

IN THE SUPREME COURT OF OHIO

The Office of the Ohio Consumers' Counsel,

Appellant,

v.

The Public Utilities Commission
of Ohio,

Appellee.

Case No. **08-0466**

Appeal from the Public
Utilities Commission of Ohio
Case Nos. 06-1068-EL-UNC, 05-
725-EL-UNC, 06-1069-EL-UNC,
05-724-EL-UNC. 06-1085-EL-UNC

NOTICE OF APPEAL
OF
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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Appellant, the Office of the Ohio Consumers' Counsel, pursuant to R.C. 4903.11, R.C. 4903.13, and S. Ct. Prac. R. II (3)(B), hereby gives notice to the Supreme Court of Ohio and to the Public Utilities Commission of Ohio ("Appellee" or "PUCO") of this appeal to the Supreme Court of Ohio from Appellee's Order entered in its Journal on November 20, 2007 and Appellee's Entry on Rehearing entered in its Journal on January 16, 2008 in consolidated cases (each docket designation noted in the caption above) before the PUCO. The Order was issued in cases that were consolidated with cases that were heard on remand from this Court's decision in an appeal by Appellant. *Ohio Consumers' Counsel v. Public Util. Comm.*, 111 Ohio St.3d 300, 2006-Ohio-5789.

Pursuant to R.C. Chapter 4911, Appellant is the statutory representative of the residential customers of the Duke Energy Ohio, Inc. ("Duke Energy," formerly known as the Cincinnati Gas and Electric Company). Appellant was a party of record in the cases before the PUCO.

On December 20, 2007, Appellant timely filed an Application for Rehearing from the November 20, 2007 Order pursuant to R.C. 4903.10. Appellant's Application for Rehearing was denied with respect to the issues raised in this appeal by an Entry on Rehearing entered in Appellee's Journal on January 16, 2008.

Appellant files this Notice of Appeal, complaining and alleging that Appellee's November 20, 2007 Order and January 16, 2008 Entry on Rehearing result in a final order that is unlawful and unreasonable, and that Appellee erred as a matter of law, in the following respects that were raised in Appellant's Application for Rehearing:

- A. The Commission's Order is unreasonable and unlawful because the Commission failed to determine that certain entities had no standing in these cases and the Order relies upon statements of support by those entities.
- B. The Commission's Order is unreasonable and unlawful because the Commission failed to properly apply the test for approval of a partial stipulation. *Consumers' Counsel v. Pub. Util. Comm.*, (1992), 64 Ohio St. 3d 123, 125.
 - 1. The settlement was not the product of serious bargaining.
 - 2. The settlement package does not benefit the public interest.
 - 3. The settlement package violates important regulatory policies and practices.

WHEREFORE, Appellant respectfully submits that the Appellee's November 20, 2007 Opinion and Order and January 16, 2008 Entry on Rehearing are unreasonable and unlawful, and should be reversed, vacated, or modified. These cases should be remanded to Appellee with instructions to correct the errors complained of herein.

Respectfully submitted,

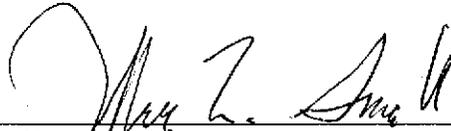
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Notice of Appeal of the Office of the Ohio Consumers' Counsel was served upon the Chairman of the Public Utilities Commission of Ohio by leaving a copy at the office of the Chairman in Columbus and upon others mentioned below (including all parties of record) by electronic service and regular U.S. Mail, postage prepaid, this 3rd day of March 2008.



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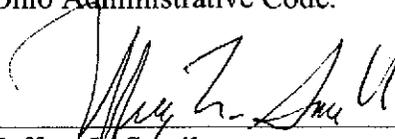
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CERTIFICATE OF FILING

I hereby certify that a Notice of Appeal of the Office of the Ohio Consumers' Counsel was filed with the docketing division of the Public Utilities Commission in accordance with sections 4901-1-02(A) and 4901-1-36 of the Ohio Administrative Code.



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The Commission, coming now to consider the stipulation, testimony, and other evidence presented in these proceedings, hereby issues its opinion and order.

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OPINION

I. HISTORY OF THE PROCEEDINGS

The above-captioned consolidated cases (rider cases) all relate to certain riders that are charged by Duke Energy Ohio, Inc., (Duke)¹ and were instituted as part of our approval of Duke's rate stabilization plan (RSP) in *In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Nonresidential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish an Alternative Competitive-Bid Service Rate Option Subsequent to the Market Development Period*, Case No. 03-93-EL-ATA, et al. (RSP case). As these rider cases and the RSP case are inextricably connected, we will begin our discussion with a review of the history of the RSP case.

A. History of Associated RSP Case

On June 22, 1999, the Ohio General Assembly passed legislation² requiring the restructuring of the electric utility industry and providing for retail competition with regard to the generation component of electric service (SB 3). Pursuant to SB 3, on August 31, 2000, the Commission approved a transition plan for Duke, to be effective during the market development period.³

On January 10, 2003, Duke filed an application for approval of rates subsequent to the market development period, together with three related matters. A stipulation and recommendation was filed by several of the parties in those proceedings. On September 29, 2004, the Commission issued its opinion and order approving that stipulation with certain modifications. The stipulation provided for the establishment of an RSP for Duke, governing the rates and riders to be charged by Duke from January 1, 2005, through December 31, 2008 (with certain aspects of those rates also extending through the end of 2010). Following the filing of applications for rehearing, the Commission issued entries on rehearing that made various modifications to the approved stipulation.

¹ Duke was, previously, known as the Cincinnati Gas & Electric Company. It will be referred to as Duke, regardless of its legal name at any given time. Case names, however, will not be altered to reflect the changed name.

² Amended Substitute Senate Bill No. 3 of the 123rd General Assembly.

³ *In the Matter of the Application of The Cincinnati Gas & Electric Company for Approval of its Electric Transition Plan, Approval of Tariff Changes and New Tariffs, Authority to Modify Current Accounting Procedures, and Approval to Transfer its Generating Assets to an Exempt Wholesale Generator*, Case No. 99-1658-EL-ETP et al.

The Ohio Consumers' Counsel (OCC) appealed the decision to the Supreme Court of Ohio, raising seven claimed errors. The court issued its opinion on November 22, 2006. *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 111 Ohio St.3d 300, 2006-Ohio-5789. In that opinion, the court upheld the Commission's decisions on most issues, but remanded the proceedings to the Commission with regard to two issues.

Following a hearing on remand, the Commission issued its order on remand, on October 24, 2007. That order had the effect of modifying certain aspects of Duke's RSP, including certain of the authorized riders, while allowing other portions of the RSP to remain virtually unchanged. The extent and impact of these changes will be discussed in detail below.

B. History of Duke RSP Riders

The Commission's order on remand found that the RSP would produce reasonably priced electric service and would meet other statutory requirements. As a part of that RSP, the Commission approved the establishment of riders for the recovery of certain of expenses. The setting of rates for those riders and the audit of rates under those riders are the bases for the cases now under consideration. We will proceed, at this point, to discuss the procedural history of each of those riders in more detail.

1. Initiation of FPP Cases

The fuel and purchased power rider (FPP) is intended to allow Duke to recover the costs associated with its purchases of fuel for its generating stations, emission allowances, and economy purchased power to meet its load. Two of these consolidated cases relate to the FPP: On September 1, 2006, Duke filed its application for our review of the FPP rates charged between July 1, 2005, and June 30, 2006, in *In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Fuel and Economy Purchased Power Component of Its Market-Based Standard Service Offer*, Case No. 05-725-EL-UNC (FPP review case). On August 29, 2006, Duke initiated the other FPP-related case, *In the Matter of the Application of Duke Energy Ohio, Inc., to Modify its Fuel and Economy Purchased Power Component of Its Market-Based Standard Service Offer*, Case No. 06-1068-EL-UNC, serving as a repository for Duke's filing of periodic FPP reports (FPP filing case).

2. Initiation of SRT Cases

The system reliability tracker (SRT) is intended to recover costs that Duke incurs in maintaining a reserve margin for switched and non-switched load. Two of these consolidated cases relate to the SRT: On September 1, 2006, Duke filed an application to commence the audit of its SRT, in *In the Matter of the Application of The Cincinnati Gas & Electric Company to Adjust and Set Its System Reliability Tracker Market Price*, Case No. 05-724-EL-UNC (SRT review case). The review of the SRT consisted of two separate

components. The first is an audit by Commission staff of the accuracy of the SRT calculations. The staff report that stemmed from that audit, covering the period from January 1, 2005, through May 31, 2006, was filed on December 4, 2006. The second component of the SRT review case is a prudence review of the period from January 1, 2006, through June 30, 2006, completed by Energy Ventures Analysis, Inc., in compliance with the stipulation previously adopted by the Commission in this proceeding and was filed on October 12, 2006. The second of the cases that relates to the SRT is *In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set its System Reliability Tracker Market Price*, (SRT approval case) filed on September 1, 2006, asking the Commission to approve Duke's resource plan for 2007 and, as a consequence, the SRT charges that would stem from it. Duke also asked, in that application, that we approve its filing of quarterly updates to the SRT charges.

3. Initiation of AAC Case

The annually adjustable component (AAC) is intended to recover Duke's incremental costs associated with homeland security, taxes, and environmental compliance. One of these consolidated cases relates to the AAC: In *In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set the Annually Adjusted Component of its Market Based Standard Service Offer*, Case No. 06-1085-EL-UNC, (AAC case) Duke filed an application on September 1, 2006, asking the Commission to approve its AAC charge for calendar year 2007.

4. Continuing Consolidated Procedural History

At the prehearing on December 14, 2006, the remanded RSP cases were consolidated with proceedings regarding various riders associated with Duke's RSP and various procedural matters were addressed. Although consolidated, the examiners ordered, on February 1, 2007, that the hearing would be bifurcated to hear remanded RSP issues first and rider-related issues later. The rider phase was scheduled to commence on April 10, 2007. On April 9, 2007, a stipulation signed by Duke, Commission staff, Ohio Energy Group (OEG), Ohio Hospital Association (OHA), city of Cincinnati, and People Working Cooperatively, Inc. (PWC) was filed in the above-captioned cases. OCC and Ohio Partners for Affordable Energy (OPAE) opposed the stipulation.

The hearing on the rider phase of the proceedings commenced on April 10, 2007, with testimony provided by Paul G. Smith, Charles R. Whitlock, and William Don Wathen, Jr., on behalf of Duke. Auditors Seth Schwartz and Ralph Smith also testified. Following a brief period for discovery related to the stipulation, the hearing continued on April 19, 2007, with testimony by OCC witness Michael P. Haugh and staff witnesses Tricia Smith, L'Nard E. Tufts, and Richard C. Cahaan. Initial briefs and reply briefs were filed by Duke, OCC, OPAE, and staff on May 17 and 30, 2007, respectively.

