BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for the Establishment of a Charge Pursuant Revised Code Section 49.09.18	))))	Case No. 12-2400-EL-UNC
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods	)))	Case No. 12-2401-EL-AAM
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of a Tariff for a New Service	)))	Case No. 12-2402-EL-ATA

REPLY BRIEF OF
THE RETAIL ENERGY SUPPLY ASSOCIATION
AND
INTERSTATE GAS SUPPLY, INC.

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I. Introduction

Currently, Duke Energy Ohio, Inc. ("Duke"), charges and collects for the capacity service that it provides. In these proceedings, Duke has proposed to amend its tariffs: (a) to increase its charges for capacity service effective August 2012 through May 2015; (b) to modify its accounting to defer the difference between the higher amount it requests for capacity and the amount it now collects, plus carrying costs on the deferred balance; and (c) to recover the deferred amounts through a new tariff rider called Rider Deferred Recovery – Capacity Obligation. The basic premises of Duke's arguments for the proposed increased capacity charge and related requests are that Duke has a right to just and fair compensation,[1] which it allegedly is not receiving, and that the Public Utilities Commission of Ohio ("Commission") has the obligation to ensure that Duke and the other jurisdictional utilities receive just and fair compensation.[2] Through these proposals, Duke estimates a recovery of approximately $729 million over the 34-month period.

The Retail Energy Supply Association ("RESA") and Interstate Gas Supply, Inc. ("IGS"), who jointly filed an Initial Brief in this proceeding, now present the following reply to Duke's Initial Brief. Duke's Initial Brief is based on two faulty premises. First, Duke is entitled to just and reasonable rates, not a guaranteed level of compensation[3] or a set rate of return on equity. Second, the Ohio Commission's state compensation mechanism does not require identical capacity rates or even capacity rate formulas for jurisdictional electric distribution utilities under its supervision. Duke voluntarily agreed to its current level of compensation for its capacity service only 18 months ago. That level compensation for capacity is authorized to continue through May 2015 as per the Opinion and Order of Duke's last electric security plan ("ESP")

[1] Duke Initial Brief at 1, 5, 17, 19.
[2] *Id.* at 3, 10, 18, 27-28, 51-52.
[3] *Id.* at 17-19.

proceeding.[4] In addition, Duke's current level of compensation for its capacity service is fair and just compensation. The fact that the Commission later granted a higher nominal capacity rate to another electric utility for its capacity service[5] does not negate or supplant Duke's binding ESP decision, nor render Duke's compensation level unjust and unreasonable. Finally, Duke has not demonstrated that its specific proposal and calculations are appropriate – they contain errors, rely on outdated data, and incorporate improper assumptions.

RESA and IGS also respond to one argument made by the Ohio Consumers' Counsel ("OCC") that, in the alternative, if the Commission does grant a capacity deferral, any additional capacity costs should be collected only from competitive retail electric service ("CRES") suppliers and wholesale generation auction winners.[6] The suggestion should be rejected for two reasons. First, it would negate the effect of the deferral as any capacity cost imposed on CRES suppliers will be collected from the current customer by the supplier – by either a CRES or the standard service offer (SSO) provider. Second, it would create a capacity cost different from the RPM rate, which was the established Ohio state compensation mechanism for both AEP Ohio and Duke.

II. Duke's current compensation for capacity service is binding.

Duke is obligated to provide capacity service, for which it currently receives market-based compensation, specifically the final zonal capacity price ("FZCP").[7] Duke proposed market-based pricing for its capacity service when it joined PJM Interconnection LLC ("PJM")

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[4] *In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan, Accounting Modifications, and Tariffs for Generation Service*, Case Nos. 11-3549-EL-SSO et al., Opinion and Order (November 22, 2011).
[5] *In the Matter of the Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Opinion and Order (July 2, 2012) and Entry on Rehearing (October 17, 2012, December 12, 2012, and January 30, 2013). Ohio Power Company and Columbus Southern Power Company have since merged, and the merged entity is referred herein as "AEP."
[6] OCC Initial Br. at 59-62.
[7] Duke Initial Br. at 11, 62.

in 2010[8] and Duke agreed in 2011 in its ESP proceeding to establish Rider Retail Capacity as a "conduit through which market prices would be collected from customers and ultimately would be paid to the wholesale capacity provider."[9] That wholesale capacity provider is Duke, as Duke is the sole provider of all of the capacity in its service territory and will continue to be through at least PJM delivery year 2015.[10]

