

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of The Application of Duke)
Energy Ohio, Inc., for an Adjustment to) Case No. 21-618-GA-RDR
the Capital Expenditure Program Rider)
Rate)

INITIAL BRIEF OF INTERSTATE GAS SUPPLY, INC.

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I. INTRODUCTION

Interstate Gas Supply, Inc. (“IGS”) respectfully urges the Public Utilities Commission of Ohio (“PUCO” or “Commission”) to direct Duke Energy Ohio, Inc. (“Duke”) to remove all stock-based and earnings-related incentive compensation from its Capital Expenditure Program Rider (“CEP”). Duke should not be permitted to include these financial performance incentives in its 2019 and 2020 CEP revenue requirement because it has not provided any evidence to support the proposition that these costs are related to improving the quality of service, efficiency, or safety of its natural gas distribution business. R.C. 4929.111. The record also contains no evidence to suggest that the stock-based and earnings-related performance incentives at issue here are anything other than a financial inducement correlated with Duke’s bottom line and meeting shareholder interests. Indeed, the Commission has previously recognized that these expenses are unrecoverable from ratepayers.¹

¹ See e.g., *In the Matter of the Application of Duke Energy Ohio, Inc. for Recovery of Program Costs, Lost Distribution Revenue, and Performance Incentives Related to Its Energy Efficiency and Demand Response Programs*, Case Nos. 16-664-EL-RDR et al., Finding and Order at 6 (May 15, 2019).

Duke argues that it is authorized to recover the financial performance incentives at issue in *this case* pursuant to the Stipulation and Recommendation (“Stipulation”) approved by the Commission in Case No. 19-0791-GA-ALT;² however, its argument fails because that Stipulation was submitted for the exclusive purpose of resolving Case No. 19-791-GA-ALT, which placed an emphasis on the CEP expenditures and related assets for the five-year period described in Duke’s Application. Despite Duke’s arguments to the contrary, that Stipulation does not allow Duke to sidestep Ohio law or longstanding Commission precedent by using ratepayer funds to award financial incentives to its employees for meeting the interests of shareholders.

For the reasons set forth below, the Commission should find that Duke’s financial performance incentives are not properly recoverable and direct Duke to remove all stock-based and earnings-related performance incentives from its CEP Rider.

II. BACKGROUND

On April 23, 2021, Duke filed an application seeking approval, among other things, to continue to capitalize incentive pay through its Capital Expenditure Program Rider (“CEP”). Specifically, Duke seeks to recover stock-based and earnings-related financial incentives granted to its employees and executives via Short-Term and Long-Term Incentive Plans. Blue Ridge Consulting services performed an audit of Duke’s application in this case and made several adjustments and recommendations. Commission Staff (“Staff”) adopted the adjustments and recommendations contained in that audit report in

² Duke Energy Ohio Exhibit 3 at 19.

its entirety.³ Although the auditor acknowledged that Duke seeks to recover stock-based and earnings-related performance incentives in this proceeding, it made no recommendation as to whether those incentives should be removed from Duke's CEP.

Instead, the audit report noted that the Commission approved a Stipulation and Recommendation in Case No. 19-791-GA-ALT that authorized Duke to continue capitalize incentive pay using its existing accounting policies and procedures that follow generally accepted accounting principles.⁴ That Stipulation was approved by the Commission over the objections raised by the auditor and, by extension, Staff⁵ regarding Duke's capitalization of incentive pay. There, the auditor concluded that "the portion of Duke's incentive compensation expense that is directly attributable to meeting financial performance goals, such as net income or earnings per share, is not properly recoverable from ratepayers" due, in part, to the fact that "payouts for financial goal achievement can be distinguished from incentive compensation that is measured for improving the quality of service, efficiency, or safety goals."⁶ The auditor also concluded that the cost of Duke's stock-based compensation programs is unrecoverable because those costs are "incurred to improve the Duke Energy financial performance for the benefit of shareholders, not to improve customer service or meet other regulated utility service requirements." *Id.*

³ Staff Exhibit 2 at 4.

⁴ Staff Exhibit 1 at 75.

⁵ IGS Energy Exhibit 2 at 7.

⁶ IGS Energy Exhibit 1 at 9-9.