Certain of the parties argued over language contained in post-hearing briefs. On June 1, PWC filed a motion for an extension of time to file its reply brief, together with that brief. Its brief is dedicated to renewal of its prior motion, filed in the initial remand portion of these proceedings, intended to strike certain offensive language from OP&E's initial and reply briefs in phase one, as well as making a new motion to strike similar language in OP&E's initial brief and any similar language that OP&E might make in its reply in this rider phase. On June 6, 2007, OCC filed a memorandum contra FWC's motion for extension of time and contra the PWC's motion to strike. On June 8, 2007, OP&E filed its memorandum contra FWC's renewal of its motion to strike and, at the same time, filed its own motion to strike portion of Duke's reply brief that referred to settlement discussions. On June 11, 2007, PWC filed its reply to OCC's memoranda contra and its reply to OP&E's memorandum contra. On June 15, 2007, Duke filed a memorandum contra OP&E's motion to strike. On June 18, 2007, OP&E filed its reply to Duke's memorandum contra OP&E's motion to strike.

The Commission issued its order on remand in the remanded RSP phase of these proceedings, on October 24, 2007. The present opinion and order deals only with issues related to the rider proceedings.

II. DISCUSSION

A. FPP/SRT Audit Report

Energy Ventures Analysis, Inc., (EVA) was selected by the Commission to review the reasonableness of the FPP and the prudence of the SRT. Seth Schwartz testified that EVA, with its subcontractor, Larkin & Associates PLLC (Larkin), performed an audit that reviewed the fuel procurement activities underlying the FPP for the period beginning July 1, 2005, and ending June 30, 2006. The audit of the SRT covered the first six months of 2006. The auditors also evaluated Duke's proposed SRT for 2007.

While there were no specific statutory requirements that were applicable to the FPP, the auditors noted that the Commission had indicated that, in performing the FPP audit, it would be appropriate to follow the general guidance that had been provided for the electric fuel component audits. However, the auditors pointed out that there were major differences between the two types of audits. Among the differences, the auditors noted that electric fuel component audits included all costs, while the FPP audit was only intended to capture the difference between current and baseline costs. Second, the auditors indicated that the FPP audit related to only native customers and that it was for a period of up to four years, resulting in Duke viewing the related fuel and emission allowance commitments differently. A third difference related to the fact that, since Duke's last annual electric fuel component audit, Duke has operated as a deregulated entity with regard to distribution. (Comm. Ord. RR Ex. 1 at 1-2 to 1-3.)

Following its review of Duke's FPP, EVA made the following recommendations related to management of the FPP:

- (1) EVA recommends for the audit period that the company pass through the native load portion of the net margins associated with the trading of [Duke] coal assets purchased for delivery during the audit period except for those specifically excluded by paragraph D of the stipulation. . . . The margin from the re-sale of [certain identified] coal during the audit period was \$959,626.
- (2) EVA recommends that [Duke] adopt traditional utility procurement strategies related to the procurement of coal and emission allowances and cease its "active management" of such procurements throughout the balance of the RSP period. Accordingly, [Duke] should develop and implement a portfolio strategy such that it purchases coal through a variety of short, medium, and long-term agreements with appropriate supply and supplier diversification with credit-worthy counterparties. EVA further recommends that [Duke] no longer seek to flatten its position on a daily basis.
- (3) EVA recommends that as long as the FPP is in effect coal suppliers should not be required to allow the resale of their coal for the offers to be considered.
- (4) EVA recommends that [Duke] initiate a study to report on the recurring overstatement of coal inventory at the Zimmer station.
- (5) EVA recommends that [Duke] present several alternate sensitivity analyses of key variables, i.e., emission allowance prices and market coal prices, in its transaction review and approval process.
- (6) EVA recommends that purchases of reserve capacity from its Duke Energy North America (DNA) assets should not be eligible for inclusion in the SRT, as is currently the case.

(Comm.-Ord. RR Ex. 1, at 1-9 to 1-10.)

Following its review of Duke's FPP, Larkin made the following recommendations related to financial aspects of the FPP:⁴

- (1) . . . [D]uring the period July 2005 through June 2006, [Duke] plants were designated as "must run" units by MISO for reliability or voltage control reasons during a number of hours. Unless it has already been presented in another forum, the Commission may want to have [Duke] explain further how the "must run" generating unit designations are affecting the Company's fuel and purchased power costs that are includable in the FPP rider.
- (2) As described in this chapter of the report, . . . [Duke's] objective for the term of the RSP is to *actively manage* its native load obligations on a daily basis. By actively managing the load and generation position, [Duke] attempts to smooth the FPP component of the RSP price and reduce the volatility of the customer's bill. However, the active management can add additional transactions and related transaction costs, and tends to create a much more complex and difficult to understand audit trail. Testing by Larkin of amounts being included in the FPP . . . suggest that the costs related to [Duke's] active management can ultimately be tracked to supporting documentation. However, because [Duke's] active management reflects a reaction to daily market changes, it can be very challenging to understand the reasoning for each active management transaction (e.g., where [Duke] is adjusting a position based on market or cost changes), and how it related to [Duke's] RSP load obligation position. For this reason, it is imperative that [Duke] maintain documentation not only of the costs being included in the FPP, but also of the reasons and support for the Company's active management decisions.
- (3) [Duke] should analyze and document the net impact of its active management of FPP components and should report to the Commission and the parties to this docket concerning whether the added activity, including transaction costs of the additional activity, has resulted in increased or reduced FPP costs over time.

⁴ With regard to the coverage of its audit, Larkin specifically noted that its work "does not involve an audit of financial statements, but rather is an attestation engagement involving verification of [Duke's] FPP that is conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants . . ." (Comm.-Ord. RR Ex. 1, at 5-1, footnote 1.)

The Company implemented the FPP on January 1, 2005. The two-year period, 2005 and 2006, should be used for this analysis.

- (4) Currently, the FPP is to be in place through December 31, 2008. Because of the potential for additional Reconciliation Adjustments occurring months or years after the FPP rates were charged, due to MISO invoice revisions or other factors, the Company and Commission should address whether a cut-off period is needed for RAs after 2008 and what that cut-off period should be. [Duke] has filed an application to extend the FPP beyond 2008; however, consideration of RAs after the FPP could cease application [sic] is nevertheless something that deserves consideration.
- (5) [Duke] has made a number of changes to the specific costs that are included in the FPP by including its identified corrections and the effect of changed interpretations of FPP includible costs in its filed RA adjustments. [Duke's] quarterly FPP filings typically include a narrative discussion of the RA and that narrative identifies total amounts of changes and the RA components; however, the narratives filed for the RA adjustments could be improved by including a listing of the reasons for the changes by identifying and briefly describing significant changes and corrections that are being included in the RAs. . . .

(Comm.-Ord. RR Ex. 1, at 5-39 to 5-41.)

EVA also made three recommendations that related to Duke's SRT. Specifically, it "agrees with [Duke] that [it] should employ arrangements that include capacity commitments for more than one year." EVA also "believes that [Duke] should employ a portfolio strategy similar to what EVA is recommending for fuel . . . [and] should develop a portfolio of available instruments to manage the risk." Finally, EVA pointed out that it "does not support [Duke] in its request to purchase capacity from the legacy DENA assets . . ." (Comm.-Ord. RR Ex. 1, at 6-4 to 6-5.)

B. Stipulation

The stipulation filed in these proceedings is intended by the signatory parties to resolve all of the outstanding issues in this proceeding. It includes the following provisions:

- (1) Duke will provide a credit to FPP customers in the quarterly FPP rider filing beginning July 1, 2007, and ending September 30, 2007, resulting from the settlement of coal contracts.
- (2) The FPP auditor's recommendation 2 on page 1-9 of the Audit report dated October 12, 2006, that Duke discontinue its active management practices shall be withdrawn.
- (3) The parties agree that Duke, staff, and interested parties will meet to discuss the terms and conditions under which Duke may purchase and manage coal assets, emission allowances, and purchased power for the period after December 31, 2008, including addressing the auditor's finding (6) that Duke is actively limiting purchased fuel and emission allowance commitments beyond December 31, 2008. On the basis of those discussions, the parties will use their best efforts to agree and make a recommendation regarding the purchase and cost recovery, after December 31, 2008, of coal, emission allowances, and purchased power for consideration no later than the next FPP audit.
- (4) The parties agree that Duke's congestion costs shall be recovered through Rider FPP instead of Rider TCR, as approved in finding (26) of the Commission's December 20, 2006, entry in Case No. 03-93-EL-ATA et al. The congestion components to transfer to the FPP include congestion (day-ahead and real-time), losses (day-ahead and real-time) and firm transmission rights that were previously included on Schedule B of the TCR application.
- (5) The parties agree that Duke's proposed Rider AAC calculation shall be adjusted in accordance with the staff corrected supplemental testimony of L'Nard E. Tufts, as shown on Attachment LET-1 included as Stipulation Attachment 2. Rider AAC revenue will be trued-up to January 1, 2007, such that the amount calculated to be recovered in 2007 will be recovered by December 31, 2007.
- (6) The parties agree that Duke shall work with the staff to amend its bill format. Such amendments will be intended to reflect generation-related charges such as the FPP, SRT, and AAC in the generation portion of the customer bill. The parties also agree to simplify and standardize the monthly bill message regarding

updated rider charges and that the amendments will not result in additional programming or billing costs.

- (7) The parties agree that Rider SRT will be updated with the first billing cycle of the month following Commission approval of this stipulation to recover Duke's projected 2007 planning reserve capacity purchases by year-end, with future quarterly filings to reconcile any projected over- or under-collection
- (8) The parties agree that Duke may recover short-term capacity purchases from its generating assets formerly owned by DENA, through the SRT. Duke and staff are to agree on a pricing methodology prior to Duke's purchase of the capacity. The market price of such purchases shall be either (a) the midpoint of broker quotes received, or (b) the average price of third-party purchases transacted, or (c) an alternative agreed upon by Duke and staff. Duke's ability to maintain an offer of firm generation service to all consumers shall remain paramount. The parties agree that recommendation (6) on page 1-10 of the October 12, 2006 audit report (proposing that the Commission continue its policy that purchases of reserve capacity from DENA assets are not eligible for inclusion in the SRT) is inapplicable to the extent it is in conflict with this paragraph.
- (9) The parties agree that Duke accepts all audit recommendations made in the Report of the Financial and Management/ Performance Audit of the Fuel and Purchased Power Rider of Duke Energy-Ohio, dated October 12, 2006, except as set forth in paragraphs (1) through (8) of the stipulation.

At the hearing, staff and Duke provided a clarification to the stipulation, intended to permit Duke to utilize its DENA capacity on an emergency, intermittent basis. According to the clarification, an emergency basis would exist where capacity to meet Duke's operational requirements is necessary with less than seven days' advance notice. Further, the clarification provides that Commission approval would be required where DENA capacity is needed to meet Duke's operational requirement with less than seven days' notice during two consecutive seven-day periods. (OCC RR Ex. 3.)

C. Disputed Issues

The stipulation addresses and adopts most of the auditors' recommendations. However, it differs in a few areas.

1. Issues Associated with Rider FPP

Two issues were raised by OCC regarding the FPP audit. One related to active management of Duke's portfolio and the second related to EVA's finding that Duke is limiting its commitments beyond the end of the RSP period.

