DUKE ENERGY OHIO EXHIBIT ____

FILE

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio 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 No. 14-841-EL-SSO
In the Matter of the Application of Duke Energy Ohio for Authority to Amend its Certified Supplier Tariff, P.U.C.O. No. 20.	)	Case No. 14-842-EL-ATA

DIRECT TESTIMONY OF

WILLIAM DON WATHEN JR.

ON BEHALF OF

DUKE ENERGY OHIO, INC.

May 29, 2014

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Duke Energy Business Services LLC (DEBS), as Director of Rates and Regulatory Strategy, Ohio and Kentucky. DEBS provides various administrative and other services to Duke Energy Ohio, Inc., (Duke Energy Ohio or the Company) and other affiliated companies of Duke Energy Corporation (Duke Energy).

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.

A. I received Bachelor Degrees in Business and Chemical Engineering, and a Master of Business Administration Degree, all from the University of Kentucky. After completing graduate studies, I was employed by Kentucky Utilities Company as a planning analyst. In 1989, I began employment with the Indiana Utility Regulatory Commission as a senior engineer. From 1992 until mid-1998, I was employed by SVBK Consulting Group, where I held several positions as a consultant focusing principally on utility rate matters. I was hired by Cinergy Services, Inc., in 1998, as an Economic and Financial Specialist in the Budgets and Forecasts Department. In 1999, I was promoted to the position of Manager, Financial Forecasts. In August 2003, I was named to the position of Director -

Rates. On December 1, 2009, I was promoted to my current position, now titled Director of Rates and Regulatory Strategy, Ohio and Kentucky.

Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES AS DIRECTOR, RATES AND REGULATORY STRATEGY, OHIO AND KENTUCKY.

A. In my current role, I am responsible for all state and federal rate matters involving Duke Energy Ohio and Duke Energy Kentucky, Inc.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO?

A. Yes. I have presented testimony on numerous occasions before the Public Utilities Commission of Ohio (Commission) and various other state, local, and federal regulators.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THESE PROCEEDINGS?

A. The purpose of my testimony is to provide (1) an overview of the Company's proposed electric security plan (ESP); (2) an overview of certain proposed changes from the current ESP, including new distribution riders; (3) an analysis of the benefits of the proposed ESP relative to the results that could be expected if the Company filed for a market rate offer (MRO) under R.C. 4928.142; and (4) a discussion of how the proposed ESP advances state policy related to governmental aggregation.

II. OVERVIEW OF ELECTRIC SECURITY PLAN

Q. PLEASE DESCRIBE THE PRIMARY COMPONENTS OF DUKE ENERGY OHIO'S PROPOSED ESP.

A. The Company is proposing a three-year term for its next ESP, to begin on June 1, 2015, and end on May 31, 2018. The proposed ESP extends certain components of Duke Energy Ohio's current ESP, either eliminates or refines other elements, and adds new provisions for enhancing the Company's distribution reliability.

As provided for in R.C. 4928.143(B)(1), a standard service offer (SSO) in the form of an ESP must make provision for the supply and pricing of electric generation service. Thus, procurement of SSO supply is a fundamental component of the Company's proposed ESP. Consistent with the terms of its current ESP, Duke Energy Ohio will rely upon a competitive bidding process (CBP) plan for procuring the supply necessary to serve its SSO load. Company witness Robert J. Lee discusses the details more extensively in his testimony but, generally, the Company is proposing to continue its current procurement practice, which entails the use of competitive auctions.

The cost of the capacity and energy procured via the auctions must be converted into retail rates in a manner that, to the extent possible, creates no competitive advantage or disadvantage between the SSO price and market prices available to customers from competitive retail electric service (CRES) providers. Company witness James E. Ziolkowski provides testimony describing the proposed process to convert the winning wholesale auction prices into retail rates for each rate class and the significant measures being proposed to mitigate the

potential for creating customer incentives to migrate between the SSO and CRES offers.

Significantly, these and other proposed changes allow the Company to continue its efforts toward diminishing barriers to shopping. Toward this end, Company witness Daniel L. Jones provides testimony regarding the Company's efforts to promote Ohio's competitive retail market.

In further recognition of Ohio's competitive retail electric market and consistent with a recent Commission recommendation,[1] Duke Energy Ohio intends to continue its current purchase of receivables program, and the concomitant uncollectible electric generation rider (Rider UE-GEN), substantially in their current form, at least through the end of the proposed ESP on May 31, 2018.

Q. IS THE COMPANY PROPOSING TO CREATE ANY NEW RIDERS AS PART OF ITS NEXT ESP?

A. Yes. Another significant component of the Company's proposed ESP is the implementation of new riders. These include riders to enhance distribution service reliability and to enable timely recovery of costs incurred in responding to major storms, as well as a rider that would have the effect of providing stability and certainty in respect of retail electric service while supporting the Company's contractual interest in The Ohio Valley Electric Corporation (OVEC).

[1] *In the Matter of the Commission's Investigation of Ohio's Retail Electric Service Market*, Case No. 12-3151-EL-COI, Finding and Order, at pg. 21 (March 26, 2014).

