132-SUBSTITUTE SENATE BILL 155 (PETERSON, TERHAR)
PROPONENT TESTIMONY BEFORE THE SENATE PUBLIC UTILITIES COMMITTEE
By AMY SPILLER, DEPUTY GENERAL COUNSEL, DUKE ENERGY

October 12, 2007

Chairman Beagle, Vice Chairman LaRose, Ranking Member Williams, and Honorable members of the Senate Public Utilities Committee:

I am Amy Spiller, Deputy General Counsel for Duke Energy. Let me begin by thanking you for the considerable time and attention already invested by this committee in its consideration of Substitute Senate Bill 155. I respectfully offer this written testimony in support of the updated version of this legislation (the dash-5 version) and ask that you accept this document as the working bill in your committee, and consider it for passage soon thereafter.

You have heard in previous testimony, including my own, the myriad arguments for passing this legislation. With respect to the updated bill, the Legislative Service Commission (LSC) has published a comparison document that spells out the changes from the last version in great detail and, as always, Duke Energy Ohio is available to answer any questions you may have about those changes. Rather than restate the contents of the LSC document, I would like to take this opportunity to address issues we have heard raised in your chamber regarding how certain provisions of the legislation accomplish the sought-after goals of the bill.

Goals of Substitute Senate Bill 155

Recall that the purpose of this legislation is to provide parity, clarity, and customer protections: parity for the electric distribution utilities with other sponsors of the Intercompany Power Agreement (ICPA) with the Ohio Valley Electric Corporation (OVEC); parity among the three Ohio utilities subject to the provisions of this legislation; clarity in how the relief sought by the utilities is to be structured; and, protections not present in recovery already granted or under consideration at the Public Utilities Commission of Ohio (PUCO). All of this is to be accomplished through thoughtful consideration of the uniqueness of OVEC, the intricacies of the ICPA, and the management of the electric distribution utilities' commitments and entitlements.

Parity with other sponsors

Regarding co-sponsors to the power agreement with OVEC, the Ohio utilities are at a distinct disadvantage to their counterparts that reside in states that still regulate generation. This disparity is stark and undeniable. Of the existing co-sponsors, the majority are either located in

regulated states or electric co-ops that receive full recovery of their obligations under the ICPA – the same obligations to which Ohio's electric distribution companies are subject.

Parity among the Ohio utilities

With respect to the three Ohio utilities, the parity issue is very timely in the context of recovery already granted by the PUCO and that being considered for the future. One utility is currently recovering by way of a nonbypassable charge and is seeking an extension of that recovery mechanism for a six-year period. Another utility has entered into a settlement agreement, awaiting a PUCO order, that would grant recovery on a bypassable basis for a different time frame and with different rate design parameters. The third utility has filed a recovery request, which remains pending.

All businesses crave certainty and utilities are no different in this regard. Yet, as you can plainly see, the current situation creates a great deal of uncertainty and therefore risk for the electric distribution utilities. Now is the time for the Legislature to expressly affirm that recovery of costs related to the OVEC entitlement is appropriate, subject to the protections and provisions codified in Sub. S.B. 155-5.

No step backward; no market impact

The parity sought by the utilities is not a backward step in Ohio's move towards a market system. It does not re-regulate Duke Energy Ohio's legacy or rate based generation; nor could it. Indeed, consistent with the policies of this state, Duke Energy Ohio transferred its legacy generating assets to an affiliate that, in turn, sold them to a third party. This legislation addresses an admittedly unique commitment undertaken by Ohio's utilities, without allowing recovery of an equity component.

Furthermore, PJM Interconnection, L.L.C. (PJM) is not opposed to this legislation because it recognizes that there are already market participants that receive regulated cost recovery, as do a majority of sponsors to the ICPA with OVEC. As evidence, in the latest wholesale capacity auction conducted by PJM, approximately 170,000 megawatts of capacity cleared the auction, a portion of which was offered into the auction by regulated companies. The sum total of capacity that would be covered under this legislation is about 800 megawatts—*less than one-half of one percent of the total that cleared the auction*. And, if you look at recent PJM wholesale capacity auction clearing prices, it is plain to see that wholesale markets already factor in offers from companies receiving cost recovery and that prices would be unmoved by this legislation. Taken one step further, investment decisions for new generation are complex

and rely on the answers to a number of questions. Importantly, though, the market price signal component of those investment decisions should not be impacted by this legislation. In fact this legislation provides a clear and transparent process for cost recovery, something that businesses want when looking to make investment decisions.

