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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke )  
Energy Ohio for Approval of a Market )  
Rate Offer to Conduct a Competitive )  
Bidding Process for Standard Service ) Case No. 10-2586-EL-SSO  
Offer Electric Generation Supply, )  
Accounting Modifications, and Tariffs for )  
Generation Service. )

MERIT BRIEF

OF

DUKE ENERGY OHIO, INC.

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## **I. Introduction**

### **A. Background**

The legislature of the state of Ohio decided, in 1999, to deregulate the electric generation industry and to allow competition in the supply of electric generation. In order to accomplish this goal, the legislature passed Amended Substitute Senate Bill No. 3, enacting Chapter 4928 of the Revised Code. Electric utilities in the state were required to separate their charges into distribution, transmission, and generation portions, and entered into a phase known as the market development period. This was a period that was designed by the legislature as a transition period, to allow the market for electric generation to develop while utilities rates were still approved by the Commission and were moving away from the historical rate-of-return approach.

The market development period was set by the legislature to end no earlier than 2005, unless there was 20 percent switching in a utility's territory or a finding of effective competition.<sup>1</sup> By 2005, it was expected that the market would have developed sufficiently to allow the Commission to release the bulk of its review authority over retail generation rates. Unfortunately, due to issues in the regional transmission of power and other market-related problems, the Commission determined, near the end of the market development period, that the market had not yet matured sufficiently to allow total transition to competition.<sup>2</sup> Therefore, the Commission approved rate stabilization plans for the electric utilities, lasting in most cases through the end of 2008.<sup>3</sup>

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<sup>1</sup> Amended Substitute Senate Bill 3, 123<sup>rd</sup> General Assembly.

<sup>2</sup> See, e.g., *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.*, Entry at Finding (14) (December 9, 2003).

<sup>3</sup> See, e.g., *id.*, Opinion and Order (September 29, 2004).

The legislature's next step was comprehensive 2008 legislation to continue the deregulation process. Amended Substitute Senate Bill No. 221 (SB 221) had a number of important impacts on the electric utility industry. The most important, for purposes of electric rates, was the establishment of two types of standard service offers (SSOs): electric security plans (ESPs), which are similar to the rate stabilization plans that came before them; and market rate offers (MROs), which feature rates based on competitive bidding processes (CBPs).

Beginning January 1, 2009, an electric distribution utility shall provide consumers, on a comparable and nondiscriminatory basis within its certified territory, a standard service offer of all competitive retail electric services necessary to maintain essential electric service to consumers, including a firm supply of electric generation service. To that end, the electric distribution utility shall apply to the public utilities commission to establish the standard service offer in accordance with section 4928.142 or 4928.143 of the Revised Code...<sup>4</sup>

R.C. 4928.142 provides for the MRO and R.C. 4928.143 provides for the ESP. The determination of whether an MRO or and ESP is appropriate is left to the discretion of the utility, with the proviso that the Commission may not approve an ESP unless it finds that the ESP, including its pricing and all other terms and conditions, including deferrals and future recovery of deferrals, is more favorable in the aggregate than the expected results under an MRO.<sup>5</sup> On the other hand, the Commission is given no mandate, and indeed no authority under SB 221, to compare a requested MRO against what it anticipates *might* be included in an application for an ESP. Rather, the Commission must allow the MRO if it finds that the statutory requirements have been met by the requesting utility.

The commission shall initiate a proceeding and, within ninety days after the application's filing date, shall determine by order whether the electric distribution utility and its market-rate offer meet all of the foregoing requirements. If the

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<sup>4</sup> R.C. 4928.141(A).

<sup>5</sup> R.C. 4928.143(C)(1).

finding is positive, the electric distribution utility may initiate its competitive bidding process.<sup>6</sup>

On July 31, 2008, Duke Energy Ohio, Inc., (Duke Energy Ohio or the Company) filed an application for its first SSO under SB 221. That application requested approval of an ESP. Duke Energy Ohio was able to reach a negotiated settlement of issues in that proceeding, and the Commission approved the stipulation with certain modifications on December 17, 2008. That ESP was effective on January 1, 2009, and will remain in place through December 31, 2011.

With the anticipated expiration of the ESP later this year, Duke Energy Ohio has now begun the process of seeking approval of its next SSO.

#### **B. Procedural History**

On November 15, 2010, Duke Energy Ohio filed an application for approval of an MRO, to serve as its new SSO beginning January 1, 2012. The attorney examiner assigned to the proceeding issued a procedural entry, setting the schedule for the case. Following a period of discovery and settlement discussions among the parties, the hearing began on January 4, 2011, and continued on January 11, 12, 13, 14, 18, and 19, 2011. At the conclusion of the hearing, the attorney examiners requested that briefs and reply briefs be filed no later than January 27 and February 3, 2011, respectively.

### **II. MRO Legal Requirements**

When the Ohio legislature adopted SB 221, it set forth a series of very specific requirements. The law clearly states that, if those requirements are met, the Commission must allow the utility to implement its requested MRO. Beyond those limited requirements, the Commission has also promulgated administrative rules that add some further prerequisites. The

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<sup>6</sup> R.C. 4928.142(B).

following sections will enumerate those requirements and demonstrate how Duke Energy Ohio has met each one.

#### **A. Statutory Requirements**

The law requires an application for an MRO to demonstrate how the proposed MRO would comply with the requirements of R.C. 4928.142(A) and Commission rules, and to demonstrate that it meets the requirements of R.C. 4928.142(B). Those statutory requirements are limited to the following:

- (1) The market-rate offer shall be determined through a competitive bidding process that provides for all of the following:
  - (a) Open, fair, and transparent competitive solicitation;
  - (b) Clear product definition;
  - (c) Standardized bid evaluation criteria;
  - (d) Oversight by an independent third party that shall design the solicitation, administer the bidding, and ensure that the criteria specified in division (A)(1)(a) to (c) of this section are met;
  - (e) Evaluation of the submitted bids prior to the selection of the least-cost bid winner or winners.<sup>7</sup>

Additional requirements are found in the next division, R.C. 4928.142(B):

An application under this division shall...demonstrate that all of the following requirements are met:

- (1) The electric distribution utility or its transmission service affiliate belongs to at least one regional transmission organization that has been approved by the federal energy regulatory commission; or there otherwise is comparable and nondiscriminatory access to the electric transmission grid.
- (2) Any such regional transmission organization has a market-monitor function and the ability to take actions to identify and mitigate market power or the electric distribution utility's market conduct; or a similar market monitoring function exists with commensurate ability to identify and monitor market conditions and mitigate conduct associated with the exercise of market power.

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<sup>7</sup> R.C. 4928.142(A).

- (3) A published source of information is available publicly or through subscription that identifies pricing information for traded electricity on- and off-peak energy products that are contracts for delivery beginning at least two years from the date of the publication and is updated on a regular basis.<sup>8</sup>

In addition, the provisions of SB 221 require Duke Energy Ohio to blend the prices determined by competitive bid with those previously in effect. These provisions are found in two divisions of R.C. 4928.142:

- (D) The first application filed under this section by an electric distribution utility that, as of July 31, 2008, directly owns, in whole or in part, operating electric generating facilities that had been used and useful in this state shall require that a portion of that utility's standard service offer load for the first five years of the market rate offer be competitively bid under division (A) of this section as follows: ten per cent of the load in year one, not more than twenty per cent in year two, thirty per cent in year three, forty per cent in year four, and fifty per cent in year five. Consistent with those percentages, the commission shall determine the actual percentages for each year of years one through five. The standard service offer price for retail electric generation service under this first application shall be a proportionate blend of the bid price and the generation service price for the remaining standard service offer load, which latter price shall be equal to the electric distribution utility's most recent standard service offer price, adjusted upward or downward as the commission determines reasonable, relative to the jurisdictional portion of any known and measurable changes from the level of any one or more of the following costs as reflected in that most recent standard service offer price:
- (1) The electric distribution utility's prudently incurred cost of fuel used to produce electricity;
  - (2) Its prudently incurred purchased power costs;
  - (3) Its prudently incurred costs of satisfying the supply and demand portfolio requirements of this state, including, but not limited to, renewable energy resource and energy efficiency requirements;
  - (4) Its costs prudently incurred to comply with environmental laws and regulations, with consideration of the derating of any facility associated with those costs. In making any adjustment to the most recent standard service offer price on the basis of costs described