Q. DESCRIBE THE DISTRIBUTION RIDERS BEING PROPOSED IN THE NEXT ESP.

A. The Company is proposing to create three new riders, including two for distribution-related costs.

- Distribution Capital Investment Rider (Rider DCI)
- Distribution Storm Rider (Rider DSR)
- Price Stabilization Rider (Rider PSR)

A. Distribution Capital Investment Rider

Q. DESCRIBE THE DISTRIBUTION CAPITAL IMPROVEMENT RIDER.

A. Generally, Rider DCI is intended to allow the Company to timely recover the incremental revenue requirement on distribution-related capital investments. As Duke Energy Ohio witness Marc W. Arnold discusses in his testimony, the Company's current portfolio of infrastructure programs and level of spending are not sufficient to maintain the present level of service reliability and continue to meet our customers' evolving expectations. The pace of growth in rate base necessary to meet customer needs and expectations is expected to place significant financial constraints on the Company. Timely recovery of the incremental revenue requirement mitigates the financial impact associated with the capital spending the Company believes is needed to appropriately maintain and improve the distribution system.

This type of rider is familiar to the Commission as it has already approved similar riders for other electric distribution utilities (EDUs). Specifically, Rider DCI is designed to be similar to the riders already approved for FirstEnergy Corp.

EDUs[2] and for Ohio Power Company[3] as part of their respective ESPs, in that the recovery is limited to the incremental revenue requirement associated only with the investment in distribution plant and common and general plant allocable to distribution, as compared to the amounts included in base rates.

Modeling the Company's proposed Rider DCI after similar distribution capital riders already approved by the Commission is intended to mitigate any controversy over this proposed rider and to provide the Commission Staff with a common basis for review when auditing these riders across the companies. Duke Energy Ohio witness Peggy A. Laub provides testimony regarding the details of the rate calculations for Rider DCI and the proposed schedule for filing this rider. Company witness Arnold provides testimony detailing the Company's anticipated distribution capital investment, including costs and benefits associated with the plan.

Q. IS IT APPROPRIATE TO INCLUDE A DISTRIBUTION CAPITAL IMPROVEMENT RIDER IN AN ESP?

A. Yes. On advice of counsel, R.C. 4928.143(B)(2)(h) confirms that an ESP may include such a rider:

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[2] *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, at pp. 11-12, 46(August 25, 2010)(approval of Delivery Capital Recovery Rider); *see also, 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. 12-1230-EL-SSO, Opinion and Order, at pp. 10-11, 57 ((July 18, 2012)(approval to continue the Delivery Capital Recovery Rider).

[3] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power 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. 11-346-EL-SSO, *et al.*, Opinion and Order, at p. 46-47 (August 8, 2012)(approval of Distribution Investment Rider).

> Provisions regarding the utility's distribution service, including, without limitation and notwithstanding any provision of Title XLIX of the Revised Code to the contrary, provisions regarding single issue ratemaking, a revenue decoupling mechanism or any other incentive ratemaking, and provisions regarding distribution infrastructure and modernization incentives for the electric distribution utility. The latter may include a long-term energy delivery infrastructure modernization plan for that utility or any plan providing for the utility's recovery of costs, including lost revenue, shared savings, and avoided costs, and a just and reasonable rate of return on such infrastructure modernization. As part of its determination as to whether to allow in an electric distribution utility's electric security plan inclusion of any provision described in division (B)(2)(h) of this section, the commission shall examine the reliability of the electric distribution utility's distribution system and ensure that customers' and the electric distribution utility's expectations are aligned and that the electric distribution utility is placing sufficient emphasis on and dedicating sufficient resources to the reliability of its distribution system.

The Company's Application includes testimony regarding the reliability of the system and testimony discussing the emphasis Duke Energy Ohio places on ensuring reliable distribution. This is an expectation that in no uncertain terms is aligned between the Company and its electric distribution customers.

Q. WHAT ARE THE BENEFITS OF SUCH A RIDER?

A. The benefits of a rider, such as Rider DCI, are shared by the customer and the Company. Reasonable assurance of timely recovery of distribution capital investment provides the utility with the ability to maintain its financial integrity while making appropriate investments to ensure that its customers get the benefit of continued safe, efficient, and reliable service that they expect from their distribution company. Additionally, this rider provides for gradual increases in customer rates to recover the revenue requirement associated with capital investment as opposed to less timely and less gradual recovery, such as what

could be expected with pancaked rate cases, has a much greater potential to result in more changes in rates that are more abrupt and, most likely, of greater magnitude. As a general tenet, customers tend to favor stability and predictability in the prices the prices they can expect to pay for electric service.

B. Distribution Storm Rider

Q. WHY IS THE COMPANY PROPOSING TO IMPLEMENT A DISTRIBUTION STORM RIDER?

A. The first priority for the Company during a major storm event is restoring power and maintaining the system, as safely and as efficiently as possible. Maintaining credit worthiness and general financial integrity is essential to ensuring Duke Energy Ohio's ability to meet those important goals. Undoubtedly, restoration costs for severe storms can have a significant impact on any utility's financial condition. Duke Energy Ohio's base distribution rates were set at a level that include an expected level of storm costs[4] but, by their very nature, actual costs associated with storm restoration cannot be predicted. The amounts included in base rates are typically predicated upon historical averages. But from one year to the next, the amount an EDU spends on storm costs can deviate significantly from the "average" amount included in base rates.

As evidenced by Duke Energy Ohio's experience with Hurricane Ike,

[4] *In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in its Electric Distribution Rates*, Case No. 12-1682-EL-AIR, *et al.*, Opinion and Order, at pg. 7 (May 1, 2013). ("[R]evenue requirement...includes $4.4 million for recovery of costs incurred during major storms... .")

major storms can have a significant adverse financial impact on an EDU. Approving the Company's request to implement the deferral authority and cost recovery mechanism for incremental restoration costs associated with major storms will serve to mitigate the potential financial stress the Company may endure from a major storm event.