A. The ESP proceeding did address compensation for Duke's capacity service.

Duke argues in its Initial Brief that the ESP proceeding "only" addressed how much PJM will charge wholesale supply auction winners and CRES providers for capacity, and does not specify how much Duke would be paid for providing wholesale capacity service.[11] These arguments are in conflict with the direct testimony filed by Duke in the ESP case:

> Duke Energy Ohio bears the obligation to provide the capacity resources necessary to serve all customers in our footprint for the term of the ESP and *the Company will be compensated for capacity resources based upon competitive PJM prices*."[12] (emphasis added)

Duke's attempt to re-write history not only is contradictory to its own statements, but with its prior filings. In the last ESP case, Duke had originally proposed a cost-based compensation for its capacity service,[13] but Duke ultimately agreed in the stipulation to accept the FZCP rate for capacity in exchange for other compensations. The Commission approved the stipulation, and it is effective through May 2015. It is disingenuous now for Duke to argue that its withdrawn request for cost-of-service capacity rates as part of the stipulation was not for the entire ESP period.

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[8] FirstEnergy Solutions Corp. ("FES") Exs. 6 and 7.
[9] Hearing Transcript ("Tr.") at 90. This testimony came from one of Duke's own witness. Duke originally proposed in the ESP proceeding to receive cost-based compensation for its capacity service, but settled for market-based compensation.
[10] Duke Ex. 3 at 11.
[11] Duke Initial Br. at 39.
[12] Industrial Energy Users-Ohio ("IEU") Ex. 6 at 4-5, emphasis added. *See, also*, FES Ex. 22 at 4-5.
[13] IEU Ex. 6 at 3.

Duke also argues that a state compensation mechanism "cannot be implied" from the ESP.[14] The term "state compensation mechanism" is not an Ohio regulatory construct, but rather, it comes from the PJM tariff.[15] The purpose of the tariff is to allow open access states, such as Ohio, to set the capacity rate for a jurisdictional utility when all the customers affected by the capacity rate are within the same state. PJM tariff does not provide the rate design for the state compensation mechanism, let alone require that a state set the same rate or use the same rate formula for all utilities under the state Commission's jurisdiction. PJM merely acknowledges that a state regulatory commission, in lieu of PJM or the Federal Energy Regulatory Commission, can establish how capacity will be priced for an FRR[16] utility. The Ohio Commission first set a state compensation mechanism for AEP Ohio as part of AEP Ohio's first Electric Security Plan. Specifically, on December 8, 2010, in Case No. 10-2929-EL-UNC, the Commission on its own issued an entry in which it stated that a capacity rate was implicitly set – as opposed to explicitly set – when the Commission decided AEP Ohio's first electric security plan. Thus, Duke's statement that the Commission cannot set a state compensation plan for FRR capacity implicitly is at odds with case precedent.

Finally, the facts in the case do indicate that the capacity charge was set explicitly. The stipulation signed by Duke and all the parties provides that the FZCP would be the compensation level for Duke during the term of the ESP.[17] The Commission approved the stipulation and it is in effect through May 2015. Nothing presented by Duke in the instant proceedings justifies setting aside those binding terms.

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[14] Duke Initial Br. at 33-34, 36-37.
[15] PJM Tariff Section 8.1
[16] "FRR" stands for Fixed Resource Requirements.
[17] IEU Ex. 5 at 6-8, 12, ¶¶I.B, II.B, IV.A.

B. The ESP decision is a judicial determination of an identical claim and issue.

Duke argues that *res judicata* and collateral estoppel[18] (claim and issue preclusion, respectively) cannot preclude its requests in these proceedings because the ESP stipulation and Order do not constitute final judicial determinations on the merits of identical claims/issues.[19] To support this contention, Duke contends first that the Commission exercised only quasi-legislative authority (not quasi-judicial authority) in the ESP proceeding because the Commission approved standard service offer rates and performed the ratemaking function.[20] Duke has ignored the facts about the ESP proceeding – discovery was conducted, a hearing was held, testimony and arguments presented, the Commission weighed the evidence presented, and the Commission issued a written decision. The Commission exercised its quasi-judicial authority to decide the ESP case.