(a) Active Management

The first issue involved EVA's second recommendation, in which EVA proposed that Duke eliminate its active coal management portfolio strategy. (Comm.-Ord. RR Ex. 1 at 1-9.) In its findings, EVA stated that Duke's continued active management of its coal supply was problematic for a number of reasons, including the lack of an audit trail and the lack of documentation that this is an economical way to manage its fuel, emission allowances (EAs), and purchased power supply. EVA reported that it told Duke that it should be prepared to provide an audit trail and demonstrate that its approach yielded a lower FPP cost. (Comm.-Ord. RR Ex. 1 at 1-8.) At the hearing, Seth Schwartz, on behalf of EVA, testified that Duke did not consider any sales to native load customers to be firm for a duration beyond December 31, 2008, and was reluctant to enter, or avoided entering, into any fuel contracts that would extend past that date with fixed prices. (Tr. I at 55.) Mr. Schwartz stated that the objective of active management is to match the commitment to sell power with the commitment to supply power, either by generation or by purchased power, and to supply the inputs necessary to generate power (fuel supply and associated EAs) as precisely as possible. In addition, he explained, under active management, Duke continues to reevaluate its position on a daily basis and, based upon the revaluation, either buys or sells commitments for fuel, purchased power, or EAs so that there is a daily balancing of commitments to sell power with commitments to supply power. He pointed out that the cost difference between the two is hedged.

Mr. Schwartz distinguished active management from activities under a portfolio management system, explaining that, in the portfolio management approach, there is not a real matching of the costs to supply generation with the future demand from all rate payer classes because that demand continues for an indefinite period and is not known. Instead, he stated, the fuel supply, EA supply, and purchased power supply are purchased under a series of contracts with varying lengths of commitments and varying terms and conditions. He pointed out that some portion is left unhedged at any given point in time. A second difference between the two approaches, according to Mr. Schwartz, is that the portfolio management system is not continually readjusted on a daily basis to true up the supply and demand. (*Id.* at 58.)

Mr. Schwartz also testified regarding various short and long-term coal purchases that Duke engaged in. He noted that EVA's recommendation that Duke employ a portfolio management strategy is also based on the fact that Duke's newer coal contracts do not extend past the end of December 2008. Therefore, he pointed out, Duke's portfolio

was almost entirely purchased on a short-term and spot-basis, with almost nothing purchased for later than December 2008, at least with regard to firm pricing. (Tr. I at 92.) Finally, Mr. Schwartz testified that the documentation provided by Duke regarding its active management of coal was adequate to perform the audit, but did not demonstrate whether the approach was a lower-cost approach. (Tr. I at 69-70.)

According to Duke, EVA's recommendation is based on a preference for traditional regulated utility procurement strategies for fuel and EAs. Duke argues that such strategies and protocols, although relevant and appropriate for a fully regulated world, do not make sense in a deregulated environment where consumers may switch to a competitive retail electric service (CRES) provider at their pleasure, where a utility's load is not constant, and where a utility is responsible for its position in the marketplace. Duke claims that, through active management, it constantly reviews its position to be sure that all stakeholders are sitting in the most advantageous position in terms of price, inventory, and quality of fuel, explaining that it matches the cost of supplying generation to the demand for electricity and hedges any cost difference between generating electricity and purchasing power. (Duke Rider Reply Brief at 34-36.)

Mr. Charles Whitlock testified, on behalf of Duke, that the auditor's recommendation to abandon active management poses a substantial risk to consumers and delays the company's ability to react affirmatively to changing market factors. (Duke Rider Reply Brief at 36; Duke RR Ex. 2 at 6.) Mr. Whitlock explained that, if Duke locks in a price by purchasing coal on a date certain and the price subsequently falls while power prices increase, consumers can not benefit from coal purchases at the lower price. Similarly, he notes, if the price of coal rises while forward power prices decline, consumers cannot benefit from the sale of the coal at the higher price in the market. (Duke RR Ex. 2, at 6-7.) Mr. Whitlock contends that, because Duke "is not a regulated utility for the sale of electricity," it is not permitted to recover generation investments plus a reasonable return through the regulatory process, nor is it permitted to recover increases in many other costs. He noted that Rider FPP is fully avoidable by all consumers that purchase generation from a CRES provider and that traditional regulated utility practice is not appropriate for managing all of the risks inherent in a deregulated environment. (Duke RR Ex. 2, at 7).

Duke also pointed out EVA's recommendation that Duke evaluate its position every 90 days, unless conditions deem otherwise. It argued that this recommendation is purely speculative as there is no definition of what EVA would consider to be an appropriate circumstance for a re-evaluation of a position sooner than 90 days. Duke believes that evaluation on a 90-day schedule would result in higher cost fuel and EAs, as Duke would then be unable to take advantage of market fluctuations. (Duke Rider Reply Brief at 36.) Duke witness Charles R. Whitlock testified that the benefit of active management is that Duke may make rational economic decisions based on the market

price of coal, power, and emission allowances and reduce market price risk. He also pointed out that the auditor agreed that Duke's active management techniques have resulted in substantial savings for Rider FPP consumers. Mr. Whitlock summarized that active management limits the market risk and reduces volatility in Rider FPP. (Duke RR Ex. 2, at 8; Comm.-Ord. RR Ex. 1, at 2-14.)

With regard to the auditor's recommendation, in connection with its suggestion that Duke discontinue active management, that Duke should purchase coal through a variety of short-, medium-, and long-term agreements, Mr. Whitlock stated that Duke has short, medium, and long-term contracts in its portfolio with multiple suppliers. (Duke RR Ex. 2, at 9.)

Duke argues that its active management strategy has not increased costs to consumers, pointing out that Duke's shareholders absorb all transaction costs related to active management. (Duke Rider Reply Brief at 36-7; Tr. II at 72-78.) Duke also points out that active management has not hampered the Commission's ability to audit Duke's transactions. (Duke Rider Reply Brief at 36-7; Tr. II at 72-78.)

OPAE contends that there is no justification to disregard the auditor's recommendation on this issue and it asserts that the stipulation's provision that parties meet to discuss the problem is meaningless. According to OPAE, the Commission, in separate, ongoing proceedings, will consider issues such as the procurement of coal, EAs, and power in the post-2008 period. (OPAE Rider Brief at 19.) OPAE also noted that the auditor recommended that Duke present several alternative sensitivity analyses of key variables for EAs, coal prices, and purchased power transactions. It suggests that Duke should maintain detailed documentation of these items to enable the next FPP auditor to review prudence of incurred costs. (OPAE Rider Brief at 20.)

OCC also contends that there is no basis to disregard EVA's recommendation to discontinue Duke's active coal management practices. OCC asserts that Duke's active management should be discontinued. (OCC Rider Reply at 9.)

Based on the evidence, we find that it is reasonable to allow Duke to continue its active management of its coal, EA, and purchased power portfolio, as provided in the stipulation. Evidence of record convinces us that an active management approach allows Duke to take advantage of market fluctuations, thereby lowering the overall cost to customers. We note that certain transaction costs, including brokerage fees and certain accounting costs, were not contemplated when generation rates were established in Duke's last rate case and these costs are not passed on to customers through the FPP. In addition, we note that EVA was able to audit the transactions in question.

(b) Commitments Beyond RSP Period

The second FPP-related issue raised by opponents of the stipulation relates to whether Duke should continue to limit its commitments to the RSP period. EVA reported, in finding six of the audit report, that Duke "actively looks to limit commitments beyond the end of the RSP period. This strategy may increase the costs of both short-term and long-term procurements and certainly exposes [Duke] ratepayers to market volatility after 2008." (Comm.-Ord. RR Ex. 1, at 1-8.)

In response to this finding, the stipulation provides that the parties would meet to discuss the terms under which Duke might make purchases for the period following December 31, 2008. (Stipulation, para. 3.) On behalf of OCC, Mr. Michael Haugh testified that this provision of the stipulation fails to accomplish anything, as this issue is the subject of a separate Commission proceeding.⁵

Duke disagrees, noting that EVA made no recommendation with regard to this finding. Duke asserts that there is no reason to delay consideration of this issue and that discussions should begin immediately. (Duke Rider Brief at 7-8.)

OCC points to the auditor's second recommendation, which includes language suggesting that Duke should adopt traditional utility procurement strategies. (OCC Rider Reply Brief at 9.)

We find that the stipulation provision proposing the initiation of discussions relating to the post-RSP period is reasonable, especially in light of pending legislation relating to the post-RSP period. We do not believe that it would be appropriate for us to mandate any particular strategy at this juncture and on the basis of evidence before us.

2. Issue Associated with Rider SRT

As explained by Duke's witness, Paul Smith, Rider SRT recovers costs that Duke incurs in maintaining a 15 percent planning reserve margin for switched and non-switched load. Rider SRT is avoidable by non-residential consumers who agree to stay off Duke's system through 2008. (Duke RR Ex. 6, at 3.) Rider SRT was approved by the Commission in Case No. 04-1820-EL-ATA on an interim basis and the Rider SRT 2006 funding was approved by the Commission in case No. 05-724-EL-UNC. For 2006, Duke's Rider SRT was based on Duke's estimated cost of capacity products required to maintain at least a 15 percent reserve margin adjusted by the over-recovered 2005 Rider SRT costs to be refunded to non-residential customers.⁶ Rider SRT is similar to Rider FPP in that it is

⁵ In the Matter of the Application of Duke Energy Ohio, Inc. to Modify Its Market-Based Standard Service Offer, Case No. 06-986-EL-UNC.

⁶ Residential customers were not covered by the SRT in 2005 and therefore are not eligible for the refund.

also subject to quarterly adjustments with an annual audit and true-up. 05-724 is Duke's annual review of its 2006 SRT and 06-1069 is Duke's application to establish and set its 2007 Rider SRT. (Duke RR Ex. 6 at 3.)

With regard to Rider SRT, the opponents to the stipulation raised an issue involving Duke's request to purchase capacity from the assets it obtained from Duke Energy North American LLC (DENA assets). Currently, DENA assets are not eligible for inclusion in the SRT, as the Commission previously approved a stipulation requiring approval of the Commission prior to using DENA assets as part of the SRT. *In the Matter of the Application of The Cincinnati Gas & Electric Company To Adjust and Set its System Reliability Tracker Market Price*, Case No. 05-724-EL-UNC, Opinion and Order (November 22, 2005). In paragraph 8, that stipulation describes, *inter alia*, restrictions regarding Duke's use of DENA assets:

[Duke] cannot use the DENA Assets as part of the SRT unless it receives Commission authorization to do so after [Duke] applies to the Commission for approval to include such DENA Asset(s) in the portfolio and for approval of the SRT market price associated with such DENA Asset(s). [Duke] shall provide OCC with workpapers and other data supporting the use of DENA Assets as part of the SRT and if any interested party is concerned about the use of DENA Assets in the SRT the Commission will hold a hearing.

In its audit in these proceedings, EVA reported that, in the first half of 2006, Duke satisfied its SRT requirements by purchasing almost all of its required capacity through regulatory capacity purchases. EVA noted that it agreed with Duke as to the types of capacity products it considered and also supports the use of a greater mix of products, similar to what Duke employed in 2005, rather than the heavy reliance on one type of product in 2006. EVA noted that, in its 2007 Rider SRT proposal, Duke is proposing a number of changes with respect to future capacity purchases in order to maintain its required reserve margin. According to EVA, Duke would like to purchase capacity instruments for periods longer than a year and it would like to purchase capacity from the DENA assets. EVA stated that it agreed with Duke that it should employ arrangements that include capacity commitments for more than one year. EVA also stated that Duke should employ a portfolio strategy similar to what EVA is recommending for fuel. (Comm.-Ord. RR Ex. 1, at 6-4 to 6-5.)