As Company witness Laub discusses further in her testimony, Duke Energy Ohio's proposal related to storm costs is to initially track the annual costs related to major storms and either credit or debit a regulatory asset for the amount the annual storm cost exceeds a threshold amount already included in base rates. In years when storm costs are below the amounts included in base rates, there would be a credit to the regulatory asset deferral and when storm costs are higher than the base amount, there would be a debit. Only when, or if, the regulatory asset exceeds the threshold amount would the Company seek to invoke the proposed Rider DSR. At the time of the next rate case, the Company may seek to amortize the credit or debit balance of the regulatory asset for recovery in base rates or may seek to continue the deferral and tracker mechanism.

Q. IS THERE SUPPORT FOR SUCH A RIDER IN OHIO?

A. Yes. The Commission has approved a similar rider in an ESP approved for Ohio Power Company.[5] Also, in a recent case involving The Dayton Power & Light

[5] *In the Matter of the Application of Columbus Southern Power Company and Ohio Power 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. 11-346-EL-SSO, *et al.*, Opinion and Order, at pp. 68-69(August 8, 2012)(approval of Storm Damage Recovery Mechanism).

Company (DP&L),[6] the Commission Staff recommended that, in its next base rate case, DP&L "apply for a tracker and a baseline level of expenses for repairs related to major storms for inclusion in base rates."[7] The Commission's approval of such a mechanism and the ultimate recovery of storm costs pursuant to the mechanism are an indication that it recognizes the fact that storm costs are volatile and may negatively impact an EDU's financial condition. The Company believes that approval of its proposed DSR will be a positive step in ensuring its ongoing financial integrity and the benefit of continued safe and reliable service for its customers.

C. Price Stabilization Rider

Q. WHAT IS OVEC AND HOW DOES IT RELATE TO DUKE ENERGY OHIO?

A. Duke Energy Ohio, along with twelve other entities (Sponsoring Companies), owns stock in OVEC. The Company's share of the investment is currently 9 percent. OVEC, created in the 1950s, is a corporation that was created to provide power for uranium enrichment facilities located near Portsmouth, Ohio. OVEC owns two coal-fired generating units with a combined nameplate capacity of

[6] *In the Matter of the Application of The Dayton Power and Light Company for Authority to Recover Certain Storm-Related Service Restoration Costs*, Case No. 12-3062-EL-RDR, *et al.*, Staff Audit Report, at pg. 8 filed on(January 3, 2014). ("In the Company's next base rate case, Staff recommends that the Company apply for a tracker and a baseline level of expenses for repairs related to major storms for inclusion in base rates. Then each subsequent yearly request for recovery would be net of the baseline amount.").

[7] *In the Matter of the Application of The Dayton Power and Light Company for Authority to Recover Certain Storm-Related Service Restoration Costs*, Case No. 12-3062-EL-RDR, *et al.*, Staff Audit Report, at pg. 8(January 3, 2014). ("In the Company's next base rate case, Staff recommends that the Company apply for a tracker and a baseline level of expenses for repairs related to major storms for inclusion in base rates. Then each subsequent yearly request for recovery would be net of the baseline amount.")

nearly 2,400 megawatts. The Department of Energy (DOE) was the primary consumer of the power from OVEC until 2003, when the DOE canceled the contract making the output of OVEC's generation available to OVEC's owners. Duke Energy Ohio's current commitment to OVEC extends through June 30, 2040. Duke Energy Ohio's share of the capacity and energy from OVEC is equal to its 9 percent equity interest. OVEC's fixed and variable cost associated with its two generating assets are allocated to the Sponsoring Companies based on their respective equity interests.

Q. IS DUKE ENERGY OHIO REQUIRED TO TRANSFER ITS EQUITY INTEREST IN OVEC AS PART OF ANY PRIOR COMMITMENT?

A. No. The Stipulation and Recommendation that was approved by the Commission establishing the current ESP provided that all of Duke Energy Ohio's directly owned generation was to be transferred by the end of 2014, but did not address contractual entitlements. OVEC's two generation assets are not directly owned by Duke Energy Ohio; consequently, the Company has no obligation to transfer its equity interest in OVEC to an affiliate as part of the broader transfer of directly owned assets.

Q. DESCRIBE THE COMPANY'S PROPOSAL WITH RESPECT TO OVEC.

A. The Company is offering the economic value of its share of the capacity and energy from OVEC to its retail customers for the duration of Duke Energy Ohio's entitlement. The Company is proposing to sell one hundred percent of its share of OVEC's energy and capacity into the wholesale market. The difference between

the revenue generated from such sales and the costs allocated from OVEC to Duke Energy Ohio would be flowed through to customers.

Q. IS THE COMPANY'S PROPOSAL AN OFFER OF GENERATION SERVICE TO RETAIL CUSTOMERS?

A. No. The capacity and energy available from OVEC will not displace any of the capacity and energy procured for SSO service and will not displace any of capacity and energy provided by CRES providers. It is simply a financial arrangement intended to act as a hedge against price volatility that exists in the PJM Interconnection, L.L.C., (PJM) power markets. Thus, the Company's proposal does not contravene the Commission's objective to transition Ohio to a competitive retail market construct.

Q. ASSUMING THE COMMISSION APPROVED THE COMPANY'S PROPOSAL REGARDING OVEC, DOES THAT MEAN THE COMPANY IS DOUBLE RECOVERING CAPACITY OR ENERGY CHARGES?

