**BEFORE**

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| In the Matter of the Application of Duke Energy Ohio, Inc., for the Establishment of a Charge Pursuant to Revised Code Section 4909.18.  In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.  In the Matter of the Application of Duke Energy Ohio, Inc., for the Approval of a Tariff for a New Service. | Case No. 12-2400-EL-UNC  Case No. 12-2401-EL-AAM  Case No. 12-2402-EL-ATA |

**REPLY BRIEF OF GREATER CINCINNATI HEALTH COUNCIL**

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# I. INTRODUCTION

Numerous parties have filed initial briefs in this case, addressing a wide range of issues raised by Duke’s application. The Greater Cincinnati Health Council (“GCHC”) and Cincinnati Bell Inc. (“CBI”) find themselves in agreement with virtually everything said in all of the other Intevenors’ initial briefs. There are a number of reasons for the Commission to deny Duke’s application and no lawful way for the Commission to grant Duke’s application. So much has been said about this case, there is little left to discuss. GCHC/CBI will use this Reply Brief as an opportunity to briefly address some of the issues raised by Duke Energy Ohio, Inc. (“Duke”) in its initial brief.

Granting Duke’s Application would eviscerate the global settlement of capacity charges the parties made in Case No. 11-3549-EL-SSO (“the ESP case”). Duke asks the Commission to ignore the express terms of that settlement and allow it to extract more than $729 million in additional, unjustified revenue from its customer base. Duke is already being compensated for its capacity services exactly as it agreed to be compensated and exactly how it will be compensated after May 2015, when it is no longer an FRR entity. Duke’s entire case is based upon sour grapes: it made a calculated decision to accept a deal that did not turn out to be as good as what AEP achieved through litigation. That is no basis for abrogating the voluntary arrangements upon which all parties have relied. The returns Duke earns on its capacity assets are irrelevant because generation service is now fully competitive.

Duke’s capacity rates are not unjust and unreasonable (a concept that no longer even applies to generation service in Ohio), nor can they be deemed unconstitutionally confiscatory because they are the product of a voluntary agreement by Duke and the result of a fully competitive market. Having agreed to a comprehensive ESP Stipulation governing capacity compensation, knowing exactly what rates it would be allowed to charge, Duke cannot complain that any rates were “imposed” on it. Returns are not guaranteed in competitive markets and Duke’s failure to earn the returns it would like is no basis for granting Duke additional capacity compensation.

# II. JURISDICTION AND APPLICABLE LAW

As an FRR entity, Duke provides wholesale FRR capacity service pursuant to PJM's tariffs and, specifically, Schedule 8.1 of PJM's RAA. This is a federal tariff filed with and approved by the FERC. Duke’s wholesale capacity rates are governed by federal law. A state’s potential role in setting capacity charges is collateral, quite narrow and inapplicable in this case. The RAA provides three possible pricing mechanisms for capacity service – the default competitive market pricing determined by the RPM; a FERC-determined rate; or, under certain limited circumstances, rates based on a state compensation mechanism. Duke gave up the right to seek a FERC-determined rate, leaving the alternatives of PJM competitive pricing (which it agreed to in the ESP Stipulation) or a state compensation mechanism, if applicable.

The RAA only incorporates a state compensation mechanism, if one exists, under limited circumstances not applicable here. The RAA is not a source of jurisdiction for this Commission to create a state compensation mechanism where one does not already exist. As a creature of statute, the Commission can only act to the extent there is a state law source of authority to do so. As several parties have clearly demonstrated in their initial briefs, particularly IEU-Ohio and the OCC, there is no independent state law basis for the Commission to do what Duke requests. Generation is now completely unregulated in Ohio and, except to the extent the Commission has authority under Chapter 4928 to set the terms of an standard service offer (“SSO”), the Commission may not regulate generation rates.

The prerequisite in the RAA for a state compensation mechanism to apply is as follows:

In the case of load reflected in the FRR Capacity Plan that switches to an alternative retail LSE, **where** **the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations**, such state compensation mechanism will prevail.[[1]](#footnote-1)

It is crucial to note that this provision is limited to switched load. It has no application to Duke’s non-switching customers. Except to the extent it may be implied from the approval of the ESP Stipulation, the Commission has never required switching customers or CRES providers to purchase capacity from Duke or to compensate Duke for its capacity obligations. As demonstrated in the GCHC/CBI Initial Brief and admitted by Duke’s own witnesses, Duke’s right to charge switching customers and CRES providers for capacity is solely a product of PJM market rules. In order to participate in the PJM market, load serving entities must purchase capacity from PJM (acquired either through the PJM auction process or the self-supply obligations of an FRR entity). That would be true without any action by this Commission and without even mentioning it in the ESP Stipulation. The ESP Stipulation merely mirrored these basic PJM market principles when it described how CRES providers would compensate Duke for capacity. Thus, the necessary prerequisite for application of a state compensation mechanism under the RAA is lacking because the Commission has never required switching customers or CRES providers to compensate Duke for its capacity.

Alternatively, if one views the Commission’s approval of the ESP Stipulation as independently imposing capacity obligations on shopping customers and CRES providers, then the ESP Stipulation *itself* is also the state compensation mechanism for Duke. The ESP Stipulation expressly discusses what every type of Duke customer, wholesale and retail, would pay for capacity. Duke has no right to request this Commission to establish a different compensation mechanism for its capacity resources.

