BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the OVEC Generation Purchase Rider Audits Required by R.C. 4928.148 for Duke Energy Ohio, Inc., The Dayton Power and Light Company d/b/a AES Ohio, and Ohio Power Company d/b/a AEP Ohio.	:	Case No. 21-477-EL-RDR

INITIAL BRIEF SUBMITTED ON BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

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On Behalf of the Staff of the
Public Utilities Commission of Ohio

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TABLE OF CONTENTS

PAGE

INTRODUCTION 2

BACKGROUND 3

ARGUMENT 4

CONCLUSION 12

CERTIFICATE OF SERVICE 14

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In the Matter of the OVEC Generation	:	
Purchase Rider Audits Required by	:	Case No. 21-477-EL-RDR
R.C. 4928.148 for Duke Energy Ohio,	:	
Inc., The Dayton Power and Light	:	
Company d/b/a AES Ohio, and Ohio	:	
Power Company d/b/a AEP Ohio.	:	

INITIAL BRIEF SUBMITTED ON BEHALF OF
THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

INTRODUCTION

This case concerns London Economics International LLC's ("LEI" or "Auditor") independent audits of the prudency and reasonableness of the actions of three electric distribution utilities ("EDUs"), Duke Energy Ohio, Inc. ("Duke"), The Dayton Power and Light Company d/b/a AES Ohio ("AES Ohio"), and Ohio Power Company d/b/a AEP Ohio ("AEP Ohio") (collectively, the "EDUs" or "Companies"), in regard to their Legacy Generation Resource ("LGR") ownership for the period spanning January 1, 2020, through December 31, 2020. The Audit Reports for this proceeding were filed on December 17, 2021. Though the Audit Reports recommend continued and/or further evaluation of certain practices by the Companies related to the LGR Riders, the Auditor found "[o]verall, . . . the processes, procedures, and oversight were mostly adequate and consistent with good utility practice, given that the [Amended and Restated Inter-Company Power Agreement] is in place and customers will be charged for the cost of the plants until at least May 2024." *In re the OVEC Generation Purchase Rider Audits*

Required by R.C. 4928.148 for Duke Energy Ohio, Inc., The Dayton Power and Light Company d/b/a AES Ohio, and Ohio Power Company d/b/a AEP Ohio, Case No. 21-477-EL-RDR, Duke Audit Report at 9-11 (Dec. 17, 2021), AEP Ohio Audit Report at 9-11 (Dec. 17, 2021), AES Ohio Audit Report at 9-11 (Dec. 17, 2021).

BACKGROUND

R.C. 4928.148, which became effective on October 22, 2019, requires the Commission to (1) establish a replacement nonbypassable rate mechanism for the retail recovery of prudently incurred costs related to an LGR, including the Ohio Valley Electric Corporation ("OVEC"), for the period commencing January 1, 2020, and extending up to December 31, 2030, and (2) determine the prudence and reasonableness of the actions of EDUs with ownership interests in an LGR. R.C. 4928.148; R.C. 4928.01(A)(41).

By Entry issued on November 21, 2019, in Case No. 19-1808-EL-UNC, the Commission established the LGR Riders pursuant to R.C. 4928.148. *In re Establishing the Nonbypassable Recovery Mechanism for Net Legacy Generation Resource Costs Pursuant to R.C. 4928.148*, Case No. 19-1808-EL-UNC, Entry (Nov. 21, 2019). In accordance with R.C. 4928.148(A)(1), the Commission is required to determine, in the years 2021, 2024, 2027, and 2030, the prudence and reasonableness of the actions of EDUs with LGR ownership interests in OVEC. R.C. 4928.148(A)(1).

On May 5, 2021, the Commission issued an Entry directing Staff to issue a request for proposal ("RFP") for audit services to assist with an audit of the actions of Duke, AES Ohio, and AEP Ohio for the period from January 1, 2020, through December 31, 2020. *In* *re the OVEC Generation Purchase Rider Audits Required by R.C. 4928.148 for Duke Energy Ohio, Inc., The Dayton Power and Light Company d/b/a AES Ohio, and Ohio Power Company d/b/a AEP Ohio*, Case No. 21-477-EL-RDR, Entry (May 5, 2021). By Entry dated July 14, 2021, the Commission selected LEI to conduct the audits of those EDUs. *In re the OVEC Generation Purchase Rider Audits Required by R.C. 4928.148 for Duke Energy Ohio, Inc., The Dayton Power and Light Company d/b/a AES Ohio, and Ohio Power Company d/b/a AEP Ohio*, Case No. 21-477-EL-RDR, Entry (July 14, 2021). Pursuant to the RFP, the final audit reports were due to be filed with the Commission on December 17, 2021. The final reports were filed on that date.