A. Duke Energy Ohio will collect no revenue from any retail customer for generation service except for generation service provided by SSO auction winners. All of the revenue collected for the generation service provided by SSO auction winners is passed through to those suppliers. As I indicated earlier, none of Duke Energy Ohio's share of OVEC's capacity and energy will be used to displace any SSO service and no physical capacity or energy from OVEC will be delivered to any retail customer; consequently, there can be no double recovery. Retail customers taking service from SSO auction winners or from CRES providers will pay once, and only once, for the capacity and energy underlying their generation service.

Q. IS THERE A REGULATED RETURN ASSOCIATED WITH DUKE ENERGY OHIO'S INVESTMENT IN OVEC?

A. Although OVEC does include return on investment in the calculation of the fixed costs it allocates to its Sponsoring Companies, Duke Energy Ohio does not earn a regulated return on the equity owns in OVEC. For its investment in OVEC, Duke Energy Ohio is entitled to capacity and energy that it can sell into the wholesale market but Duke Energy Ohio has no guaranteed return.

Q. IS IT CORRECT THAT THE COMPANY IS PROPOSING THIS HEDGING ARRANGEMENT PERSIST BEYOND THE TERM OF THE ESP BEING PROPOSED?

A. Yes. Not unlike other riders established in prior ESPs (*e.g.*, the Alternative Energy Recovery Rider), this rider would remain in place beyond the May 31, 2018, end date being proposed in the proposed ESP.

Q. WHAT ARE THE BENEFITS OF THE COMPANY'S PROPOSAL REGARDING OVEC?

A. The Company's proposal with respect to OVEC has three primary benefits. First, the output from OVEC will be used, to the benefit of customers, as a long-term hedge (or insurance) against the volatility of future market prices. As I indicated above, Duke Energy Ohio will sell its contractual entitlement to OVEC's energy and capacity into the PJM markets and, after deducting all allocated costs from OVEC, will record either a gain or a loss on the sale of that generation. In quarterly filings with the Commission, gains or losses will be assigned to the retail load on a non-bypassable basis, allocated based on energy, creating a hedge

against volatility in market prices. At times of very low prices, there may be a charge flowing through to customers as the output of OVEC will have less value vis-à-vis market prices. But when market prices are very high, such as the prices seen in PJM during the recent polar vortex, the profits from OVEC would serve to benefit customers by reducing overall rates. In either case, the effect is to temper the volatility of prices customers will see for the generation rates, thereby having the effect of adding stability and certainty with regard to the overall price of retail electric service.

Duke Energy Ohio's costs for its share of OVEC are relatively stable as it is allocated a share of fixed costs, which are generally very stable, and variable costs, which are mostly fuel. Certainly when compared to the volatility in the PJM capacity and energy markets, the costs associated with OVEC are relatively stable. Consider the January 2014 polar vortex. Although the market prices in PJM exceeded $1,000 per MWh, OVEC's underlying variable costs were essentially the contracted-for cost of fuel. And the polar vortex confirms that most of Duke Energy Ohio's customers are subject to varying degrees of volatility in the price of capacity and energy whether they take service under the SSO or from CRES providers. Indeed, as a result of the polar vortex, it has become apparent that CRES contracts may contain provisions to allow for the flow through of incremental costs associated with drastic market price increases. It is the stability and predictability associated with OVEC's costs that will serve to benefit Duke Energy Ohio's retail customers.

At times of high market prices, customers will be negatively impacted by those market conditions; coincidentally, it is during those times of high prices when the value of the Company's share of OVEC capacity and energy sold in the wholesale market increases. Allowing customers to receive all of this benefit serves to mitigate the impact of overall high market prices.

Second, the OVEC proposal is competitively neutral. As Duke Energy Ohio's entitlement share of the energy and capacity from the OVEC generating stations will continue to be sold into the wholesale markets, this proposal will not impact the competitive retail electric market that is active in Duke Energy Ohio's service territory. In other words, no CRES provider is impacted in any way by the approval of this rider. The proposal would also be neutral in terms of wholesale competition as no wholesale supplier will benefit or be harmed from this proposal. As of the effective date of the proposed ESP, Duke Energy Ohio will have no generation business of its own. As such, there cannot be any subsidy between its non-competitive electric business and its generation business.

Finally, the OVEC generating stations reflect actual "steel in the ground." And as we observed during the recent polar vortex, plants such as these were on line, providing reliable service, at a time when other generation resources were not. The continued access to the benefit of the reliable power available from the OVEC generating assets is positive for Ohio.

Q. PLEASE PROVIDE MORE DETAILS ON HOW RIDER PSR WILL WORK.

A. On a quarterly basis, Duke Energy Ohio will file a projection of the revenue expected from selling its share of the output from OVEC into the PJM markets and the expenses it expects to be billed from OVEC. The difference between the expected revenue and expected cost for that upcoming quarter will be divided by the projected kWh sales for the same quarter to calculate a "$/kWh" rate applicable to all customers. Customers taking service above distribution voltage levels will have slightly lower prices to account for the lower line losses at their service level. As actual data is available, the rider would be trued up to ensure that there is no over- or under-recovery.

III. CHANGES FROM CURRENT ESP

Q. THE COMPANY IS INTENDING TO PERPETUATE A CBP PLAN IN ITS PROPOSED ESP. IS IT SIMILARLY SEEKING TO CONTINUE ALL OF THE RIDERS OR ARRANGEMENTS APPROVED IN THE CONTEXT OF ITS CURRENT ESP?

