THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Review of the Reconciliation Rider of Duke Energy Ohio, Inc.	**Case No. 20-167-EL-RDR**

OPINION AND ORDER

Entered in the Journal on September 6, 2023

I. Summary

{¶ 1} The Commission approves and adopts the audit performed by London Economics International LLC of Duke Energy Ohio, Inc.'s Price Stabilization Rider for the period of January 1, 2019 to December 31, 2019, consistent with the findings within this Opinion and Order.

II. Procedural History

{¶ 2} Duke Energy Ohio, Inc. (Duke or the Company) is an electric distribution utility and a public utility as defined in R.C. 4928.01(A)(6) and R.C. 4905.02, respectively. As such, Duke is subject to the jurisdiction of this Commission.

{¶ 3} R.C. 4928.141 provides that an electric distribution utility (EDU) shall provide consumers within its certified territory a standard service offer (SSO) of all competitive retail electric services necessary to maintain essential electric services to customers, including a firm supply of electric generation services. The SSO may be either a market rate offer in accordance with R.C. 4928.142 or an electric security plan (ESP) in accordance with R.C. 4928.143.

{¶ 4} On May 29, 2014, Duke filed its third ESP application (ESP III). On April 2, 2015, the Commission issued an Opinion and Order modifying and approving Duke's ESP III application for the period of June 1, 2015, through May 31, 2018. *In re the Application of Duke Energy Ohio, Inc. for Authority to Establish a Std. Serv. Offer in the Form of an Electric*

Security Plan, Case No. 14-841-EL-SSO, et al. (*ESP III Case*), Opinion and Order (April 2, 2015). As part of the approved ESP III, the Commission authorized the establishment of the Price Stabilization Rider (PSR) as a non-bypassable and zero-placeholder rider for the term of ESP III.

{¶ 5} Under the PSR, Duke was authorized to provide to customers the net benefit of all revenues accruing to the Company because of its ownership interest and contractual entitlement in the Ohio Valley Electric Corporation (OVEC), excluding all costs associated with said entitlement. The Commission stated that implementation details for the PSR would be determined in a future proceeding. OVEC was originally created in 1952 to assist the United States government to enrich uranium and two large electric generating facilities were built by OVEC to support the federal government's uranium nuclear fuel enrichment project: Clifty Creek and Kyger Creek stations. Duke is a nine percent owner of OVEC, and a party to the Amended and Restated Inter-Company Power Agreement (ICPA). The original power agreement with the federal government ended in 2003 and all of the output of the OVEC-owned plants essentially reverted to the co-sponsors under the ICPA. The ICPA, as approved by the Federal Energy Regulatory Commission (FERC), sets the contracting parties' rights and obligations. The ICPA became effective in 2011 and extends to 2040.

{¶ 6} On March 31, 2017, Duke filed an application in Case No. 17-872-EL-RDR, et al. (*PSR Case*) to modify and amend the PSR and to seek approval to change its accounting methods.

{¶ 7} On June 1, 2017, Duke filed its fourth and current ESP application (ESP IV) that, among other things, proposed an extension of the PSR beyond May 31, 2019. On December 19, 2018, the Commission issued an Opinion and Order modifying and approving an amended stipulation establishing ESP IV that included revisions to the PSR, resolving issues in the then-pending *PSR Case*. *In re Duke Energy Ohio, Inc.*, Case No. 17-1263-EL-SSO, et al. (*ESP IV Case*), Opinion and Order at ¶ 136-140 (Dec. 19, 2018). As part of ESP IV, the

Commission authorized Duke to recover or credit the net proceeds of selling OVEC energy and capacity into the PJM Interconnection, LLC (PJM) marketplace and OVEC costs through the PSR. *Id*.

{¶ 8} The PSR is subject to quarterly filings starting with the first billing cycle of April 2019. *Id*. at ¶ 140. Additionally, the Commission provided for an annual audit to establish the prudency of all costs and sales flowing through the PSR and to demonstrate that the Company made reasonable efforts to transfer its contractual entitlement under the ICPA.

{¶ 9} By Entry dated February 13, 2020, the Commission directed Staff to issue a request for proposal (RFP) for audit services necessary to assist the Commission with the audit of Duke's PSR for the period of January 1, 2019, through December 31, 2019. On April 8, 2020, the Commission selected London Economics International LLC (LEI) to complete the audit.

{¶ 10} LEI filed its audit report on October 21, 2020.

{¶ 11} By Entry issued November 25, 2020, the attorney examiner invited interested stakeholders to file comments by December 18, 2020, and reply comments by January 8, 2021, as well as required motions to intervene to be filed by December 18, 2020.

{¶ 12} Thereafter, motions to intervene were granted for the Ohio Consumers' Counsel (OCC), The Kroger Co. (Kroger), the Ohio Manufacturers' Association Energy Group (OMAEG), and the Ohio Energy Group (OEG).

{¶ 13} OCC filed initial comments on December 18, 2020. Reply comments were filed by Duke and jointly by Kroger and OMAEG on January 8, 2021. On January 19, 2021, OCC filed additional correspondence.

{¶ 14} The hearing was originally scheduled for November 9, 2021, but was rescheduled for good cause until May 25, 2022. The hearing commenced on that date and was completed on May 31, 2022.

{¶ 15} On July 28, 2022, Staff filed its initial brief. Duke, OEG, OCC, and, jointly, Kroger and OMAEG filed their initial briefs on July 29, 2022. On August 19, 2022, reply briefs were filed by Duke, Staff, OCC, and jointly by OMAEG and Kroger.

