at 3398-99.

Further, Duke's own cash flow projection predicts that as market prices [redacted] OVEC's costs.[69] Specifically, Duke projects that there will be a large market price [redacted] as [redacted] carbon regulations coupled with an [redacted] in OVEC's cost of production.[70] Because these [redacted] will lead to no additional margin for the OVEC units, the PSR will *not* credit additional revenues to customers in the face of [redacted]. Thus, based upon Duke's own projections, the PSR does not provide a hedge.

5. Duke's Cash Flow Projections are Flawed and Understate the Cost of the PSR

In addition to the above, Duke's cash flow projections are flawed. And therefore Duke has understated the negative impact of the PSR on customers. As discussed in the Testimony of Joseph Haugen, Duke's cash flow projections rely on many suspect assumptions including overstated generation output, overstated unforced capacity levels, suspect future energy price projections, and it ignores the risk that OVEC will be excluded from the PJM markets.[71]

Initially, the cash flow analysis appears to overstate OVEC's generation output. Duke projects that OVEC's output will [redacted] by [redacted] in the 2019-2020 time frame.[72] This projected [redacted], according to Duke witness Zhang, is driven primarily by the assumption that wholesale energy prices will [redacted] as a result of carbon

[69] Tr. Vol IX CONFIDENTIAL at 2517-18.

[70] IGS Ex. 12 at 13-14 and TH-7.

[71] IGS Ex. 12 at 10-16.

[72] IGS Ex. 12 at TH-4.

regulations.[73] But As IGS Witness Haugen testified, the EPA's proposed carbon emissions regulations are intended to (and are likely to) decrease the output of coal fired generation, such as the OVEC generation units.[74] Thus, Duke's projections are fundamentally flawed inasmuch as it is highly illogical and unlikely that regulations that are designed to [redacted] the output of carbon-intensive resources would actually have the [redacted].[75] Duke witness Dougherty testified that if OVEC's generation output does not [redacted] as projected, the PSR will remain cash flow negative through 2024.[76]

Moreover, even if carbon regulations are not enacted, IGS witness Haugen correctly notes that carbon regulations are not dispositive of the economics of OVEC. Duke has projected that market prices will [redacted] in [redacted] as a result of carbon regulations. And this price [redacted] will cause OVEC to dispatch [redacted]—and then become profitable. Given this correlation, if carbon regulations are not enacted, market prices will not [redacted] as expected, OVEC will not be dispatched [redacted]—and then it will continue to be cash flow negative.[77] Therefore, whether carbon regulations go into effect or not, Duke's estimates on OVEC's output are likely to be highly overstated.

Duke's cash flow projections also reflect overstated capacity revenue. The overstatement occurs as a result of Duke's utilization of a [redacted] Megawatt Day UCAP

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[73] Tr. Vol. XI CONFIDENTIAL at 3030.

[74] IGS Ex. 12 at 14-15 (citations omitted).

[75] Duke clearly also agrees that carbon regulations are likely to negatively impact its coal plants, given that it testified to the Kentucky Commission that its East Bend coal plant may not have a useful life longer than 10 years—which is 15 years shorter than Duke proposes to establish the PSR. IGS Ex. 2 at 20; IGS Ex. 3 at DR-01-010; Tr. Vol. I at 239.

[76] Tr. Vol. IX CONFIDENTIAL 2519.

[77] Tr. Vol. XV CONFIDETNIAL at 4136-37.

projection.[78] It is noteworthy that Duke cleared less unforced capacity in the last two base residual auctions than the [redacted] Megawatt Day UCAP projected by Duke.[79] Moreover, Duke has indicated that OVEC is currently implementing a plan to reduce operations and maintenance expenses and to defer capital expenditures.[80] John Brodt, OVEC's Chief Financial Officer, testified that these deferred capital expenditures will increase the likelihood that OVEC's forced outage rate will increase in the future.[81]

Given OVEC's historical forced outage rate and risk of future forced outages, IGS witness Haugen identified that "a more appropriate unforced capacity level would be closer to [redacted], if not lower."[82]

Moreover, the OVEC units (Clifty Creek and Kyger Creek) are external resources (not located in PJM). Thus, there is the risk that—sometime between now and 2040—the OVEC units could be prohibited from participating in the PJM capacity and energy markets.

The Clifty Creek and Kyger Creek plants do not participate in the base residual auction as typical capacity resources. As discussed by IGS witness Haugen, because the OVEC generating units are PJM resources (they are external resources) "there is a risk that, at some point, they may not be permitted to participate in the base residual auction (or PJM energy markets) and receive capacity compensation. The removal of

[78] Ex. TH-5 (containing Duke's response to OCC INT-9-169).

