

IN THE SUPREME COURT OF OHIO
On Appeal from the Public Utilities Commission of Ohio

| | | |
|--|---|------------------------------|
| Office of the Ohio Consumers' Counsel |) | |
| and |) | |
| Ohio Partners for Affordable Energy, |) | Case No. 08-0466 |
| |) | |
| Appellants, |) | |
| |) | Appeal from the Public |
| |) | Utilities Commission of Ohio |
| v. |) | |
| |) | |
| The Public Utilities Commission of Ohio, |) | Public Utilities |
| |) | Commission of Ohio |
| Appellee. |) | Case No. 05-725-EL-UNC |
| |) | 06-1068-EL-UNC |
| |) | 06-1069-EL-UNC |
| |) | 06-1085-EL-UNC |

**MERIT BRIEF OF APPELLANT,
OHIO PARTNERS FOR AFFORDABLE ENERGY**

Colleen L. Mooney, Counsel of Record
(Reg. No. 0015668)
David C. Rinebolt
(Reg. No. 0073178)

Nancy H. Rogers
(Reg. No. 0002375)
Attorney General of Ohio

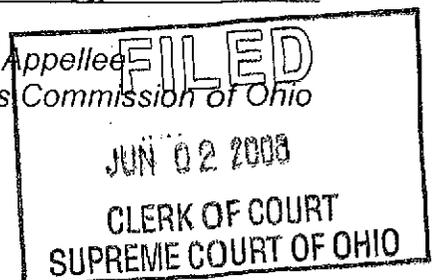
Duane Luckey
(Reg. No. 0023557)
Senior Deputy Attorney General
Stephen P. Reilly
Counsel of Record
(Reg. No. 0019267)
Assistant Attorney General

Ohio Partners for Affordable Energy
1431 Mulford Road
Columbus, Ohio 43212
(614) 488-5739 – Telephone
(419) 425 8862 – Facsimile
cmooney2@columbus.rr.com
drinebolt@aol.com

Public Utilities Commission of Ohio
180 East Broad Street, 9th Floor
Columbus, Ohio 43215-3793
(614) 644-8698 - Telephone
(614) 644-8764 – Facsimile
duane.luckey@puc.state.oh.us
thomas.mcnamee@puc.state.oh.us

Attorneys for Appellant
Ohio Partners for Affordable Energy

Attorneys for Appellee
Public Utilities Commission of Ohio



Janine L. Migden-Ostrander
(Reg. No. 0002310)
Ohio Consumers' Counsel
Jeffrey L. Small
(Reg. No. 0061488)
Counsel of Record
Ann M. Hotz
(Reg. No. 0053070)
Assistant Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
(614) 466-8574 – Telephone
(614) 466-9475 – Facsimile
small@occ.state.oh.us

*Counsel for Appellant
Office of the Ohio Consumers' Counsel*

Paul A. Colbert
(Reg. No. 0058582)
Counsel of Record
Rocco D'Ascenzo
(Reg. No. 0077651)
Duke Energy Ohio, Inc.
155 East Broad Street
Columbus, Ohio 43215
(614) 221-7551 - Telephone
(614) 221-7556 - Facsimile
Paul.Colbert@duke-energy.com

*Counsel for Intervening Appellee
Duke Energy Ohio, Inc.*

TABLE OF CONTENTS

| | <u>Page</u> |
|---|-------------|
| I. INTRODUCTION | 1 |
| II. STATEMENT OF THE FACTS | 2 |
| III. ARGUMENT | 6 |
| Proposition of Law No. 1: | 6 |
| The PUCO acts unreasonably and unlawfully when it disregards the Supreme Court's instructions, ignores evidence and finds that a stipulation and recommendation is the product of serious bargaining among the parties when side agreements undermine the settlement negotiations and when the stipulation is not supported by any customer group actually affected by its terms. | |
| Proposition of Law No. 2: | 16 |
| Given the stipulation's treatment of the issues, the PUCO 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. | |
| A. The PUCO acted unreasonably and unlawfully by approving a stipulation which includes excessive compensation to Duke for Construction Work in Progress ("CWIP"), which does not benefit ratepayers, serve the public interest, and violates important regulatory principle or practice. | |
| B. The PUCO acted unreasonably and unlawfully when it approved the stipulation allowing for the compensation to Duke for the cost of generation assets that do not provide benefits to ratepayers, serve the public interest, and violate important regulatory principle or practice. | |
| IV. CONCLUSION..... | 25 |

TABLE OF AUTHORITIES

| <u>Cases</u> | <u>Page</u> |
|---|-------------|
| <i>Constellation NewEnergy, Inc. v. Pub. Util. Comm.</i> , (2004) 104 Ohio St.3d 530, 2004-Ohio-6767 | 12, 13 |
| <i>Consumers' Counsel v. Pub. Util. Comm.</i> , (1979) 58 Ohio St.2d 108 | 26 |
| <i>Elyria Foundry v. Pub. Util. Comm.</i> , (2007) 2007-Ohio-4164 (August 29, 2007) | 14 |
| <i>Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.</i> (1994), 68 Ohio St.3d 559..... | 1, 6 |
| <i>Ohio Consumers' Counsel v. Pub. Util. Comm.</i> (1992), 64 Ohio St.3d, 123, 126..... | 1, 6 |
| <i>Ohio Consumers' Counsel, v. Pub. Util. Comm.</i> , (2006), 109 Ohio St.3d 328, 2006-Ohio-2110..... | 13, 14 |
| <i>Ohio Consumers' Counsel v. Pub. Util. Comm.</i> (2006), 111 Ohio St.3d 300, 2006-Ohio-5789..... | passim |

Statutes

| | |
|---------------------|----------------|
| R.C. §4909.15 | 16,17,19,20,26 |
| R.C. 4909.18..... | 16, 18, 19, 20 |
| R.C. 4909.19..... | 16 |
| R.C. 4928.14..... | 16, 20, 26 |

Entries and Orders of the Public Utilities Commission of Ohio

| | |
|---|---|
| <i>In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set its System Reliability Tracker Market Price, et al.</i> , Case No. 05-724-EL-UNC, et al., Entry on Rehearing (January 16, 2007)..... | 6 |
|---|---|

TABLE OF AUTHORITIES, cont.