ARGUMENT

LEI was selected by the Commission to conduct an independent audit of the actions of EDUs with LGR ownership for the period of January 1, 2020, through December 31, 2020. *Id.* LEI prepared a report for each EDU containing the results of its audits, which were filed on December 17, 2021. The public versions of the Audit Reports were admitted as evidence during the hearing as Staff Exhibits 2 (AES Ohio), 4 (AEP Ohio), and 6 (Duke), while the confidential versions of the Audit Reports were admitted as Staff Exhibits 3C (AES Ohio), 5C (AEP Ohio), and 7C (Duke). There was also a confidential errata sheet admitted as Staff Exhibit 8C to the Audit Reports to correct numbers that had been transposed in a table in the Audit Reports.

The Audit Reports were sponsored at the hearing by Dr. Marie Fagan. The direct testimony of Dr. Fagan was admitted into evidence as Staff Exhibit 1. Dr. Fagan has a

PhD in Economics and has over 30 years of experience in the electric power industry. Staff Ex. 1 at 2.

As explained in the Audit Reports, AES Ohio, AEP Ohio, and Duke are Sponsoring Companies of OVEC, meaning that each of those EDUs is under a contract known as the Amended and Restated Inter-Company Power Agreement ("ICPA"), is entitled to a share of OVEC's electricity generation, and must also pay that same share of OVEC's costs. Staff Ex. 2, 4, and 6 at 7-8. Each of those EDU's net costs (its share of OVEC's costs less sales of energy and capacity) are passed on to its ratepayers through the LGR Riders of all EDUs in Ohio, established in the Commission's decision in Case No. 19-1808-EL-UNC. *In re Establishing the Nonbypassable Recovery Mechanism for Net Legacy Generation Resource Costs Pursuant to R.C. 4928.148*, Case No. 19-1808-EL-UNC, Entry (Nov. 21, 2019).

During the audits, LEI considered the following items:

1. **Industry context**: A review of the current dynamics of the PJM wholesale markets in which OVEC operates, and the impact that changing market dynamics have on OVEC's operations and practices;
2. **OVEC bill and LGR Rider reconciliation**: Examination of whether charges on the OVEC bills are accurately reflected in the accounts of the audited EDUs, and in their LGR Riders;
3. **Disposition of energy and capacity**: A review of the unit scheduling and offering of energy into PJM administered wholesale markets, offering behavior in PJM administered capacity markets, and offering behavior and/or participation in any

other market that may provide revenue above and beyond that which is received in energy and capacity markets;

4. **Fuel and variable costs**: An assessment of OVEC's fuel operations and maintenance related expenses, including comparison between incurred fuel costs and market prices to evaluate the reasonableness of fuel expenses during the audit period;

5. **Capital expense**: Examination of the prudency of OVEC's process for allocating capital and conducting capital projects, and an assessment of whether the fixed costs incurred by OVEC are properly allocated to the audited EDUs, including depreciation, debt service, and plant maintenance expenses;

6. **Environmental compliance**: A review of OVEC's environmental compliance activities. This includes, but is not limited to, the impact that compliance activities had on OVEC's fuel procurement strategy, overall emission allowance management strategy, and methods used to analyze compliance options and develop overall mitigation strategies; and

7. **Power plant performance**: A review of significant plant outages or other degradations observed in the operating availability, equivalent availability, or capacity factors of OVEC's generating plants, and an assessment of at least one of OVEC's generating stations based on a virtual site visit.

Staff Ex. 2, 4, and 6 at 7-8.

Additionally, LEI used data obtained from the audited EDUs, as well as publicly available sources such as the U.S. Energy Information Administration. *Id.* at 8-9. LEI concluded that "[o]verall, . . . the processes, procedures, and oversight were mostly adequate and consistent with good utility practice, given that the ICPA is in place and customers will be charged for the cost of the plants until at least May 2024." Staff Ex. 2, 4, and 6 at 9. The Auditor further concluded:

> LEI's analysis shows that at this time the OVEC plants cost customers more than the cost of energy and capacity that could be bought on the PJM wholesale markets. However, 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.