However, EVA opposed Duke's request to purchase capacity from the DENA assets, for several reasons. First, EVA stated that Duke has not demonstrated that its native customers are paying more for capacity in the market than they would if Duke purchased capacity from the DENA assets. Second, according to EVA, purchases from an affiliate are always problematic as they cause suspicion in the market and, potentially, reduce competitive offers. In addition, the existence of such offers puts a greater burden

on the audit process. Finally, Duke would not be disadvantaged by this requirement, as DENA assets should be able to be sold at market prices. Duke should be indifferent to whether the legacy DENA assets are sold to Duke or on the open market. (Comm.-Ord. RR Ex. 1, at 6-5.)

OCC argues that the record does not support any change in the prohibition against charging for the DENA assets and that the auditor's recommendation should be followed by the Commission. OCC points to EVA's report that states that Duke has not demonstrated that its native customers are paying more for capacity in the market than they would if Duke purchased capacity for the DENA assets. (OCC Rider Brief at 11.) Similarly, OCC witness Haugh testified that Duke has not demonstrated that use of the DENA assets will provide benefits to customers. (OCC RR Ex. 1 at 15.) Mr. Haugh also explained that one reason for his opposition to the use of DENA assets was that, as admitted by Duke's witness, during situations when Duke would purchase capacity from the DENA assets, there are usually very few broker quotes. Thus, Mr. Haugh argued that the proposed pricing methodology does not provide proper protection for ratepayers. (OCC RR Ex. 2, at 4; Tr. I at 145.)

OCC also points to the auditor's report that states that affiliate transactions "are always problematic and make the market suspicious regarding pricing and potentially reducing competitive offers." According to OCC, Duke helped to create a problem by reducing the number of market participants through the Duke merger and its proposal to use the DENA assets may compound that problem by discouraging the remaining market. OCC also opposes affiliate transactions on the grounds that a company is always expected to act in its own best interests as opposed to the public interest and that such transactions put a greater burden on the auditor, the Commission and the audit process. (OCC Rider Brief at 13.)

OCC advocates the imposition of strict rules as to when the DENA assets can be used, such as only in an emergency situation where there are no other options. Mr. Haugh also indicated that guidelines for formulating a price for the DENA assets need to be stringent, such as a minimum number of broker quotes and transactions to determine the price of the DENA capacity, as well as a cap on the amount Duke is charging to the customers who are paying the SRT. (OCC RR Ex. 2, at 5.)

OPAE also opposes the use of DENA assets in the SRT. OPAE notes that, pursuant to the finding and order in *In the Matter of the Joint Application of Cinergy Corp., on Behalf of The Cincinnati Gas & Electric Company, and Duke Energy Holding Corp. for Consent and Approval of a Change of Control of The Cincinnati Gas & Electric Company*, Case No. 05-732-EL-MER, costs related to the transfer of the DENA assets may not be passed on to Ohio customers without prior approval of the Commission. OPAE also points out that the stipulation approved by the Commission with regard to SRT, discussed above, provides

that Duke may not use the DENA assets to satisfy the SRT margin requirements without an application to the Commission requesting approval of a market price associated with the DENA assets. OPAE argues that Duke has not provided any market pricing mechanism in its application. OPAE also argues that Duke has not shown that customers are better off by Duke using DENA assets than they would be by Duke paying for capacity in the market. (OPAE Rider Brief at 14-15.)

OPAE asserts that Duke should be allowed to purchase capacity from the DENA assets in the future only in an emergency situation. (OPAE Brief at 16, 18.)⁷ OPAE argues that the guidelines for formulating a price for the DENA assets need to be more stringent and agreed with OCC's contention that a minimum of three bids and offers from three separate brokers would be needed. (OPAE Rider Brief at 17.)

Staff supports Duke's use of DENA assets in a limited, emergency, situation. Staff argues that recovery of costs related to DENA assets does not violate any significant regulatory principle or practice. Staff specifically states that the stipulation would allow cost recovery when assets are used in emergency situations. With regard to pricing, Staff asserts that the stipulation provides protections in the face of a limited market, while benefitting customers during emergency circumstances. (Staff Reply Brief at 19-20.)

Duke points out that the auditor justifies its opposition to Duke's use of DENA capacity as a resource eligible for inclusion through the SRT on the base that affiliate transactions are difficult to audit and that a market price is difficult to verify. (Duke Rider Reply Brief at 37.) Duke claims that it is beneficial to its consumers that all reasonably priced generation options, including DENA assets, are available to meet the needs, especially in an emergency. In his testimony, Duke witness Charles Whitlock testified that the purpose of the SRT is to ensure adequate capacity to meet Duke's obligation as provider of last resort. This obligation requires Duke to maintain a 15 percent capacity reserve margin. Mr. Whitlock stated that there are limited assets located in the MISO footprint that meet MISO's designated network resource requirements and that consumers need to have access to every possible economic option of available generating assets. The risks to consumers are increasingly likely if Duke does not have access to market price capacity during a time of need. Mr. Whitlock also testified that, on a daily operational level, the ability to include the DENA assets makes sense since arbitrarily excluding specific generators from consideration can only increase the cost to consumers. Mr. Whitlock testified that the auditor's concern about the reduction of competitive bid offers is unwarranted. He indicated that the vast majority of competitive bidders are not aware of Duke's exclusion of DENA assets. He also testified that the auditor's position

⁷ We note that in a clarification to the stipulation in these cases, Duke and Staff attempted to clarify the circumstances under which an "emergency" would exist where DENA assets would be appropriately used. Witnesses testified as to the circumstances under which an emergency would exist. (Tr. II at 89-90, 94, 108.)

with respect to the size of the market and the ability to sell legacy DENA capacity in the market is dubious. He added that, if the Commission does not permit Duke to purchase capacity from its DENA assets to satisfy its Rider SRT obligations, Duke will continue to sell the capacity on the open market. (Duke RR Ex. 2, at 10-14.)

Duke contends that the need for available capacity options is especially strong in the day-ahead market, where a sudden capacity constraint coupled with a need for capacity would likely expose consumers to high prices. Duke also contends that the nature of a capacity purchase in an emergency makes the market price unpredictable, as the availability of capacity is unknown. Therefore, Duke contends that a capped market price is unreasonable. Duke asserts that the stipulation provides two alternatives for pricing the DENA capacity at the time it is needed, through the midpoint of broker quotes or an average of third-party purchases. Duke also argues that the next SRT auditor will be able to audit all DENA transactions properly because the pricing methodologies require Duke to maintain records of brokers' quotes and third-party transactions. (Duke Remand Reply Brief at 38.)

The issues in contention, relating to the recovery of costs of DENA capacity through the SRT, are the procedural compliance with prior orders, the clarity and meaning of the term "emergency," and the reasonableness of the proposed pricing mechanism. First, while we are aware that our prior orders required certain procedural steps to be taken before Duke might get approval for the recovery of the costs of using DENA capacity, we find that Duke has complied with the underlying intent of those procedural safeguards. The process that was instituted required Duke to give notice of its intent to use the DENA assets, to allow discovery of relevant facts by interested parties, and to provide sufficient detail to allow analysis of the reasonableness of its proposal. In this situation, all of those goals have been met. Notice was given, discovery was pursued, and details are available. While it is true that the stipulation does not include a proposed price, it does include a methodology for determining a price. We find that the process that has been followed in this proceeding has complied with the substance of our prior orders.

Although certain of the parties contend that the stipulation would allow use of the DENA assets in non-emergency situations, it is clear to us that this is not the case. The clarification of the stipulation, submitted at the hearing, specifically states that the stipulation "is intended to permit [Duke] to utilize its DENA capacity on an emergency, intermittent basis. An 'emergency' basis exists where capacity to meet [Duke's] operational requirements is necessary with less than seven days [sic] advance notice."

We find that the pricing mechanism proposed in the stipulation is reasonable. Although we are aware that the market for capacity is not mature, Mr. Whitlock did testify that he would likely be able to get multiple quotes. (Tr. I at 144-145.) In addition, we note that the stipulation provides two different mechanisms for setting a price and also allows

for the possibility that Commission Staff might agree to a different system in appropriate circumstances. In light of the fact that Duke would likely be unable to obtain timely Commission approval of a DENA purchase in an emergency circumstance, the system established by the stipulation is a reasonable solution.

3. Issue Associated with Rider AAC

Rider AAC is defined as a component to recover incremental costs associated with homeland security, taxes, and environmental compliance. The charges under Rider AAC were established for calendar years 2005 and 2006 in the Commission's entry on rehearing in 03-93. For non-residential consumers, Rider AAC was set at an agreed market price of four percent of little g⁸ for 2005 and eight percent of little g for 2006. For residential consumers, Rider AAC was not applicable in 2005, because these consumers continued to be in the market development period. After January 1, 2006, Rider AAC was set for residential consumers at a market price of six percent of little g. In 03-93, Duke was required to file an annual application to set its AAC price.

Duke's 2007 proposed price for Rider AAC was filed in Case No. 06-1085-EL-UNC. (Duke RR Ex. 6, at 4.) Mr. William Don Wathen, Jr., testified on behalf of Duke with regard to the AAC. Mr. Wathen described how Rider AAC was calculated and applied in the first two years of the RSP and discussed the components that are included in the calculation of the proposed Rider AAC for 2007. (Duke RR Ex. 4 at 2.) Mr. Wathen testified that the current Rider AAC market price is insufficient to fully recover the costs eligible under the AAC, which include earning a return on and of the capital investment for environmental compliance equipment capital investment, operation and maintenance expenses and environmental reagent costs; tax rates due to changes in tax laws; and homeland security, costs including a return on and a return of capital and expenses. (Duke RR Ex. 4 at 4.) Mr. Wathen also testified that there are dozens of projects where Duke is proposing recovery of a return on construction work in progress (CWIP) through Rider AAC. (Tr. I at 162.)

There is one issue associated with the calculation of the AAC that was raised by OCC and OP&E. Specifically, the nonsignatory parties question whether a return on CWIP should be recovered through Rider AAC. According to OCC witness Haugh, Duke is looking to collect \$73,818,962 from the AAC, which equates to a charge equal to 9.1 percent of little g. (OCC RR Ex. 1 at 5.) Mr. Haugh recommended that CWIP be removed from the return on environmental plant calculation, in order to set a more reasonable AAC charge (*id.* at 8.)

⁸ "Little g" represents the result of removing the regulatory transition charges from the company's unbundled generation rate, referred to as Big G.