As mentioned in my prior testimony, the retail markets are similarly unaffected as the bill requires that the relief be nonbypassable, consistent with the PUCO's recent decisions that granted recovery. Once again, providing the parity sought in this bill will not have a negative impact on Ohio's move towards competition as its adopted generation model.

Customers stand to substantially benefit from a clearly defined process and specific protections

Substitute Senate Bill 155 will codify the terms and conditions of recovery, as well as require many customer protections that currently do not exist. Customers, therefore, stand to benefit in many ways with passage of this legislation:

- First, the legislation makes it clear that only prudently incurred costs – as determined by the PUCO – will be recovered and further directs the PUCO to regularly assess the actions of the Ohio utilities in respect of their contractual entitlement in OVEC for purposes of assessing whether such actions were prudent and reasonable.
- Second, the legislation establishes that the output of OVEC will be transacted in the wholesale market and not used for purposes of retail supply, thereby retaining the competitiveness of the current processes used to secure load for an electric utility's non-shopping customers.
- Third, this legislation confirms that any revenues associated with wholesale market transactions involving the OVEC entitlement will benefit customers.
- Fourth, customers will be protected by monthly bill caps.
- Fifth, the PUCO must exclude any return on common equity as a component of prudently incurred costs. This ensures that the utilities are merely "getting to zero".
- Sixth, under the terms of the bill, absent action by the Legislature, no cost incurred by the utilities after December 31, 2030, may be approved for recovery. Only those costs, if any, that have been approved for recovery but uncollected prior to that sunset date, as well as any credit that may be due to customers, may be reconciled by the PUCO through the rider after that date.
- Seventh, in the event of a premature retirement of the OVEC plants, any accelerated debt would be excluded from eligibility for recovery.

- Eighth, the state adopts as a matter of policy support for the transfer of the utilities' obligations.

Decisions, decisions

Much attention has been paid to decisions made by OVEC and the sponsors of the ICPA. Certainly, the value of hindsight is indisputable. However, it is unfair and perhaps unwise to view decisions of the past without considering the environment and influencers of the time. Attached to my testimony is a timeline that displays the evolution of the electric utility industry and OVEC decisions from the point of view of Duke Energy Ohio. Several of those points are pertinent to this discussion.

The 2003 decision to refinance and extend the ICPA:

- In 2003, the Department of Energy, within its contractual rights, terminated the contract with OVEC. When this happened, the sponsors to the ICPA became responsible for 100% of the costs and entitled to 100% of the output associated with OVEC.
- In the same year, acting on Ohio's mandate for electric distribution utilities to divest their generation, Duke Energy Ohio asked the PUCO for permission to transfer its generation assets to an unregulated affiliate, and to move to a market based standard service offer for its customers.
- Instead, the PUCO ordered the Company to retain its generation assets and submit a rate stabilization plan to set rates for generation service, thereby continuing to support regulated ownership and control of generation.
- Also during that period of time, OVEC had the option to refinance its debt at lower interest rates, thereby lowering its costs. This refinancing meant that the sponsors would have to agree to extending the ICPA to 2026.
- Given the signals from the PUCO that the move to deregulation might not be entirely decided, this decision seemed prudent and reasonable, as did the decision to lower costs through refinancing.

The decision to install environmental control measures:

- Around 2006, acting in response to federal regulations aimed at reducing emissions from coal-fired generating units, OVEC decided that the prudent course of compliance was to install environmental control measures (Flu-Gas-Desulfurization, or FGD, systems).

- Because OVEC is a public utility in the state of Ohio, the PUCO has the responsibility and authority to annually review and authorize OVEC's short- and long-term debt financing plans. The financing for the FGD systems was part of those plans made available to, and authorized by, the PUCO.

The decision to once again lower costs:

- In 2008, the PUCO approved Duke Energy Ohio's first Electric Security Plan (ESP) for providing generation service to customers that had not chosen an alternative supplier. Yet again the PUCO order prohibited the Company from divesting its coal-fired generating assets. Fast forward to 2011 when the PUCO approved the Company's second ESP. This time the PUCO required Duke Energy Ohio to transfer its directly owned generating assets by the end of 2014. .
- Once again, an opportunity existed for OVEC to take advantage of lower interest rates and refinance its debt, necessitating an extension of the ICPA to 2040. In connection with this request for an extension, OVEC provided a market study that confirmed that the OVEC units were the low-cost supply option.
- In the same time period, Duke Energy Ohio attempted to transfer its contractual entitlement under the ICPA to an unregulated affiliate. Unfortunately, the conditions of the transfer never fully satisfied other sponsoring companies and the transfer attempt was vetoed.