[79] IGS Ex. 12 at 11-12 and TH-5.

[80] Tr. Vol. V at 1435-36, 1446; *see also* IGS Ex. 12 at 12,16.

[81] Tr. Vol. V at 1446. *See also* IGS Ex. 12 at 12,16.

[82] IGS Ex. 12 at 12.

this revenue stream would negatively impact the cash flow of these plants, because MISO, the most likely alternative market, does not have a comparable capacity market and generally lower energy prices."[83]

Mr. Haugen's concerns are buttressed by the fact that the existing PJM rules limit the amount of external resources that may be granted exceptions from PJM's Capacity Import Limits. According to PJM Manual 18, "*The total MW quantity of exceptions* [to the Capacity Import Limits] granted for a Delivery Year in an external source zone plus the Capacity Import Limit for the external source zone *may not exceed the total MW quantity of confirmed Network External Designated Transmission Service on such interface*."[84]

Finally, in evaluating the PSR, the Commission should consider that Duke has not been completely forthcoming regarding the potential liability that may be assigned to customers in the future. As discussed by IGS witness Haugen, there is a significant "balloon payment" that will come due in 2040. Duke's share of this amount would be approximately $[redacted] in increased costs.[85] Thus, if the Commission approves the PSR, it will place customers (or their children) on the hook for [redacted] costs that OVEC projects will come due far down the road.

6. The Commission Will Have Limited Authority to Audit OVEC-Related Costs

If the Commission approves the PSR, it will have little authority to effectively regulate the amount of costs that OVEC charges to Duke. As Duke witness Wathen

[83] *Id.*

[84] IGS Ex. 14 at 14-15; *see also* Tr. XVI at 4252-53 (emphasis added).

[85] IGS Ex. 12 at 15-16 (citing Ex. TH-9).

testified, if the Commission evaluates the prudence of OVEC's costs, "I do not believe the PUCO would have the authority to interject what we pay [OVEC] . . . it would be FERC preempt[ed] from doing that."[86] While the Commission may have authority to disallow costs for imprudence, as a practical matter, such a decision would only reduce the return on equity of Duke, the EDU.[87]

Because Duke is an EDU, a large disallowance could potentially bankrupt Duke or trigger a request for an emergency rate case. For this reason, Dr. Choueiki agreed that the right to audit the PSR may provide little benefit.[88] Thus, the right to audit costs that OVEC charges to Duke is an illusory and ineffectual tool that is unlikely to safeguard customers. As such, the Commission should reject the PSR.

7. If the Commission Approves the PSR, it Should be Bypassable and Limited to OVEC.

IGS adamantly opposes the PSR. But, if it is approved, it should be bypassable and only for the duration of Duke's ESP. While a PSR of any form would be anticompetitive, a bypassable PSR would at least not require all distribution customers to subsidize a competitive service and it would not send as negative of a signal to other generators in the market.[89] Moreover, it would preserve customers' right to choose—as is their right under Ohio law.

Further, there is no reason why the Commission should authorize Duke to include additional purchase power agreements in the PSR. Duke has already indicated

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[86] Tr. Vol. III at 645.

[87] *Id.* at 646.

[88] Tr. Vol. XII at 3400-01.

[89] IGS Ex. 12 at 19.

that it has transferred its other generating assets (with the exception of Beckjord). And, its parent/affiliate has entered into a definitive purchase agreement to sell the remaining generating assets to Dynegy.[90] Because Duke and its Ohio-based affiliates will not own generating assets, there is no reason to leave the door open for Duke to include additional purchased power agreements in the future.

III. CONCLUSION

For the reasons stated herein, IGS requests the Commission reject the proposals in Duke's Application which will undermine competition. Specifically IGS requests that the Commission:

- Reject the PSR outright and order Duke to transfer its OVEC generation assets;
- Reject Duke's proposal to prohibit CRES providers from using the bill ready function to place non-commodity charges on the EDU bill; instead, the Commission should make the determination that CRES providers can bill for non-commodity charges on the EDU bill;
- Order that Duke is required unbundle the costs required to support the SSO and immediately initiate a proceeding to determine the costs that must be unbundled from the SSO.
- Adopt the recommendations contained in the Post-Hearing Brief of the Retail Energy Supply Association.

[90] In fact, Duke has agreed to include to close the Midwest Commercial Generation group—which has historically operated and dispatched Duke's generating assets—after the Dynegy sale. Thus, it appears that Duke is ill-equipped to manage even its OVEC entitlement. Tr. Vol. X at 2885-86.

IGS appreciates the opportunity to participate in these important proceedings and to contribute to the development of the record.

Respectfully submitted,

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