Due to the Commission’s ruling in the 19-0791-GA-ALT case, however, the auditor indicated that it limited its review in this proceeding to the amount of incentive pay included in Duke’s application to ensure that it is consistent with what was authorized under the Stipulation.⁷ As part of that review, the auditor asked Duke to identify by amount and account, the amounts of incentive compensation and /or stock-based compensation included in the CEP expenditures for December 31, 2019 and December 31, 2020. *Id.* The auditor also asked Duke to identify and quantify incentive compensation by “any amounts of incentive and/or stock-based compensation *that relates to the Company’s stock price, dividends or financial goals included in the CEP.*”⁸ (emphasis added).

Based on the responses Duke provided, the auditor found that as to the former question Duke increased the percentage related to earnings for the allocated incentives by approximately 10% since the last audit was performed in Case No. 19-0791-GA-ALT. *Id.* As to the latter question, the auditor found that the earnings-based incentive compensation that Duke allocated to capital “spiked” in 2019 by approximately \$45 million from the prior year. *Id.* For those reasons, the auditor recommended that “the capitalization and recovery of stock-based and earnings-related incentive compensation should be monitored to ensure the amount does not significantly increase.” *Id.*

Although the auditor offered no opinion as to whether Duke’s earnings-based and stock-based incentives included in its CEP Application in this case are properly

⁷ Staff Exhibit 1 at 75.

⁸ *Id.* at 76.

recoverable, there is also no evidence in the record to distinguish the financial performance incentives in the 19-0791-GA-ALT case from those at issue here. It follows then that had the auditor and/or Staff reviewed Duke's application independently, either party likely would have arrived at the same conclusion it did in in Case No. 19-791-GA-ALT (i.e., Duke's financial performance incentives are tied to its bottom line and therefore should not be recovered from ratepayers). Accordingly, the Commission should require Duke to remove the financial performance incentives from its CEP.

III. ARGUMENT

A. Duke's Proposed Recovery of Financial Performance Incentives Is Contrary to Ohio Law and Commission Precedent.

To recover the costs associated with the implementation of a capital expenditure program, a natural gas utility must demonstrate that its CEP is consistent with the utility's obligation to furnish necessary and adequate services and facilities. R.C. 4929.111. To that end, the expenses that Duke seeks to recover should provide some measurable benefit to ratepayers by improving the quality, efficiency, or safety of its natural gas distribution service. Financial performance incentives that are correlated to a utility's bottom line and meeting shareholder interests do not achieve those goals.

Indeed, financial performances incentives, which the Commission defines as including "performance awards, restricted stock units, executive incentives, earnings per share, shareholder returns, stock purchases, and/or other financially motivated incentives *tied to the [utility's] bottom line*,"⁹ are completely unrelated to the utility's obligation to furnish

⁹ See *In the Matter of the Application of Duke Energy Ohio, Inc. for Recovery of Program Costs, Lost Distribution Revenue, and Performance Incentives Related to Its Energy Efficiency and Demand Response Programs*, Case Nos. 16-664-EL-RDR et al., Finding and Order at 6 (May 15, 2019) (citing *In the Matter of*

necessary and adequate natural gas distribution services and facilities and, therefore, should not be recovered from ratepayers under R.C. 4929.111. (emphasis added).

Moreover, longstanding Commission policy prohibits utilities from charging ratepayers for financial incentives. The Commission has previously determined that “to the extent that a public utility awards financial incentives to its employees for achieving financial goals, shareholders are the primary beneficiary and, therefore, that portion of the incentive compensation should not be recovered from ratepayers.”¹⁰ On several occasions, the Commission has excluded financial performance incentives from utility expense after it determined that those costs were correlated with the utility’s bottom line.¹¹ The policy supporting those decisions is clear: Financial inducements distributed to utility employees for achieving financial goals only serve the interests of the utility’s shareholders and provide no benefit to the consumers who pay for those charges.

Here again, Duke has failed to provide any evidence in the record to suggest that the financial performance incentives at issue here are any different from those that the auditor and Staff flagged for removal in Case No. 19-0791-GA-ALT. Given Duke’s contention

the Application of Duke Energy Ohio, Inc. for recovery of program costs, lost distribution revenue and performance incentives related to its Energy Efficiency and Demand Response Program, Staff Report and Recommendation at 2 (Sept. 11, 2018).

¹⁰ *In the Matter of the 2016 Review of the Distribution Investment Rider Contained in the Tariff of the Ohio Power Company; In the Matter of the 2017 Review of the Distribution Investment Rider Contained in the Tariff of the Ohio Power Company*, Consolidated Case Nos. 17-38-EL-RDR and 18-230-EL-RDR, Opinion and Order at ¶47 (Jun. 17, 2020).