A. No. The Company is not proposing to continue all tariffs or arrangements approved in the context of its current ESP.

Q. WHY NOT?

A. The Company's current ESP was the product of a near unanimous and uncontested settlement, arrived at through a series of compromises. Indeed, the signatory parties to the Stipulation and Recommendation agreed that it was a "reasonable compromise that balances diverse and competing interests and does not necessarily reflect the position that any one or more of the Parties would have

taken had these issues been fully litigated."[8] As a result of the compromises made in the settlement, the Company's current ESP includes several non-market-based incentives that have the potential to influence customer behavior for reasons other than purely competitive forces. But these incentives are not conducive to the continued development of a healthy and vital competitive retail market and thus run afoul of the Commission's expectations, as evident from its investigation into the competitive retail electric services market and the ESPs under which Ohio's other EDUs are operating. Further, Duke Energy Ohio is fully at market in terms of its SSO supply procurement. As such, it is appropriate to eliminate artificial enhancements to customer choice through the modification of certain tariffs and termination of other tariffs and arrangements.

Q. PLEASE DISCUSS THE CHANGES TO THE MANNER IN WHICH COSTS RELATED TO SSO LOAD ARE ALLOCATED AMONG THE RATE CLASSES AND ANY CHANGES IN THE RATE DESIGN FOR SUCH RECOVERY.

A. As discussed above, the Company intends to continue using competitive procurements for its SSO supply under the proposed ESP. The Company also proposes to continue recovering the costs associated with SSO service from retail customers via the same riders currently being used. The Retail Capacity Rider (Rider RC) and the Retail Energy Rider (Rider RE) will continue to be the means

[8] *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 No. 11-3549-EL-SSO, *et al.*, Stipulation and Recommendation, at pg. 2 (October 24, 2011).

of recovering the underlying capacity, energy, and other supply costs, respectively, related to procurements in the SSO auctions. Similarly, the existing Supplier Cost Reconciliation Rider (Rider SCR) will continue as the means of truing up the difference between the invoiced cost of SSO service and the revenue collected by Duke Energy Ohio through Rider RC and Rider RE. As is currently the case, Rider SCR will also continue to recover the costs of conducting the auctions, as well as costs associated with any audits, consultants, or other incremental costs incurred by or billed to the Company to procure the SSO service.

However, the Company is proposing to make changes to the manner in which capacity costs are allocated in the calculation of Rider RC and to change the rate design for both Rider RC and Rider RE. The change in the allocation factor used for allocating the cost of the underlying capacity in the SSO auction price is intended to reflect the manner in which such costs are actually incurred. To that end, the Company is proposing to use the "5 coincident peak" (5 CP) method. The current method used to allocate capacity costs is not the 5 CP; instead, the agreed-to method was just one component of a much broader settlement reached in the prior ESP. The current allocation method is reasonable when combined with all of the provisions of the approved Stipulation and Recommendation; however, the Company believes that, strictly following cost causation principles, customers should be charged for costs in a manner that reflects how such costs are actually incurred. All of the capacity that will be used to serve retail load during the term of the proposed ESP will ultimately be

acquired from PJM. The charges for capacity billed by PJM to meet the total load obligation is essentially based on the Company's load at the time of PJM's five highest system hourly peaks. Consequently, the most equitable method for allocating capacity cost is to base the allocation on how much each customer class contributes to those five PJM coincident peaks. In other words, the Company intends to match the costs to the cost causers – a fundamental principle in ratemaking.

In addition to the intended change in allocation methodology, the Company is also proposing to make certain rate design changes. For certain customers, the current rate design for Rider RC includes demand charges and energy charges; however, the Company is proposing to modify Rider RC so that all demand charges are removed and recovery for all generation-related charges for all SSO customers would then be based only on kWh consumption. For Rider RE, the changes are also intended to better align SSO rates with the reality of a purely competitive market for retail generation service.

Company witness Ziolkowski provides a full description and illustration of how Riders RC and RE will be calculated in the proposed ESP based on SSO auction results. Mr. Ziolkowski's testimony also explains how the Company's modification to the rate design for Rider RC will continue to recognize the benefits associated with higher customer load factors.

Q. WHY IS THE COMPANY PROPOSING TO MAKE THESE CHANGES?

A. To the extent practicable, a purely competitive market must be free of influences over customer choices between potential suppliers that are not based exclusively

on market forces. The winners of the SSO auctions are competing for load just the same as the CRES providers. In order to protect the interests of both the SSO auction winners and CRES providers, rates for SSO service should, to the extent possible, be designed in such a way that SSO rates are priced as competitively as possible with competing offers customers may see from CRES providers. CRES providers pay PJM for capacity based on factors influenced by PJM's 5 CP method; therefore, SSO costs should be allocated to customer classes in the same manner to avoid a disparity between SSO rates and CRES offers. Similarly, the easiest and most common way for customers in all classes to compare a CRES offer to the SSO rate is on a "$/kWh" basis. The existing combination of demand and energy charges makes that comparison difficult and it has the potential to make SSO prices disproportionately high for very low load factor customers. Mr. Ziolkowski explains how the Company's proposed rate design will improve price transparency and comparability for customers and recognize the benefit of higher load factors even with rates based exclusively on "per kWh" charges.