Second, Duke argues that the ESP case involved different claims/issues than what are involved in these proceedings.[21] Duke neatly packages the ESP claims as involving only "competitive retail pricing" and the instant claims as only "noncompetitive wholesale pricing." Although Duke contends that the ESP case did not address it *costs* to provide capacity service, Duke ignores that it had made a claim for cost-based compensation for its capacity service and then negotiated away from that compensation level. Duke then defended the stipulated terms for

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[18] *Res judicata* bars a subsequent claim if the claim was or might have been litigated in a prior case. *Grava v. Parkman Twp.* (1995), 73 Ohio St. 3d 379, 653 N.E. 2d 226. The element are: (1) a final decision on the merits by a court of competent jurisdiction; (2) a subsequent action between the same parties or their "privies"; (3) an issue in the subsequent action which was or which should have been litigated in the prior action; and (4) an identity of the causes of action. *Supremacy Capital Co. v. Tri-Med Finance Co.* (2001), 165 F. Supp. 2d 679, 2001 U.S. Dist. LEXIS 22344. Collateral estoppel bars re-litigation of an issue of fact or law if the issue was actually litigated and determined by a final decision and the determination was essential to the judgment. *Krahn v. Kinney* (1989), 43 Ohio St. 3d 103, 107, 538 N.E. 2d 1058, quoting *Goodson v. McDonough Power Equip. Inc.* (1983), 2 Ohio St. 3d 193, 195, 443 N.E. 2d 978. Importantly, both doctrines apply to administrative proceedings of a judicial nature in which the parties have had an ample opportunity to litigate the contested issue(s). *Superior's Brand v. Lindley* (1980), 62 Ohio St. 2d 133, 403 N.E. 2d 996.

[19] Duke Initial Br. at 39.

[20] *Id.*

[21] Duke Initial Br. at 41-42.

its capacity service. The ESP case involved a claim for compensation of Duke's capacity service, just like the instant proceedings. There is an identity of claims.

Third, Duke argues that the issue in this case (cost-based compensation for its capacity service) was not litigated and decided by the Commission in the ESP proceeding because it was not part of the parties' stipulation.[22] Again, Duke ignores the fact that discovery was conducted, a hearing was held, and testimony was presented in the ESP proceeding. A stipulation in the ESP proceeding does not erase the parties' litigation of the issue of compensation for Duke's capacity service. The issue of compensation for the capacity service was not dropped from the ESP case, as Duke seems to contend. The parties ultimately proposed an outcome on the compensation for Duke's capacity service and the Commission weighed and considered it, along with the other settlement terms. In fact, the Commission accepted the proposal for compensation at the FZCP and it has been in effect.

III. The evidence in the record establishes that market-based compensation for capacity service is just and reasonable compensation.

The Federal Energy Regulatory Commission ("FERC") established an auction mechanism in 2007 for the capacity market, through which wholesale providers are compensated at market-based levels for capacity service.[23] The FERC has determined that pricing from those auctions will approximate the pricing of a competitive market, and results in rates that are generally just and reasonable.[24] Among other things, the FERC stated that the market-based compensation will be just and reasonable because mitigation measures will constrain sellers to submit bids that prevent the exercise of market power.[25] The FZCP is based on those market

[22] *Id.* at 42-43.
[23] FES Ex. 15.
[24] *Id.* at 12; Tr. 466, 626.
[25] FES Ex. 15 at 12.

auction results.[26] There is no reason to conclude, suddenly, that FZCP has resulted in unjust or unreasonable compensation for Duke's capacity service and a new compensation level is needed for Duke.

Additionally, Duke's desires for additional monies do not mean that the FZCP has resulted in unjust or unreasonable compensation for Duke's capacity service. Nor do Duke's desires to be compensated like that authorized for AEP mean that the FZCP has resulted in unjust or unreasonable compensation for Duke's capacity service. AEP's rates do not decide whether Duke is receiving just and reasonable compensation.

Finally, it should be noted that, if Duke truly felt that the FZCP constituted unjust or unreasonable compensation, logic would dictate that it request a different compensation mechanism from the FERC, a right that Duke itself acknowledges.[27] However, in April 2011, Duke entered into a different stipulation and, among other things, agreed to not request cost-based compensation for its capacity service from the FERC.[28] Duke acknowledges that this stipulation precludes Duke from receiving cost-based compensation for its capacity service from January 2012 through May 2015.[29]

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[26] Tr. 414-415. The FZCP is "approximately a weighted average of the base residual auction price and the incremental auction price, depending on the volume in each. * * * [A]ll of the payments to generators for their capacity that cleared through the base residual auction and the incremental auction is allocated back to load, pro rata, based on their share of the peak load. So the FZCP is the rate that makes the equation work out so that the amount that's being collected from load equals the amount that's being paid to generators." (Tr. 591-592)

[27] Duke Initial Br. at 8-9.