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<sup>8</sup> R.C. 4928.142(B).



in division (D) of this section, the commission shall include the benefits that may become available to the electric distribution utility as a result of or in connection with the costs included in the adjustment, including, but not limited to, the utility's receipt of emissions credits or its receipt of tax benefits or of other benefits, and, accordingly, the commission may impose such conditions on the adjustment to ensure that any such benefits are properly aligned with the associated cost responsibility. The commission shall also determine how such adjustments will affect the electric distribution utility's return on common equity that may be achieved by those adjustments. The commission shall not apply its consideration of the return on common equity to reduce any adjustments authorized under this division unless the adjustments will cause the electric distribution utility to earn a return on common equity that is significantly in excess of the return on common equity that is earned by publicly traded companies, including utilities, that face comparable business and financial risk, with such adjustments for capital structure as may be appropriate. The burden of proof for demonstrating that significantly excessive earnings will not occur shall be on the electric distribution utility. Additionally, the commission may adjust the electric distribution utility's most recent standard service offer price by such just and reasonable amount that the commission determines necessary to address any emergency that threatens the utility's financial integrity or to ensure that the resulting revenue available to the utility for providing the standard service offer is not so inadequate as to result, directly or indirectly, in a taking of property without compensation pursuant to Section 19 of Article I, Ohio Constitution. The electric distribution utility has the burden of demonstrating that any adjustment to its most recent standard service offer price is proper in accordance with this division.

- (E) Beginning in the second year of a blended price under division (D) of this section and notwithstanding any other requirement of this section, the commission may alter prospectively the proportions specified in that division to mitigate any effect of an abrupt or significant change in the electric distribution utility's standard service offer price that would otherwise result in general or with respect to any rate group or rate schedule but for such alteration. Any such alteration shall be made not more often than annually, and the commission shall not, by altering those proportions and in any event, including because of the length of time, as authorized under division (C) of this section, taken to approve the market rate offer, cause the duration of the blending period to exceed ten years as counted from the effective date of the approved market rate offer. Additionally, any such alteration shall be limited to an alteration affecting the prospective proportions used during the blending period and shall not

affect any blending proportion previously approved and applied by the commission under this division.<sup>9</sup>

## **B. Requirements in Administrative Rules**

The Commission has promulgated administrative rules to expand on and to detail the statutory MRO requirements. The portion of the rule governing MRO applications, O.A.C. 4901:1-35-03(B), requires the following substantive matters to be addressed:

An SSO application that contains a proposal for an MRO shall comply with the requirements set forth below.

- (1) The following electric utility requirements are to be demonstrated in a separate section of the standard service offer SSO application proposing a market-rate offer MRO:
  - (a) The electric utility shall establish one of the following: that it, or its transmission affiliate, belongs to at least one regional transmission organization (RTO) that has been approved by the federal energy regulatory commission; or, if the electric utility or its transmission affiliate does not belong to an RTO, then the electric utility shall demonstrate that alternative conditions exist with regard to the transmission system, which include non-pancaked rates, open access by generation suppliers, and full interconnection with the distribution grid.
  - (b) The electric utility shall establish one of the following: its RTO retains an independent market-monitor function and has the ability to identify any potential for a market participant or the electric utility to exercise market power in any energy, capacity, and/or ancillary service markets by virtue of access to the RTO and the market participant's data and personnel and has the ability to effectively mitigate the conduct of the market participants so as to prevent or preclude the exercise of such market power by any market participant or the electric utility; or the electric utility shall demonstrate that an equivalent function exists which can monitor, identify, and mitigate conduct associated with the exercise of such market power.
  - (c) The electric utility shall demonstrate that an independent and reliable source of electricity pricing information for any energy product or service necessary for a winning bidder to fulfill the

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<sup>9</sup> R.C. 4928.142(D) and (E).

contractual obligations resulting from the competitive bidding process (CBP) is publicly available. The information may be offered through a pay subscription service, but the pay subscription service shall be available under standard pricing, terms, and conditions to any person requesting a subscription. The published information shall be representative of prices and changes in prices in the electric utility's electricity market, and shall identify pricing of on-peak and off-peak energy products that represent contracts for delivery, encompassing a time frame beginning at least two years from the date of the publication. The published information shall be updated on at least a monthly basis.

- (2) Prior to establishing an MRO under division (A) of section 4928.142 of the Revised Code, an electric utility shall file a plan for a CBP with the commission. The electric utility shall provide justification of its proposed CBP plan, considering alternative possible methods of procurement. Each CBP plan that is to be used to establish an MRO shall include the following:
  - (a) A complete description of the CBP plan and testimony explaining and supporting each aspect of the CBP plan. The description shall include a discussion of any relationship between the wholesale procurement process and the retail rate design that may be proposed in the CBP plan. The description shall include a discussion of alternative methods of procurement that were considered and the rationale for selection of the CBP plan being presented. The description shall also include an explanation of every proposed non-avoidable charge, if any, and why the charge is proposed to be non-avoidable.
  - (b) Pro forma financial projections of the effect of the CBP plan's implementation, including implementation of division (D) of section 4928.142 of the Revised Code, upon generation, transmission, and distribution of the electric utility, for the duration of the CBP plan.
  - (c) Projected generation, transmission, and distribution rate impacts by customer class and rate schedules for the duration of the CBP plan. The electric utility shall clearly indicate how projected bid clearing prices used for this purpose were derived.
  - (d) Detailed descriptions of how the CBP plan ensures an open, fair, and transparent competitive solicitation that is consistent with and advances the policy of this state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code.

- (e) Detailed descriptions of the customer load(s) to be served by the winning bidder(s), and any known factors that may affect such customer loads. The descriptions shall include, but not be limited to, load subdivisions defined for bidding purposes, load and rate class descriptions, customer load profiles that include historical hourly load data for each load and rate class for at least the two most recent years, applicable tariffs, historical shopping data, and plans for meeting targets pertaining to load reductions, energy efficiency, renewable energy, advanced energy, and advanced energy technologies. If customers will be served pursuant to time-differentiated or dynamic pricing, the descriptions shall include a summary of available data regarding the price elasticity of the load. Any fixed load provides to be served by winning bidder(s) shall be described.
- (f) Detailed descriptions of the generation and related services that are to be provided by the winning bidder(s). The descriptions shall include, at a minimum, capacity, energy, transmission, ancillary and resource adequacy services, and the term during which generation and related services are to be provided. The descriptions shall clearly indicate which services are to be provided by the winning bidder(s) and which services are to be provided by the electric utility.
- (g) Draft copies of all forms, contracts, or agreements that must be executed during or upon completion of the CBP.
- (h) A clear description of the proposed methodology by which all bids would be evaluated, in sufficient detail so that bidders and other observers can ascertain the evaluated result of any bids or potential bids.
- (i) The CBP plan shall include a discussion of time-differentiated pricing, dynamic retail pricing, and other alternative retail rate options that were considered in the development of the CBP plan. A clear description of the rate structure ultimately chosen by the electric utility, the electric utility's rationale for selection of the chosen rate structure, and the methodology by which the electric utility proposes to convert the winning bid(s) to retail rates of the electric utility shall be included in the CBP plan.
- (j) The first application for a market rate offer by an electric utility that, as of July 31, 2008, directly owned, in whole or in part, operating electric generation facilities that had been used and useful in this state shall include a description of the electric utility's proposed blending of the CBP rates for the first five years

of the market rate offer pursuant to division (D) of section 4928.142 of the Revised Code. The proposed blending shall show the generation service price(s) that will be blended with the CBP determined rates, and any descriptions, formulas, and/or tables necessary to show how the blending will be accomplished. The proposed blending shall show all adjustments, to be made on a quarterly basis, included in the generation service price(s) that the electric utility proposes for changes in costs of fuel, purchased power, portfolio requirements, and environmental compliance incurred during the blending period. The electric utility shall provide its best current estimate of anticipated adjustment amounts for the duration of the blending period, and compare the projected adjusted generation service prices under the CBP plan to the projected adjusted generation service prices under its proposed electric security plan.