III. DISCUSSION

A. Audit Report

{¶ 16} On October 21, 2020, LEI filed its audit report. The purpose of the audit was to establish the prudency of all the costs and sales flowing through the PSR, and to investigate whether Duke's actions were in the best interest of its retail ratepayers. The timeframe LEI was instructed to inspect was January 1, 2019 to December 31, 2019. In order to examine this question, the scope of the audit covered the following topics: (1) providing industry context, (2) reconciling OVEC bills and Duke riders, (3) assessing the accuracy of true ups from 2016 to 2019, (4) examining the prudency of OVEC's disposition of energy and capacity, (5) assessing the prudency of fuel and variable costs incurred, (6) examining the prudency of capital expenses, (7) reviewing environmental compliance activities, and (8) reviewing power plant performance. (Staff Ex. 1 at 1.)

{¶ 17} LEI performed its audit based on information requested from Duke, primarily via formal data requests and publicly available data, such as OVEC annual reports and other public sources of data for context and establishing benchmarks. The formal requests were made between May 2020 and September 2020, after which LEI conducted numerous conference calls and email exchanges. No in-person interviews or site visits were conducted because of COVID-19 safety protocols, but LEI did conduct one virtual site visit to inspect the environmental controls at the OVEC plants. (Staff Ex. 1 at 8-9.)

{¶ 18} Regarding Duke's true-up process for Rider PSR, LEI determined that Duke had done its work accurately and timely. LEI recommended that, going forward, Duke should only use more recent estimates for annual sales when estimating costs for the riders. (Staff Ex. 1 at 9.)

{¶ 19} LEI determined that Duke's fixed cost components were billed correctly. (Staff Ex. 1 at 9.) LEI questioned the payment per common share in the ICPA, called "Component (D)" in the OVEC bill, which LEI noted was a small part of the monthly bill but a substantial part of net profits earned from OVEC. However, LEI did not recommend any changes to Component (D). (Staff Ex. 1 at 28.)

{¶ 20} LEI also reviewed the disposition of OVEC's energy and capacity. Capacity offers were considered prudently formulated. (Staff Ex. 1 at 10.) LEI expressed concern about energy disposition, analyzing OVEC's typical offer of energy on a must-run basis. *Id.* The analysis run by LEI showed that the PJM energy price at which the energy was offered did not even cover fuel and variable costs. LEI did caution that it had not fully evaluated a re-dispatching of OVEC units. However, LEI determined that Duke had developed a prudent strategy for reconsidering the must-run offer strategy and utilizing near-term demand and price forecasts to formulate energy offers. The only recommendation LEI offered was to continue the modification strategy as currently implemented. (Staff Ex. 1 at 54.)

{¶ 21} In assessing the prudency of fuel and variable cost expenses incurred, LEI stated that high coal inventories in 2019 may have indicated a problem with managing contract deliveries versus projected coal burns, though an event in April 2019, perhaps an anomaly, may have been to blame. (Staff Ex. 1 at 10.) Nonetheless, LEI recommended that OVEC update its forecasting methodology and practice, renegotiate contracts with coal suppliers to get better coal prices, and conduct an annual internal audit to improve coal procurement management. (Staff Ex. 1 at 71.) Also, LEI recommended OVEC improve its inventory management processes, and examine its coal burn outlooks and coal delivery policies. (Staff Ex. 1 at 76.)

{¶ 22} Regarding OVEC's capital expenses, LEI largely deemed OVEC to have a well-managed process for planning and executing individual capital projects. But LEI took issue with OVEC's lack of a cap on annual capital expenses. Without such a cap, LEI stated, OVEC could over-invest in its plants without Commission review and approval. LEI recommended that the Commission establish a cap, though LEI acknowledged that OVEC is not allowed to earn a return on capital projects. (Staff Ex. 1 at 10.)

{¶ 23} LEI reviewed OVEC's environmental compliance practices and concluded that OVEC is compliant with currently applicable environmental regulations. (Staff Ex. 1 at 10.) LEI recommended that OVEC continue to closely monitor changes in federal environmental regulations and communicate with its state regulators about the most reasonable cost-version of its environmental controls. (Staff Ex. 1 at 89.)

{¶ 24} LEI reviewed plant performance and concluded that they mostly performed well. LEI identified a couple issues for which it recommended improvements: budgeting at Kyger Creek, and inspections and repairs to the baffle wall at Clifty Creek should be done, LEI determined, to minimize forced outages. (Staff Ex. 1 at 10.)

B. Summary of the Comments

{¶ 25} OCC filed initial comments on December 18, 2020. Reply comments were filed by Duke and jointly by Kroger and OMAEG on January 8, 2021. These comments align with and are expanded upon in each party's position articulated in hearing and in their filed briefs, which are more fully examined below.

C. Evidentiary Rulings

{¶ 26} Ohio Adm.Code 4901-1-15(F) provides that any party adversely affected by a procedural ruling who (1) elects not to take an interlocutory appeal from the ruling or (2) files an interlocutory appeal that is not certified by the attorney examiner may still raise the propriety of that ruling as an issue for the Commission's consideration by discussing the matter as a distinct issue in its initial brief prior to the issuance of the Commission's opinion and order.

{¶ 27} Pursuant to Ohio Adm.Code 4901-1-15(F), OCC appealed in its initial brief two evidentiary rulings which were issued during the hearing: (1) striking portions of testimony from the OCC's witness, Michael Haugh; and (2) excluding the draft audit report of another utility's OVEC rider from evidence. (OCC Initial Brief at 20.) To remedy the alleged errors, OCC asks the Commission to re-open the hearing to allow OCC to obtain the above-listed evidence and conduct reasonable follow-up questioning. (OCC Initial Brief at 21.)