[28] *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of Rider BTR and Associated Tariffs*, Case No. 11-2641-EL-RDR, and *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of the Establishment of Rider RTO and Associated Tariffs*, Case No. 11-2642-EL-RDR.

[29] Tr. 409. In its Initial Brief at page 4, Duke says only that the stipulation "addressed treatment of transmission-related costs." Of course, this omits the pertinent aspect of the stipulation for purposes of these proceedings.

IV. Duke's proposals are for an increase in rates, constitute retroactive ratemaking, and are intended to directly support its unregulated generation assets.

Duke argues that its proposals are not requesting to modify any rates; rather, Duke only seeks a deferral and tariff approval.[30] Duke is incorrect. Duke's own witness testified that Duke is proposing a new, non-bypassable charge to all customers.[31] Duke's application in these matters reflects that Duke "seeks the determination of a charge" and the "charge so determined will apply for the duration of the Company's commitment as an FRR entity."[32] Plus, the effect of Duke's proposals cannot be ignored. Duke's ratepayers will pay more for the same capacity service if the proposals are approved -- part of the cost will be paid through the existing Rider Retail Capacity and the other part will be paid through its proposed Rider Deferred Recovery – Capacity Obligation.

Similarly, Duke argues that it is not asking the Commission to approve any rate; rather, Duke only seeks a deferral and tariff approval.[33] Again, Duke is incorrect. Duke is asking for approval of its new non-bypassable charge, and is asking the Commission for authority to collect that charge beginning in August 2012, which is in advance of any Commission approval. Duke further emphasizes its desire for that start date, contending that it is "critical" to have the cost-based compensation begin in the same month as AEP began to receive cost-based compensation for its capacity service.[34] While Duke's proposals include a deferral request, Duke nonetheless is asking for authority to apply the new charge to customer bills dated before Commission approval. This is akin to retroactive ratemaking and should be rejected on that ground alone.[35]

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[30] Duke Initial Br. at 46.
[31] Duke Ex. 35 at 35. *See, also*, Duke's Initial Br. at 53, wherein Duke admits that it is asking for a change in its capacity rate structure.
[32] Duke Ex. 1 at 4.
[33] Duke Initial Br. at 49.
[34] *Id.*
[35] *Ohio Edison v. Pub. Util. Comm.* (1978), 56 Ohio St. 2d 419, 424, 384 N.E. 2d 283, 286; *Columbus Southern Power Co. v. Pub. Util. Comm.* (1993), 67 Ohio St. 3d 535, 541, 620 N.E. 2d 835.

The Commission declared an interim state compensation mechanism for AEP in December 2010, and stated its intention to examine the issue further.[36] That is prior to the submission of the stipulation or the decision in Duke ESP II case. The timing of the application then is clearly not tied to Commission's establishment of an Ohio state compensation mechanism. The record in the matter at bar reveals both the motive as well as the timing for the application. Duke acknowledges that it wants more money to support the *transferee* of its generation assets. Duke seeks now to receive "the financial support necessary to enable the provision of capacity service to satisfy Duke's obligations."[37] Duke even argued that, every day that the current capacity rate remains unchanged, it "loses money."[38] As a factual matter, RESA and IGS dispute the statement that every day the current rate stays in place "Duke loses money" as the application seeks funds from August 2012, seeks carrying costs for the deferral, and the funds will financially support another entity.[39] Regardless of whether Duke can or cannot receive capacity compensation retroactively, the key point is that Duke did not claim it needed to be part of the AEP Ohio capacity case or was entitled to the same capacity rate methodology as AEP when the Commission established a state compensation mechanism. The Duke request comes later when the just and reasonable rates that were set failed to produce the desired level of net revenues.

At its core, Duke is requesting authority to collect an additional $729 million specifically to support Duke's unregulated business segment, the same segment that it will spin off by the

[36] *Capacity Charge, supra*, December 8, 2010 Entry at 2.
[37] Duke Initial Br. at 50.
[38] Duke Initial Br. at 53.
[39] Duke Ex. 1 at 4, 8-9; Tr. 168-169, 213, 621; Duke Ex. 3 at 22.

end of 2014. As argued by RESA and IGS previously,[40] this request is specifically contrary to the framework set forth in Chapter 4928, Ohio Revised Code.