A little more on the subject of transferring obligations

Under the ICPA, a transfer can be made to a permitted assignee – an affiliate that is creditworthy on its own, as determined at the discretion of OVEC, or one for whom the sponsoring company would provide an unlimited guaranty, the conditions and parameters of which are determined by OVEC. In other words, the transferring entity, Duke Energy Ohio, a regulated utility, would retain all of the risk of nonperformance by an unregulated affiliate, yet it would no longer be a party to the governing agreement (ICPA). Such a transfer would be ill-advised and contrary to reasonable business practices, as reflected in the state policy incorporated into S.B. 155.

Also under the ICPA, there exists the ability to transfer to an unaffiliated third party. But, again, such a transfer is weighed down by an unwieldy approval process that includes a right of first refusal held by other sponsoring companies, compressed deadlines for offers and counter offers, capped transfer prices, the same credit requisites as for a permitted assignee (affiliate), and ultimate OVEC consent.

Despite the high hurdles, and despite the mixed signals regarding deregulation, Duke Energy Ohio tried to transfer its obligation and entitlement. A negative response from just one of the other sponsoring companies prevented that transfer.

Location and makeup of assets

Questions have also surfaced around where OVEC assets are located and how that factors into the discussion. Physical location of the OVEC assets is not a factor in the determination of the need to provide the parity, clarity, and customer protection goals of this legislation. This bill seeks to provide relief from a contractual commitment made by Ohio electric distribution utilities—each a major employer, taxpayer and corporate citizen. It does not seek to cover the expenses of any particular generation asset, in-state or otherwise.

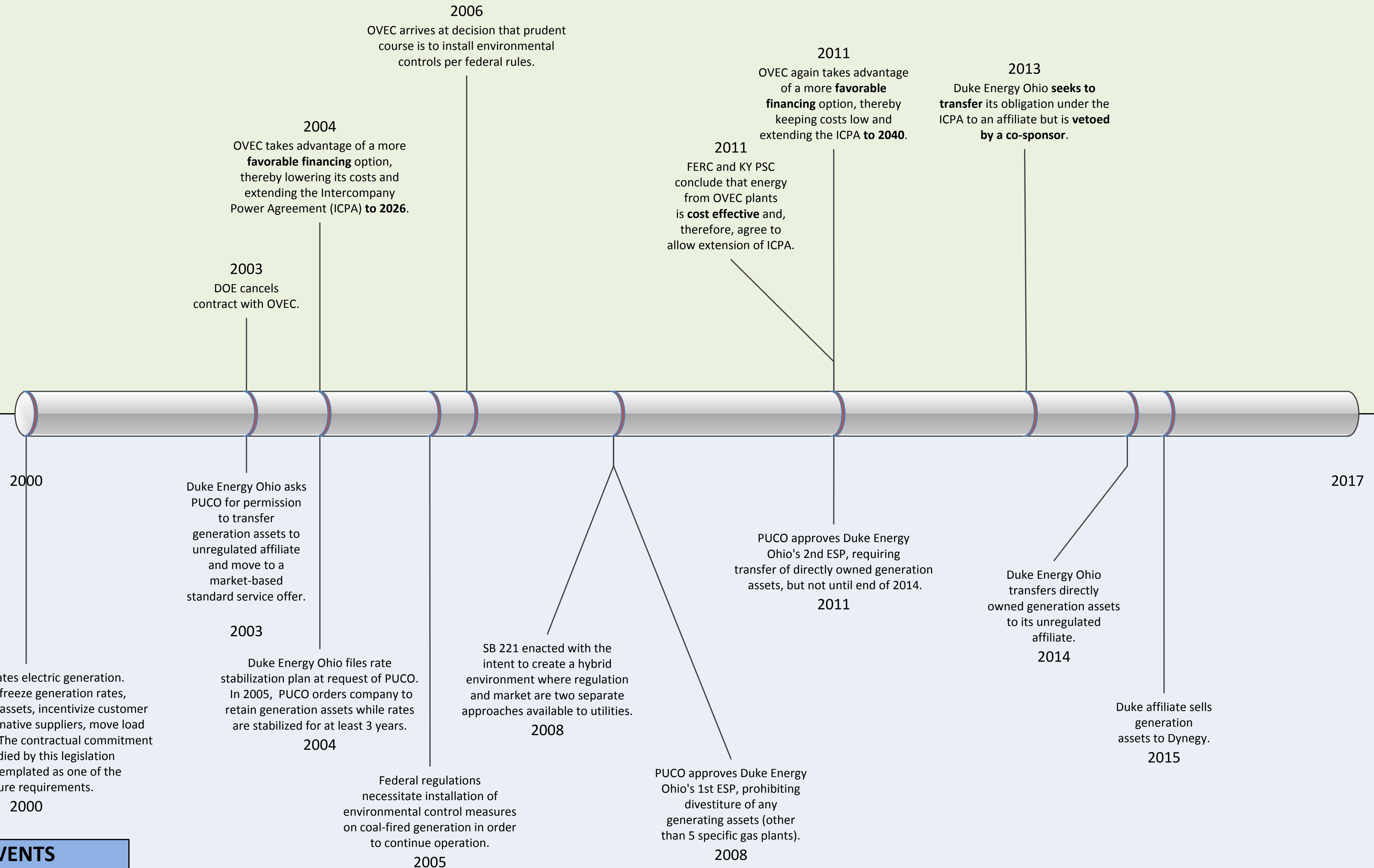
Similar to physical location, neither does this bill speak to equity ownership of any assets. It is focused on the plight of three companies that have obligations under a purchase power agreement with OVEC, the actual owner of assets. The circumstances of independent power producers that own and control their assets are vastly different than those surrounding the three Ohio utility sponsors to the ICPA. Attempting to reconcile the business environments of these two types of entities can only be expected to yield results skewed to the viewpoint of the one conducting the comparison.