{¶ 28} OCC's first allegation of error is the attorney examiner's striking portions of Mr. Haugh's testimony. OCC argues that this ruling was improper according to Ohio R. Evid. 103(A), which states: "[e]rror may not be predicated upon a ruling which admits or excludes evidence unless a substantial right of the party is affected." In this instance, OCC claims its substantial rights were affected because the stricken testimony addressed a key evidentiary question in the case: whether Staff asked LEI to change the draft audit report in a separate proceeding. (OCC Initial Brief at 21, citing Tr. Vol. II at214.) Beyond identifying a substantial right impacted by the ruling, however, OCC's appeal does not discuss any evidentiary grounds which should have supported the testimony's admissibility.

{¶ 29} Duke responded to this appeal in its reply brief, arguing that Mr. Haugh's testimony contained hearsay and was prejudicial and confusing.

{¶ 30} In ruling on the motion to strike during the hearing, the attorney examiner pointed to the irrelevancy of the testimony related to the current proceedings. (Tr. Vol. III at 427–428.)

{¶ 31} OCC's second assignment of error is the attorney examiner's exclusion of the draft report from evidence. (OCC Initial Brief at 22.) OCC supports this appeal by arguing, once again, that one of its substantial rights was affected by this ruling. Once again, OCC reasons that the draft audit report for another EDU's audit report was critical evidence on the most operative question in the case: whether the auditor's ultimate conclusion was affected by Staff influence. Yet again, OCC offered no argument for the evidentiary grounds supporting the report's admissibility.

{¶ 32} Duke responded to this appeal by arguing that no good cause is given in OCC's appeal for overturning the attorney examiner's ruling. (Duke Reply Brief at . 41.)

{¶ 33} At hearing, the attorney examiner excluded the draft audit report, stating that it was irrelevant to the Duke audit proceeding. (Tr. Vol. II at 223.)

{¶ 34} We find that the attorney examiner properly granted the motions to strike in both instances. OCC does not identify an error in the attorney examiner's evidentiary analysis; rather, OCC believes the rulings were in error merely because it affected what OCC claims is a substantial right. We agree with the attorney examiner's findings that the draft audit report, and Mr. Haugh's testimony related to that report, lack relevance in this proceeding. There are obvious similarities between the audits, as they were conducted by the same auditor, on similar timelines, and both concern similar OVEC riders. However, they were still completely separate audits. The evidence in question here pertains to a draft report, concerning a different rider, and a different EDU. As explained by the attorney examiner, the purpose of this proceeding is not to relitigate another EDU's rider. (Tr. Vol. III at 427.) While the Commission and the attorney examiners are not bound by the rules of evidence, OCC has not established that any substantial right was affected. Parties were given the opportunity to explore the relevancy of the draft audit report during the cross-examination of LEI's auditor, Dr. Marie Fagan, as well as to submit arguments as to the relevancy of the audit. Parties were able to cross-examine Dr. Fagan and to explore her and LEI's determinations regarding Duke's rider, as well as explore Staff's role in the auditing process. *See e.g.* Tr. Vol. II at 182-215. Accordingly, we affirm the attorney examiner's rulings that the draft audit report and Mr. Haugh's related testimony are not relevant to this proceeding.

D. Summary of Arguments

{¶ 35} As has been discussed, and will be discussed, the Commission pursued this audit for the purpose of establishing the "prudency of all costs and sales flowing through the PSR." Entry (Feb. 13, 2020) at ¶ 7. As detailed further in the RFP issued by the Commission, this includes ensuring that accounting procedures accurately and properly allocate revenues to ratepayers and reviewing the prudency of:

- Unit scheduling and bidding of energy into wholesale markets;
- Bidding behavior in capacity markets;
- Fuel and operation and maintenance (O&M) expenses; and
- Any fixed costs.

(Entry (Feb. 13, 2020), att. at 5-7.)

In the 118-page audit report, LEI made determinations and provided analysis as to each of those points, as well as other required determinations. LEI's overall conclusion was that "the processes, procedures, and oversight were mostly adequate and consistent with good utility practice." Staff Ex. 1 at 9. LEI submitted recommendations, documented above, but did not recommend any funds be disallowed for recovery.

{¶ 36} Staff submits that LEI's audit was properly conducted, and that the resulting recommendations should be adopted by the Commission. Duke and OEG generally agree. According to Duke, the audit demonstrates that the Company has prudently handled Rider PSR. Duke and OEG emphasized that the purpose of the audit is not to relitigate the existence of the rider but rather to ascertain whether the Company prudently managed its participation in OVEC and whether the Company prudently managed its entitlements. Duke further points out that the standard for prudency, as determined by the Supreme Court of Ohio, is whether an expenditure "was prudent when it was made," citing *In re Application of Suburban Natural Gas Co.*, 2021-Ohio-3224, 166 Ohio St. 3d 176 at ¶ 32. Thus, Duke contends that a review of the Company's actions should focus on the facts and knowledge available to Duke at the time of its decisions, and not look back with hindsight. As argued by the Company, the auditor appropriately considered Duke's management of the PSR and rightly determined that the Company's actions were prudent.

{¶ 37} OCC and, jointly, OMAEG/Kroger argue, in sum, that Duke mismanaged its entitlement in OVEC, to the detriment of the ratepayers, and the approximately $24 million that Duke recovered for Rider PSR should be disallowed. Both OCC and OMAEG/Kroger submit two broad points. The first point of contention is that the auditor's report was lacking. As discussed below, they both aver that LEI failed to do a proper analysis and also did not make the requisite determinations. OCC and OMAEG/Kroger additionally maintain the evidence demonstrates that Duke's handling of its OVEC entitlement was improper. They largely take issue with OVEC's ongoing commitment, with Duke's consent, to a "must-run" strategy that has repeatedly and predictably shown to be, according to OCC and OMAEG/Kroger, an uneconomic venture that ultimately harms ratepayers.

