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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

Consolidated Duke Energy Ohio, Inc.,	)	Case Nos.	03-93-EL-ATA
Rate Stabilization Plan Remand, and	)		03-2079-EL-AAM
Rider Adjustment Cases	)		03-2081-EL-AAM
	)		03-2080-EL-ATA
	)		05-725-EL-UNC
	)		06-1069-EL-UNC
	)		05-724-EL-UNC
	)		06-1085-EL-UNC
	)		06-1068-EL-UNC

SUPPLEMENTAL TESTIMONY OF

WILLIAM DON WATHEN, JR.

ON BEHALF OF

DUKE ENERGY OHIO

_____ Management policies, practices, and organization

_____ Operating income

_____ Rate base

_____ Allocations

_____ Rate of return

_____ Rates and tariffs

__x__ Other – Supplemental Testimony

February 28, 2007

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is William Don Wathen, Jr. My business address is 139 East Fourth Street, Cincinnati, Ohio 45202.

Q. ARE YOU THE SAME WILLIAM DON WATHEN, JR., WHO FILED DIRECT TESTIMONY IN CASE NUMBER 06-1085-EL-UNC, ONE OF THE ABOVE CAPTIONED CONSOLIDATED CASES?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A. I am providing supplemental testimony to provide some historical context to the Annually Adjusted Component ("Rider AAC") of the Company's Market-Based Standard Service Offer ("MBSSO") that was approved in Case No. 03-93-EL-ATA.

II. RIDER AAC CALCULATION

Q. PLEASE DESCRIBE THE EVOLUTION OF THE ANNUALLY ADJUSTED COMPONENT OF THE COMPANY'S MARKET-BASED STANDARD SERVICE OFFER.

A. On May 19, 2004, the Company filed a Stipulation and Recommendation (Stipulation) in the MBSSO case, which was signed by most of the parties to the case, including the Commission Staff. This Stipulation contained a non-bypassable Provider of Last Resort (POLR) charge comprised of two components: the Rate Stabilization Charge (RSC) and the Annually Adjusted Component. The

RSC was to be 15% of the generation charge known as little g.[1] Rider AAC consisted of a return on and recovery of costs associated with the following: Emission Allowances, Reserve Margin, Environmental Compliance, Homeland Security and Tax Changes.

Q. DID THE STIPULATION SEEK RECOVERY OF THE ENTIRE AMOUNT OF THE POLR CHARGE?

A. No. The Stipulation contained a gradual increase in Rider AAC, beginning with a non-residential charge set at 8% of little g in 2005 with automatic annual increases of a minimum of 6% of little g, or annual increases of up to 8% if the Company provided sufficient support for the increase. The residential Rider AAC would be set at 6% of little g in 2006 with a maximum increase of 7% in 2007 and 8% in 2008. Stipulation Exhibit 1 demonstrated a calculation for Rider AAC that would produce a charge of over 14% of little g based on data for the twelve months ended of June 2004.

Q. DID THE COMMISSION APPROVE THE STIPULATION AS FILED?

A. No. In addition to other changes, the Commission in its Opinion and Order reduced the amount to be recovered through Rider AAC in 2005 from the amount reflected in the Stipulation, $60,172,267, to $53,757,267 in its Order. Further, Rider AAC was to be 100% bypassable by all consumers.

Q. WHAT WAS THE COMPANY'S RESPONSE TO THE COMMISSION'S OPINION AND ORDER?

[1] "Little g" is the term used to describe the net unbundled generation rate remaining after the regulatory transition charge is deducted.

A. The Company filed an Application for Rehearing asserting a number of assignments of error. In addition, the Company requested that the Commission reinstate the Stipulation, as filed and without modification, or adopt an Alternative Proposal attached to the Request for Rehearing.

Q. DID THE COMPANY PROPOSE CHANGES TO THE RIDER AAC CALCULATION IN ITS ALTERNATIVE PROPOSAL?

A. Yes. The Company suggested removing the cost of emission allowances from the Rider AAC calculation and, instead, recover these costs through the Fuel and Purchased Power Tracker ("Rider FPP"). It also proposed recovering the Reserve Margin component through two separate riders: (i) the System Reliability Tracker (SRT) to recover the cost of purchasing capacity in the market to meet a 15% planning reserve margin and (ii) the Infrastructure Maintenance Fund (IMF) to compensate it for committing its generation capacity to serve MBSSO consumers through 2008. Residential consumers would not be subject to the IMF or the AAC in 2005. In addition, the Alternative Proposal would make Rider AAC bypassable for some consumers who switch suppliers, up to the first 50% of non-residential consumers and up to the first 25% of residential consumers.