- (k) The electric utility's application to establish a CBP shall include such information as necessary to demonstrate whether or not, as of July 31, 2008, the electric utility directly owned, in whole or in part, operating electric generation facilities that had been used and useful in the state of Ohio.
- (l) The CBP plan shall provide for funding of a consultant that may be selected by the commission to assess and report to the commission on the design of the solicitation, the oversight of the bidding process, the clarity of the product definition, the fairness, openness, and transparency of the solicitation and bidding process, the market factors that could affect the solicitation, and other relevant criteria as directed by the commission. Recovery of the cost of such consultant(s) may be included by the electric utility in its CBP plan.
- (m) The CBP plan shall include a discussion of generation service procurement options that were considered in development of the CBP plan, including but not limited to, portfolio approaches, staggered procurement, forward procurement, electric utility participation in day-ahead and/or real-time balancing markets, and spot market purchases and sales. The CBP plan shall also include the rationale for selection of any or all of the procurement options.
- (n) The electric utility shall show, as a part of its CBP plan, any relationship between the CBP plan and the electric utility's plans to comply with alternative energy portfolio requirements of section 4928.64 of the Revised Code, and energy efficiency requirements and peak demand reduction requirements of section 4928.66 of the Revised Code. The initial filing of a CBP plan shall include a

detailed account of how the plan is consistent with and advances the policy of this state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code. Following the initial filing, subsequent filings shall include a discussion of how the state policy continues to be advanced by the plan.

- (o) An explanation of known and anticipated obstacles that may create difficulties or barriers for the adoption of the proposed bidding process.
- (3) The electric utility shall provide a description of its corporate separation plan, adopted pursuant to section 4928.17 of the Revised Code, including but not limited to, the current status of the corporate separation plan, a detailed list of all waivers previously issued by the commission to the electric utility regarding its corporate separation plan, and a timeline of any anticipated revisions or amendments to its current corporate separation plan on file with the commission pursuant to Chapter 4901:1-37 of the Administrative Code.
- (4) A description of how the electric utility proposes to address governmental aggregation programs and implementation of divisions (I) and (K) of section 4928.20 of the Revised Code.<sup>10</sup>

The Commission's rules also require the following additional information:

- (F) The SSO application shall include a section demonstrating that its current corporate separation plan is in compliance with section 4928.17 of the Revised Code, Chapter 4901:1-37 of the Administrative Code, and consistent with the policy of the state as delineated in divisions (A) to (N) of section 4928.02 of the Revised Code. If any waivers of the corporate separation plan have been granted and are to be continued, the applicant shall justify the continued need for those waivers.
- (G) A complete set of work papers must be filed with the application. Work papers must include, but are not limited to, all pertinent documents prepared by the electric utility for the application and a narrative or other support of assumptions made in the work papers. Work papers shall be marked, organized, and indexed according to schedules to which they relate. Data contained in the work papers should be footnoted so as to identify the source document used.
- (H) All schedules, tariff sheets, and work papers prepared by, or at the direction of, the electric utility for the application and included in the application must be available in spreadsheet, word processing, or an

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<sup>10</sup> O.A.C. 4901:1-35-03(B).

electronic non-image-based format, with formulas intact, compatible with personal computers. The electronic form does not have to be filed with the application but must be made available within two business days to staff and any intervening party that requests it.<sup>11</sup>

### **III. Evidence Regarding Required Elements**

#### **A. Competitive Bidding Process – R.C. 4928.142(A)(1)(a) through (e); O.A.C. 4901:1-35-03(B)(2)(d)**

Open, Fair, and Transparent. In its MRO application, Duke Energy Ohio designed a competitive bidding process (CBP) that would comply with all of the statutory requirements. As noted above, the CBP must incorporate an open, fair, and transparent solicitation; include a clear product definition; include standardized bid evaluation criteria; be subject to oversight by an independent third party who designs the solicitation, administers the bidding and ensures that the first three criteria are met; and result in bids being evaluated prior to selection of the least-cost winner or winners.

The CBP, as proposed, is open, fair, and transparent. Duke Energy Ohio witness Robert J. Lee, a principal at CRA international, Inc. d/b/a Charles River Associates (CRA), testified that, based on his review and understanding of the proposed CBP, the process would meet this criteria. According to Mr. Lee's pre-filed testimony, the product definition, the information channels, the bidder qualification process, the bidding design and the rules for participation all factor into creating a CBP that is open, fair, and transparent. Mr. Lee notes that these products, as well as the qualification and auction processes, are familiar to and are the same for all bidders. He points out that information about the solicitations will be timely and readily available. Mr. Lee explains that the participation rules are known ahead of time and will be applied equally to

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<sup>11</sup> O.A.C. 4901:1-35-03(F), (G), and (H).

all participants.<sup>12</sup> Under cross-examination, Mr. Lee confirmed that he expects the same type of information to be available to bidders in Duke Energy Ohio's CBP as has been available in successful, Commission-approved auctions in FirstEnergy's territory.<sup>13</sup> Mr. Lee also discussed plans to post responses to queries on a website, for convenient access by all potential bidders. That website, he explained, would also include post-auction information that would help winning bidders to understand their risk profile.<sup>14</sup>

It is also noteworthy that the design of the CBP here is substantially similar to that approved by this Commission for use by FirstEnergy's distribution utilities.<sup>15</sup>

There is no doubt that the CBP proposed by Duke Energy Ohio will be open, fair, and transparent. In fact, no party, including Commission Staff, submitted any testimony challenging this point, and there is no absolutely no evidence in the record to the contrary.<sup>16</sup>

Clear Product Definition. Mr. Lee also discussed how the CBP will provide a clear product definition, noting the familiar, standardized products are for load-following, full requirements service that includes energy, capacity, firm transmission charges, and ancillary services. Thus, he explained that the products can be readily evaluated and priced by bidders.<sup>17</sup>

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<sup>12</sup> Duke Energy Ohio Ex. 7, at 23- 25.

<sup>13</sup> Tr. I at 165-167.

<sup>14</sup> Tr. I at 167-169.

<sup>15</sup> *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 10-388-EL-SSO (Opinion and Order, August 25, 2010).

<sup>16</sup> See, e.g., Cross-examination of Michael J. Swartz, Tr. IV at 779; Cross-examination of Louis D'Alessandris, Tr. IV at 809; Cross-examination of David I. Fein, Tr. V at 831; Cross-examination of Kevin C. Higgins, Tr. V at 896; Cross-examination of Stephen J. Baron, Tr. V at 952-953; Cross-examination of Teresa L. Ringenbach, Tr. V at 991; Cross-examination of Tamara S. Turkenton, Tr. V at 1009; Cross-examination of Raymond W. Strom, Tr. V at 1090; and Cross-examination of Steven W. Criss, Tr. VI at 1134-1135.

<sup>17</sup> Duke Energy Ohio Ex. 7, at 25.



In their comments, Commission Staff admits that the Company met this requirement.<sup>18</sup> No party submitted any testimony challenging this point and there is no evidence to the contrary in the record of this proceeding. Duke Energy Ohio's CBP provides a clear product definition.

Standardized Bid Evaluation Criteria. Mr. Lee detailed the criteria proposed for evaluating bids, explaining that bidders must first successfully complete Parts 1 and 2 of the Application, thereby ensuring that bids will be evaluated based upon equal application of evaluation criteria and that submitting bidders are willing, able, and committed to satisfying winners' responsibilities. Non-price criteria are satisfied through the application process, again ensuring a level playing field, no unfair advantage, and standardized judging. As a result, the bids themselves will be evaluated on an objective, price-only basis.<sup>19</sup> This was not disputed at the hearing and there is no evidence to the contrary in the record. Indeed, Commission Staff's comments explicitly state that the Company met this requirement.<sup>20</sup> Duke Energy Ohio's CBP provides standardized bid evaluation criteria.

Oversight by Independent Third Party. As explained by Mr. Lee, CRA is an independent auction manager, and has served in the role of managing and overseeing competitive bids for several years. He notes that the remuneration of CRA for these services is not dependent on any outcome of the CBP.<sup>21</sup> As further discussed by Duke Energy Ohio witness James Northrup, Duke Energy Ohio's CBP provides for oversight by an independent third party that has designed the solicitation, will administer the bidding, and will ensure that the criteria specified in division

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<sup>18</sup> Staff Ex. 3, at 2-3.

<sup>19</sup> Duke Energy Ohio Ex. 7, at 25-26.

<sup>20</sup> Staff Ex. 3, at 3.

<sup>21</sup> Duke Energy Ohio Ex. 7, at 26.

(A)(1)(a) to (c) of R.C. 4928.142 are met.<sup>22</sup> No Party disputed that Duke Energy Ohio's CPB met this requirement.<sup>23</sup> Indeed, Commission Staff expressly agrees that the Company met this requirement.<sup>24</sup> The CBP will include oversight by an independent third party.