{¶ 38} For several reasons, OCC and OMAEG/Kroger maintain that LEI's audit report is deficient and should be discounted by the Commission. Continuing, OCC and OMAEG/Kroger state a new audit should be conducted. They each submit that the main purpose of the audit, as explained by the Commission and as made explicit in the RFP, was to make a determination as to Duke's prudency concerning the PSR. OCC and OMAEG/Kroger allege the final audit report failed in that regard. They point out that the main conclusion of LEI's report, found in Staff Ex. 1 at 9, states Duke's "processes, procedures, and oversight were mostly adequate and consistent with good utility practice." OCC and OMAEG/Kroger infer that the "prudency" of Duke's actions have thus ultimately not been determined by the auditor, even though that was the principal purpose for the auction. A finding of "mostly adequate," assert OCC and OMAEG/Kroger, is a lower standard than what the Commission requires of Duke. They both note that, upon cross-examination, LEI's Dr. Marie Fagan would go no further than considering Duke's actions "more on the prudent side" or "fairly prudent," instead of actually making a decision as to prudency, citing Staff Ex. 1 at 9 and Trans. Vol. II at 32.

{¶ 39} OMAEG/Kroger also asserts that the auditor's report lacks sufficient analysis to support a conclusion that Duke's actions were prudent, and no funds should be disallowed. As discussed in LEI's report, "OVEC plants cost customers more than the cost of energy and capacity that could be bought on the PJM wholesale markets" and serve as a charge to ratepayers, citing to Staff Ex. 1 at 9. OMAEG/Kroger state that, despite Rider PSR being a charge to ratepayers, the audit report justifies the expense as prudent because "there may be other considerations, such as providing employment at the plants, or the plants' contributions to fuel diversity in the State, that outweigh the impact on ratepayers, which the Ohio legislature takes into consideration," citing Staff Ex. 1 at 9. As argued by OMAEG/Kroger, consistent with the RFP, employment and fuel diversity were not considerations to be evaluated by the auditor in its review. Additionally, OMAEG/Kroger avers that LEI did no analysis of employment and fuel diversity to justify the cost to customers. OMAEG/Kroger also takes issue with the auditor's approval of Duke/OVEC's "must-run" strategy with the coal plants. According to OMAEG/Kroger, a major part of OVEC's rationale for adhering to that strategy is that there is a substantial cost to start up and shut down the plants. Thus, under this argument, which is discussed in more detail below, it is more economical to sometimes run the plants at a loss than it is to repeatedly shut down and start up the plants and incur an even greater loss. OMAEG/Kroger avers LEI did no quantitative examination into whether such an approach was valid. As explained by OMAEG/Kroger, the costs to shut down or start up the plants are not provided in the audit report and Dr. Fagan could not provide estimates of the costs on cross-examination. Therefore, OMAEG/Kroger conclude that the audit report fails to properly analyze whether the "must run" strategy was actually prudent.

{¶ 40} Finally, concerning the work of the auditor, OCC and OMAEG/Kroger infer that LEI would have and should have made a determination that the PSR is not in the best interest of ratepayers, but for improper influence from Staff. OCC and OMAEG/Kroger cite to a draft audit report from LEI of a similar OVEC rider for a different EDU, with language that ultimately was not included in the final audit report for that EDU's rider. In that draft audit report, according to OMAEG/Kroger, LEI concluded that it was not in ratepayers' best interests to be responsible for the EDU's OVEC entitlements. OMAEG/Kroger highlight that LEI performed Duke's Rider PSR audit at the same time as the other audit and that Dr. Fagan led both audits, testified in both audits, and conducted both audits simultaneously. They therefore submit that this was the true supposition of the auditor and that the Commission should accept that statement from the other case's draft report as the ultimate conclusion of LEI in this matter.

{¶ 41} In reply, Duke counters that OCC and OMAEG/Kroger's arguments are without merit. Duke states that the audit report determined that Duke prudently handled its OVEC entitlement and that OCC and OMAEG/Kroger are merely attempting to twist words around to combat a conclusion with which they disagree. As Duke explains, the audit report made no findings of imprudence and the parties' dismay over the use of phrases such "mostly adequate," "more on the prudent side," and "generally prudent" is just an impractical attempt to parse words. The Company avers that the auditor's review was thorough and examined numerous specific topics associated with Rider PSR. Duke states that LEI concluded Duke's actions were prudent regarding each topic in its nearly 120-page report. Further, Duke disputes that it was necessary for LEI to quantify the shutdown and startup costs associated with the OVEC plants. As explained by Duke, such costs were a part of the record and Dr. Fagan explained she understood that coal plants such as OVEC have higher shutdown and startup costs relative to plants that are designed to ramp up and down easily. Staff agrees with Duke, stating that the audit was conducted consistent with the Commission's directive and the RFP. Both Staff and Duke rebuke OCC and OMAEG/Kroger's attempt to conflate statements made in a draft report for another EDU's OVEC rider with the audit report in this proceeding. Although there are obvious similarities between the riders, and LEI conducted both audits, Duke and Staff contend it would be inappropriate to give the draft statement any weight in this proceeding. Duke and Staff reiterate that LEI's statement concerning the best interests of ratepayers was a draft statement that was not ultimately included in a report for a separate proceeding and a separate EDU. Duke asserts Dr. Fagan testified that such a statement never appeared in Duke's audit report. Regardless, Duke states that LEI's review was thorough and complete and found no indication of imprudence. Staff explains that the auditor serves as an extension of Staff and that Staff's review and oversight of the audit process is typical and consistent with the RFP. That being said, Staff asserts LEI provided an independent analysis that was not interfered with. Accordingly, both Staff and Duke maintain that OCC and OMAEG/Kroger's reliance on statements from another proceeding should be given zero weight.