Q. DOES THE COMPANY'S PROPOSED CHANGE ADVANCE STATE POLICY GOALS?

A. Absolutely. Section 4928.02(B) of the Ohio Revised Code (RC) establishes the following state policy goal:

> Ensure the availability of unbundled and comparable retail electric service that provides consumers with the supplier, price, terms, conditions, and quality options they elect to meet their respect needs.

It is in all stakeholders' interests to ensure that SSO service be as competitively priced as possible when compared to potential CRES offers. To do otherwise

would put the Commission in the unenviable position of creating a competitive disadvantage for the competitive wholesale suppliers providing SSO service, as compared to CRES providers, thereby undermining the objective of promoting and advancing competition.

It is important to reiterate that the Company ultimately has no economic interest in whether its retail customers take generation service via the SSO or via CRES providers; however, Duke Energy Ohio believes it would be a detriment to competition to consciously create an advantage or disadvantage for either the SSO auction winners or the CRES providers.

Q. IS THE COMPANY PROPOSING TO CONTINUE ITS LOAD FACTOR ADJUSTMENT RIDER?

A. No. The Company is proposing to eliminate the Load Factor Adjustment Rider (Rider LFA) effective June 1, 2015, subject only to a true up, as discussed by Mr. Ziolkowski. The true-up ensures that the customer and the utility are ultimately made whole by this rider, which was approved as part of the overall stipulation reached in the current ESP and is revenue-neutral to the Company. Once the rider is trued up, the Company proposes to eliminate it from its tariff schedule.

Q. WHY IS THE COMPANY PROPOSING TO ELIMINATE THIS RIDER?

A. As I discussed earlier, the Company believes that the price customers pay for all generation-related costs should be established by market forces. Customers with higher load factors should be rewarded by appropriate CRES offers or in the form of lower SSO rates, as Duke Energy Ohio is proposing with the changes to the rate design for Rider RC. Rider LFA was one of several provisions agreed to as

part of an overall settlement in the current ESP.[9] Standing alone, however, Rider LFA represents a non-market-based influence on the usage behavior for all demand-metered customers' bills and, therefore, undermines the desired objective of having market influences alone determine the cost of competitive generation service.

Q. ARE THERE ANY OTHER MAJOR RATE-RELATED PROVISIONS OF THE CURRENT ESP THAT ARE BEING ELIMINATED IN THE PROPOSED ESP?

A. Yes. Again, as part of an overall settlement, the Company agreed to offer transmission voltage customers with loads in excess of 10 MW the opportunity to participate in a demand response program. That program offered customers an opportunity to receive an above-market credit by allowing Duke Energy Ohio the ability to use interruptible load in the Company's Fixed Resource Requirement (FRR) plan. The cost of the program is being recovered via the Economic Competitiveness Fund Rider (Rider DR-ECF).

Because the Company's current status as an FRR entity expires effective June 1, 2015, it will no longer need the demand resources potentially available under this program for its FRR obligations and the rationale for this program will no longer be valid. Furthermore, elimination of this arrangement helps to ensure that only competitive forces are at work in establishing competitive generation charges for customers, which is consistent with the continued development of a

[9] Id, at pg. 22.

truly competitive retail electric market. The value of participating in the PJM capacity markets and the willingness of customers to participate in the related demand response programs should be determined only with regard to competitive market forces and not by non-market-based incentives.

Q. IS THERE ANY REASON FOR CUSTOMERS PARTICIPATING IN THIS PROGRAM TO ASSUME THAT IT WOULD EXTEND BEYOND MAY 31, 2015?

A. Admittedly, it is difficult to speculate on what an individual customer's expectations would be but the fact of the matter is that this program has a sunset provision. It is not implausible that a customer would have some desire that this program persist beyond May 31, 2015, but any plans made with respect to participating or not participating in PJM's demand response market for periods beyond May 31, 2015, could only be characterized as speculative as the sunset provision on the program in the current ESP inarguably expires on May 31, 2015.

Q. WILL THERE BE A NEED TO TRUE UP RIDER DR-ECF?

A. It is likely that there will be an over- or under-recovery of costs included in Rider DR-ECF as of May 31, 2015. Consequently, the Company will need to do a final true up of this rider after the current ESP expires on May 31, 2015. Once that true up is complete, Duke Energy Ohio proposes to eliminate Rider DR-ECF as obsolete.

Q. WITH THE PROPOSAL TO ELIMINATE DEMAND CHARGES UNDER RIDER RC AND TO ELIMINATE RIDER LFA, WILL THERE BE ANY DEMAND CHARGES ON SSO CUSTOMERS' BILLS?

A. Yes. Those customers who are currently billed for transmission and distribution services based, at least in part, upon their monthly demand will continue to be billed on demand[10] for these charges. The Company is not proposing any changes to rate design, or its existing demand ratchet provisions, for those two components of electric service. However, with the changes being proposed here, there will no longer be any demand charges for any SSO-related service from Duke Energy Ohio. All charges for SSO service will be reflected on customers' bills in terms of a rate per kilowatt-hour. Whether customers of CRES providers pay demand-based generation charges will depend upon the contracts agreed to by these parties.

IV. BETTER IN THE AGGREGATE TEST

Q. IS THE COMPANY'S PROPOSED ESP MORE FAVORABLE, IN THE AGGREGATE, THAN THE EXPECTED RESULTS THAT WOULD OTHERWISE APPLY UNDER SECTION 4928.142 OF THE REVISED CODE?