OCC supports the AAC calculations that exclude return on CWIP for environmental plant. OCC indicates that staff is accepting Duke's AAC calculations based on a return on 100 percent of CWIP for environmental plant with no showing by Duke regarding the percentage of completion of that plant. (OCC Rider Reply Brief at 15.) OCC notes that Staff witness Tufts states that he did not form an opinion on whether a return on CWIP is an appropriate component of the AAC. (Tr. II at 35.) According to OCC, no precedent exists for such calculations, which are traditionally based on a showing the plant is at least 75 percent complete. (OCC Rider Brief at 15-16.) OCC witness Haugh indicated that removing the CWIP portion of the environmental plant reduces the revenue requirement for the 2007 AAC to \$45,246,994 and results in the AAC being set at 5.6 percent of little g. (OCC RR Ex. 1, at 11.) According to OCC, Duke fails to recognize the Commission's regulatory practice of allowing a return on CWIP only after an installation is 75 percent or more complete. OCC points out that calculation of the AAC and review of the underlying transactions were not within the scope of the auditor's report and that neither the staff nor Duke provided any detail of the percentage completion of environmental upgrades at Duke's plants. Rather, OCC explains, staff only investigated Duke's accounts regarding capital environmental plant additions and verified the existence of certain plant additions and did not complete a management audit related to the AAC. Hence, it argues, the reasonableness of a return on CWIP for environmental plant in the AAC calculation is not covered by staff's inquiries. In OCC's opinion, elimination of the return on CWIP is appropriate since customers may receive little or no benefit from the plant additions. (OCC Rider Brief at 14-16.)

OPAE contends that there is no justification for the inclusion of a return on CWIP in the AAC.⁹ OPAE states that the Commission has not determined that a return on CWIP may be included in the AAC and the components of the AAC mention expenses, but do not describe the return on CWIP. OPAE also claims that the Commission did not approve a set formula for the calculation of the AAC but adopted a flexible approach, citing factors such as proven expenses and other factors that may be appropriate from time to time. (OPAE Rider Brief at 11.) OPAE argues that CWIP should be excluded from the revenue that Duke seeks to obtain through the AAC, noting that, in a traditional ratemaking proceeding, CWIP be required to be at least 75 percent complete before a return would be allowed. OPAE points out that Duke has made no such showing. OPAE also argues that under traditional regulatory treatment, Duke would be allowed to earn a return on CWIP during construction, but customers might pay less at a future date when the plant is in service. However, OPAE suggests, the current treatment provides no assurance of lower capital costs for customers at a future date. OPAE argues that, in a truly competitive market, a return on CWIP would not be earned at all and a return on the plant would not occur until a new plant is fully operational. (OPAE Rider Brief at 11-14.)

⁹ On page 11 of its initial brief, OPAE claims that the m/p auditor recommended that a return of CWIP be excluded from the AAC. The m/p auditor made no recommendations related to the AAC.

Staff disagrees with OCC's analogy to ratemaking principles, because those principles do not apply in this competitive environment. Staff referred to testimony of its witness, Mr. Cahaan, who testified in the remand phase of the hearing in these proceedings that the RSP is not cost-based ratemaking, but is a market-based standard service offer, and that the rate setting provisions of Section 4909, Revised Code, do not apply. (Staff RR Ex. 1, at 4-5.) According to Mr. Cahaan, traditional rate-case components, such as CWIP, are used differently in an RSP case than in a traditional rate case. In a rate case, he explained, individual components are evaluated individually and the "correct" determination of each item is presumed to generate a fair, reasonable, and sustainable solution and an appropriate balance of competing interests. In an RSP case, he continued, the assessment of individual components does not matter. Rather, Mr. Cahaan asserted, the important principle here is the balance among conflicting policy goals that include protecting consumers from a volatile, risky, and an imperfect market; assuring companies of financial stability; and encouraging the development of retail markets. (Staff Rider Brief at 7-11.)

Duke argues that a limitation on earning a return prior to attainment of a 75 percent completion level was statutorily eliminated by the legislature. Duke points out that CWIP was included in the initial support for the AAC, as a part of Duke's market price, as evidenced by supportive testimony of Mr. Wathen and by reference to Attachment JPS-4 to the testimony of Mr. Steffen in approval of the RSP, as well as by the fact that OCC's recommended change would result in a reduction of the total Rider AAC price to a level below what the Commission approved in 2004. Further, according to Duke, if it cannot recover a return on CWIP on its environmental investments, it will be forced to substitute emission allowances, more expensive low sulfur coal, and purchased power, in place of the scrubbers that are included in CWIP, in order to meet environmental requirements. It contends that those substitutes will directly affect the costs recovered through the FPP and will, therefore, directly affect the price for all consumers. Duke contends that, as long as its total price is within the range of prices available to consumers in the market and is just and reasonable, it is irrelevant what types of underlying costs are included in the price. (Duke Rider Reply Brief at 41-46.) Duke also notes that a management performance audit is not necessary, given the nature of the expenses recovered in Rider AAC. (Duke Rider Reply Brief at 46-49.)

In the Commission's September 29, 2004, opinion and order, we indicated that we would consider future AAC charges. There was no discussion regarding a return on CWIP in the AAC. However, in our approval of the AAC, we based our determination in part on Duke's supplied calculations. Attachment JPS-4 to the testimony of John Steffen clearly showed CWIP as a factor in the AAC, with no reference to percentage completion. We would note that, in the present market environment, ratemaking standards such as the limitation on earning a return on CWIP are not dispositive of the outcome in these proceedings. Therefore, we find that the stage of completion of CWIP should not, under

these specific circumstances, be a bar to Duke's earning a return on CWIP. In addition, we would note that we do not find a management performance audit to be necessary at this time, based on the nature of the items being recovered under Rider AAC and based on the fact that we are monitoring Duke's activities in these spheres in the course of our periodic financial audits. However, we would also respond that just because Duke incurs a particular cost does not necessarily mean that such cost would be appropriate for recovery under any given rider. Duke should expect that its claimed costs may be reviewed for reasonableness.

D. Evaluation of the Stipulation

Rule 4901-1-30, O.A.C., authorizes parties to Commission proceedings to enter into stipulations. Although not binding on the Commission, the terms of such agreements are accorded substantial weight. *See Consumers Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St.3d 123, 125, citing *Akron v. Pub. Util. Comm.* (1978), 55 Ohio St.2d 155. This concept is particularly valid where the stipulation is supported or unopposed by the vast majority of parties in the proceeding in which it is offered. In reviewing the stipulation, our primary concern, however, is that the stipulation is in the public interest.

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. *See, e.g., Ohio-American Water Co., Case No. 99-1038-WW-AIR* (June 29, 2000); *The Cincinnati Gas & Electric Co., Case No. 91-410-EL-AIR* (April 14, 1994); *Ohio Edison Co., Case No. 91-698-EL-FOR et al.* (December 30, 1993); *The Cleveland Electric Illuminating Co., Case No. 88-170-EL-AIR* (January 30, 1989); *Restatement of Accounts and Records (Zimmer Plant), Case No. 84-1187-EL-UNC* (November 26, 1985). The ultimate issue for our consideration is whether the agreement, which embodies considerable time and effort by the signatory parties, is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

- (1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
- (2) Does the settlement, as a package, benefit ratepayers and the public interest?
- (3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. The court stated in that case that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission. *Indus. Energy*

Consumers of Ohio Power Co. v. Pub. Util. Comm. (1994), 68 Ohio St.3d 559 (citing *Consumers' Counsel, supra*, at 126).

1. Serious Bargaining

OPAE asserts that the stipulation is not balanced and does not represent the views of all customer classes that are parties to the proceedings. It explains that, in its view, the Supreme Court of Ohio has affirmed rate stabilization plans only on the basis of customer agreement in a stipulation, therefore arguing that customer support is critical. OPAE states that the stipulation has no support from marketers, residential customers, or any other customer group that will be subject to its terms. In making this claim, OPAE discounts the support of PWC, asserting that PWC is unconcerned about the impact of the stipulation on residential customers' bills. It also discounts the support of the city of Cincinnati, as it is a party to a side agreement that required support for the stipulation in Duke's RSP case (not this stipulation). Finally, it discounts the support of certain other customer groups on the basis of confidential agreements that arose in the context of Duke's RSP remand proceeding. (OPAE Rider Brief at 2-10.) OPAE asserts that special considerations in the form of side agreements may have allowed one or more parties to gain an unfair advantage in the bargaining process. (OPAE Rider Reply Brief at 4.)

OCC similarly claims that the settlement was not the product of serious bargaining. OCC argues that its "participation in drafting an agreement would have provided credibility to the argument that serious bargaining took place over the 2007 Stipulation, but the OCC's efforts to correct even the obvious flaws in the document were entirely rebuffed." (OCC Rider Brief at 21.) OCC argues that the "legacy of the side agreements" discounts the conclusion that serious bargaining took place. (OCC Rider Brief at 22.) OCC also claims that the city of Cincinnati has not demonstrated any knowledge of the issues in these proceedings and the city's interest in these proceedings was to protect its side deal with Duke. Thus, OCC claims, there was no serious bargaining between Duke and Cincinnati. OCC also claims that PWC failed to demonstrate any knowledge of the issues in these cases and that its only interest in these cases was focused on maintaining the financial support for its narrow interests. (OCC Rider Brief at 22-23.) OCC also claims that many of the stipulating parties evidenced their lack of involvement by being uninterested in OCC's discovery activity, failing to participate in the hearing, and failing to file briefs. According to OCC, a party that declines to accept and review copies of documents that were important to these cases, is not "knowledgeable," regardless of the identity of that party. (OCC Rider Reply Brief at 6-7.)

Duke, on the other hand, contends that the stipulation was the product of serious bargaining, pointing to the fact that all of the parties, including the signatories to the stipulation, as well as those who chose not to sign the stipulation, were invited to, and participated in, the settlement discussions and have extensive experience before the Commission. Duke's witness, Paul Smith, specifically testified that all parties were invited

to attend the three settlement discussion related to these matters, at which many issues were addressed. (Duke RR Ex. 6, at 5.) Specifically, Duke indicates that parties participating in settlement discussion represented all stakeholder groups, including residential, industrial, and commercial customers, as well as CRES providers. The parties so identified by Duke include OCC, OPAE, the city of Cincinnati, PWC, IEU, OEG, OHA, OMG, and Dominion, in addition to Duke and staff of the Commission. Duke emphasizes that the signatory parties also represent all stakeholder groups other than CRES providers and that no CRES provider opposed the stipulation. (Duke Rider Brief at 6.) Duke thus discounts OCC's and OPAE's claim that there was no serious bargaining because residential stakeholders did not support the stipulation, submitting that there was substantial support by residential representatives including PWC, which represents low income residential consumers who rely on programs funded by Duke for energy efficiency and weatherization, and the city of Cincinnati, which is the statutory representative of residential consumers within its municipal boundaries. (Duke Rider Reply Brief at 17-20.)

Duke also maintains that, during the settlement discussions, many positions were advocated and considered and were ultimately accepted or rejected by the negotiating parties. It proposes that few stipulations contain every demand by every party and necessarily include concessions made by parties to reach an acceptable resolution. Thus, it argues, the fact that many of the settlement positions of OCC and OPAE were rejected does not mean that serious bargaining did not take place. (Duke Rider Reply Brief at 14.)

Duke discounts OCC and OPAE's claims that OEG and OHA did not engage in serious bargaining because their members are parties to certain side agreements. Duke notes that nothing in those side agreements prohibits opposition to the increases resulting from Duke's applications in these cases. (Duke Rider Reply Brief at 22-23.) Duke also argues that there is no justification for OCC's and OPAE's claims that PWC only supported the stipulation because it has energy efficiency and weatherization contracts with Duke and because it seeks to maintain its funding from those contracts. Duke indicates that PWC is one of a number of energy efficiency and weatherization service providers to residential consumers in the Cincinnati area and that PWC competes against other providers for contracts that are awarded by a local organization that Duke does not control. (Duke Rider Reply Brief at 25.)