Page

In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set its System Reliability Tracker Market Price, et al., Case No. 05-724-EL-UNC, et al., Opinion and Order (November 20, 2007) passim

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, et al., Case No. 03-93-EL-ATA, et al., Order on Remand (October 24, 2007) passim

**APPENDIX TO MERIT BRIEF
TABLE OF CONTENTS**

| | <u>Page</u> |
|--|-------------|
| <u>Notice of Appeal</u> | |
| <i>Ohio Partners for Affordable Energy, Appellant, v. The Public Utilities Commission of Ohio, Appellee, Notice of Appeal, Ohio Supreme Court Case No. 08-466 (March 11, 2008)</i> | 001 |
| <u>Orders from which Appeal is Taken</u> | |
| <i>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, et al., Entry on Rehearing (January 16, 2008)</i> | 008 |
| <i>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, et al. Opinion and Order (November 20, 2007)</i> | 021 |
| <u>Order Relevant to the Issue</u> | |
| <i>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, et al., Case No. 03-93-EL-ATA, et al., Order on Remand (October 24, 2007)</i> | 052 |
| <u>Statutes</u> | |
| R.C. 4905.17..... | 097 |
| R.C. 4909.18..... | 098 |
| R.C. 4909.19..... | 100 |
| R.C. 4928.14..... | 102 |
| <u>Appellant's Application for Rehearing</u> | |
| <i>In the Matter of Duke Energy Ohio, Inc, to Adjust and Set its System Reliability Market Price, Case No. 05-724-EL-UNC, et al., Application for Rehearing by Ohio Partners for Affordable Energy (December 20, 2007)</i> | 103 |

**SUPPLEMENT TO MERIT BRIEF
TABLE OF CONTENTS**

| | <u>Page</u> |
|---|-------------|
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-725-EL-UNC, et al., Stipulation and Recommendation, Jt. Remand Rider Exhibit 1 (April 9, 2007)</i> | 01 |
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-725-EL-UNC, et al., Clarification of April 9, 2007 Stipulation and Recommendation, OCC Remand Rider Exhibit 3 (April 19, 2007)</i> | 11 |
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-725-EL-UNC, et al., Motion to Intervene by People Working Cooperatively, Inc. (March 9, 2004)</i> | 14 |
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-725-EL-UNC, et al., Settlement Agreement, OCC Remand Exhibit 6 (June 14, 2004)</i> | 17 |
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-725-EL-UNC, et al., Prepared Testimony of Michael P. Haugh OCC Remand Rider Exhibit 1 (March 9, 2007)</i> | 20 |
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-725-EL-UNC, et al., Supplemental Testimony of Michael P. Haugh OCC Remand Rider Exhibit 2 (April 17, 2007)</i> | 47 |
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-725-EL-UNC, et al., Corrected Supplemental Testimony of L'Nard E. Tufts, Staff Exhibit 2 (March 9, 2007)</i> | 58 |
| <i>In the Matter of the Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand and Rider Adjustment Cases, Case No. 05-724-EL-UNC, OCC Remand Rider Exhibit 4 Stipulation and Recommendation, (October 27, 2005)</i> | 64 |

I. INTRODUCTION

Ohio Partners for Affordable Energy ("OPAE") is a non-profit Ohio corporation with the stated purpose of advocating for affordable energy policies for low- and moderate-income Ohioans. OPAE includes as members non-profit organizations located in the service territory of The Cincinnati Gas & Electric Company ("CG&E"), now known as Duke Energy Ohio, Inc. ("Duke"). OPAE members advocate on behalf of Duke's low- and moderate-income customers and manage bill payment assistance programs to ensure customer access to electric service from Duke. OPAE members also provide weatherization and energy efficiency services to those same customers. Finally, some of OPAE's nonprofit members are also ratepayers of Duke.

OPAE was an intervener at the Public Utilities Commission of Ohio ("PUCO") in these cases, which concern applications made by Duke to adjust riders known as the fuel and purchased power ("FPP") tracker, the system reliability tracker ("SRT") and the annually adjusted component ("AAC") of the market-based standard service offer. The PUCO approved the adjustments to Duke's riders on the basis of a stipulation and recommendation submitted on April 9, 2007. This rider stipulation is not the product of serious bargaining among the parties; it violates important regulatory practices and principles; and, it fails to benefit ratepayers and the public interest. The rider stipulation does not meet the PUCO's criteria for the reasonableness of stipulations, which have been endorsed by the Court. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.* (1994), 68 Ohio St.3d 559; *Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St.3d, 123, 126. The

Court should reverse the PUCO's approval of the rider stipulation and remand this case to the PUCO for correction of errors discussed herein.

II. STATEMENT OF FACTS

Duke requested riders to recover certain expenses as part of its rate stabilization plan ("RSP") in PUCO Case No. 03-93-EL-ATA, et al. After the PUCO approved Duke's RSP, the Office of the Ohio Consumers' Counsel ("OCC") appealed the decision. On appeal, the Court remanded the case to the PUCO for correction of errors. *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2006), 111 Ohio St.3d 300, 2006-Ohio-5789. The Court questioned whether the existence of side agreements supported the PUCO's finding that the stipulation and recommendation filed in the RSP case was the product of serious bargaining among the parties. *Id.* The Court found that the PUCO had erred in denying discovery requested by OCC of side agreements as relevant to the PUCO's first test of reasonableness of stipulations, i.e., whether the settlement is a product of serious bargaining among capable, knowledgeable parties.