{¶ 42} Notwithstanding the auditor's final conclusions, OCC and OMAEG/Kroger assert that the evidence in the report demonstrates that Duke's management of Rider PSR was imprudent. OMAEG/Kroger emphasize there were times during which the PJM day-ahead prices did not cover the variable costs of running the plants and that LEI ultimately recommended that OVEC reconsider its "must-run" commitment strategy. OMAEG/Kroger highlights Duke's actions related to OVEC's commitment status in 2020 compared to 2019. OCC and OMAEG/Kroger submit that during the second quarter of 2020, due to the impact of COVID and the resulting low energy prices in PJM, OVEC's units had a negative margin, so, at Duke's request, OVEC's Operating Committee voted and approved the use of an "economic" commitment status during this time. They argue that, although Duke had a detailed analysis on the cost to operate the OVEC plants and possessed some authority under the ICPA to influence some of the operational decisions at OVEC, it wrongfully declined to invoke that authority in 2019. OMAEG/Kroger further contend that

Duke did not present evidence that it attempted to reconsider or take any other actions within its authority in regards to the OVEC units' "must-run" strategy even though, as the audit reports states, utilities have begun shifting away from a "must-run" strategy to an "economic" dispatch and seasonal commitments in response to increased regulatory scrutiny. OMAEG/Kroger assert that the Operating Committee would consider the costs associated with the different commitment strategies and other risk factors when determining its commitment status, and the plant operator should conduct daily analysis of the costs and expected revenues from participating in the Day-Ahead Energy Market. Additionally, OMAEG/Kroger argue that the Commission should consider the fact that the OVEC plants are the oldest utility-owned coal-fired power plants in the United States over 20 megawatts in size without a scheduled retirement date. According to OMAEG/Kroger, neither Duke nor the Operating Committee took any of the above steps during the audit period. Moreover, the Operating Committee only met three times over the audit period, and it did not discuss the prospect of holding more meetings. Importantly, the auditor recognized that the Operating Committee should hold more frequent meetings to examine each plant's operating performance, including cost of service of profit/loss statements for market-based revenues derived from the PJM markets in a timelier manner. The parties emphasize that Dr. Fagan noted that the Operating Committee choosing to dispatch the plants on an "economic" basis rather than a "must-run" basis may have been prudent and in the best interest of ratepayers. Finally, OMAEG/Kroger argue that, given that it was prudent to make the commitment status change in 2020 when the plant was operating at a loss, it was imprudent to not act in the same manner in 2019; therefore, the Commission should disallow any costs passed through Rider PSR during the audit period in 2019.

{¶ 43} Similarly, according to OCC, Duke and OVEC's effort to reduce costs incurred by a "must-run" strategy was lacking. Concerning the daily profit-and-loss reports prepared by Duke related to the commitment status of OVEC, OCC argues that the 325 reports created during the audit period shows that there were extended periods of time when the plants were projected to experience consistent losses, noting Duke had negative margins during five of the twelve calendar months. OCC further contends that the above-market costs in 2019 did not result from any unusual conditions, considering OVEC's above-market costs for 2015-2018 show that losses from the competitive market were foreseeable in 2019. OCC asserts that Duke could have avoided these costs if it shut down the plants during these months, consistent with its own profit-and-loss reports; however, Duke chose not to contact OVEC concerning the reports. Furthermore, OCC argues that Duke should have taken additional steps to limit costs passed on to customers through Rider PSR, such as reevaluating certain provisions of the OVEC Agreement, conducting a retirement analysis, and evaluating the economics of operation changes at the OVEC plants. According to OCC, considering the above, Duke failed to act prudently with respect to OVEC in 2019 and, as such, the Commission should disallow the entire $24.6 million in costs related to Rider PSR.

{¶ 44} Besides the commitment strategy, OMAEG/Kroger also alleges other imprudent actions taken by Duke and OVEC. OMAEG/Kroger notes that the audit stated that the fuel obtained by OVEC for the two plants was 17 percent higher than the expected cost of fuel. Additionally, the audit reports that the number of employees at the two plants is at least 10 percent larger than the number of employees at other, similar plants. According to OMAEG/Kroger, these are instances that further demonstrate that OVEC is being managed imprudently, to the detriment of ratepayers.

{¶ 45} In response, Duke asserts that LEI examined OVEC's "must-run" commitment strategy in detail, and, though the auditor made some recommendations related to OVEC's commitment strategy, LEI found that Duke's efforts to modify, or not, OVEC's "must-run" strategy were prudent and had no recommendations except to continue doing so. According to Duke, LEI did not find the use of a "must-run" strategy as imprudent and did not recommend disallowance of any costs associated with OVEC. Duke outlines the difference between OVEC's commitment status versus dispatch. According to Duke witness Swez, commitment is the act of starting a generator that is off-line or maintaining an on-line generation status for a unit that is already on-line. OVEC determines the unit commitment of PJM, and PJM allows for four different commitment status offers: "Not Available or Outage," "Emergency," "Economic," and "Must-Run." According to Duke, for an "economic" commitment status, the decision to turn on or continue running a unit is made by PJM, such that PJM's commitment model may choose the unit to operate, or it may choose not to run the unit. For a "must-run" commitment status, the owner makes the decision whether to continue running the unit or not, and it can choose to run, not run, or change the offer status to "economic." In contrast, dispatch is the process of determining at which output to operate an on-line generating facility, and the movement of the unit to that desired output. Duke notes that PJM's dispatch model chooses how much energy it will deliver, based upon the unit's commitment status, and units that are "must-run" will be dispatched at a level that depends upon various factors including the unit's cost. The dispatch of generating units, in OVEC's case, refers to the instructions for the dispatch of OVEC's units from PJM and movement of the unit to the requested setpoint. Duke states that PJM sends these dispatch instructions for OVEC's generating units to OVEC every 5 minutes. Further, OVEC generators are dispatched based on the units' incremental cost offer between minimum and maximum available output unless a unit is required to be at an exact output such as what would be required for an environmental test.