Evaluation of Submitted Bids. The process proposed for the CBP will have CRA providing a post-bidding report to the Commission, within 24 hours after the close of the bidding process, such that the Commission can evaluate the solicitation and select the least-cost bid winner or winners. That report is designed to include a summary of the CBP results, as well as all information required by O.A.C. 4901:1-35-08(B)(1) through (7). Finally, Commission Staff and CRA will have access to the CBP, data, information, and communications relating to the CBP, on a real-time basis.<sup>25</sup> Duke Energy Ohio's CBP provides for the evaluation of submitted bids prior to the selection of the least-cost bid winner or winners. Any generation supplier is allowed to participate in the CBP through the Part 1 and Part 2 Applications as there is no restriction other than substantive requirements designed to ensure that bidders are willing and able to serve as suppliers if they are ultimate winners. No witness offered testimony serving to challenge the bid evaluation process described in the Company's application. Bids will be evaluated appropriately.

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<sup>22</sup> Duke Energy Ohio Ex. 8, at 3-4.

<sup>23</sup> See, e.g., Cross-examination of Tamara S. Turkenton, Tr. V at 1009; See also Cross-examination of Raymond W. Strom, Tr. V at 1092 "I believe that [Charles River Associates] are an independent third party auction manager that would be appropriate to choose to use for some period of time but not necessarily into perpetuity."

<sup>24</sup> Staff Ex. 3, at 3; Tr. V at 1092.

<sup>25</sup> Duke Energy Ohio Ex. 7, at 27.

**B. Regional Transmission Organizations – R.C. 4928.142(B)(1) and (2); O.A.C. 4901:1-35-03(B)(1)(a) and (b)**

Membership in RTO. In order for the Commission to grant Duke Energy Ohio's application for an MRO, Duke Energy Ohio is required to demonstrate that it (or a transmission affiliate) belongs to at least one regional transmission organization (RTO) that has been approved by the Federal Energy Regulatory Commission (FERC) or, in the alternative, that there is comparable and nondiscriminatory access to the electric transmission grid. Duke Energy Ohio witness Kenneth J. Jennings stated unequivocally in his testimony that Duke Energy Ohio is currently a transmission owner in the Midwest Independent Transmission System Operator, Inc., (Midwest ISO) and also that Duke Energy Ohio is a non-transmission owner in PJM Interconnection LLC (PJM). Further, Mr. Jennings confirmed that both Midwest ISO and PJM are FERC-approved RTOs, as of 2001 and 1997, respectively.<sup>26</sup> Mr. Jennings also noted, beyond the statutory requirements, that Duke Energy Ohio has applied to the FERC for permission to withdraw from the Midwest ISO to become a transmission-owning member of PJM. Mr. Jennings went on to explain the current status of that FERC proceeding.<sup>27</sup> Significantly, no party challenged Duke Energy Ohio's anticipated realignment to PJM as complicating any aspect of the CBP, with the first load auction proposed to be conducted in June 2011.

It is undeniable that R.C. 4928.142(B)(1) does not identify any particular FERC-approved RTO to which an applicant must belong and does not require the applicant to prove that the FERC-approved RTO to which it belongs is preferable to any other choice. It is also undeniable that Duke Energy Ohio belongs to at least one FERC-approved RTO, as required by

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<sup>26</sup> Duke Energy Ohio Ex. 12, at 4.

<sup>27</sup> *Id.*

R.C. 4928.142(B)(1). No party, not even the Commission Staff, disputed this fact at the hearing.<sup>28</sup> And, thus, there is no evidence to the contrary in this record.

Market Monitor. R.C. 4928.142(B)(2) and O.A.C. 4901:1-35-03(B)(1)(b) require the applicant for an MRO to be a member of an RTO that has an independent market monitor (IMM) function and the ability to take actions to identify and mitigate market power or the applicant's market conduct. Duke Energy Ohio witness Jennings confirmed in his testimony that both the Midwest ISO and PJM have IMM functions and the ability to identify and mitigate market power. The Midwest ISO uses Potomac Economic, Ltd., as its IMM; PJM uses Monitoring Analytics, LLC.<sup>29</sup>

Mr. Jennings explained that the purpose of the IMMs is to identify actual or potential market design flaws that could result in the ability of a utility to exercise market power. Both RTOs' IMMs, he confirmed, monitor the competitiveness of the RTO markets, investigate violations of market rules, address the conduct of market participants exercising market power, recommend corrective actions and consider reporting those recommendations to federal and state governmental bodies. The Midwest ISO's IMM monitors the markets in real time and prepares reports assessing the markets' performance and other issues. PJM's IMM monitors and reports on auctions, PJM's administration of the secondary bilateral market, supply and demand fundamentals, credit issues, patterns of ownership, trade volumes, prices, revenue, revenue adequacy, bids, market structure test results, the application of offer bid caps and other metrics.<sup>30</sup>

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<sup>28</sup> See, e.g., Cross-examination of David I. Fein, Tr. V at 833; Cross-examination of Kevin C. Higgins, Tr. V at 897; Cross-examination of Stephen J. Baron, Tr. V at 952-953; Cross-examination of Teresa L. Ringenbach, Tr. V at 990-991; Cross-examination of Tamara S. Turkenton, Tr. V at 1009-1010; Cross-examination of Raymond W. Strom, Tr. V at 1093; and Cross-examination of Steven W. Criss, Tr. VI at 1134-1135.

<sup>29</sup> Duke Energy Ohio Ex. 12, at 4.

<sup>30</sup> *Id.* at 5-6.

It is undeniable that an appropriate IMM exists in both the Midwest ISO and PJM and that fact was not disputed by any party, including Commission Staff.<sup>31</sup>

**C. Published Information Source – R.C. 4928.142(B)(3); O.A.C. 4901:1-35-03(B)(1)(c)**

An applicant for an MRO is required to demonstrate that a published source of information is available publicly or through subscription, identifying pricing information for traded electricity on- and off-peak energy products that are contracts for delivery beginning at least two years from the date of publication. Such information must be updated on a regular basis. Duke Energy Ohio witness Judah Rose, a managing director of ICF International, testified that this requirement is met. Mr. Rose stated that electricity pricing, identifying pricing of on-peak and off-peak energy products, is available, representing contracts for future delivery and updated daily or monthly, well beyond twenty-four months. Mr. Rose also clarified that such published information is representative of prices and changes in prices in Duke Energy Ohio's market.<sup>32</sup> As also recognized by Commission Staff in its comments,<sup>33</sup> the required public information is available and Duke Energy Ohio has satisfied this requirement.

**D. Blending Requirement and Ownership of Generation Facilities – R.C. 4928.142(D) and (E); O.A.C. 4901:1-35-03(B)(2)(j) and (k)**

As reviewed above, a first-time MRO applicant that, as of July 31, 2008, directly owned operating electric generating facilities that had been used and useful in this state, must blend its competitively bid rates with those from the most recent SSO price. The baseline blending

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<sup>31</sup> See, e.g., Cross-examination of David I. Fein, Tr. V at 833; Cross-examination of Kevin C. Higgins, Tr. V at 897; Cross-examination of Stephen J. Barron, Tr. V at 952-953; Cross-examination of Teresa L. Ringenbach, Tr. V at 990-991; Cross-examination of Tamara S. Turkenton, Tr. V at 1009-1010; Cross-examination of Raymond W. Strom, Tr. V at 1093; and Cross-examination of Steven W. Criss, Tr. VI at 1134-1135.

<sup>32</sup> Duke Energy Ohio Ex. 4, at 23-24.

<sup>33</sup> Staff Ex. 3, at 4-5.

percentages are set forth in division (D) of R.C. 4928.142 and then, in division (E) of that section, the Commission is granted flexibility to change the percentages after the second year of the MRO.

The division (D) baseline was set by the legislature as “ten per cent of the load in year one, not more than twenty per cent in year two, thirty per cent in year three, forty per cent in year four, and fifty per cent in year five. Consistent with those percentages, the commission shall determine the actual percentages for each year of years one through five.” The flexibility in division (E) allows the Commission, “beginning in the second year of a blended price...and notwithstanding any other requirement of this section...[to] alter prospectively the proportions specified...to mitigate any effect of an abrupt or significant change in the electric distribution utility’s standard service offer price... .”