Q. WAS THE SUBJECT OF CONSTRUCTION WORK IN PROGRESS (CWIP) ADDRESSED IN THE MBSSO CASE?

A. Yes. In his initial Direct Testimony, filed on April 15, 2004, Company witness John P. Steffen included, as an Attachment, an illustration of the formula to be used to calculate the Rider AAC, using a revenue requirement type calculation. Attachments JPS-2 through JPS-7 were included in the May 19, 2004, Stipulation as Stipulation Exhibit 1. The Commission's Staff extensively reviewed these calculations and did not dispute the accuracy of the figures presented or the methodology used. That formula, initially called the "POLR Charge Calculation," included a provision for a return on the entirety of its investment in environmental compliance plant, including CWIP (See Attachments JPS-4, in Case No. 03-93-EL-ATA, *et al.*).

Q. IN THE MBSSO CASE, DID ANY PARTY OBJECT TO THE INCLUSION OF CWIP IN THE RIDER AAC REVENUE REQUIREMENT CALCULATION?

A. Yes. The Ohio Consumers' Counsel (OCC) did object to including CWIP in Rider AAC. In its Request for Rehearing, OCC asserted one assignment of error related to the establishment of the procedure to increase Rider AAC, asserting that the calculation does not meet the requirements of the Ohio Revised Code. OCC contended that any changes to Rider AAC required a full traditional rate case review pursuant to the Ohio Revised Code, under which CWIP is only permitted under certain circumstances.

Q. DID THE COMMISSION ADDRESS OCC'S ISSUE IN THE MBSSO CASE?

A. Yes. In its November 23, 2004, Entry on Rehearing, the Commission directly addressed OCC's objection to the Rider AAC calculation. Responding to OCC's objection, the Commission wrote, beginning on page 19 of the Entry on Rehearing, that "competitive retail electric services, including a firm supply of electric generation service, shall be provided to customers at market-based rates, rather than establishing such services through the traditional rate-based approach..."

Q. UNDER ITS TRADITIONAL REGULATED RATE MAKING PARADIGM, THE COMMISSION ONLY PERMITTED CWIP IN RATE BASE IN CERTAIN CIRCUMSTANCES. WHY DO YOU BELIEVE THE COMMISSION ALLOWED CWIP EXPENDITURES IN THE MARKET-BASED POLR CHARGE?

A. Admittedly, it has been difficult to reshape the mindset of regulators, advocates, and even utilities away from the traditional concepts of establishing retail generation prices. However, with the passage of Senate Bill 3, the traditional regulatory framework no longer applies to the establishment of prices for generation in Ohio. The applicability of traditional ratemaking regulations, such as the limit on CWIP at issue here, must be set aside because we are not dealing with traditional cost based regulation – instead, we have a "new" formula to determine a market price, just as the Commission wrote on page 19 of its Entry on Rehearing. The Rider AAC formula has been explicitly defined, and extensively litigated, throughout the record of the MBSSO case and specifically included a provision for CWIP.

Electric generation in Ohio is deregulated. The MBSSO price can be based on factors not necessarily included, or even considered, in traditional rate-making regulation, as long as the price is not discriminatory or set below cost for the purpose of destroying competition.

III. TRUE-UP OF 2007 RIDER AAC

Q. IS THE COMPANY CURRENTLY COLLECTING RIDER AAC REVENUE?

A. Yes. The Commission issued an Order in these cases, on December 20, 2006, allowing the Rider AAC to continue at the current rate (*i.e.*, the rate for 2006).

Q. IS THERE A PROVISION FOR A TRUE-UP OF THE 2007 RIDER AAC?

A. Yes. The Commission specifically provided for a true-up in its December 20, 2006, Order.

Q. IS THE COMPANY REQUESTING ANY ADDITIONAL RELIEF?

A. Yes. First, DE-Ohio asks that the Commission order that any true-up of Rider AAC revenue be measured from January 1, 2007, to the time the new Rider AAC prices are approved and effective. Second, the Company requests that the Commission order that such true-up be calculated with a carrying cost computed at the Company's long-term debt cost rate approved in its distribution rate case, Case No. 05-059-EL-AIR.

Q. IS THE PROPOSAL TO INCLUDE CARRYING COSTS AN UNUSUAL REQUEST?

A. No. In fact, the Company currently computes a carrying cost on over- and under-recovery of Rider TCR revenues using the same carrying cost rate.

IV. CONCLUSION

Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION ON THIS MATTER?

A. The Commission has to look no further than its own November 23, 2004, Entry on Rehearing in the MBSSO case to establish the validity of the Company's Rider AAC calculation, including the recovery of a return on all of its environmental CWIP. In my opinion, traditional regulation should not apply to market-based formula rates and, consequently, any attempt to impose traditional regulatory rules on the Rider AAC calculation, or to any part of the MBSSO formula for that matter, is misguided and should be rejected by the Commission. The Company's Rider AAC revenue requirement calculation follows the pricing formula approved by the Commission in its November 23, 2004 Entry on Rehearing, and, therefore, should be approved.

It is worth noting that the Company has made substantial new investment in environmental compliance equipment even since the time of the initial POLR proposal. The investment in CWIP has increased by over $70 million; similarly, net plant has increased by over $70 million as well.

Also, the Commission should allow the Company to true-up Rider AAC revenues for 2007 beginning January 1, 2007, with a carrying cost.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.