On remand, the PUCO found that the evidence of the side agreements demonstrates that serious bargaining did not take place. The PUCO rejected the RSP stipulation on that basis; however, the PUCO approved the Duke RSP as if a sham stipulation had not been filed. Remand Order. OPAE Appendix ("App.") 52. The PUCO's remand order is now itself on appeal to the Court. *Ohio Consumers' Counsel v. Pub. Util. Comm.*, Case No. 08-367. OPAE filed a brief *amicus curiae* in support of the appellant OCC in that case.

The PUCO's remand order retained the RSP riders, and the instant cases involve the setting of rates for the riders and the audit of rates under those riders. On April 9, 2007, Duke and certain parties presented a stipulation and recommendation to the PUCO to resolve the issues associated with these rider cases. Joint Exhibit Remand Rider 1 at 3, OPAE Supplement ("Supp.") 01. In addition to Duke, the rider stipulation was signed by the Staff of the Commission ("Staff"), Ohio Energy Group ("OEG"), the Ohio Hospital Association ("OHA"), the City of Cincinnati, and People Working Cooperatively ("PWC").

The PUCO found that the rider stipulation meets its criteria for the reasonableness of stipulations. The PUCO found that the rider stipulation is the product of serious bargaining by knowledgeable parties. Opinion and Order at 27, App. 21. The PUCO stated that the signatory parties to the rider stipulation had entered into no side agreements related to the rider stipulation. *Id.* The PUCO also found that there was no connection between the rider stipulation and the RSP stipulation that the PUCO rejected on remand. *Id.*

The PUCO made these findings even though nearly all of the signatory parties to the rider stipulation also signed the RSP stipulation, and the PUCO itself recognized that the RSP case and these rider cases are "inextricably connected." Opinion and Order at 4, App. 21; Remand Order at 5, App. 52. The PUCO ignored the fact that the rider stipulation is also a product of the side agreements to the RSP stipulation. On remand, in spite of the Court's instructions, the PUCO ignored the evidence of the side agreements that would have confirmed this fact.

The PUCO also found that the rider stipulation was supported by representatives of all stakeholder groups--residential consumers by PWC and the City of Cincinnati, industrial consumers by OEG, and commercial interests by the OHA. The PUCO ignored the facts that PWC did not represent residential customers in these cases, that the City of Cincinnati has a side agreement under which it was compensated by CG&E, and that OEG and OHA represent customers with side agreements. In short, contrary to the PUCO's assertions, no customer group actually affected by the terms of the rider stipulation supported it.

The PUCO also stated that OCC and OPAE were involved in the settlement discussions for the rider stipulation and were not successful in obtaining a result to which they could agree but the lack of agreement by "two parties" should not cause the "entire stipulation" to be rejected as if serious bargaining had not occurred. The PUCO claimed that to do so would give those two parties "veto power" over the result. App. 21. The PUCO ignored the fact that only OCC and OPAE represent customers without side agreements and customers who will actually pay the riders as set forth in the stipulation. It is absolutely necessary that the only parties representing customers who have no side agreements and are actually paying these riders must be parties to the stipulation in order to demonstrate serious bargaining. The PUCO failed to recognize that the "entire stipulation" is a sham, because it involves stipulating parties who have negotiated exemption from these riders and/or are not directly affected by the terms of the stipulation or the riders.

The PUCO also found that the rider stipulation does not violate important regulatory principles and practices and benefits ratepayers and the public interest,

thus meeting the second and third tests for reasonableness of stipulations. These findings were made even though the PUCO allowed for the inclusion of a return on construction work in progress ("CWIP") in Duke's AAC without regard to the statutory standards for the allowance of a return on CWIP. The PUCO also failed to clarify that the Duke Energy North America ("DENA") assets may be used only in an emergency when no alternative is available and only subject to a price cap for purposes of any cost recovery.

OPAE filed an application for rehearing from the PUCO's Opinion and Order approving the rider stipulation. App. 106. The PUCO's error is that the rider stipulation fails all three parts of the PUCO's three-part test for the reasonableness of stipulations. First, the rider stipulation is not the product of serious bargaining among the parties, but is the product and continuation of the side agreements to the RSP stipulation, which was rejected by the PUCO on remand because it is not the product of serious bargaining. Moreover, the rider stipulation is not supported by any customer group that is actually subject to its terms.

The rider stipulation also violates important regulatory practices and principles and does not benefit ratepayers nor serve the public interest. It allows for the inclusion of a return on CWIP in Duke's AAC without regard to the statutory standards for the allowance of a return on CWIP. Recovery of a return on CWIP in the AAC must be disallowed if a reasonable means to develop costs for the standard service offer prices is used. The rider stipulation also fails to clarify that the DENA assets may only be used in an emergency when no alternative is available and only

subject to a price cap for purposes of any cost recovery. The recovery through the SRT of capacity costs associated with the DENA assets should not be allowed.

After the PUCO denied OP&E's application for rehearing, OP&E filed this appeal with the Court. App. 08, 106, 01. OP&E respectfully requests the Court to reverse, vacate or modify the PUCO's orders and remand this case to the PUCO with instructions to correct the errors in law and fact as set forth herein.

III. ARGUMENT

Proposition of Law No. 1

The PUCO acts unreasonably and unlawfully when it disregards the Supreme Court's instructions, ignores evidence and finds that a stipulation and recommendation is the product of serious bargaining among the parties when side agreements undermine the settlement negotiations and when the stipulation is not supported by any customer group actually affected by its terms.