Conclusion

So, in conclusion, Duke Energy Ohio, having divested its competitive generation assets and having complied with the letter and spirit of state policy regarding the move to deregulation, now asks for your prompt passage of Sub. S.B. 155. This legislation will ensure long-term parity for the utilities, provide clarity to the regulatory process, and require a number of customer protections. The entire Duke Energy team stands ready to answer any questions you may have. Thank you for your time and consideration.

Sincerely,

Amy Spiller
Deputy General Counsel for Duke Energy Ohio



OVEC INTERNAL EVENTS
1952
Utilities answer the call of the Atomic Energy Commission to build 2,400 MW of capacity in support of the nation's security strategy.
2003
DOE cancels contract with OVEC.
2004
OVEC takes advantage of a more **favorable financing** option, thereby lowering its costs and extending the Intercompany Power Agreement (ICPA) **to 2026**.
2006
OVEC arrives at decision that prudent course is to install environmental controls per federal rules.
2011
FERC and KY PSC conclude that energy from OVEC plants is **cost effective** and, therefore, agree to allow extension of ICPA.
2011
OVEC again takes advantage of a more **favorable financing** option, thereby keeping costs low and extending the ICPA **to 2040**.
2013
Duke Energy Ohio **seeks to transfer** its obligation under the ICPA to an affiliate but is **vetoed by a co-sponsor**.
2000
2017
1952
Cold War Era – nuclear Armageddon considered possible
Ohio deregulates electric generation. Utilities must freeze generation rates, divest generation assets, incentivize customer switching to alternative suppliers, move load to market. (NOTE: The contractual commitment being remedied by this legislation was not contemplated as one of the divestiture requirements.
2000
Duke Energy Ohio asks PUCO for permission to transfer generation assets to unregulated affiliate and move to a market-based standard service offer.
2003
Duke Energy Ohio files rate stabilization plan at request of PUCO. In 2005, PUCO orders company to retain generation assets while rates are stabilized for at least 3 years.
2004
Federal regulations necessitate installation of environmental control measures on coal-fired generation in order to continue operation.
2005
SB 221 enacted with the intent to create a hybrid environment where regulation and market are two separate approaches available to utilities.
2008
PUCO approves Duke Energy Ohio's 1st ESP, prohibiting divestiture of any generating assets (other than 5 specific gas plants).
2008
PUCO approves Duke Energy Ohio's 2nd ESP, requiring transfer of directly owned generation assets, but not until end of 2014.
2011
Duke Energy Ohio transfers directly owned generation assets to its unregulated affiliate.
2014
Duke affiliate sells generation assets to Dynegy.
2015
EXTERNAL EVENTS