¹¹ See e.g., *In the Matter of the Application of Duke Energy Ohio, Inc. for Recovery of Program Costs, Lost Distribution Revenue, and Performance Incentives Related to Its Energy Efficiency and Demand Response Programs*, Case Nos. 16-664-EL-RDR et al., Finding and Order at 6 (May 15, 2019); *In the Matter of the Application of Duke Energy Ohio, Inc. for Recovery of Program Costs, Lost Distribution Revenue, and Performance Incentives Related to Its Energy Efficiency and Demand Response Programs*, Case No. 18-397-EL-RDR, Finding and Order at 5 (Jul. 31, 2019); and OCC Exhibit 2 at pp 14-16.

that the Stipulation approved in the 19-0791-GA-ALT case authorizes the continued recovery of financial performance incentives in this proceeding, there is no reason to think that Duke's current stock-based and earnings-related incentives should not also be characterized as payouts for meeting financial performance goals for the benefit of Duke's shareholders. Therefore, because these incentives are most likely unrelated to Duke's obligation to furnish necessary and adequate services and facilities, the Commission should order Duke to remove those charges from its CEP in accordance with Ohio law and Commission precedent.

B. Duke's Proposed Recovery of Financial Performance Incentives in This Case Should be Reviewed De Novo.

Duke's argument that the Stipulation in Case No. 19-791-GA-ALT contemplates the future treatment of earnings-related capitalized incentives with regard to its CEP in this case is unavailing.¹² To support its claim, Duke cites to the express language found on Page 3 of the Stipulation, which provides in relevant part, "These are the rates calculated in the Larkin & Associates Audit Report dated May 11, 2020 excluding adjustments to earnings-related incentives, **which will continue to be capitalized, and included in Rider CEP . . .**"¹³ Duke's argument fails for two reasons.

As mentioned above, the Stipulation was submitted for the exclusive purpose of resolving Case No. 19-791-GA-ALT with an emphasis on the CEP expenditures and related assets for the period of January 1, 2013 through December 31, 2018.¹⁴ The CEP

¹² Duke Energy Ohio Exhibit 3 at 21.

¹³ *Id.* at pp 20-21.

¹⁴ IGS Energy Exhibit 1 at 2-2.

Application at issue here places an emphasis on the CEP expenditures and related assets for two completely different time periods (i.e., January 1, 2019 through December 31, 2019; and January 1, 2020 through December 31, 2020).¹⁵ Despite Duke's argument to the contrary, the Stipulation in Case No. 19-791-GA-ALT cannot bind the Commission for a time period beyond that which the agreement seeks to resolve. Thus, any audit or review of Duke's current financial performance incentives should have been performed independent of the Stipulation Duke filed in the prior case.

Second, the negotiated provision on Page 3 of the Stipulation that Duke relies on to support its claim must be read differently when reviewing the evidentiary record in the 19-079-GA-ALT case as a whole. IGS was not a party to the Stipulation that was filed and approved in that case; thus, the Stipulation does not bind IGS. Moreover, the audit report demonstrates that Staff expressly recommended that Duke remove the earnings-based portion of incentive compensation and stock-based compensation from its CEP.¹⁶ Such prior statements are admissions of the Staff's position on this matter and cannot be ignored by the Commission in determining this matter.

Using that audit report as a guide, it is reasonable to conclude that the purpose of the negotiated provision that Duke cited is to make clear that the signatory parties have simply agreed—over the auditor and Staff's recommendation—to continue to capitalize those financial incentives as Duke originally proposed in its application. There is no language in the Stipulation to suggest that those incentives are intended to be included in Duke's

¹⁵ Duke Energy Ohio Exhibit 1 at 2.

¹⁶ IGS Energy Exhibit 1 at 2-15.

CEP on an ongoing basis, and Duke should not be entitled to reap the benefits of the auditor's and Staff's oversight in this case by charging Ohio ratepayers for incentive payments that are potentially distributed to out-of-state executives¹⁷ and employees.

Based on the foregoing, IGS respectfully requests that the Commission direct Duke remove all incentive-based and stock-based compensation included in Duke's CEP application in this case.

IV. CONCLUSION

The incentive payments that Duke seeks to capitalize are unlikely to provide any measurable benefit to ratepayers and should therefore be removed from the CEP.

Respectfully submitted,

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¹⁷ IGS notes that Duke Energy Ohio, Inc.'s parent company, Duke Energy, is headquartered in Charlotte, North Carolina.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing *Initial Brief of Interstate Gas Supply, Inc.* was served this 10th day of March 2022 via electronic mail upon the following:

/s/ Michael Nugent

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