Proper statutory interpretation of the language in these two divisions is critical, particularly in this situation where the language in question has not previously been interpreted and applied. The Commission has previously been faced with cases of first impression where statutory interpretation was key. In one such case, for example, the Commission stated the problem as follows:

Several of the provisions of [the statute] are susceptible of differing interpretations. This fact resulted in expert testimony being presented at the hearing, as well as analysis in the briefs, regarding the definitions and applications of terms. Therefore, prior to analyzing the application of the law to the facts of this case, we will discuss the appropriate understanding of the terms of the relevant statutory sections.<sup>34</sup>

After reviewing the requirements for statutory construction, as found in both statutory and case law, the Commission determined that it would first give meaning to the individual

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<sup>34</sup> *In the Matter of the Complaint of WorldCom, Inc., et al. v. City of Toledo*, Case No 02-3207-AU-PWC, *et al.*, Opinion and Order (May 14, 2003) at 11.

words, based on their ordinary meaning, except where they have a special, technical meaning. Its next step would be “to attempt to give effect to the intent of the General Assembly” from the face of the statute. If that was impossible, the Commission explained that it would consider such factors as the object sought to be attained, the circumstances under which the statute was enacted, legislative history, common law, consequences of a particular construction, and the administrative construction of the statute, all of which are based upon R.C. 1.49.

The manner in which the Commission has previously undertaken to construe particular statutory language is generally consistent with the well established and uncontroverted rules of statutory construction. Significantly, those rules mandate that:

In construing a statute, a court’s paramount concern is the legislative intent in enacting the statute. ...In determining legislative intent, the court first looks to the language in the statute and the purpose to be accomplished. Words used in a statute *must* be given taken in their usual, normal, or customary meaning. In construing a statute, it is the duty of the court to give effect to the words used and not to insert words not used. Where the language of the statute is plain and unambiguous and conveys a clear and definite meaning, there is no need to apply rules of statutory interpretation.<sup>35</sup>

As the Ohio Supreme Court has further instructed, “[t]he court must look to the statute itself to determine legislative intent, and if such intent is clearly expressed therein, the statute may not be restricted, constricted, qualified, narrowed, enlarged or abridged.”<sup>36</sup> Or to properly summarize, “it is [the court’s] duty to give effect to the words used in a statute”<sup>37</sup> and “if the meaning of the statute is unambiguous and definite, then it must be applied as written and no further interpretation is appropriate.”<sup>38</sup>

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<sup>35</sup> *State ex rel. Cassels v. Dayton City School District Board of Education*, (1994) 69 Ohio St.3d 217, 220, 1994 Ohio 92, 631 N.E.2d 150 (internal citations omitted; emphasis added).

<sup>36</sup> *Wachendorf v. Shaver*, (1948), 149 Ohio St. 231, Syllabus of Court, ¶ 5, 78 N.E.2d 370.

<sup>37</sup> *Cleveland Electric Illuminating Co. v. Cleveland* (1988), 37 Ohio St.3d 50, Syllabus of Court, 524 N.E.2d 441.

<sup>38</sup> *State ex rel. Herman v. Klopffleisch*, (1995), 72 Ohio St.3d 581, 584, 651 N.E.2d 995 (internal citations omitted).

Applying these cardinal rules of statutory construction to the relevant provisions at issue, it follows that both divisions (D) and (E) of R.C. 4928.142 must be reviewed for purposes of determining whether Duke Energy Ohio's proposed blending period is permissible. As the Company explained, its proposal is such that 10 percent of the SSO price under the MRO is derived from the competitive bid prices for year one (defined as 17 months), 20 percent of said price is derived from the competitive bid prices in year two, and for each year thereafter, the SSO price is derived solely from the competitive bid prices.<sup>39</sup>

The baseline blending period as described in division (D) of R.C. 4928.142 provides that 10 percent of the MRO shall be competitively bid in year one. This percentage is unaffected by the flexibility afforded the Commission pursuant to division (E), which unambiguously identifies prospective alterations beginning in year two. As the words employed by division (D) are definite and unequivocal insofar as the first year of the blending period is concerned, Duke Energy Ohio must provide for an SSO price that, in the first year of its MRO, is derived from the following percentages: 10 percent competitive bid and 90 percent most recent SSO price. And it is undeniable that Duke Energy Ohio has so proposed such a blend.

Division (D) of R.C. 4928.142 plainly vests the Commission with discretion to determine the actual percentages for the second year of the blending period. But this discretion is limited. Significantly, the General Assembly decidedly inserted the words, "not more than" before the year-two percentage. And giving those words their common and ordinary meaning, it necessarily follows that the Commission's determination in respect of the year two blending percentages cannot result in more than 20 percent of the SSO price under the MRO derived from the competitive bid prices.

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<sup>39</sup> Application at 10-12.



Clearly, the words “not more than” do not also qualify the percentages applicable to any other year, such that the Commission’s determination must result in percentages that do not exceed 30, 40, and 50 percent competitive bid prices in years three, four, and five, respectively. To conclude otherwise, the Commission must insert words that the legislature deliberately chose not to include. Indeed, based on ordinary grammatical rules, there would have to be an “and” inserted before “not more than” if this limitation were to apply to these subsequent years as well. But, inserting words not otherwise used in the statute is impermissible<sup>40</sup> and it must therefore be concluded that years three, four, and five are not modified by the phrase “not more than” that appears in this division. Consistent with the unequivocal language in division (D), Duke Energy Ohio has proposed that the blending percentages for the second year of its MRO reflect 20 percent competitive bid pricing and 80 percent most recent SSO pricing.

The next, and more important, issue is the meaning of the division (E) flexibility that is granted to the Commission. The first question here is: With regard to which year of the blend does the Commission’s flexibility under division (E) begin? The statute unambiguously says that the Commission can alter the blend beginning in the second year. The statute also patently says that any alterations that the Commission may make must be done prospectively. In this regard, “prospectively” must be giving its plain and ordinary meaning, which is of or in the future.<sup>41</sup> However, division (E) of R.C. 4928.142 plainly does not limit how long before the second year such alterations to the blending percentages may be made. Thus, the clear language

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<sup>40</sup> *Cline v. Ohio Bureau of Motor Vehicles*, (1991), 61 Ohio St. 3d 93, 97, 573 N.E.2d 77.

<sup>41</sup> prospectively. (n.d.). *Dictionary.com Unabridged*. Retrieved January 26, 2011, from Dictionary.com website: <http://dictionary.reference.com/browse/prospectively>.

of the statute allows the Commission to alter prospectively the blending percentages that are applicable in year three and beyond.

Even if the Commission did not find that the clear language of the statute mandates this outcome, the same result must be reached by invoking standard rules of construction. The conclusion that the Commission may alter prospectively the blending percentages that are applicable in year three and beyond is consistent with the doctrine of *in pari materia*. That doctrine requires that statutes relating to the same general subject must be read together, "so as to give proper force and effect to each and all of the statutes."<sup>42</sup> Giving full effect to both divisions (D) and (E), it is apparent that the Commission may alter the percentages effective no earlier than year three of the MRO.

The next definitional question is what is meant by the term "alter." The common and ordinary meaning of the term "alter" is to change. No technical meaning exists to provide support for an interpretation inconsistent with the normal meaning of the word. Furthermore, the legislature used variations of the word "alter" throughout division (E) of R.C. 4928.142, making certain their intent to use the term they did. And giving the word "alter" – and variations thereof used in this division – its ordinary meaning, it is undeniable that the legislature conferred upon the Commission the ability to either increase or decrease the blending percentages. To construe the word "alter" to mean something other than its ordinary meaning, such as to lengthen, extend, or enlarge – that is, to interpret the provision to mean that the Commission can only spread the blending period over a longer period of time – would run afoul of the legislature's obvious intent, as confirmed by its deliberate choice of words. Stated another way, defining "alter" to mean only that the Commission can extend the blending period beyond five years, would compel

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<sup>42</sup> *United Telephone Co. v. Limbach*, (1994), 71 Ohio St.3d 369, 372, 643 N.E.2d 1129.

the Commission to restrict, qualify, or narrow the clear meaning of the statute. Such an outcome, however, is expressly prohibited under the Supreme Court's instruction.<sup>43</sup> Nothing in the statute mandates a minimum blending period of five years. Nothing in the statute precludes 100 percent auction-based in year three. Nothing in the statute precludes acceleration of the blend in year three or any other year. The statute cannot reasonably be construed as barring a transition to full market prices in less than five years.