In considering the reasonableness of a stipulation, the PUCO uses 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 Court has endorsed the PUCO's analysis using these three criteria to resolve issues in a manner economical to ratepayers and to public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.* (1994), 68 Ohio St.3d 559; *Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St.3d, 123, 126.

Contrary to the first part of the test, serious bargaining among the parties did not take place at the settlement negotiations for the rider stipulation. The Supreme Court has already confirmed that attendance and discussion at settlement negotiations does not satisfy the criterion that serious bargaining take place. All capable parties participate in settlement discussions. However, when several parties have already negotiated concessions and then sit down at a bargaining table ready to agree with the utility to preserve those bargains, serious negotiations cannot be pursued; the previous arrangements among the utility and select parties has poisoned the well to the point that genuine bargaining cannot occur.

In remanding the RSP case to the PUCO for correction of errors, the Court questioned whether the existence of side agreements supports a finding that serious bargaining has taken place among parties to settlement discussions. *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2006), 111 Ohio St.3d 300. As the Court stated, if CG&E and one or more of the signatory parties to the stipulation agree to a side financial arrangement or some other consideration to sign the stipulation, that information would be relevant to a determination whether all parties engaged in serious bargaining. The existence of side agreements between CG&E and the signatory parties is relevant to the integrity and openness of the negotiation process. *Id.* Any concessions or inducements apart from the terms agreed to in the stipulation have relevance when deciding whether the settlement negotiations were fairly conducted. If there were special considerations in the form of side agreements among the signatory parties, one or more parties may have gained an unfair

advantage in the bargaining process, and the open settlement discussions are compromised. *Id.*

On remand, the side agreements provided overwhelming evidence that serious bargaining did not take place at the settlement negotiations for the RSP stipulation. The PUCO's criteria for the reasonableness of settlements had not been met. This evidence is set forth in the testimony of OCC witness Beth Hixon. Appellant OCC's Supplement ("OCC Supp.") 1-495. Unfortunately, much of this testimony was shielded from the public view and the public record on grounds advanced by representatives of parties to the side agreements that they were confidential.

After the remand hearing, conducted primarily outside the public record and view, the PUCO found that the existence of side agreements in which several of the signatory parties agreed to support the RSP raised serious doubts about the integrity and openness of the negotiation process related to the RSP stipulation. Based on a review of the side agreements, the PUCO reached the "inevitable conclusion" that there was a sufficient basis to question whether the parties engaged in serious bargaining, and, therefore, the PUCO concluded that it should not have adopted the RSP stipulation. Remand Order at 27, App. 52. In short, the PUCO recognized that the RSP stipulation was a sham.

In its Opinion and Order in the instant case, the PUCO cites the signatory parties' statement that there are no side agreements related to the rider stipulation. The PUCO ignored the Court's finding that the PUCO must look beyond the stipulation itself to determine if serious bargaining has taken place. The PUCO

cannot satisfy the Court's order with a narrow statement that none of the stipulating parties entered into side agreements specific to the rider stipulation. The question is whether there are side agreements undermining the settlement process leading to the rider stipulation. The evidence of record clearly demonstrates that the answer to these questions is affirmative.

The evidence shows that there is a direct connection between the RSP stipulation and the rider stipulation. The PUCO itself stated that the RSP case and the rider cases are "inextricably connected." Opinion and Order at 4, App. 21. The evidence on remand demonstrates that the side agreements entered into as inducement to sign the RSP stipulation continue to affect the views of the signatory parties to the rider stipulation. Those signing the rider stipulation remain exempt or unaffected by the very riders to which they are agreeing.

Yet, the evidence of the side agreements was essentially ignored by the PUCO. This is a fatal error. The PUCO avoided a discussion of the concessions and inducements given to signatory parties prior to these rider proceedings and how those concessions and inducements undermined the settlement process for the rider stipulation. If the PUCO had properly considered the evidence of the side agreements, the PUCO would have recognized the obvious connection between the side agreements to the RSP stipulation, rejected on remand, and the rider stipulation. The stipulating parties joining Duke are simply continuing to follow the terms of the side agreements that benefit themselves at the expense of entire classes of customers.

Duke and five other parties submitted the rider stipulation. The City of Cincinnati signed the rider stipulation. The City of Cincinnati also signed a side agreement with Duke under which the City agreed to withdraw from the RSP case. Under the agreement, Duke provided the City with one million dollars (\$1,000,000) in total consideration for certain amendments to three electricity agreements between Duke and the City. OCC Remand Ex. 6, Supp. 17. The settlement agreement was conditioned upon the City not opposing the stipulation filed in the RSP case. The settlement agreement also would terminate on the day that the PUCO issued an order unacceptable to Duke in carrying out the terms of the stipulation in the RSP case. *Id.* at 2.

The terms of the RSP stipulation are implemented via the cases adjusting the riders. The City of Cincinnati's support for the rider stipulation is a product of its original side agreement with Duke for the RSP case. Moreover, contrary to the assertions of the PUCO, the City of Cincinnati does not serve as a representative of the residential class in the rider cases because the City's side agreement with Duke concerns the City only as a customer of Duke, not as a representative of the residential class. The City withdrew from the RSP case pursuant to its side agreement and signed the rider stipulation, also pursuant to its side agreement, so that the PUCO would not issue an order unacceptable to Duke. Signing the rider stipulation ensured the City the financial benefits of its bargain in the RSP case.