Staff asserts that all parties had an opportunity to participate fully in the settlement conferences at which many issues were addressed. (Staff Rider Brief at 5.) Addressing the first prong of the test, Staff further reasons that Mr. Haugh, testifying on behalf of OCC in opposition to the stipulation, did not question that serious bargaining among capable knowledgeable parties occurred, did not propose that the stipulation was suspect because OCC did not sign it, did not suggest that any stipulation signatory was influenced by a side agreement, and did not mention any such agreement. (Staff Rider Brief at 4-5; Staff Rider Reply Brief at 2-3.) Countering OCC's arguments, Staff also notes that it is not a

prerequisite that any specific party, such as OCC or OP&E, must be a signatory to a stipulation in order for the Commission to find that serious bargaining occurred. Thus, argues staff, OCC's decision not to support the stipulation does not alter the fact that serious bargaining took place. (Staff Rider Reply Brief at 3.) Staff also suggests that, despite claims to the contrary by OCC, the city of Cincinnati or PWC has each been a party to these cases since their inception.

On the basis of the evidence before us, we conclude that the stipulation is the product of serious bargaining by knowledgeable parties. It is clear that all parties were invited to all negotiation sessions. The fact that some parties were uninterested in OCC's discovery issues, did not brief the issues following hearing, or did not participate in the manner in which non-signatory parties might have wished does not mean that those parties were uninvolved or unknowledgeable. These are parties that have closely followed many cases related to Duke's RSP and have been involved in many levels of discussion over a long period of time. We find them to be knowledgeable and informed parties. We will not demand any particular level of participation in the proceedings.

We also note, as pointed out by Duke, that the stipulation was either supported or not opposed by representatives of each stakeholder group. Residential consumers were represented by PWC and the city of Cincinnati, OEG represented manufacturing consumers, and OHA represented commercial interests. Also involved in the negotiations were IEU, OMG, and Dominion, none of which opposed the resultant document. OCC and OP&E, representing residential customers, were involved in the discussions, although they were not, apparently, successful in obtaining a result with which they could agree. Lack of agreement by two parties should not cause the entire stipulation to be rejected as if serious bargaining had not occurred. To do so would be to give those parties, in effect, veto power over the result.

Finally, we note the references by OCC and OP&E to certain agreements that related to Duke's RSP and their argument that those agreements impacted parties' ability to negotiate seriously with regard to the stipulation in these proceedings. While we did find that those agreements impacted the stipulation in the RSP case by means of provisions requiring support of that stipulation, there is no argument that there was a similar connection to the stipulation we are considering today. The signatory parties to this stipulation specifically confirmed that there were no side agreements related to this stipulation. (Tr. I at 12-17.)

2. Benefit to Ratepayers and the Public Interest

OCC claims that the stipulation does not benefit ratepayers or serve the public interest. OCC asserts that the stipulation does not address certain credits that the auditor recommended be flowed back to customers through the FPP. OCC also complains, in its briefs, about the stipulation's approach to procurement for the post-RSP period and active

management of coal contracts, the treatment of congestion costs, the inclusion in the AAC of a return on CWIP, the location of certain charges on bills, the veracity of the apparent concession that Duke would not charge interest on AAC true-ups, the use of DENA assets in the SRT, and the acceptance by Duke of coal offers that do not allow resale. (OCC Rider Brief at 24-31; OCC Rider Reply Brief at 8-13.)

OPAE, similarly, believes that the stipulation fails to benefit ratepayers and the public interest "by allowing the return on CWIP and the use of the DENA assets under inappropriate circumstances. (OPAE Rider Brief at 11-18, 19.)

Duke argues that the stipulation does benefit the public interest by furthering the Commission's goals for RSPs. It also points out that the stipulation requires Duke to issue a bill credit related to a defaulted coal delivery contract that is greater than the amount recommended by the auditor and in a more expedited manner. This credit, Duke asserts, will "mitigate and help offset the totality of the price adjustment for the 2007 MBSSO rider components . . ." Duke also notes that stipulation requires the immediate commencement of talks about future fuel purchases and clarifies ambiguity relating to its use of DENA assets in an emergency. Further, Duke points out that the stipulation adopts "almost all of the auditor's and Staff's recommendations . . ." Finally, it confirms that its "prices remain below the national average and well below states that have implemented unfettered auction pricing such as Illinois, Maryland, and New Jersey. In contrast, OCC's recommendations would result in higher prices as have occurred in those states." (Duke Rider Brief at 26-7; Duke Rider Reply Brief at 26-27.)

Staff also argues that the stipulation benefits ratepayers and serves the public interest. Staff's witness, Richard Cahaan, opined that the stipulation, as a package, benefits customers of Duke and serves the public interest. Specifically, he asserted that the first and fifth paragraphs, both of which directly involve revenues, represent reasonable compromises among the interested parties. He designates the remainder of the stipulation as addressing "process" matters: addressing how certain problems are to be solved. Staff, evaluating the arguments put forth by OCC and OPAE, advises the Commission that, while those parties may have wanted "more" than they got in the stipulation, "their desire for 'more' does not negate the benefits the Stipulation provides ratepayers and the ways the Stipulation benefits the public interest." (Staff Rider Brief at 5-7; Staff RR Ex. 3, at 2-3; Staff Rider Reply Brief at 9-10.)

We find that the proposed stipulation does benefit Duke ratepayers and serves the public interest. We believe it is to the benefit of ratepayers and the public to resolve these issues expeditiously and to address open issues such as the circumstances under which DENA assets might be used in an emergency. In addition, we find that, in light of pending legislation relating to the electric industry, capacity purchases for the post-RSP period should be the subject of mandatory discussions among the parties, as is provided in

the stipulation. Finally, we note that the stipulation provides a greater bill credit in the FPP than was recommended by the auditor, and requires it to be refunded to customers in a more expeditious manner. This, too, is a benefit that would not be attainable outside of the stipulation.

3. Violation of Important Regulatory Principles or Practices

Duke and Commission staff conclude that the stipulation does not violate any important regulatory principle or practice. (Duke Rider Brief, *passim*; Duke Rider Reply Brief at 27-29; Staff Rider Brief at 7, 11; Staff Rider Reply Brief at 17, 18, 20.) On the other hand, the non-signatory parties make various arguments that stipulation does violate important regulatory principles and practices. These arguments have been discussed, and rejected, above. Any other issues not specifically discussed have been considered and will be denied.

E. Motions to Strike

As recited above, in the procedural history, both OP&E and PWC have filed motions to strike certain language in other parties' briefs. Similar motions were made in the remand phase of these consolidated proceedings. As we noted in the October 24, 2007, order on remand, the Commission will not strike arguments made by parties in these pleadings. However, again, the Commission will base its determination on record evidence and will ignore arguments that are not supported by evidence of record in these proceedings.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

- (1) On October 24, 2007, the Commission issued its order on remand in the remanded RSP phase of these proceedings.
- (2) The hearing on the rider phase of these proceedings was held on April 10 and 19, 2007.
- (3) Initial briefs and reply briefs were filed by Duke, OCC, OP&E, and staff on May 17 and 30, 2007, respectively.
- (4) On April 9, 2007, a stipulation signed by Duke, Commission staff, OEG, OHA, city of Cincinnati, and PWC was filed in the above-captioned cases. OCC and OP&E opposed the stipulation.
- (5) It is reasonable to allow Duke to continue its active management of its coal, EA, and purchased power portfolio, as provided in the stipulation.

- (6) The stipulation provision proposing the initiation of discussions relating to the post-RSP period is reasonable, especially in light of pending legislation relating to the post-RSP period.
- (7) Duke has complied with the underlying intent of the procedural safeguards regarding the use of DENA assets.
- (8) The stage of completion of CWIP should not be a bar to Duke's earning a return on CWIP.
- (9) The stipulation is the product of serious bargaining by knowledgeable parties.
- (10) The stipulation benefits Duke ratepayers and serves the public interest.
- (11) The stipulation does not violate any important regulatory principle or practice.
- (12) The Commission will not strike arguments made by parties in these pleadings.

It is, therefore,

ORDERED, That the stipulation be approved and adopted. It is, further,

ORDERED, That motions to strike, filed by PWC and OPAE, be denied. It is, further,

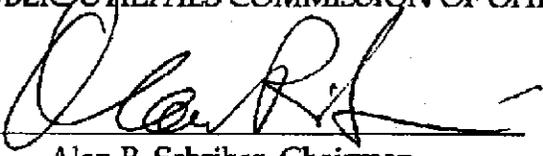
ORDERED, That any arguments not specifically discussed in this Opinion and Order be denied. It is, further,

ORDERED, That Duke work with staff to determine a reasonable period over which the amounts authorized by this Opinion and Order should be trued-up and collected. It is, further,

ORDERED, That Duke file revised tariffs to reflect the terms of this Opinion and Order. It is, further,

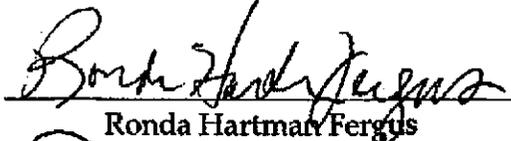
ORDERED, That a copy of this Opinion and Order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

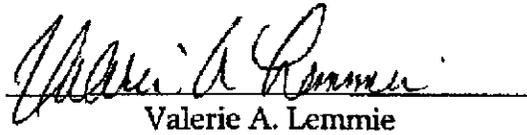


Alan R. Schriber, Chairman

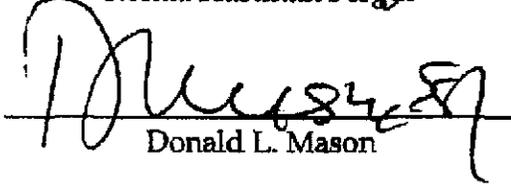
Paul A. Centolella



Ronda Hartman Fergus



Valerie A. Lemmie



Donald L. Mason

Abstract #05-724-EL-LINK

SEF/JWK:ct

Entered in the Journal

NOV 20 2007



Renee J. Jenkins
Secretary

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

- In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set its System Reliability Tracker Market Price.) Case No. 05-724-EL-UNC
- In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Fuel and Economy Purchased Power Component of its Market-Based Standard Service Offer.) Case No. 05-725-EL-UNC
- In the Matter of the Application of Duke Energy Ohio, Inc., to Modify its Fuel and Economy Purchased Power Component of its Market-Based Standard Service Offer.) Case No. 06-1068-EL-UNC
- In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set its System Reliability Tracker.) Case No. 06-1069-EL-UNC
- In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set the Annually Adjusted Component of its Market-Based Standard Service Offer.) Case No. 06-1085-EL-UNC

ENTRY ON REHEARING

The Commission finds:

- (1) On November 20, 2007, the Commission issued an opinion and order in the above-captioned cases, approving a stipulation and recommendation (stipulation) signed by Duke Energy Ohio, Inc. (Duke); the staff of the Commission; Ohio Energy Group (OEG); Ohio Hospital Association (OHA); the city of Cincinnati (city); and People Working Cooperatively (PWC). These cases involved, in part, the setting of rates for riders for the recovery of certain of expenses associated with Duke's rate stabilization plan (RSP), first approved by the Commission in *In the Matter of the Application of the Cincinnati Gas & Electric Company to Modify its Nonresidential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish an Alternative Competitive-Bid Service Rate Option Subsequent to the Market Development Period,*

This is to certify that the images appearing are an accurate and complete reproduction of a case file document delivered in the regular course of business.
 Technician _____ Date Processed 1/16/08

Case No. 03-93-EL-ATA, et al. (RSP Case). The Office of the Ohio Consumers' Counsel (OCC) and Ohio Partners for Affordable Energy (OPAE) opposed the stipulation. The riders involved in the above-captioned cases include: (1) the fuel and purchased power (FPP) rider, which is intended to allow Duke to recover the costs associated with its purchase of fuel for its generating stations, emission allowances, and economy purchased power to meet its load; (2) the system reliability tracker (SRT) rider, which is intended to allow Duke to recover the costs it incurs in maintaining a reserve margin for switched and non-switched load; and (3) the annually adjustable component (AAC), which is intended to allow Duke to recover its incremental costs associated with homeland security, taxes, and environmental compliance.