In drafting these provisions, the legislature could have chosen to use the word that unambiguously granted the Commission the right only to lengthen the blending period. But it did not. Thus, the correct – and only – reading of the statutory language is that the Commission has the right to increase or decrease the blending percentages. Either would be an alteration. Indeed, even Staff conceded that the Commission could shorten the blending period.<sup>44</sup>

Finally, under what circumstances is the Commission permitted to alter the percentages? The words of the statute state that the Commission can take such action “to mitigate any effect of an abrupt or significant change in the...utility’s standard service offer price....” Neither the statute nor any intervenor in this proceeding defines an abrupt change or a significant change. With regard to a significant change, we must consider whether the statute is intended to cover only the actual price, or other circumstances relating to the price. Certainly, since the legislature chose to include both the word “abrupt” and the word “significant,” the latter must mean something other than “abrupt.” Therefore, the clear meaning of “significant” must include considerations other than a pure price comparison. As what those considerations might encompass is not obvious from the face of the statute, we must look to the factors set forth in

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<sup>43</sup> *Wachendorf, supra*, Syllabus of Court, ¶ 5.

<sup>44</sup> Tr. V at 1065.

R.C. 1.49. Legislative history, common law, and administrative construction are of no help in this situation. However, the circumstances under which the statute was enacted are very important. The legislature based the requirement for a blending period on the assumption – as was then reality – that market prices and previous SSO prices would be substantially divergent. Without that understanding, the lengthy blending requirement would be of negligible effect and would not have been of concern to the legislators. A change in that basic fact must therefore be significant.

Moreover, the evidence confirms that, in the third year of the Company's MRO, either the market price and the most recent SSO price will converge or the market price will be lower than the most recent SSO price. Indeed, there was no evidence to suggest that market prices would exceed the most recent SSO price in 2012, 2013, or 2014. Indeed, the most recent FirstEnergy auction through 2014 resulted in auction prices no higher than \$57.47 per MWH, substantially below Duke Energy Ohio's average SSO price.<sup>45</sup> Furthermore, no party offered any evidence to suggest that market prices would exceed the most recent SSO price in 2015 and beyond. If the market price in year three is less than the most recent SSO price, altering the blend to enable full market prices at that time allows the Commission to provide Duke Energy Ohio's customers with admittedly lower rates.<sup>46</sup> This would certainly be a significant change. If, on the other hand, the market price in year three has essentially converged with the most recent SSO price, this too is a significant change, thereby justifying the Commission's alteration. Thus, under Duke Energy Ohio's proposal, the ratepayers either would be paying the least possible rate

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<sup>45</sup> *In the Matter of the Procurement of Standard Service Offer Generation for Customers of oh Edison Company, The Cleveland Electric Illuminating company and The Toledo Edison Company*, Case No 10-1284-EL-UNC (Auction Manager Report, January 26, 2011).

<sup>46</sup> See Cross-examination of Judah Rose, Tr. I at 127.

if the market price is still less than the most recent SSO price, or would be paying market price, as intended by the legislature.

In conformity with the requirements, and legislative intent, of R.C. 4928.142, the MRO proposed by Duke Energy Ohio starts with 10- and 20-percent blends in the first two years (with the first year being 17 months). After that, the Company asks the Commission to alter the blending percentages on the basis that, by year three of the Company's proposal, there should be no further blending, as the ESP price for generation and the market price for generation will have converged.<sup>47</sup> The purpose of the statutory blending, as was described in the application, is both to protect ratepayers from abrupt rate changes and to protect utilities' financial integrity. SB 221 was not designed as consumer protection legislation but, rather, an alteration in the way in which the electric industry functions, with protections included for both ratepayers and utilities. Once market prices and the previous SSO prices have converged, neither of those intentions is further served by continued blending. Therefore, Duke Energy Ohio submits that its blending proposal is both legal and reasonable.

Section (B)(2)(j) of O.A.C. 4901:1-35-03 also requires that an MRO applicant "compare the projected adjusted generation service prices under the CBP plan to the projected adjusted generation service prices under its proposed electric security plan." This provision does not apply to Duke Energy Ohio's application in this proceeding. Clearly, there is no requirement that an MRO applicant also prepare an ESP, in order to compare the projected adjusted generation service prices under that ESP proposal with the prices under the CBP. Nothing in statutory provisions would suggest such a reading. Thus, as the sentence, on its face, does not appear to be complete, the appropriate reading must move to consideration of other factors. As

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<sup>47</sup> Duke Energy Ohio Ex. 4, at 6-7, 17, 18, 19, 43.

the first application to be filed under R.C. 4928.141, as it was enacted by SB 221, was required to include an ESP proposal, it appears that this requirement must have been referencing MRO applications that were filed together with the first ESP applications. That is the only circumstance when an MRO application would be required to include a proposal for an ESP. Thus, it is inapplicable to the present proceeding.

**E. Procurement Options – O.A.C. 4901:1-35-03(B)(2), (B)(2)(m)**

The Commission's rules require an applicant for an MRO to demonstrate justification for its proposed CBP, considering alternative possible methods of procurement. It must also discuss alternative methods of procurement that were considered and the rationale for selecting the CBP. Duke Energy Ohio witness Northrup explained the rationale for a number of aspects of the CBP proposal, including inclusion of other types of products in the auctions, including its alternative energy obligation in the auctions, why Duke Energy Ohio selected a slice-of-system product, and why Duke Energy Ohio selected the timeline and number of tranches proposed. In addition, Mr. Northrup explained that Duke Energy Ohio also considered managing its SSO obligation through use of requests for proposals and other portfolio optimization methods.<sup>48</sup>

Duke Energy Ohio witness Robert Lee also discussed alternatives to the proposed CBP that were considered. He explained that the company also considered a one-shot sealed-bid format for the auction. However, he pointed out that there is little if any advantage of that format, with several advantages to the chosen descending-price clock auction format.<sup>49</sup>

Procurement issues have been appropriately explained and were unopposed on the record, including by Commission Staff.

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<sup>48</sup> Duke Energy Ohio Ex. 8, at 8-11.

<sup>49</sup> Duke Energy Ohio Ex. 7, at 20-23.

**F. Retail Rate Design – O.A.C. 4901:1-35-03(B)(2)(a); 4901:1-35-03(B)(2)(i)**

The Commission's rules also require the MRO applicant to discuss any relationship between the wholesale procurement process and the retail rate design, as well as an explanation of every proposed non-avoidable charge. Additionally, the rules require a description of the rate structure chosen and rationale for that structure, as well as alternative retail rate options that were considered. Duke Energy Ohio witness Jeffrey Bailey discussed how the results of the CBP would be converted into retail rates. According to Mr. Bailey, each year's clearing prices will be averaged to obtain a blended competitive bid price.<sup>50</sup> That blended price will be converted into an SSO generation charge based on the blending percentage for that year, as also described by Duke Energy Ohio witnesses James Ziolkowski and William Don Wathen Jr.<sup>51</sup> Capacity-related costs associated with the CBP will be allocated to rate classes and will then be converted to energy charges for each class, as has been approved by this Commission in at least one other proceeding.<sup>52</sup> The results of capacity- and energy-related charges will be modified for seasonal and time-of-day factors for billing purposes.<sup>53</sup> The only party to question the rate design was the Kroger Company, which offered that a demand charge should be retained in the market bid portion of the SSO price under the Company's MRO. But Kroger, through its witness, admitted that this suggestion was not a basis upon which the Commission could rely in rejecting the Company's application for an MRO.<sup>54</sup> Indeed, there is no requirement, either in R.C. 4928.142

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<sup>50</sup> Duke Energy Ohio Ex. 15, at 3-4.

<sup>51</sup> Duke Energy Ohio Exs. 17, at 6-8 and 16, at 6.

<sup>52</sup> *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company For authority to Establish a Standard Service Offer Pursuant to R.C. § 4928.143 in the form of an Electric Security Plan*, Case No. 10-388-EL-SSO (Opinion and Order, August 25, 2010).

<sup>53</sup> Duke Energy Ohio Ex. 15, at 3-4.

<sup>54</sup> Cross-examination of Kevin C. Higgins, Tr. V at 916.

or the Commission's corresponding rules that demand charges be incorporated into the conversation of market rates to retail rates. Thus, Duke Energy Ohio's proposed rate design satisfies the applicable requirements.