Another signatory party, which the PUCO cites as representing the residential class, is People Working Cooperatively ("PWC"). PWC operates demand-side management programs funded by Duke. PWC's primary purpose in these rider

cases is to assure that funding promised by Duke will be continued and extended through the end of the market development period. PWC Motion to Intervene (March 9, 2004), Supp. 14. PWC itself stated that its purpose in intervening in the RSP case was to preserve the funding from Duke available to PWC to provide PWC's services. *Id.* PWC signed the rejected RSP stipulation, just as it signed the rider stipulation. Thus, PWC's position is that rates for residential customer should be increased to fund programs that PWC operates and to yield the revenue outcome requested by Duke. Because PWC showed no concern for the rate increases that the rider stipulation will impose on residential customers, its support for the rider stipulation cannot be construed as support from the residential class.

Other signatory parties to the rider stipulation include OEG and the OHA. Members of OEG and OHA have side agreements with Duke. The evidence of these side agreements remains confidential and is set forth in the sealed testimony of OCC witness Beth Hixon. OCC Supp. 1-495. This evidence demonstrates that serious bargaining among the parties did not take place at the settlement negotiations not only for the RSP stipulation but also for the rider stipulation. The only customer parties to the RSP and rider stipulations have side agreements with Duke.

The rider stipulation has no support from marketers, residential customers, or any other customer group that will be subject to its terms. OCC, which, by statute, represents all residential customers, opposed the rider stipulation, as did OPAE, which has served as an advocate for residential and low-income customers since its founding in 1996. OPAE also represents the interests of its member agencies that

are commercial customers of Duke. It is absurd for the PUCO to dismiss OCC and OPAE as simply two parties who failed to achieve a satisfactory result in the settlement process. OCC and OPAE are the two parties representing the vast majority of Duke's customers. OCC and OPAE are the only two parties representing customers without side agreements and without special inducements. They are the two parties representing customers who will actually pay all the charges set forth in the rider stipulation. They are the only parties actually concerned about the stipulation's terms.

The PUCO did not heed the Court's warning. The signatory parties to the stipulation have concessions, inducements and special interests outside the terms of the stipulation; the signatory parties have no concern for the terms of the rider stipulation. If the signatory parties are not subject to the terms of the stipulation, the stipulation cannot be the product of serious bargaining. The rider stipulation is not the bargain made by its signatory parties; their agreements with Duke are elsewhere, where the PUCO refuses to look. The rider stipulation is as much a sham as the RSP stipulation.

This Court has affirmed the PUCO's RSP concept solely on the basis of stipulations supported by a wide range of parties to the cases. In *Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, 104 Ohio St.3d 530, 2004-Ohio-6767, the Court affirmed the PUCO's finding in approving a rate plan for Dayton Power and Light Company ("DP&L") on the basis of the reasonableness of a stipulation supported by all customer classes. *Constellation* is based almost entirely on the Court's affirmation of the PUCO's approval of a stipulation to which parties from all

customer classes agreed. *Id.* The stipulation provided cover for the PUCO's actions, which were not expressly authorized by statute.

Proof of the importance of a stipulation was emphasized by the Court when it stated in a subsequent case involving the RSP of FirstEnergy Corp., as follows:

The absence of a stipulation signed by customer groups factually distinguishes this case from *Constellation*. In *Constellation* we also noted that "no entire customer class was excluded from settlement negotiations and that the following classes were represented and signed the stipulation: residential customers, low-income customers, commercial customers, industrial customers, and competitive retail electric service providers." When it enacted R.C. 4928.14, the General Assembly anticipated that at the end of the market-development period, customers would be offered both a market-based standard service as required by R.C. 4928.14(A) and service at a price determined through a competitive-bidding process as required by R.C. 4928.14(B); one very narrow exception contained in R.C. 4928.14(B) permits the commission to determine that a competitive-bidding process is not required. In *Constellation*, the customer groups, by stipulation, agreed to accept a market-based standard service offer and waive any right to a price determined by competitive bid. Those facts are not present in this case.

Ohio Consumers' Counsel v. Pub. Util. Comm., 2006-Ohio-2110 ¶18.

The Court made it clear that the stipulation signed by a wide range of parties was the determining factor that allowed the Court to affirm the PUCO's RSP order for DP&L in spite of the failure to adhere to the statute. The Court made a strong distinction between RSP orders, such as the DP&L order, that could be approved pursuant to a stipulation supported by a wide range of parties and RSP orders that could not be approved absent such a stipulation. In the same opinion, the Court also stated:

In contrast to the customer groups in *Constellation*, the customer groups here did not agree to the FirstEnergy rates, and most customer groups, including the OCC, which represents all residential customers, opposed them. Under these circumstances, the PUCO had no authority to adopt the rate-stabilization plan without also ensuring that a reasonable means for customer participation had been developed.

Id. ¶19.

Reliance on a stipulation was also central to the Court's decision in *Elyria Foundry v. Pub. Util. Comm.*, 2007-Ohio-4164 (August 29, 2007), which the PUCO cited in its Remand Order. In *Elyria*, the Court stated as follows:

¶64. Moreover, several parties representing divergent groups of ratepayers signed the stipulation on the rate-certainty plan. Those include IEU and the Ohio Energy Group (consortia of large industrial customers); the cities of Akron, Cleveland, Parma, and Toledo; Ohio Consumers' Counsel; and Ohio Partners for Affordable Energy and the Neighborhood Environment Coalition (low-income and energy-efficient customer programs). In addition, the Northeast Ohio Public Energy Council and the Northwest Ohio Aggregation Coalition (northern Ohio residential customer aggregators) pledged not to oppose it.

Extra-legal rate plans can only be achieved through stipulations. CG&E-Duke and certain of its large customers presented sham stipulations to the PUCO to facilitate PUCO and Court approval by implying that there was support for the stipulated outcome among customers. In fact, the customers who signed the sham stipulations have side agreements with CG&E-Duke under which they are exempt from the terms of the stipulations – the rate increases under the RSP and rider stipulations. Parties not representing customers also signed the agreements but are unaffected by the rates produced by the stipulations.