Id.

LEI also made the following recommendations and/or observations:

1. **Components of fixed cost:** The components of fixed costs were billed properly. However, one component of fixed costs, referred to as "Component (D)" in the OVEC bill, is identified by the ICPA as a payment per common share (like a dividend). R.C. 4928.01(A)(42) requires that "'[p]rudently incurred costs related to a legacy generation resource' . . . shall exclude any return on investment in common equity…." Component D seems to be such a return. The annual $2.51 million per year for Component D amounted to nearly all OVEC's $2.81 million of net income in 2020. OVEC's capital expenditures are not part of a rate base for which they are allowed a regulated rate of return, but Component D is itself a return to the owners of OVEC. LEI advised that the Commission may wish to examine this issue. Staff Ex. 2 at 9; Staff Ex. 4 at 9; Staff Ex. 6 at 9-10.

2. **Disposition of energy and capacity**: OVEC energy and capacity are sold into the

PJM markets. OVEC typically self-schedules its units in the PJM day-ahead market (in other words, OVEC informs PJM that a unit's availability status is "must-run"). The alternative to must-run availability status for a unit which is not on outage is to offer the unit so that it may be committed by PJM (in other words, OVEC would inform PJM that availability status is "economic"). Must-run units are committed by the market participant and then dispatched by PJM without regard to whether the hourly energy price is high enough to cover the unit's fuel and variable costs. LEI's analysis (based on monthly average PJM prices) shows that some of the time, the PJM energy price did not cover fuel and variable costs. LEI believes the temporary permission given by the OVEC Operating Committee (of which the EDUs are members) to allow the OVEC plants to be committed either as must-run or based on economic commitment was prudent. That option was in place temporarily in 2020; LEI recommends that the EDUs and the other members of the Operating Committee allow this flexibility on an ongoing basis. Ideally, the units would be committed based on economics all or most of the time, but in the case of coal plants this can cause difficulties in managing staffing and fuel deliveries, and repeated start-up of coal plants can damage equipment. Staff Ex. 2 at 9-10; Staff Ex. 4 at 9-10; Staff Ex. 6 at 10.

a. The Auditor found that Duke's capacity offers were formulated prudently, and transparently reflect the risks and reward features of the PJM capacity construct. Staff Ex. 6 at 10.

b. In terms of disposition of capacity, LEI recommends that AES Ohio consider developing price and volume offer pairs based on analysis of bonus payments and penalties at various MW offer levels. Staff Ex. 2 at 9-10.

c. In terms of disposition of capacity, LEI believes AEP Ohio's capacity offer strategy could be made potentially more profitable if AEP Ohio developed price and volume offer pairs based on analysis of potential bonus payments and penalties at various offer volumes. Staff Ex. 4 at 9-10.

3. **Fuel and variable cost expenses**: Coal inventories were much higher than target levels in 2020. LEI recommends that AES Ohio, AEP Ohio, and Duke, through their roles on the Operating Committee, encourage ongoing review and improvement to OVEC's coal burn forecasting methods, and coal procurement practices. Staff Ex. 2, 4, and 6 at 10.

4. **Capital expenses**: Total OVEC capital spending in 2020 was $8.55 million. Staff Ex. 2 at 81; Staff Ex. 4 at 85; Staff Ex. 6 at 87. The process of planning and executing individual capital projects appears to be well-managed. However, it appears there is no cap on annual capital expenses. This could lead to over-investment in the plants, as the review and approval of the Commission is not needed for OVEC to engage in capital spending projects. Staff Ex. 2 at 82; Staff Ex. 4 at 87; Staff Ex. 6 at 89.

5. **Environmental compliance activities**: Based on LEI's virtual site visit, LEI found that OVEC complied with environmental requirements during the audit period. Management of emissions allowance inventories was reasonable and prudent. Staff Ex. 2, 4, and 6 at 10.