Non-avoidable charges were discussed by Duke Energy Ohio witness Wathen. Mr. Wathen explained that only two unavoidable riders would exist under the MRO. The first is Rider BTR, or Base Transmission Rider. This is proposed as the vehicle through which Duke Energy Ohio would recover "all transmission and transmission-related costs, including ancillary and congestion costs, imposed on or charged to the utility by the federal energy regulatory commission or a regional transmission organization, independent transmission operator, or similar organization approved by the federal energy regulatory commission," in accordance with unambiguous authority granted in R.C. 4928.05(A)(2) and in an analogous manner to that which has previously been approved by this Commission.<sup>55</sup> Such costs include but are not limited to costs billed from an RTO (such as the network integrated transmission service charge), other than those billed directly to the entity serving the load. Because this revenue requirement is for all retail load, whether switched or not, and because the goal is to relieve competitive suppliers and auction participants of the obligation to procure this service from Duke Energy Ohio, it must be a non-bypassable charge.<sup>56</sup> It should also be noted that Duke Energy Ohio has not requested approval of actual recovery amounts in this proceeding.

The next unavoidable rider discussed by Mr. Wathen is Rider RECON, or Reconciliation Rider. This rider is described by Mr. Wathen as a vehicle for the collection or refund of the

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<sup>55</sup> *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company For authority to Establish a Standard Service Offer Pursuant to R.C. § 4928.143 in the form of an Electric Security Plan*, Case No. 10-388-EL-SSO (Opinion and Order, August 25, 2010).

<sup>56</sup> Duke Energy Ohio Ex. 16, at 22-24.



collective balance of any over- or under-recovery of costs or refunds of current riders that are being eliminated or zeroed. As this is a true up from the current ESP, it is reasonable for all customers to share in the cost or refund.

Finally, Mr. Wathen referenced one rider, Rider SCR, that could be potentially unavoidable. Consistent with R.C. 4928.142(C), Rider SCR is designed to recover “[a]ll costs incurred by the electric distribution utility as a result of or related to the competitive bidding process or to procuring generation service to provide the standard service offer, including the costs of energy and capacity and the costs of all other products and services procured as a result of the competitive bidding process.”<sup>57</sup> Mr. Wathen explained that Rider SCR is designed to allow Duke Energy Ohio to recover from non-switched customers exactly the cost of acquiring that portion of their SSO load that is served by the winning bidders. The rider would allow reconciliation of the revenue and the cost, where the auction price billed to customers is slightly different from the rate paid to the winning bidders. Although Rider SCR is intended only to true up these differences, and also to recover the cost of the CBP plan consultant, making it generally relate only to non-switched customers, it is proposed as provisionally non-bypassable. The possibility for it to become non-bypassable avoids the theoretical risk that only one remaining non-switched customer would pay all of these costs. Therefore, Duke Energy Ohio proposed that Rider SCR would become non-bypassable during any period when the net credits/charges are over five percent of the total generation costs being supplied under the MRO.<sup>58</sup>

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<sup>57</sup> R.C. 4928.142(C). R.C. 4928.142(C) further states that such costs “shall be timely recovered through the standard service offer price, and, for that purpose, the commission shall approve a reconciliation mechanism, other recovery mechanism, or a combination of such mechanisms for the utility.”

<sup>58</sup> Duke Energy Ohio Ex. 16, at 18-20. See, also, Duke Energy Ohio Ex. 17, at 8-10.

Another rationale for non-bypassability of Rider SCR is that the SSO supply to be auctioned covers the provider-of-last-resort load. Auction participants are bidding on 100 percent of a fraction (tranche) of the retail load. The amount of load the winning bidders will actually serve is a function of switching, but they must factor into their bids the potential for serving 100 percent of the tranche. The resulting price of the bid is available to all customers, regardless of switching.

Finally, the Commission recently approved a similar mechanism, including terms for conditional avoidability, for the three FirstEnergy distribution utilities, as part of Case No. 10-388-EL-SSO.<sup>59</sup>

The overall rate structure and the rationale therefor were discussed at length by witnesses Wathen and Ziolkowski. Mr. Ziolkowski, in particular, also references the fact that residential customers have access to the option time-of-day rate, the time-of-day rate for residential service with advanced metering, and peak-time rebate – residential pilot program. He noted that the Company anticipates approval of its residential critical peak pricing tariff and hopes to continue another time-differentiated pricing option into the MRO period. Mr. Ziolkowski also detailed non-residential options, including the load management rider, real-time pricing program, and PowerShare.<sup>60</sup>

Testimony in this proceeding fully addresses rate design issues. This was not disputed by any party, including Commission Staff.

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<sup>59</sup> *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 10-388-EL-SSO (Opinion and Order, August 25, 2010).

<sup>60</sup> Duke Energy Ohio Ex. 17, at 13.

**G. Financial and Rate Impact Projections – O.A.C. 4901:1-35-03(B)(2)(b) and (c)**

MRO applicants must provide pro forma financial projections of the effect of implementation of the CBP during the proposed blending period, on generation, transmission, and distribution, for the duration of the CBP plan. In addition, the applicant must project generation, transmission, and distribution rate impacts by class and rate schedule, for the duration of the plan, indicating how the projected bid clearing prices were derived. The required pro forma financial projections were sponsored by Duke Energy Ohio witness Brian Savoy, covering the proposed three-year blending period. This blending period is consistent with the blending period proposed in the application and with Duke Energy Ohio's expectation that it will transfer its legacy generating assets to an affiliate on or before June 1, 2014. Mr. Savoy also testified that he does not anticipate that the proposed CBP will have any effect on Duke Energy Ohio's distribution or transmission rates.<sup>61</sup>

The required projections have been provided.

**H. State Policy – R.C. 4928.02; O.A.C. 4901:1-35-03(B)(2)(d)**

In enacting SB 221, the Ohio Legislature enumerated the policies that drove its decisions. Those policies of the state are set forth in R.C. 4928.02; some relate to MROs directly, some do not. The Commission's administrative rules make it clear that an application for an MRO must detail how the CBP will be consistent with and advance those state policies.

The president of Duke Energy Ohio, Julia Janson, provided testimony addressing each and every policy and explaining, in each case, the impact of the MRO on that policy. In every

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<sup>61</sup> Duke Energy Ohio Ex. 14, at 3-6.

instance, Ms. Janson confirmed that the MRO either had no impact or relationship with the policy or supported and advanced the policy.<sup>62</sup>

Additionally, certain individual sections of the Commission's rules also require that a particular element of the MRO application be consistent with state policy. Hence, other Duke Energy Ohio witnesses also review their particular areas of emphasis in light of state policy. In no instance is any element of the MRO inconsistent with state policy. There is no evidence in the record disputing that Duke Energy Ohio's proposed MRO is consistent with state policy and no party, including Commission Staff, presented testimony that the MRO would violate any part of R.C. 4928.02.

The proposed MRO is fully supportive of state policy, as set forth in R.C. 4928.02.

**I. Customer Load Description – O.A.C. 4901:1-35-03(B)(2)(e)**

O.A.C. 4901:1-35-03(B)(2)(e) requires a detailed description of the customer load that is to be served by winning bidders, as well as known factors that may affect such loads. This requirement includes a number of different elements, which elements were addressed by multiple witnesses.

Duke Energy Ohio witness Ziolkowski testified to the description of the various load and rate classes, together with historical switching rates and price-to-compare data. Mr. Ziolkowski proposed new, revised tariffs to effectuate the proposed MRO.<sup>63</sup> Duke Energy Ohio witness Bailey discussed time-differentiated pricing and seasonality in various rate classes, and historical shopping.<sup>64</sup> Duke Energy Ohio witness Andrew Ritch testified as to plans for meeting targets for

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<sup>62</sup> Duke Energy Ohio Ex. 2, at 16-29.

<sup>63</sup> Duke Energy Ohio Ex. 17, at 18-19.