- (2) Section 4903.10, Revised Code, indicates that any party who has entered an appearance in a Commission proceeding may apply for rehearing with respect to any matters determined by filing an application within 30 days after the entry of the order upon the journal of the Commission.
- (3) On December 21, 2007, OCC and OPAE filed applications for rehearing. Duke filed a memorandum contra both applications for rehearing, on December 31, 2007.
- (4) In its application for rehearing, OPAE raises four assignments of error. OPAE's first assignment of error suggests that the Commission acted unreasonably and unlawfully when it found that the stipulation was the product of serious bargaining among the parties. OPAE argues that, contrary to the Commission's finding, serious bargaining did not take place at the settlement negotiations for the stipulation. OPAE contends that the Supreme Court has already confirmed that attendance and discussion at settlement negotiations does not satisfy the criterion the serious bargaining take place. OPAE claims that the Commission ignored the Supreme Court's determination that the Commission must look beyond the stipulation to determine if serious bargaining has taken place. OPAE argues that the question is whether there are side agreements undermining the settlement process. OPAE reasons that the evidence on remand in the RSP case, demonstrating that the side agreements affected the signatory parties to the stipulation, was ignored by the Commission on remand. OPAE claims that the stipulation is simply the furtherance of the side agreements that benefit a

handful of customers at the expense of whole classes of customers. OP&A points out that the stipulation was submitted by Duke and five other parties, all of whom supported the stipulation filed in the RSP case. OP&A argues that the city of Cincinnati is acting as a customer of Duke and not as a representative of the residential class and, in addition, suggests that its support can be seen as a product of its separate side agreement with Duke. OP&A also contends that PWC represents the interest of consumers only to the extent that those interests coincide with the funding PWC receives from Duke for its projects. OP&A argues that OEG and OHA, which support the stipulation, also had side agreements with Duke that could have influenced their support for the stipulation. Further, OP&A argues that this is also true of IEU, although it did not sign the stipulation. According to OP&A, it and OCC, both of whom oppose the stipulation, are the two parties representing the vast majority of Duke's customers. (OP&A application for rehearing at 7-14.)

- (5) Duke, in its memorandum contra, disagrees with OP&A's contention that the existence of side agreements in the RSP case makes certain signatory parties' support suspect. Duke argues that there is no requirement that each party come to the negotiating table with the same interests. After detailing the positions and backgrounds of various parties, Duke asserts that each party, whether a signatory or not, fully participated in negotiation of the stipulation. Duke also points out that parties to side agreements in the RSP case are not exempted from paying increases in the FPP, SRT, or AAC riders and that those side agreements make no mention of the above-captioned cases. (Duke memorandum contra at 17-21.)
- (6) We find no merit to OP&A's first assignment of error. Many of these arguments were raised by OP&A and discussed by the Commission in its opinion and order. We found that the stipulation was the product of serious bargaining by knowledgeable parties. We noted that all parties were invited to all negotiations. There was no evidence provided by OP&A to the contrary. We also found that the stipulation was either supported or not opposed by representatives of each stakeholder group. Residential consumers were represented by PWC and the city, OEG represented manufacturing consumers, and OHA represented commercial interests. OMG and Dominion did not oppose the stipulation and were involved in negotiations. As we

noted, the lack of agreement to the stipulation by two parties in this case should not cause the entire stipulation to be rejected as if serious bargaining had not occurred. We also found that, while the stipulation in the RSP case was impacted by the side agreements, there were no such connections between any side agreements and the stipulation in these cases. As to OPAE's contention that the city's support for the stipulation "can be seen as a product of its separate side agreement with Duke" or that OEG and OHA, both of which supported the stipulation, also had side agreements with Duke that could have influenced their support for the stipulation, we find no evidence for either claim. We also note that, contrary to OPAE's assertion that the existence of side agreements in a separate proceeding might inappropriately "affect" the parties to the stipulation in these cases, the Supreme Court of Ohio, on which OPAE was relying, was, on appeal of the RSP case, considering the impact of undisclosed side agreements on the fairness of the bargaining process. In the present circumstance, those same side agreements were fully known to all parties. As to OPAE's claim that PWC represents the interests of consumers only to the extent that those interests coincide with the funding PWC receives from Duke for its projects, we find no proof and no merit. OPAE's first assignment of error will be denied.

- (7) OPAE's second assignment of error provides that, given the stipulation's treatment of returns on construction work in progress (CWIP), the Commission acted unreasonably and unlawfully when it found that the stipulation benefits ratepayers, serves the public interest, and does not violate any important regulatory principle or practice. OPAE argues that the stipulation fails to benefit ratepayers and the public interest and violates important regulatory practice and principles by allowing for the recovery of a return on CWIP through Duke's AAC. OPAE asserts that this approach is contrary to the findings of the auditor and results in unreasonable AAC charges. According to OPAE, a return on CWIP would not be allowed in ratemaking proceedings because such proceedings require that any CWIP be at least 75 percent complete before the Commission would consider allowing a return, a fact not demonstrated by Duke. OPAE also argues that the current regulatory paradigm does not provide any assurance of lower capital costs for customers at a future date, noting that, under a traditional regulatory paradigm, *after construction is complete, the customers have a claim that the return on CWIP will provide lower capital costs at a future*

date when the plant is in service. OP&E contends that the AAC has no place in the market environment and that traditional regulatory practices can and should be used to ensure reasonable standard service offer rates. OP&E argues that there is no market for retail electric generation to serve Ohio's residential and small commercial customers and, therefore, no reason why standards for CWIP should not apply. (OP&E application for rehearing at 14-17.)

- (8) Duke asserts that the limitation on earning a return on CWIP does not apply to competitive retail electric service. (Duke memorandum contra at 23.)
- (9) We find no merit to this assignment of error. Again, many of these same arguments were made by OP&E on brief and were considered by the Commission in our opinion and order. As we noted in our September 29, 2004, opinion and order, there was no discussion regarding a return on CWIP in the RSP's establishment of the AAC. However, we based our determination in part on Duke's supplied calculations. We noted that the Attachment JPS-4 to the testimony of John Steffen clearly showed CWIP as a factor in the AAC, with no reference to percentage completion. We also found that, in the present market environment, ratemaking standards, such as the limitation on earning a return on CWIP, are not dispositive. Therefore, we found that the stage of completion of CWIP should not, under these specific circumstances, be a bar to Duke's earning a return on CWIP. In our opinion and order, we fully considered OP&E's and other parties' arguments that CWIP should be treated in these cases as is normally done with rate proceedings, i.e., to permit a return on CWIP when projects are 75 percent complete. OP&E has raised nothing new in this assignment of error. OP&E's second ground for rehearing will be denied.
- (10) In its third assignment of error, OP&E claims that the Commission acted unreasonably and unlawfully in its treatment of the use of Duke Energy North America (DENA) assets. OP&E contends that the Commission's opinion and order does not provide a reasonable method to set the price for the capacity from the DENA assets and, therefore, that the Commission has not provided adequate protection for ratepayers against Duke potentially overcharging for capacity from the DENA assets. OP&E also claims that the use of broker quotes or third-party

transactions to arrive at a market price is inadequate because there are usually very few broker quotes and there is a limited market. OP&A urges that the guidelines for formulating a price for the DENA assets need to be more stringent, with a greater number of bids and a price cap. (OP&A application for rehearing at 17-19.)

- (11) We find no merit to OP&A's third assignment of error. In our opinion and order, we found that the pricing mechanism for the DENA assets proposed in the stipulation was reasonable. We also noted that, while the market for capacity is not mature, the witness for Duke, Mr. Whitlock, provided testimony that he would likely be able to get multiple broker quotes for determining market prices. As to OP&A's claim that the pricing of DENA assets is flawed, we find no basis for this argument. We noted that the stipulation provides two different mechanisms for setting a price and also allows for the possibility that Commission staff might agree to a different system in appropriate circumstances. Further, we must not lose sight of the fact that Duke's use of the DENA assets is to be on an emergency basis only and will be subject to audit by the Commission. Therefore, we continue to believe that the method established by the stipulation for establishing prices for DENA assets is reasonable. OP&A's third ground for rehearing will be denied.
- (12) Finally, in its fourth ground for rehearing, OP&A contends that the Commission acted unreasonably and unlawfully when it approved the stipulation, even though the stipulation failed, without sufficient reason, to adopt the recommendations of the management/performance auditor. In this regard, OP&A specifically references the auditor's recommendations regarding use of DENA assets, allowance of a return on CWIP, and cessation of Duke's active management. OP&A argues that the Commission should have rejected the stipulation to the extent that it allowed Duke to ignore such recommendations.
- (13) In our November 20, 2007 opinion and order, we considered all of these issues and all of the arguments made by the parties. The fact that our decision did not fully accept the findings of the auditor on any of these issues does not, in and of itself, render such decisions to be unlawful or unreasonable. OP&A's fourth ground for rehearing will be denied.

- (14) In its application for rehearing, OCC raises four assignments of error. OCC's first assignment of error states that the Commission's remand order is unreasonable and unlawful because the Commission failed, as a quasi-judicial decision-maker, to "permit a full hearing upon all subjects pertinent to the issue(s) and to base [its] conclusion upon competent evidence" in violation of case law and Section 4903.09, Revised Code. This assignment of error is broken down into three subparts:
- (a) The auditor's report should be followed regarding FPP charges.
 - (b) Capacity costs should be based on actual costs, which exclude charges related to the DENA assets at this time.
 - (c) The order fails to eliminate additional AAC charges requested by Duke without any evidentiary basis.
- (15) As to the first general assignment of error, there is no evidence that the Commission failed to permit a full hearing upon all subjects pertinent to the issues. OCC was permitted to introduce any evidence and sponsor any witnesses it deemed relevant, cross-examine any other party's witnesses, and make any legal argument it deemed relevant. A claim by OCC that a full and fair hearing was not conducted is dubious absent any specific examples of just how a full hearing on all subjects was not permitted. As to OCC's claim that the opinion and order was not supported by competent evidence, we find no merit.
- (16) With regard to the first subpart of its first assignment of error, OCC claims that the Commission should have ordered Duke to follow the auditor's recommendations regarding its coal management policies. These recommendations concern the adoption of traditional utility procurement strategies related to the procurement of coal and emission allowances, the cessation of Duke's active management of coal and the development of portfolio strategy for coal purchases. OCC argues that Duke should develop a portfolio approach to the purchase of coal and, as support for its argument, it cites to the auditor's report that states that Duke has passed up attractive coal contracts, resulting in increased FPP charges. OCC also claims that the recommendation for Duke to adopt a traditional utility

procurement strategy for its coal purchases was supported by the auditor and it urges the Commission not to dismiss this expert opinion. Further, OCC argues that the order failed to address an issue raised by OCC regarding the recommendation by the auditor that, as long as the FPP is in effect, coal suppliers should not be required to allow the resale of their coal for the offers to be considered. OCC argues that the Commission should have adopted the recommendation of the auditor that Duke permit the consideration of bids from bidders who seek to limit the resale of their coal. (OCC application for rehearing at 5-9.)