The evidence of the side agreements shows that consideration was provided to gain the support of certain large users of electricity to the RSP. OCC. Supp. 1-495. Contrary to the Court's opinions cited above, the PUCO failed to require any support for the rider stipulation from any customer group actually affected by its terms. The evidence on remand, currently under seal, demonstrates that side agreements undermined the negotiations among the parties so that the Court must conclude that serious bargaining did not take place at the settlement negotiations for the rider stipulation, just as serious bargaining did not occur for the RSP stipulation.

A disservice is done to public policy when the PUCO approves stipulations that do not meet the PUCO's reasonableness criteria. The public interest is not served by the PUCO's approval of stipulations that do not actually reflect an agreement among the parties. If the PUCO refuses to consider the evidence that a stipulation is not a bargained for agreement, there is a diminished incentive for parties to enter the negotiation process. Parties cannot trust that the PUCO will prevent the approval of sham stipulations.

The Court should reverse and vacate the unlawful and unreasonable PUCO order in this case approving a stipulation and recommendation that is clearly not the product of serious bargaining among the signatory parties. The Court should further the public interest by requiring the PUCO to approve a stipulation only when it represents serious bargaining and agreement among the parties to the case that are actually affected by the outcome through higher utility bills. The PUCO resolves many of the issues before it through stipulations of the parties. The Court should

require the PUCO to approve only stipulations that meet the PUCO's own criteria for determining the reasonableness of stipulations.

Proposition of Law No. 2

Given the stipulation's treatment of the issues, the PUCO 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.

- A. The PUCO acted unreasonably and unlawfully by approving a stipulation which includes excessive compensation to Duke for Construction Work in Progress ("CWIP"), which does not benefit ratepayers, serve the public interest, and violates important regulatory principle or practice.

The PUCO found that its approval of Rider AAC was based on Duke's calculations, which include the current costs of construction work in progress, also known as CWIP as a component of Rider AAC with no reference to the completion percentage of the construction projects. Ohio statutes limit payments for CWIP to capital investments that are 75% complete and will satisfy the 'used and useful' status required for ultimate cost recovery. R.C. §4909.15, App. 97. The PUCO found that Ohio ratemaking standards, such as the statutory limitation on earning a profit/return on CWIP, are not relevant in the present market environment and that the consumer protections against unjust and unreasonable rates provided by statute can be ignored. R.C. §§4909.15, 4909.18, 4909.19, 4928.14, App. 97, 101, 103, 105. Therefore, the PUCO found that the percentage completion of a project should not be a bar to Duke's earning a return on CWIP. Opinion and Order at 24, App. 21.

The rider stipulation fails to benefit ratepayers and the public interest, and violates important regulatory practice and principle -- the second and third parts of the PUCO's three-part test for the reasonableness of stipulations -- by allowing for the recovery of a return on CWIP through Duke's AAC Rider without regard to any completion percentage of the affected projects. The PUCO's Staff offered no justification for the inclusion of a return on CWIP in the AAC. Staff witness L'Nard E. Tufts merely verified CG&E-Duke's revenue requirement by tracing numbers from Duke's filing to its records. Staff R.R. Ex. 2 at 2, Supp. 58. Adjustments were made to update and correct numbers based on the information supplied by Duke. Although the Staff signed the stipulation, the Staff made no recommendations and provided little justification for ignoring Ohio law and providing for a return on CWIP in the AAC rider.

The inclusion of a return on CWIP results in unreasonable Rider AAC charges. First, a return on CWIP without regard to percentage completion would not be allowed in regulatory proceedings. A revenue requirement determined through a regulatory cost calculation would require that any CWIP be at least 75% complete before a return on it would be allowed. R.C. §4909.15, App. 97. Duke did not demonstrate that the CWIP portion of the environmental compliance net plant is or will be at least 75% complete (or any other percentage) during the time that the Rider AAC is being collected.

Second, under the regulatory paradigm, customers might pay a return on CWIP that is at least 75% complete during plant construction, because, after construction is complete, the customers will have lower capital costs as a result of

the return on CWIP during the final stages of construction. The law represents the balance between the interests of the customer and the utility; the customers pay sooner to avoid higher costs and interest in future years. R.C. §4909.15, App. 97. However, in the case before the Court, the RSP is only in place until the end of 2008, hardly enough time for customers to see any benefit from the prepayment of construction costs. The three-year RSP does not provide any assurance of lower capital costs for customers at a future date.

The PUCO stated that traditional regulatory treatment embedded in Ohio statutes does not apply in the present market environment despite the fact that compliance with the law is not optional under the plain meaning of current statutes. In fact, the ACC Rider itself has no place in the market environment. As OCC witness Michael P. Haugh pointed out, the “new” formula used by Duke to determine a market price for standard service generation simply seeks cost-based recovery that is similar to the traditional methodology for the treatment of CWIP, but without the traditional limitation regarding the percentage of completion for additions to environmental plant and without any assurance of lower capital costs in the future. OCC Ex. R.R. 1 at 7, Supp. 20. Duke is seeking for itself the best of both worlds: cost recovery using the regulatory revenue requirement methodology (such as CWIP) instead of a market approach but disregard for regulatory ratemaking principles, statutes, and rules governing cost recovery such as those that limit CWIP. *Id.* In a market environment, a return on CWIP would not be earned at all. A return on the plant would not occur until the plant is fully operational. Thus, in a market environment, CWIP would simply not exist.

Under the circumstances of an application requesting recovery for a typically regulated cost such as CWIP, it is obvious that regulatory practices can and should be used to ensure reasonable standard service offer rates, which must be filed pursuant to R.C. §4909.18 and conform to a just and reasonable standard. A reasonable method should be used to reflect actual costs for charges such as the AAC rider.