<sup>64</sup> Duke Energy Ohio Ex. 15, at 5-10.

renewable energy, advanced energy, and advanced energy technologies, indicating that, historically, Duke Energy Ohio has used renewable energy certificate purchases as the primary means by which it would meet its alternative energy compliance obligations. The Company is, he noted, presently implementing methods to supplement these short-term transactions with longer-term commitments. Under the proposed MRO, Duke Energy Ohio intends to continue maintaining flexibility in order to assure the most cost-effective compliance possible.<sup>65</sup> Finally, Duke Energy Ohio witness Richard Stevie indicated that Duke Energy Ohio has no available estimates of time differentiated price elasticity of its residential load. In addition, Dr. Stevie described the Company's current portfolio of energy efficiency and peak demand reduction programs, noting that the MRO will have no effect on the current energy efficiency model or portfolio of programs.<sup>66</sup>

The required explanation of customer load has been provided. This was not disputed by any party, including Commission Staff.

**J. Services to be Provided by Winning Bidder; Agreements – O.A.C. 4901:1-35-03(B)(2)(f) and (g)**

The Commission's rules require the application for an MRO to describe the services that are to be provided by the winning bidders, including capacity, energy, transmission, ancillary and resource adequacy services, and the term. Copies of required agreements, forms, and contracts are also to be included with the application. Duke Energy Ohio witness Northrup describes the product being auctioned and, therefore, the services to be provided, as an hourly, load-following full requirements tranche of the company's load.<sup>67</sup> Further, as Mr. Northrup

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<sup>65</sup> Duke Energy Ohio Ex. 9, at 3, 8-10.

<sup>66</sup> Duke Energy Ohio Ex. 10, at 6, 9-12, 14, 16.

<sup>67</sup> Duke Energy Ohio Ex. 8, at 6.

testified, the Master SSO Supply Agreement addresses the detailed services that are to be provided.<sup>68</sup> Based upon testimony submitted by intervening potential CBP participants, Duke Energy Ohio revised its proposed Master SSO Agreement to incorporate many of the suggestions of the parties that expressed concerns regarding the Agreement.<sup>69</sup> With those changes, neither Commission Staff nor any intervening party who submitted testimony regarding the Master SSO Agreement disputes that Duke Energy Ohio's MRO should be approved.<sup>70</sup> This requirement is met.

**K. Evaluation Methodology for Bids – O.A.C. 4901:1-35-03(B)(2)(h)**

As required by Commission rules, Duke Energy Ohio witness Lee described in detail the methodology by which bids will be evaluated. As he explained, prospective bidders will be qualified, prior to the auction, on financial and non-financial requirements, through a two-part application process. This will allow prospective bidders to demonstrate their ability and commitment, prior to bidding. Following the auction, Mr. Lee explained that the auction manager will provide a report to the Commission, summarizing the process and results and providing a list of the least-cost bidders and number of least-cost tranches for each product for each such bidder. The Commission will then be able to select the least-cost bid winner or winners and the selected bid or bids.<sup>71</sup> This requirement is met and was not disputed by any party or by Commission Staff.

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<sup>68</sup> *Id.*, at 12.

<sup>69</sup> Duke Energy Ohio Ex. F-1.

<sup>70</sup> *See, e.g.*, Cross-examination of Michael J. Swartz, Tr. IV at 805; Cross-examination of Louis D'Alessandris, Tr. IV at 818; Cross-examination of David I. Fein, Tr. V at 835; and Cross-examination of Teresa L. Ringenbach, Tr. V at 993.

<sup>71</sup> Duke Energy Ohio Ex. 7, at 8, 15.

**L. Consultant – O.A.C. 4901:1-35-03(B)(2)(l)**

Pursuant to the Commission's rules, the Commission may select a consultant to assess and report on the solicitation design, oversight of the bidding process, clarity of the product definition, fairness, openness, transparency, market factors, and other criteria. The application in this proceeding recognizes that such a consultant might be selected and provides for funding that consultant through Rider SCR.<sup>72</sup> The proposed MRO meets this requirement and was not disputed by any party or by Commission Staff.

**M. Alternative Energy – O.A.C. 4901:1-35-03(B)(2)(n)**

Commission rules require a discussion of the relationship between the CBP plan and alternative energy portfolio, energy efficiency, and peak demand reduction requirements. Duke Energy Ohio witness Stevie discussed the relationship between the CBP and requirements for energy efficiency and peak demand. Dr. Stevie described the history of Duke Energy Ohio's programs in this area and indicated that, although its current SSO plan expires at the end of 2011, Duke Energy Ohio will not discontinue effective energy efficiency and peak demand reduction programs at that time. The Company's objective remains to meet the benchmarks established in Ohio law, subject to the level of cost-effective achievable impacts. Dr. Stevie confirmed that neither Duke Energy Ohio's energy efficiency model nor its portfolio of programs will change as a result of approval of the MRO.<sup>73</sup>

Similarly, with regard to alternative energy, Duke Energy Ohio witness Ritch recounted the Company's current plans and indicated the Company's commitment to meeting alternative energy requirements. Mr. Ritch also explained that the MRO, being an indefinite approach to

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<sup>72</sup> Duke Energy Ohio Ex. 3 at 39.

<sup>73</sup> Duke Energy Ohio Ex. 10, at 5-6.

standard service, creates some advantages for alternative energy compliance in that applicable cost-recovery riders are not subject to expiration.<sup>74</sup>

The requirements of this rule are met and were not disputed by any party or by Commission Staff.

**N. Obstacles – O.A.C. 4901:1-35-03(B)(2)(o)**

As required by Commission rules, Duke Energy Ohio witness Robert Lee explained that there should be no barriers or difficulties for bidders with respect to the CBP. He noted that critical factors in the success of an auction are whether the products are attractive and whether bidders have sufficient time and information to evaluate the opportunity. The factors are met under the proposed CBP plan, so no obstacles should be present.<sup>75</sup> The requirements of this provision have been met and were not disputed by any party or by Commission Staff.

**O. Corporate Separation Plan, Aggregation – O.A.C. 4901:1-35-03(B)(3) and (4), and (F)**

The Commission requires that an MRO application include a description of the applicant's current corporate separation plan, its status, a list of waivers under that plan, and a timeline of anticipated revisions. Further, the rules require a description of how the applicant proposes to address governmental aggregation programs. Duke Energy Ohio witness Daniel Jones described the status of both the most recently approved corporate separation plan and the plan that is currently awaiting approval by the Commission following a successful audit. He described the provisions of the most current plan and indicated that no waivers have been requested or issued under that plan. Mr. Jones also indicated that the Company anticipates

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<sup>74</sup> Duke Energy Ohio Ex. 9, at 3-10.

<sup>75</sup> Duke Energy Ohio Ex. 7, at 23.



updating the plan once approval of the corporate separation plan under consideration has been received.<sup>76</sup>

With regard to aggregation, Mr. Jones pointed out that nothing in the MRO proposal would inhibit governmental aggregation. He also indicated that, if a phase-in of rates were to be ordered by the Commission under R.C. 4928.144, Duke Energy Ohio would comply with a Commission determination as to the portion to be charged to governmental aggregations.<sup>77</sup>

No party, including Commission Staff, submitted testimony to suggest that Duke Energy Ohio is not in compliance with terms of the corporate separation plan or that the corporate separation and aggregation requirements have not been fully addressed. The requirements of these provisions have been met.

#### **IV. Conclusion**

Duke Energy Ohio has filed an application for approval of its first market rate offer, as is its option under R.C. 4928.141. The application meets all requirements under R.C. 4928.142, as well as the Commission's rule promulgated thereunder. Therefore, Duke Energy Ohio respectfully requests that the Commission approve its application, as submitted. In the event that the Commission finds any requirement that has not been met, Duke Energy Ohio will then

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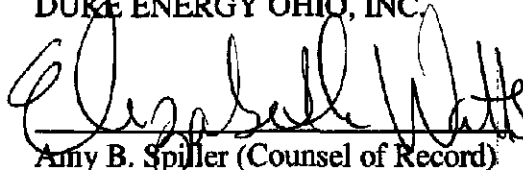
<sup>76</sup> Duke Energy Ohio Ex. 18, at 4-7.

<sup>77</sup> Duke Energy Ohio Ex. 18, at 10-11.

consider the Commission's direction as to how such deficiency may be remedied in a timely manner and to the Commission's satisfaction.

Respectfully submitted,

DUKE ENERGY OHIO, INC.

A handwritten signature in black ink, appearing to read "Elizabeth H. Watts", is written over a horizontal line.

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## CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Merit Brief of Duke Energy Ohio has been served to the parties by regular U. S. Mail, overnight delivery, or electronic delivery this 27<sup>th</sup> day of January 2011.

  
Elizabeth H. Watts

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