6. **Power plant performance:** The plants performed reliably in 2020, with forced outage rates generally better than PJM averages; and availability factors slightly higher than PJM averages for some units, and slightly lower for other units. However, heat rates were higher (i.e., efficiency was lower) than in 2019 owing to weaker demand and low energy prices in 2020, which resulted in plant dispatch at levels below optimal operating levels. *Id.*

Additionally, as noted in the audits for this case, in the previous audits of AES Ohio, AEP Ohio, and Duke, the auditor also made several recommendations. The following three figures, taken from the Audit Reports, show the status of the recommendations. Staff Ex. 2, 4, and 6 at 11.

Figure 1. Auditor recommendations from AES Ohio RR audit for 2019

Topic	Auditor recommendation	Status or outcome
Disposition of energy and capacity	Prepare report for PUCO covering potential ancillary services OVEC plants could provide	under way
Capital expenditures	Examine small projects to determine if they are capital in nature	unknown
OVEC bill and rider reconciliation	Formally document the procedures for cost recovery for OVEC capital costs and expenses	unknown
Environmental compliance	OVEC operating Committee should continue to monitor projected implementation of regulations, and the impact on operations	under way

Figure 1. LEI recommendations from AEP Ohio PPA audit for 2019

Topic	LEI recommendation	Status or outcome
The true up process for the PPA Rider	Six month lag in true-up should be reducd to 3-month	No longer relevant, PPA Rider replaced by LGR Rider with different methodology
Components of fixed costs	"Component (D)" in the OVEC bill is identified by the ICPA as a payment per common share	To be determined by the Commission
Disposition of energy and capacity	Reconsider "must-run" offer strategy	AEP Ohio/OVEC Operating Committee allowed economic-based commitment on a temporary basis in 2020
Fuel and variable cost expenses	Coal inventories higher than target; coal burn forecasts inaccurate	Does not appear to have been addressed
Capital expenses	No cap on annual capital expenses; LEI recommended that the Commission consider implementing such a cap	To be determined by the Commission
Environmental compliance activities	No recommendation	n/a
Power plant performance	OVEC should inspect and fix the technical problems with the baffle wall at Clifty Creek Unit 6 to minimize forced outages	In 2020, reliability metrics for Clifty Creek Unit 6 were back to normal, indicating the problem had been addressed

Figure 1. LEI recommendations from DEO PSR audit for 2019

Topic	LEI recommendation	Status or outcome
The true up process for the PSR Rider	More recent estimates for annual sales should be used in estimating costs for the PSR Rider	No longer relevant, PSR replaced by LGR Rider with different methodology
Components of fixed costs	"Component (D)" in the OVEC bill is identified by the ICPA as a payment per common share	To be determined by Commission
Disposition of energy and capacity	LEI believes DEO's strategy of creating a process whereby OVEC re-considers its "must-run" offer strategy and utilize near-term demand and price forecasts to formulate energy offers is prudent	DEO/OVEC Operating Committee allowed economic-based commitment on a temporary basis in 2020
Fuel and variable cost expenses	Coal inventories higher than target; coal burn forecasts inaccurate	Does not appear to have been addressed
Capital expenses	No cap on annual capital expenses; LEI recommended that the Commission consider implementing such a cap	To be determined by Commission
Environmental compliance activities	No recommendation	n/a
Power plant performance	OVEC should inspect and fix the technical problems with the baffle wall at Clifty Creek Unit 6 to minimize forced outages	In 2020, reliability metrics for Clifty Creek Unit 6 were back to normal, indicating the problem had been addressed

The Audit Reports prepared by LEI accomplished the Commission's directives. The audits were conducted appropriately and consistent with the Commission's directives. Therefore, the Commission should adopt the Audit Reports.

CONCLUSION

The scope of this proceeding was clearly defined by the Commission. The Commission determined that the audits would review the prudence and reasonableness of the actions of the EDUs with LGR ownership for the period from January 1, 2020, through December 31, 2020. The Auditor completed its audits as directed by the Commission and consistent with the governing law. The Commission should adopt the conclusions and recommendations made by the Auditor and, as applicable, make appropriate determinations consistent with the Auditor's recommendations and observations.

Respectfully submitted,

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On Behalf of the Staff of the
Public Utilities Commission of Ohio

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the **Initial Brief**, on behalf of the Staff of the Public Utilities Commission of Ohio, has been served upon the below-named counsel via electronic mail, this 12th day of February 2024.

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