CWIP should be removed from the "Return on Environmental Plant" calculation in Duke's filing for purposes of setting a reasonable AAC charge in conformance with the just and reasonable standards of R.C. §4909.18. Mr. Haugh removed the \$244,413,759 CWIP amount from the "Return on Environmental Plant" calculation of Duke witness Wathen's at Attachment WDW-2, Schedule 2. This reduces the "Pre-Tax Return" to \$53,938,303 and reduces the "Total Environmental Compliance Increase" to \$50,429,411. OCC Ex. R.R. 1 at 11, Supp. 20. The removal of the CWIP portion of the Environmental Plant reduces the revenue requirement for the 2007 AAC to \$45,246,994. *Id.*; MPH Attachment 1, Supp. 20. It is difficult to comprehend how approving a rider that allows a utility to collect almost \$29 million more than it would under Ohio law can be advantageous to customers or in the public interest, let alone consistent with traditional regulatory principles.

There is no "market environment" for retail electric generation to serve Ohio's residential and small commercial customers. Retail competition is non-existent for these customers in Duke's service area. That is why the PUCO developed the RSP concept which this Court has affirmed. Therefore, any determination of an AAC Rider amount or overall generation price must necessarily involve a proxy for a

market price. The proxy can only be the use of the regulatory approach to cost-of-service ratemaking, which is designed to mimic the return provided by a competitive market. A key principle is that a utility can reap a return on construction costs/CWIP only once a project is 75% complete because ratepayers will benefit from lower capital costs once the project is in service. There is no reason why such standards for CWIP should not apply here; in fact, standards must be applied in order for the AAC rider to meet the just and reasonable standard required by R.C. §4909.18 for standard service offers pursuant to R.C. §4928.14. If the construction is still a component of rates established under R.C. §4909.18 when it is 75% complete, then a profit on the investment is authorized under Ohio law. Permitting collection of that profit when there is no assurance that ratepayers will reap the benefits of lower capital costs, because the RSP only holds sway through 2008, cannot be just and reasonable as required by Ohio law.

- B. The PUCO acted unreasonably and unlawfully when it approved the stipulation allowing for the compensation to Duke for the cost of generation assets that do not provide benefits to ratepayers, serve the public interest, and violate important regulatory principle or practice.

A key component of the merger between Duke and CG&E's parent company was the transfer of the so-called DENA assets, three combined-cycle natural gas-fired generating plants, to CG&E, now Duke. These assets, which were originally constructed as merchant – unregulated – plants, cannot sell competitively-priced generation given current natural gas prices.

After the rider stipulation was filed in this matter, Duke and the Staff presented a clarification of the rider stipulation. OCC R.R. Ex. 3, Supp. 11. This clarification states that Paragraph 8 of the rider stipulation is intended to permit Duke to use its DENA capacity on an emergency basis where capacity to meet operational requirements is necessary with less than seven days advance notice during two consecutive seven-day periods. In that event, Duke must obtain PUCO approval before using such capacity during the second seven-day period. The Staff and Duke agreed that Duke may recover short term (seven days or less) capacity purchases from its DENA assets through the SRT. Duke and the Staff agreed to agree on a pricing methodology before Duke purchases the DENA capacity. Duke and the Staff also agreed that a recommendation of an outside auditor critical of having ratepayers pay for DENA capacity was inapplicable to the extent it is in conflict with their agreement in the rider stipulation and its clarification. OCC R.R. Ex. 3, Supp. 11.

Given the treatment of the use of DENA assets in the rider stipulation and its clarification, the PUCO acted unreasonably and unlawfully when it found that the rider stipulation benefits ratepayers, serves the public interest and does not violate any important regulatory principle or practice. First, the rider stipulation rejects the management/performance auditor's recommendation regarding the DENA assets; the auditor recommended that Duke's purchases of reserve capacity from DENA assets not be eligible for inclusion in the SRT. The auditor found that purchasing capacity from other providers would be better for ratepayers than buying capacity from the uncompetitive DENA assets. Commission-Ordered Ex. 1 at 6-5, OCC

Supp. 496. The auditor also found that Duke could sell the DENA capacity elsewhere. *Id.* Moreover, the auditor stated that affiliate transactions, such as purchases of DENA capacity by Duke, are problematic and burdensome to audit. *Id.*

The auditor's recommendations reflect the PUCO's current orders regarding the DENA assets. The PUCO had previously found that costs related to the transfer of the DENA assets may not be passed on to Ohio customers without prior approval of the PUCO. Further, in Case No. 05-724-EL-UNC, the PUCO adopted a stipulation, which states that Duke may not use the DENA assets to satisfy the SRT margin requirements without an application to the PUCO requesting approval of a market price associated with the DENA assets. OCC R.R. Ex. 4. Supp. 64. Duke did not provide any market pricing mechanism in its SRT application. OCC Ex. R.R. 1 at 12, Supp. 20.

OCC witness Haugh concurred with the auditor's recommendation that charges related to DENA assets should not be collected from customers in Duke's SRT. Duke has not shown that customers are better off by using DENA assets than paying for capacity in the market while the outside auditor found that ratepayers would see no savings from the self-dealing of Duke with its DENA assets. Thus, Duke has not demonstrated that the use of the DENA assets benefits customers. The use of the DENA assets may result in SRT costs that do not provide reasonably-priced retail electric service for Ohio customers. OCC Ex. R.R. 1 at 15, Supp. 20.

Duke should be allowed to purchase capacity from the DENA assets in the future only in an emergency situation and only if Duke demonstrates that the DENA

assets clearly offered a better price or a better product for customers than that offered in the open market. The DENA capacity should be used only as a last resort and only if there is a pre-determined reasonable method to set the price for the capacity from the DENA assets. OCC Ex. R.R. 1 at 15-16, Supp. 20.