{¶ 46} Duke avers that the current startup cost of a single OVEC unit is approximately $22,000 per cold startup and $10,000 per intermediate or hot startup. With eleven total units, cycling the plants multiple times a month, Duke argues, would be costly. Further, the facilities were not designed for instantaneous startup and shutdown; therefore, keeping the plants functional in a marginal setting served to avoid a more costly outcome than frequently cycling the plants.

{¶ 47} According to Duke, any commitment decision must factor in cycling timing, risks, and costs. Duke highlights that there are no benefits to switching to an "economic" strategy, with the downside being that the unit would short cycle, meaning it would come offline and have to come back online during a period of time. Duke points out that witness Swez testified that placing the unit offline and then online would only create additional costs, wear and tear, and higher forced outage rates. Further, other risks exist pertaining to a coal-fired unit with more frequent cycling, such as the unit can fail to start due to thermal cycles or other cycling issues causing potential damage to the units and loss of market revenue. Duke argues that these other risks must be factored into committing a unit as ″economic″ or "must-run."

{¶ 48} Duke contends that it is often more economic to run a unit during periods where it is ″out of the money" (i.e., generating unit revenue less than variable cost) so that the unit is capable of operations during periods when it is ″in the money" (i.e., generating unit revenue is greater than variable cost) to maximize potential revenues. During the audit period, Duke asserts that, in the instances where the OVEC units were ″out of the money,″ the margins were slim. For example, OVEC's net revenue was -$0.28/Megawatt Hour (MWh) in August 2019, and was -$0.44/MWh in December 2019. On the other hand, in OVEC's net revenue in months where the units are ″in the money,″ the margins were large. For example, in January 2019, OVEC's net revenue was $8.32/MWh and was $5.05/MWh in March 2019. According to Duke, OVEC could have attempted to cycle the units when they were ″out of the money;″ however, the units' margin would have been reduced, thus achieving the opposite of the desired result. Furthermore, other factors must be considered outside of the above financial analysis, including but not limited to required unit testing, risk of cycling the unit, PJM impacts of not operating such as the potential for PJM capacity performance penalties, and external-to-PJM sponsor requests. Duke argues that, in regard to its share of OVEC, the OVEC units' commitment strategy in the PJM energy market caused a positive margin of approximately $33 million in 2019 despite being ″out of the money" in some months. Duke further points out that LEI's Ms. Fagan testified that if you own power plants and you are paying costs like demand charges, then you are better off producing energy at a high level. Related to OVEC's commitment strategy, Staff reiterated LEI's recommendation that OVEC reconsider its "must-run" strategy and use near-term (one week to one month) demand and price forecasts to formulate offers. Staff further affirmed that LEI noted, during some periods of time, a "must-run" strategy can be optimal, but at other times it may not.

{¶ 49} OMAEG/Kroger reiterate that the sustained and substantial losses incurred by OVEC, and passed through to Duke's customers, resulted from the imprudent "must-run" commitment strategy. On average, OVEC units cost customers about $25 more per MWh than energy and capacity purchased in the PJM market and that there were times when the PJM prices did not cover the variable costs of running the plants. Thus, OMAEG/Kroger contends that, if startup and shutdown costs make an economic commitment strategy infeasible, then the owner should consider shutting the resource down permanently. Although Duke claims that it is only one of many co-sponsoring companies for OVEC, the joint parties argue that Duke could have raised the issue of reassessing the commitment strategy during the audit period, could have requested that the OVEC Operating Committee meet more than three times a year to discuss these issues, and could have shared its daily profit and loss reports with the Operating Committer; however, Duke failed to take action on any of these matters.

{¶ 50} OMAEG/Kroger also contend that, as a Sponsoring Company and a member of the Operating Committee, Duke has a duty to act during the audit period to limit incurring negative energy margins at the plants and to act in a prudent and reasonable manner that is in the best interest of customers. This responsibility stems not just from the ownership in OVEC but also from the Commission's decision to allow cost recovery from customers for costs associated with OVEC. OMAEG/Kroger assert that, instead of acting prudently, Duke attempts to argue that it cannot control OVEC or the Operating Committee by itself, so there was no point in acting at all.

{¶ 51} OCC notes that, when Duke argues that the "must-run" commitment strategy resulted in approximately $33 million of net benefits to all customers, this analysis focused on variable costs and revenues and ignored fixed costs. When preparing the daily profit-and-loss reports, Duke included revenue, hourly dispatch, and variable costs, but did not include fixed costs. OCC contends that, with fixed costs added, there was a $2 million average per month loss that was passed to Duke customers in 2019, yet Duke did not incorporate fixed costs into its forecasting. Not including fixed costs in the reports, according to OCC, was imprudent. Along those lines, OMAEG/Kroger assert that the fixed costs associated with OVEC, such as debt payments, should not be recoverable by Duke. As explained by OMAEG/Kroger, Rider PSR is limited to just the proceeds of selling generation and the cost to produce the generations.

{¶ 52} Duke first addresses OMAEG/Kroger's argument that Duke should have modified OVEC's "must-run" strategy. Duke explains that the Operating Committee decides commitment status by a majority vote, so Duke cannot singlehandedly make a commitment status decision. Duke emphasizes that OMAEG/Kroger did not analyze conditions at play in 2019 versus 2020 yet focuses on Duke's steps in 2020 to make its recommendation. Duke argues that conditions related to the pandemic are clearly different than those observed in 2019 and reiterates that the margins were small when the units were "out of the money;" therefore, reasonable minds could disagree about whether or not shutting down plants of this age and function for such margins was practical.