A. Yes. In the aggregate, the Company's proposed ESP is more favorable than the expected results of an MRO under R.C. 4928.142. Although the cost of generation service to customers under the proposed ESP is necessarily equal to the cost of generation service under an MRO, the totality of the proposed ESP does provide benefits to customers as compared to the expected results under the MRO provision of R.C. 4928.143(C)(1).

[10] These customers are billed based on kilowatts (kW) or on kilovolt amperes (kVA).

Q. WILL YOU EXPLAIN HOW THE COST OF SSO SERVICE UNDER THE PROPOSED ESP IS EQUAL TO THE COST THAT WOULD BE EXPECTED UNDER AN MRO?

A. In the proposed ESP, there are no competitive generation-related charges being sought by the Company other than the flow-through of the cost of procuring SSO generation service via the CBP plan. Therefore, the only driver of SSO costs under the proposed ESP is competitively priced, market-based generation service. Under an MRO, the source and the price of SSO generation service must be the same, as 100 percent of the SSO load requirement would have to be procured in a competitive process just as is being done in the existing and proposed ESP. Inasmuch as the SSO service to be procured in both an ESP and an MRO would be pursuant to purely competitive process, the quantitative value of the ESP versus the MRO, as it relates to competitive generation service, is necessarily equal.

Q. IF THE COST OF SSO GENERATION SERVICE UNDER THE PROPOSED ESP IS THE SAME AS COSTS THAT WOULD BE EXPECTED UNDER AN MRO, WHAT IS THE BASIS FOR CONCLUDING THAT THE PROPOSED ESP IS MORE FAVORABLE THAN AN MRO?

A. On the advice of counsel, it is my understanding that the Ohio Supreme Court has confirmed that the "in the aggregate test" is not limited to a price comparison. Rather, the Commission has been instructed to also consider other terms and

conditions of a proposed ESP.[11] The Commission has similarly affirmed the scope of the "better in the aggregate" test in recent orders. Specifically, in DP&L's most recent SSO filing (DP&L ESP Case),[12] the Commission defined the test as one that "includes a quantitative and a qualitative analysis."[13] On advice of counsel, the implication of the Commission's finding in the DP&L ESP Case is that the qualitative benefits of an ESP can render that form of an SSO better than the expected results under R.C. 4928.142, where the quantitative factors are comparable or even favor the MRO.

In the Company's proposed ESP, the Commission's determination as to whether this ESP is "better in the aggregate" than the results expected under the MRO provision will therefore depend on the qualitative benefits of the proposed ESP. Insofar as the proposed ESP and the MRO are necessarily equal quantitatively, the scale can only be tipped one way or the other based on the qualitative benefits of the proposed ESP relative to the MRO. The Company believes that its proposed ESP provides significant advantages over the results that could be expected under an MRO. Some of the most conspicuous benefits of the proposed ESP include:

- Changes to rate design and the elimination of non-market-based influences on customer behavior;

[11] *In re Columbus Southern Power Co.*, 128 Ohio St.3d 402, 2011-Ohio-958, at ¶ 407.
[12] *In the Matter of the Application of The Dayton Power and Light Company for Approval of its Electric Security Plan*, Case No. 12-426-EL-SSO, *et al.*
[13] Id, Opinion and Order, at pg. 48 (September 4, 2013).

- Promotion of the competitive market by further leveling the playing field between SSO auction winners and CRES providers;
- Proposed Rider DCI, which offers the Company, the Commission, and customers an opportunity to improve the safety and reliability of the system in an economical and efficient manner; and
- A means to stabilize competitive generation prices for shopping and non-shopping customers through the competitively neutral Rider PSR.

While the benefits I have ascribed to an ESP that are not available under an MRO are mostly qualitative, the Commission has recognized that such qualitative benefits are meaningful in determining whether the "in the aggregate" test is satisfied. Consequently, the Commission should find that the ESP being proposed in this Application is better in the aggregate than the results that would be expected under R.C. 4918.142.

V. GOVERNMENTAL AGGREGATION

Q. WHAT IS GOVERNMENTAL AGGREGATION?

A. Governmental aggregation is a process by which municipalities, townships, or counties may negotiate rates for the collective load of the non-mercantile customers in the area. Thus, the loads of the residents are aggregated for improved negotiating leverage. Governmental aggregation is provided for in R.C. 4928.20.

Q. WHAT IS REQUIRED BY DIVISION (I) OF REVISED CODE 4928.20?

A. Division (I) of that statute reads as follows:

> Customers that are part of a governmental aggregation under this section shall be responsible only for such portion of a surcharge under section 4928.144 of the Revised Code that is proportionate to the benefits, as determined by the commission, that electric load centers within the jurisdiction of the governmental aggregation as a group receive. The proportionate surcharge so established shall apply to each customer of the governmental aggregation while the customer is part of that aggregation. If a customer ceases being such a customer, the otherwise applicable surcharge shall apply. Nothing in this section shall result in less than full recovery by an electric distribution utility of any surcharge authorized under section 4928.144 of the Revised Code.

R.C. 4928.144, referenced in division (I), provides that:

> The public utilities commission by order may authorize any just and reasonable phase-in of any electric distribution utility rate or price established under sections 4928.141 to 4928.143 of the Revised Code, and inclusive of carrying charges, as the commission considers necessary to ensure rate or price stability for consumers. If the commission's order includes such a phase-in, the order also shall provide for the creation of regulatory assets pursuant to generally accepted accounting principles, by authorizing the deferral of incurred costs equal to the amount not collected, plus carrying charges on that amount. Further, the order shall authorize the collection of those deferrals through a nonbypassable surcharge on any such rate or price so established for the electric distribution utility by the commission.