- (17) In response, Duke points out that, rather than arguing its lack of opportunity to litigate this issue, OCC is actually urging the Commission to require Duke to adopt the auditor's recommendation. Duke contends that the auditor's recommendation is not binding on the Commission or the parties. It also stresses that the evidence showed that Duke's active management has not increased costs and has not inhibited the audit process. In addition, Duke noted that shareholders, not customers, absorb transaction costs related to active management.
- (18) We find no merit to this assignment of error. In our consideration of the stipulation, we reviewed all of the evidence, including the auditor's recommendations. We balanced the traditional utility strategies for the procurement of coal and emission allowances versus Duke's active management of coal and determined that Duke's active management of coal was reasonable. Short of claims that we should have followed the auditor's recommendations because OCC thinks we should have, OCC has identified no new evidence in the record that we have not considered. With regard to the auditor's recommendation that Duke permit the consideration of bids from bidders who seek to limit the resale of their coal, this recommendation was considered by us in our opinion and order. We note that testimony at the hearing showed that Duke does not require the ability to resell coal as a condition to its purchase and it does not exclude an offer from consideration if the supplier does not permit resale. (Duke Rem. Rider Ex. 2, at 9.) We would clarify that Duke's standard request for proposals should not prohibit bids from suppliers who do not allow resale.
- (19) The second subpart to OCC's first assignment of error asserts that capacity costs should not include charges related to the DENA

assets at this time. OCC claims that the order unreasonably rejects the auditor's recommendations, citing the Commission's lack of concern over Duke's non-compliance with prior orders and its acceptance of the proposed pricing mechanism. OCC claims that the original stipulation in the SRT proceeding required Duke to submit an application for approval of the SRT market price associated with DENA assets and to provide OCC with work papers and other data supporting the use of DENA assets. OCC claims that it was provided no information other than that which was sought by the OCC in ordinary discovery. OCC contends that use of broker quotes or third-party transaction prices would not result in customers benefitting from the most reasonably priced capacity available. OCC also argues that allowing the DENA generation to be priced based on a method agreed to by Duke and the staff gives those two parties the opportunity to enter into negotiations and make decisions without the involvement of other parties in these cases. (OCC application for rehearing at 9-13.)

- (20) Duke submits that the requirements of SRT stipulation have been met, as it has applied for Commission approval, has supplied all work papers to OCC, and will, in the event DENA assets are used, provide detailed information to OCC as required by the SRT stipulation. Duke stresses that reasonably priced generation options are critical for meeting capacity requirements in an emergency. The stipulation, according to Duke, sets forth pricing methodologies and defines the circumstances under which DENA assets could be used. This allows subsequent auditors the ability to audit any DENA transactions, Duke explains. (Duke memorandum contra at 10-12.)
- (21) We find no merit to this assignment of error. First, we would note that, rather than having any "lack of concern over the Company's non-compliance with prior orders," as claimed by OCC, we found, in our opinion and order, that the process that has been followed in this proceeding has complied with the substance of our prior orders. We find nothing in what OCC has raised on rehearing to warrant a different finding. With regard to OCC's claims concerning the substance of the pricing mechanism, we also find no merit. Under the terms of the proposal, Duke is required to give notice of its intent to use the DENA assets and, thereafter, to allow discovery of relevant facts by interested parties and to provide sufficient detail to allow

analysis of the reasonableness of its proposal. (Opinion and Order at 20.) This ground for rehearing will be denied.

- (22) The third subpart to OCC's first assignment of error asserts that a return on CWIP should not be included in the AAC charges. This assignment of error was similarly set forth by OPAE and was discussed above and rejected by the Commission. This ground for rehearing will be denied.
- (23) OCC's second assignment of error states that the Commission's order is unreasonable and unlawful because the Commission improperly delegated its duties to the Company and the Commission's staff. OCC points to the language in the Commission's order that "Duke work with staff to determine a reasonable period over which the amounts authorized by this opinion and order should be trued-up." OCC claims that such a directive unreasonably delegates the Commission's decision-making responsibilities and the Commission should make these decisions regarding the adjustment of rates based on a record developed in these cases. OCC also argues that the order fails to clearly define the Commission's treatment of interest charges that could be associated with any true-up.
- (24) Duke notes that any bill credit would have to be reflected in tariffs, subject to Commission approval. Thus, it says, the Commission has ceded no authority. (Duke memorandum contra at 15.)
- (25) We find no merit to this assignment of error. Our directive to Duke, on page 30 of the opinion and order, was that it work with staff to determine a reasonable period over which the amount authorized by this opinion and order should be trued-up and collected. The Commission has only directed Duke to work with staff to determine the period of time for such calculations. Nothing in this directive authorizes any entity, other than the Commission, to determine the amount of said true-ups or the amounts to be collected. Furthermore, nothing in this directive cedes any review of any such amounts, since final tariffs must still be approved by the Commission. This ground for rehearing will be denied.

With regard to interest charges associated with the AAC true-up, we note that the stipulation in these proceedings provides for Duke to forego the collection of interest on the trued-up AAC

charges. To the extent that our opinion and order in these cases was unclear, we would clarify that this aspect of the stipulation should be implemented. Duke's agreement to forego the imposition of carrying charges was part of the basis for our conclusion that the stipulation benefitted ratepayers and was in the public interest. Therefore, although collection of trued-up AAC amounts by December 31, 2007, was not possible by the time the opinion and order was issued, our order did not permit Duke to collect any carrying charges on the AAC true-up.

- (26) In its third assignment of error, OCC argues that the Commission's order is unreasonable and unlawful because the Commission failed to determine that certain entities had no standing in these cases. OCC claims that the Commission erred by basing its approval of the stipulation on the support by PWC, which represented residential customers, because PWC did not have standing in these proceedings. OCC claims that PWC and OHA never formally intervened in these proceedings and, therefore, are not parties to these proceedings. Further, OCC argues that it was deprived the opportunity to state its objection to any characterization that PWC represented residential customer in rate-setting matters. (OCC application for rehearing at 19-21.)
- (27) At the initiation of the rider phase of the remand portion of these proceedings, the attorney examiners consolidated these cases with the cases that had been remanded from the Supreme Court. Thus, parties in the remanded RSP case were also parties to the rider proceedings that were consolidated with the RSP case. As such we find no merit to OCC's third assignment of error. It will be denied.
- (28) Finally, OCC's fourth assignment of error asserts that the Commission's opinion and order is unreasonable and unlawful because the Commission failed to properly apply the test for approval of a partial stipulation. This assignment of error is broken down into three subparts. First, OCC claims that the settlement was not the product of serious bargaining. This same argument was made by OP&E. OCC claims that the option agreements that were discussed in the order on remand in the RSP case provide some of the signatory parties with protections against the increases that are the subject of the rider phase of these proceedings. OCC also contends that neither the city of Cincinnati nor PWC represents residential interests in these

proceedings and that they were not knowledgeable parties. OCC argues that the city did not appear at the hearings, did not file a brief, and has not demonstrated any knowledge of the issues in the rider cases. Therefore, OCC states, serious bargaining did not take place between Duke and the city in these cases. OCC also argues that PWC is not a party to these proceedings and, therefore, that no representatives of residential consumers were included in the stipulation.

- (29) As with the similar arguments of OP&E, we find no merit in this assignment of error. As we noted in the opinion and order in these cases, there was no connection between the side agreements that had been negotiated prior to our decision in the RSP case and the stipulation filed in these cases. In addition, the signatory parties to the stipulation filed in these cases specifically confirmed that there were no side agreements related to the stipulation in these cases. As to OCC's contention that because the city of Cincinnati did not appear at a hearing nor file a brief means that it did not seriously bargain, we find no merit. We found that the city was a knowledgeable party during the initial phase of these cases. We have no basis to find that they have suddenly become less knowledgeable simply because they did not attend the hearings in these cases. On that basis, we would have to disqualify other, seemingly knowledgeable, parties. Similarly, the decision whether to file a brief in these cases should not constitute a bar to qualify as a knowledgeable party. We would also note that OCC has not demonstrated that it is privy to all of the discussions that may have occurred between the city and Duke and, therefore, it has no basis to state that serious bargaining did not take place between Duke and the city. As to PWC's party status in these proceedings, we have previously discussed this matter. This ground for rehearing will be denied.
- (30) OCC's second subpart to this assignment of error is that the settlement package does not benefit the public interest. OCC claims that the Commission should have adopted the recommendations of its auditor and rejected the treatment given to the AAC. These same arguments were made by OCC in its post-hearing brief in these proceedings and were fully considered by the Commission. This ground for rehearing will be denied.
- (31) Finally, OCC claims that the settlement package violates important regulatory policies and practices. OCC raises nothing new in this assignment of error that was not previously

considered by the Commission. This ground for rehearing will be denied.

It is, therefore,

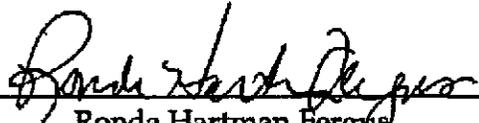
ORDERED, That OCC's and OPAE's applications for rehearing be denied. It is, further,

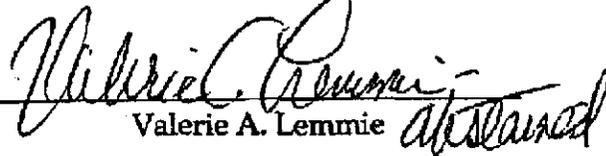
ORDERED, That copies of this entry on rehearing be served upon parties of record.

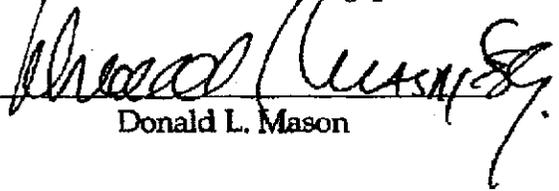
THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman


Paul A. Centolella


Ronda Hartman Fergus

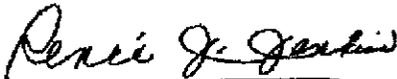

Valerie A. Lemmie *attested*


Donald L. Mason

SEF/JWK:geb

Entered in the Journal

JAN 16 2008



Renee J. Jenkins
Secretary