{¶ 53} Duke contends, however, that these arguments fundamentally misunderstand or ignore the ICPA and wrongly presume Duke can unilaterally decide to place the OVEC units on indefinite shutdown status at its own will. As to OMAEG/Kroger's arguments concerning debt payments, Duke explains that Rider PSR flows through to customers the net impact of Duke's contractual entitlement to OVEC, as described in the ICPA. Duke asserts debt payments are part of that entitlement and described as part of the demand charges in Component A of the ICPA and are, appropriately, included in the rider.

{¶ 54} In sum, OCC and OMAEG/Kroger maintain that Duke's recovery of the roughly $24 million should be disallowed. They contend that the evidence demonstrates that Duke has mismanaged its OVEC entitlement by making imprudent decisions that will cost ratepayers millions of dollars. OCC and OMAEG/Kroger aver it is appropriate and necessary to disallow the entire amount because Duke was continuously imprudent and not acting in the best interests of the ratepayers. At the very least, OMAEG/Kroger contend that the Commission should disallow anything over the approximately $18 million that Rider PSR was originally predicted to cost ratepayers. OMAEG/Kroger explains that when Rider PSR was originally approved to go into effect, Duke predicted that, in 2019, the rider would cost customers around $18 million. Thus, according to OMAEG/Kroger, anything over that amount should be considered the result of imprudent decision making from the Company and should be disallowed. Duke and Staff aver that the Commission should adopt the auditor's report and the included recommendations. Duke states that the report shows its actions concerning OVEC and Rider PSR were prudent and that the Company managed the flow of costs and sales through the rider appropriately. According to Duke, OCC and OMAEG/Kroger are merely attempting to relitigate the existence of the PSR and thus are seeking disallowance of the entire amount. Similarly, Staff recommends that the audit report and all recommendations be adopted by the Commission. Staff affirms that the audit was conducted properly, with oversight from Staff, and that the recommendations of the report are appropriate.

E. Commission Conclusion

{¶ 55} The Commission finds that the audit report, including all recommendations, should be adopted. In doing so, we determine that all costs and sales flowing through Rider PSR for the period of January 1, 2019, to December 31, 2019, are prudent.

{¶ 56} We initially express that we find the audit was conducted appropriately and consistent with our directives. The Commission notes that LEI's nearly 120-page analysis was thorough and detailed. While the focus of the hearing and the briefs was on LEI's general overall conclusion, we recognize that the auditor reviewed several specific issues associated with Rider PSR and Duke's OVEC entitlements and made determinations of prudency as to each issue. This includes: OVEC bill and Rider PSR reconciliation (e.g.

ensuring OVEC bill, journal entries and rider charges are consistent, and analyzing over/under recovery); disposition of energy and capacity (i.e. the commitment strategy); fuel and variable costs (e.g. coal procurement and coal inventory management); environmental compliance; capital expenses; and power plant operations (e.g. organizational staffing and plant maintenance costs). (Staff Ex. 1 at 9-10.) We are, thus, unpersuaded by the arguments of OCC and OMAEG/Kroger that LEI did not make proper conclusions or conduct sufficient analysis. We do not find it worthwhile or necessary to parse the semantical differences between "prudent," "mostly prudent," or "mostly adequate." It is evident from the report that overall, and in regards to each specific issue, the auditor found Duke's actions to be appropriate and sensible and, accordingly, prudent. We observe that no disallowances were recommended and no findings of imprudence were recorded. The Commission additionally does not find any evidence of undue influence in the creation of the audit report or any reason to consider that LEI was prevented from conducting an independent review. Much ink has been spilled and time spent in hearing arguing over a statement made in a draft audit report concerning a different EDU (with a similar OVEC rider). Above, we affirmed the attorney examiner's decision to keep that draft report out of the formal record in this proceeding. In doing so, the Commission concludes that it is not relevant in this proceeding. The Commission notes that it is not controversial or unexpected that, for 2019, Rider PSR would result in a net deficit for ratepayers. This was originally contemplated for 2019 when the rider was approved. See *ESP IV Case*, Opinion and Order at ¶¶ 136-140 (Dec. 19, 2018). The audit report confirms this, stating "the ICPA costs (Duke) more than would an equivalent amount of energy and capacity procured from the PJM markets." (Staff Ex. 1 at 29). The function of this review, as originally stated in the Entry opening this proceeding, is to determine whether the costs and sales associated with Duke's OVEC entitlements that flow through Rider PSR were prudently managed. We find the auditor ably completed that task and emphasize that they were not responsible for adjudicating the existence or continuation of the rider.

{¶ 57} As to Duke's management of Rider PSR, the Commission affirms the findings of the audit report that the Company has prudently handled its OVEC entitlement, subject to the recommendations described in the report. Initially, we observe that the audit report generally found that Duke's Rider PSR accounting was prudent. The true-up process was determined to be accurate and timely. (Staff Ex. 1 at 9.) The components of fixed costs were found to be properly billed (Staff Ex. 1 at 9-10). These aspects were not disputed by any party. The Commission affirms these findings of the audit report and adopts the associated recommendations.