The rider stipulation allows Duke to determine the "market price" it will charge ratepayers subject to the stipulation (i.e., those not supporting it) by either using the midpoint of broker quotes, the average price of third-party transactions, or another method determined by Duke and the Staff. In reality, there are usually very few broker quotes. OCC R.R. Ex. 2 at 4, Supp. 47. The problem with the stipulated method is that there is a limited market. If there are very few or no transactions, then there is only speculation about the market price. Given the lack of transactions in the capacity market, the market price for capacity would be determined with limited or no market data. This is not an acceptable solution for determining the market price of the DENA assets, nor does it provide a reasonable cost for capacity for Duke customers who must pay the SRT. OCC Ex. R.R. 1 at 14, Supp. 20.

Contrary to the PUCO's finding, the guidelines for formulating a price for the DENA assets need to be more stringent. If there are limited broker quotes and transactions in the capacity market, there will be too much uncertainty regarding the true market price. The formula set forth in the rider stipulation should not be used unless there is a minimum number of broker quotes and transactions to determine the price of the DENA capacity. A minimum of three bids and offers from three separate brokers is needed, and a minimum of three third-party transactions should be required. Finally, when formulating a price, there needs to be a cap on the

amount Duke is charging to the customers who are paying the SRT. The price should be capped at the median price Duke has paid for capacity during the time frame in which the emergency occurs. This cap should be implemented if any capacity from the DENA assets is used. OCC R.R. Ex. 2 at 6, Supp. 47. Given that the price of capacity in a true emergency can be extremely high, there is good reason to cap the price.

The use of DENA assets should be limited only to an emergency situation as a last resort and only if Duke demonstrates that the DENA assets clearly offered a better price for customers through a pre-determined reasonable method to set the price for the capacity from the DENA assets. The stipulated methodology to formulate a "market price" for the DENA assets based on discussions between Duke and the Staff does not provide a reasonable method to set the price for the capacity from the DENA assets or adequate protection for customers who will not be represented in those discussions. The stipulation also disregards the recommendation of the management/ performance auditor and previous PUCO precedent prohibiting charging ratepayers for any costs associated with the DENA assets. Therefore, the PUCO has not provided adequate protection for ratepayers nor has it prevented overcharging Duke's customers for capacity.

The rider stipulation's treatment of the DENA assets (and the awkward attempt to clarify its meaning) confirms that the rider stipulation is harmful to ratepayers and against the public interest. There was apparently no need to purchase capacity from the DENA plants to provide generation services to ratepayers prior to the Duke merger with CG&E's parent. Yet once the merger was

consummated, the mere whiff of an emergency now justifies ratepayers paying for something they never before needed. The use of DENA assets should be limited to emergency situations where there are no other options or when Duke is willing to charge less for the capacity than available from other sources. Moreover, the PUCO should have adopted the limitations and safeguards recommended by OCC witness Haugh for pricing the DENA capacity in the event of its use in an emergency situation.

V. CONCLUSION

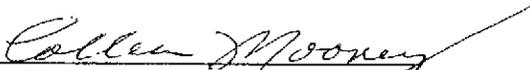
The rider stipulation fails all three parts of the PUCO's three-part test for the reasonableness of stipulations. The rider stipulation is not the product of serious bargaining among the parties. The evidence demonstrates that side agreements undermined the settlement negotiations for the rider stipulation. Moreover, the rider stipulation is not supported by any class of customers that are subject to its terms.

The rider stipulation also violates important regulatory practices and principles. It does not benefit ratepayers and serve the public interest. It allows for the inclusion of a return on CWIP in Duke's Rider AAC without regard to any standards for the allowance of a return on CWIP. Recovery of a return on CWIP in the AAC must be disallowed because it does not result in just and reasonable rates as is required by current law. R.C. §§4909.15, 4909.18 and 4928.14. The rider stipulation also fails to clarify that the DENA assets may only be used in an emergency when no alternative is available and only subject to a price cap for

purposes of any cost recovery. The recovery through the SRT rider of capacity costs associated with the DENA assets should not be allowed.

The Court is required to reverse, vacate or modify final orders of the PUCO where the orders are unreasonable or unlawful. *Consumers' Counsel v. Pub. Util. Comm.*, (1979) 58 Ohio St.2d 108, 110. The Court should reverse and vacate the unlawful and unreasonable PUCO decision in this case approving the rider stipulation that was not the product of serious bargaining, that did not benefit ratepayers nor the public interest, and that violates important regulatory practices and principles. The Court should further the public interest by requiring the PUCO to approve only stipulations that meet the PUCO's three-part test for determining the reasonableness of stipulations.

Respectfully submitted,


Colleen L. Mooney, Counsel of Record
David C. Rinebolt
Ohio Partners for Affordable Energy
1431 Mulford Road
Columbus, Ohio 43212
(614) 488-5739 – Telephone
(419) 425-8862 – Facsimile
drinebolt@aol.com
cmooney2@columbus.rr.com

*Attorneys for Appellant,
Ohio Partners for Affordable Energy*

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Merit Brief of Appellant, Ohio Partners for Affordable Energy, was served upon all parties to this proceeding by hand delivery or regular U. S. Mail this 2nd day of June 2008.



Colleen L. Mooney
Counsel for Appellant
Ohio Partners for Affordable Energy

PARTIES OF RECORD

Duane Luckey, Esq.
Stephen Reilly, Esq.
Attorney General's Office
Public Utilities Section
180 East Broad Street
Columbus, Ohio 43215

Jeffrey L. Small, Esq.
Ann M. Hotz, Esq.
Office of the Ohio Consumers' Counsel
Assistant Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485

Paul A. Colbert, Esq.
Duke Energy Ohio, Inc.
155 East Broad Street
Columbus, Ohio 43215