Q. WHAT IS REQUIRED BY DIVISION (J) OF REVISED CODE 4928.20?

A. Division (J) of that statute states that:

> On behalf of the customers that are part of a governmental aggregation under this section and by filing written notice with the public utilities commission, the legislative authority that formed or is forming that governmental aggregation may elect not to receive standby service within the meaning of division (B)(2)(d) of section 4928.143 of the Revised Code from an electric distribution utility in whose certified territory the governmental aggregation is located and that operates under an approved electric security plan under that section. Upon the filing of that notice, the electric distribution

> utility shall not charge any such customer to whom competitive retail electric generation service is provided by another supplier under the governmental aggregation for the standby service. Any such consumer that returns to the utility for competitive retail electric service shall pay the market price of power incurred by the utility to serve that consumer plus any amount attributable to the utility's cost of compliance with the alternative energy resource provisions of section 4928.64 of the Revised Code to serve the consumer. Such market price shall include, but not be limited to, capacity and energy charges; all charges associated with the provision of that power supply through the regional transmission organization, including, but not limited to, transmission, ancillary services, congestion, and settlement and administrative charges; and all other costs incurred by the utility that are associated with the procurement, provision, and administration of that power supply, as such costs may be approved by the commission. The period of time during which the market price and alternative energy resource amount shall be so assessed on the consumer shall be from the time the consumer so returns to the electric distribution utility until the expiration of the electric security plan. However, if that period of time is expected to be more than two years, the commission may reduce the time period to a period of not less than two years.

With introductory text taken from division (B)(2), R.C. 4928.143(B)(2)(d), referenced in that section, provides as follows:

> The plan may provide for or include, without limitation, any of the following:
>
> (d) Terms, conditions, or charges relating to limitations on customer shopping for retail electric generation service, bypassability, standby, back-up, or supplemental power service, default service, carrying costs, amortization periods, and accounting or deferrals, including future recovery of such deferrals, as would have the effect of stabilizing or providing certainty regarding retail electric service;

R.C. 4928.64, referenced in division (J), addresses the provision, by an electric distribution utility, of electricity from alternative energy resources.

Q. WHAT IS REQUIRED BY DIVISION (K) OF REVISED CODE 4928.20?

A. Division (K) reads as follows:

> The commission shall adopt rules to encourage and promote large-scale governmental aggregation in this state. For that purpose, the commission shall conduct an immediate review of any rules it has adopted for the purpose of this section that are in effect on the effective date of the amendment of this section by S.B. 221 of the 127th general assembly, July 31, 2008. Further, within the context of an electric security plan under section 4928.143 of the Revised Code, the commission shall consider the effect on large-scale governmental aggregation of any nonbypassable generation charges, however collected, that would be established under that plan, except any nonbypassable generation charges that relate to any cost incurred by the electric distribution utility, the deferral of which has been authorized by the commission prior to the effective date of the amendment of this section by S. B. 221 of the 127th general assembly, July 31, 2008.

Q. HOW DOES DUKE ENERGY OHIO INTEND TO ADDRESS GOVERNMENTAL AGGREGATION PROGRAMS AND THE IMPLEMENTATION OF DIVISION (I) OF REVISED CODE 4928.20?

A. As I understand, based upon advice of counsel, Duke Energy Ohio is not, in this Application, seeking any deferral or to phase in any deferrals, as authorized under R.C. 4928.144. Thus, the provisions of R.C. 4928.20(I) are not applicable to the Company's proposed ESP. And to the extent R.C. 4928.20(I) is intended to assist governmental aggregators, the Company's proposed ESP will not impede that intent.

Q. HOW DOES DUKE ENERGY OHIO INTEND TO ADDRESS GOVERNMENTAL AGGREGATION PROGRAMS AND IMPLEMENTATION OF DIVISION (J) OF REVISED CODE 4928.20?

A. As I understand, based upon advice of counsel, the provisions of R.C. 4928.20(J) that concern a charge for standby service are also not applicable to the Company's ESP Application. Duke Energy Ohio is not proposing any charge for providing

standby service. Accordingly, the implementation of R.C. 4928.20(J) is not complicated by the Company's proposed ESP.

Q. HOW DOES DUKE ENERGY OHIO INTEND TO ADDRESS GOVERNMENTAL AGGREGATION PROGRAMS AND IMPLEMENTATION OF DIVISION (K) OF REVISED CODE 4928.20?

A. As I understand, based upon advice of counsel, R.C. 4928.20(K) provides instruction to the Commission in promulgating rules to "encourage and promote large-scale governmental aggregation" in Ohio. As this instruction is directed to the Commission, Duke Energy Ohio's proposed ESP is necessarily irrelevant to implementation of certain parts of R.C. 4928.20(K). That is, the Company's filing will not result in rules designed to encourage or promote aggregations.

R.C. 4928.28(K) also directs the Commission to consider the effect of any non-bypassable generation charge on large-scale aggregation, with the exception of non-bypassable charges for which a deferral was created prior to the effective date of SB 221. First of all, compliance with this statutory provision requires conduct by the Commission but, importantly, there are no non-bypassable generation charges being proposed in the proposed ESP. Consequently, this requirement is moot insofar as Duke Energy Ohio's Application is concerned.

VI. CONCLUSION

Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?

A. Yes.