{¶ 58} We also uphold the audit's findings that OVEC's commitment strategy was prudent at the time. Consistent with the Supreme Court of Ohio, we analyze prudency at the time the decision was made. *In re Application of Suburban Natural Gas Co.*, 2021-Ohio-3224, 166 Ohio St. 3d 176. Largely at issue in this case is whether it was prudent to offer the OVEC plants under a "must-run" strategy. As described by the auditor, it is typical and common for most coal plants to operate under such a strategy, where the load is essentially always online and inputted into the system on a daily basis. However, the auditor noted the conventional wisdom on this strategy is evolving. (Staff Ex. 1 at 18-19.) Examining the strategy as a whole, for 2019, Duke/OVEC's decisions appear to be prudent. In total, the OVEC plants, for Duke's apportionment, created around $33 million in revenue (Duke Ex. 1 at 14). That is, the sum of the revenue from generation sold into PJM was $33 million greater than the variable cost to run the plants to produce the generation. Notably, fixed costs that are in place whether the plants are running or not, such as debt payments, PJM fees, and O&M costs, ultimately offset those revenues and result in a net charge to customers. However, without that $33 million in revenue, the cost to ratepayers would be significantly higher. (Staff Ex. 1 at 10.) In five months of 2019, the variable costs were greater than the revenue coming in, and the plants operated at a loss. In hindsight, it is possible an "economic" commitment strategy may have been more profitable. With an "economic" approach, the plants would only go online as needed, per the direction of PJM. However, the main reason many coal plants consistently operate under a "must-run" strategy is that there are significant costs associated with starting up and shutting down the plants. Economically, it costs approximately $22,000 to startup a single unit (OVEC has 11 units). Further, it takes significant time to ramp up a unit to get it online. Starting and stopping a unit also results in substantial wear and tear and increases the risk of a unit breaking down. (Duke Ex. 1 at 123-14.) Accordingly, while it may retroactively appear that, in some months, it would have been more prudent for OVEC to have implemented an "economic" strategy, other factors come into play to demonstrate that it was still prudent to go forward with a "must-run" commitment.

{¶ 59} The Commission recognizes that what is at issue here is not what strategy would have been the most prudent, but rather, whether the strategy deployed by Duke was prudent. Thus, the Commission determines that Duke's 2019 commitment strategy was prudent. The audit report explains that the common approach to have all coal plants on a "must-run" commitment plan is evolving (Staff Ex. 1 at 18). We note Duke later made recommendations to OVEC in 2020 that an "economic" path, in some situations, might be more beneficial. We adopt and emphasize the auditor's recommendation that Duke/OVEC examine under what circumstances a "must-run" offer is the better option (Staff Ex. 1 at 44). As expressed in the audit report, Duke should "utilize near-term demand and price forecasts to formulate energy offers." Further, Operating Committee meetings should be held more frequently in order to react to updates on plant performance and profit/loss statements in a more timely fashion. (Staff Ex. 1 at 10.)

{¶ 60} Accordingly, we are not persuaded by the arguments of OMAEG/Kroger and OCC that the recoverable amount should be disallowed. While in some instances an "economic" path may have been more beneficial, as discussed above, they have not demonstrated that OVEC's strategy was imprudent. Further, in total, the "must-run" strategy bore out to be the most beneficial approach (Duke Ex. 1 at 13-14). The Commission also finds that OMAEG/Kroger's argument that any dollar amount over the originally predicted cost of $18 million should be disallowed to be unpersuasive. There was no language in the original order that explicitly tied recovery to the predicted amount. Instead, the recovery amounts would be subject to annual prudency reviews, which brought forth this proceeding and the audit. The Commission also disagrees with OMAEG/Kroger's assertion that debt payments and other fixed costs should be disallowed from recovery. Rider PSR, as approved, allows Duke to "flow through to customers the net impact of the Company's contractual entitlement" in OVEC and would, therefore, include such expenses as debt payments.

{¶ 61} We also determine that Duke/OVEC's coal procurement practices were prudent. OCC and OMAEG/Kroger point out that the auditor found OVEC's coal prices at the Clifty Creek plant to be 17 percent higher than spot prices. As explained by the auditor, however, the higher costs were attributable to, among other things, higher quality coal and existing contractual obligations with suppliers (Staff Ex. 1 at 63-64). We, thus, affirm the auditor's findings that OVEC's actions were prudent, but also adopt the recommendations to continue negotiations with coal suppliers and conduct an internal audit to improve coal procurement management.

IV. Findings of Fact and Conclusions of Law

{¶ 62} Duke is an electric distribution utility and a public utility as defined in R.C. 4928.01(A)(6) and R.C. 4905.02, respectively. As such, Duke is subject to the Commission's jurisdiction.

{¶ 63} On April 8, 2020, the Commission selected LEI to complete the audit.

{¶ 64} On October 21, 2020, LEI filed its Audit Report.

{¶ 65} The attorney examiner granted motions to intervene filed by OCC, Kroger, OMAEG, and OEG.

{¶ 66} An evidentiary hearing commenced on May 25, 2022, and continued until it was adjourned on May 31, 2022.

{¶ 67} On July 28, 2022, Staff filed its initial brief. Duke, OEG, OCC, and jointly, OMAEG and Kroger filed their initial briefs on July 29, 2022. On August 19, 2022, reply briefs were filed by Duke, Staff, OCC, and jointly by OMAEG and Kroger.

{¶ 68} Based on the record, we find that LEI's audit of Duke's Rider PSR for the period of January 1, 2019, to December 31, 2019, should be approved and adopted, subject to the findings discussed herein.

V. ORDER

{¶ 69} It is, therefore,

{¶ 70} ORDERED, That, consistent with this Opinion and Order, LEI's audit of Duke's Rider PSR for the period of January 1, 2019 to December 31, 2019, including all recommendations, be adopted. It is, further,

{¶ 71} ORDERED, That a copy of this Opinion and Order be served upon all parties of record.

COMMISSIONERS:
Approving:
Jenifer French, Chair
Daniel R. Conway
Lawrence K. Friedeman
Dennis P. Deters
John D. Williams

NJW/dr