V. The AEP decision does not automatically apply to Duke or support/negate Duke's binding agreement to receive FZCP for its capacity service.

The Commission made it abundantly clear – the AEP decision applied to AEP and no other jurisdictional capacity supplier was analyzed.[41] Also, nothing in the AEP decision addressed or altered Duke's ESP Order either. Therefore, it would be improper for Duke to be relieved of its agreement to receive compensation at the FZCP through May 2015, just because the Commission established a different compensation level for AEP's capacity service.

VI. It would be improper to accept Duke's proposal and the underlying calculations because they contain errors, rely on outdated data, and incorporate improper assumptions.

Duke requested cost-based compensation for its capacity service and presented underlying calculations in support. Duke's proposals and the underlying calculations though are flawed. The Commission should not determine a "cost-based" compensation level that contains errors, relies on outdated data, and incorporates improper assumptions. Duke admitted during the hearing that its calculations contain errors.[42] In addition to the errors Duke admitted there are other mistakes and improper adjustments identified during the hearing.[43] Please see the RESA and IGS initial brief in which the many flaws in Duke's proposal and calculations are detailed previously.[44] However, the Commission must recognize that, with so many mistakes, inaccuracies, and improper inputs, the end result is that Duke did not carry its burden of proof.

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[40] RESA/IGS Initial Br. at 24-25.
[41] Ohio Consumers' Counsel ("OCC") Ex. 1 at 22, 38; OCC Ex. 3 at 32, 38-39.
[42] Tr. 1335-1336, 1300, 1417.
[43] Tr. 2339, 2365-2366, 2366-2370.
[44] RESA/IGS Initial Br. at 25-32.

Nor should the Commission take it upon itself to "fix" the proposals/calculations at this late stage and without the proper factual record before it.

VII. If the Commission grants Duke a capacity deferral as part of the state compensation mechanism, the deferral should be collected in the same manner as AEP Ohio.

OCC, RESA, IGS, Staff and all other active intervenors to these proceedings believe that Duke's application for a capacity deferral and surcharge should be totally rejected. In the event that does not occur though, OCC alone asks for a different collection mode. OCC asks that instead of a capacity deferral rider which collects the extra transition monies from retail customers, the capacity deferral be collected from CRES suppliers and wholesale generation auction winners.[45] Since this is an unavoidable business expense, both the CRES suppliers and the SSO Suppliers would of course collect the capacity deferral from the retail customers, only with less transparency than is done via the rider. So there is no economic benefit for the retail customer. There are however practical problems, Unlike the utility, SSO bid winners and CRES suppliers have a much shorter time horizon over which to collect deferred capacity charges. In fact, bid winners must build the deferral charge into the bid. Thus, the OCC plan actually reduces the flexibility of the deferral plan adopted by the Commission for AEP Ohio in which the amount of the collection rider can be adjusted based on the outstanding balance. Further, if the reason to establish the capacity deferral was because the capacity deferral was part of the state compensation mechanism, then logically the deferral collection system is also part of the state compensation mechanism.

VIII. Conclusion

While espousing its right to fair and just compensation, Duke ignores or downplays facts that have a crucial and detrimental impact on Duke's pending proposals. Duke agreed to its

[45] OCC Initial Br. at 59-62.

current level of compensation for its capacity service and, significantly, Duke agreed to receive that specific level through May 2015 and nothing more. The Commission approved that plan and Duke's current level of compensation for its capacity service as just and reasonable. The fact that the Commission later granted a different level of compensation to AEP does not negate or supplant that binding ESP decision. Also, Duke is asking for retroactive ratemaking, which is impermissible. Moreover, Duke has not demonstrated that its specific proposal and underlying calculations are appropriate – they contain errors, rely on outdated data, and incorporate improper assumptions.

If the Commission decides that additional capacity costs can be collected by Duke, it should reject OCC's proposal to impose those additional capacity costs on only the CRES suppliers and the wholesale auction winners. OCC's proposal is illogical and bad policy. Rather, the Commission should continue the current cost recovery approach for capacity service.

For the foregoing reasons, Duke's application in these matters should be rejected and dismissed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Brief was served this 30th day of July 2013, via email, on the parties listed below.

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