# III. THE AEP OHIO CASE HAS NO BEARING ON THE COMPENSATION DUKE SHOULD RECEIVE AS AN FRR ENTITY.

This case would not exist but for the approval of AEP Ohio’s request to recover its embedded costs of capacity. Duke should not be compensated for its capacity obligation the same as AEP Ohio. The claimed similarities between Duke and AEP Ohio are irrelevant because there are determinative differences between the two that preclude applying the AEP Ohio result to Duke. Duke settled with all parties as to how it would be compensated for capacity; AEP Ohio did not. The two companies took vastly divergent paths: Duke took a sure deal by committing to charge only market-based capacity prices ***plus*** the $330 million ESSC subsidy that was negotiated among the parties and was not part of its initial SSO proposal. AEP Ohio took the risk of receiving only market-based prices *without* any non-bypassable subsidy and litigated with the parties in its case to pursue cost-based charges for capacity. Even though AEP Ohio succeeded in convincing the Commission to allow it recovery of its embedded capacity costs, that decision is on appeal at the Ohio Supreme Court and is being challenged by numerous parties.[[2]](#footnote-2) AEP Ohio may in the end recover even less than Duke. This difference between the situations of Duke and AEP Ohio is alone enough to be conclusive. But there are many other significant differences discussed in other Intervenors’ briefs that provide more reasons why the two situations are completely different. Without relying on the AEP Ohio decision, there is no basis for even considering Duke’s application in this case – hence, the application must be rejected.

Failure to follow the AEP Ohio outcome in this case would not result in any discriminatory treatment of similarly situated utilities. Parties who settle cases are not similarly situated to parties that litigate cases. The parties who settle do not have terms dictated to them; they agree upon them. It is incongruous for Duke to compare the result that it voluntarily agreed to accept in its ESP Stipulation to the result AEP Ohio achieved through litigation (which after appeals are resolved may actually turn out to be less favorable) and to claim that disparate results are the product of discrimination. The Commission did not impose any compensation scheme on Duke.

It is ironic that Duke bases its claim of discriminatory treatment on the need to “assure the predictability which is essential in all areas of the law.” This entire case is in contravention of that very principal, as Duke is attempting to jettison the predictable compensation scheme all parties agreed to over the objection of all of the other parties to this case. Duke already has a predictable outcome - its compensation mechanism was established in 2011 by agreement long before AEP Ohio’s case was decided and it has not changed. Duke was not harmed by the Commission having *subsequently* established a different compensation scheme in another utility’s litigated case, when that utility could not reach agreement with its customers and competitors.

Duke cannot complain about inconsistency in regulatory treatment when its case was the first one decided. Duke’s complaint is not about how its case was handled (it got exactly what it agreed to), but that AEP Ohio achieved a better result. Duke has no standing to complain about a subsequent litigated case having a different outcome from its settled case.[[3]](#footnote-3)

# IV. DUKE IS NOT ENTITLED TO RECOVER ITS ACTUAL COSTS WHEN IT AGREED OTHERWISE.

The ESP Stipulation, as approved by the Commission, sets forth the terms and conditions applicable to Duke’s provision of competitive retail electric service under Chapter 4928, Revised Code. With regard to capacity pricing, the Stipulation addressed how much PJM would charge wholesale supply auction winners and CRES providers for capacity. It also addressed how much wholesale auction winners would charge Duke pursuant to supplier contracts, *and* how much Duke would charge its retail SSO customers through Riders RC and SCR. Having established the retail charges for capacity to its retail customers and the wholesale charges for capacity to the wholesale auction suppliers (which happen to be the same), there is no room left to also charge retail customers for wholesale capacity service. Wholesale charges are necessarily subsumed within retail prices. It would strain credulity to suggest that Duke intended to reserve the right to impose such an additional charge later, when it knowingly and intentionally abandoned its original SSO plan to charge all retail customers (shopping and non-shopping) a cost-based capacity charge in favor of a market-based capacity charge to be paid by all wholesale suppliers.

Duke understood the risks that FRR entities face when it chose to change RTOs and move from MISO to PJM. The decision was thoroughly analyzed by Duke, including the financial ramifications. It knew what its costs were and the market rates that it would be allowed to charge for capacity. The returns that Duke would earn on its capacity resources were known to it and studied by it before it agreed to the Stipulation. Nothing has changed financially. The only thing that has changed since Duke signed the ESP Stipulation is the AEP Ohio decision.

Duke is not entitled to any rate other than what it agreed to accept in the ESP Stipulation. Duke’s attempt to make this into a constitutional “taking” case is unfounded. Constitutional ratemaking principals have no bearing on Duke’s situation because no capacity rates have been imposed on Duke against its will. Generation service is fully competitive in Ohio and not subject to ratemaking principals. Duke agreed to a comprehensive ESP plan, only one part of which was capacity rates. No one forced Duke to accept the market-based capacity prices – it voluntarily did so. In fact, Duke had a statutory option to withdraw its ESP application and file for a new SSO if it did not like the terms of the plan as ordered by the Commission.[[4]](#footnote-4) Alternatively, Duke could have filed for rehearing of the Order approving the ESP Stipulation.[[5]](#footnote-5) But there are strict time limits within which Duke could do so.[[6]](#footnote-6) Duke could not wait over a year and a half to challenge the ESP, as it did here.

Takings analysis has no applicability to Duke because no one has “taken” its property. Duke finds itself in its current situation strictly through voluntary measures. Duke made an eyes-wide-open decision to realign to PJM, knowing how the capacity market works in that RTO. Duke originally proposed an embedded cost recovery that it knowingly abandoned in favor of market-based capacity rates plus the ESSC. Duke incorporated the terms on which it would be compensated for capacity in a voluntary stipulation that it signed without duress. Duke had an opportunity to reject the ESP plan as confirmed by the Commission in December 2011, but chose to accept it instead. Duke had an opportunity to seek rehearing and appeal any adverse decision on rehearing, but decided to forego that opportunity as well. No one forced Duke to take any of these steps. Hence, constitutional ratemaking principals have no application. The Commission did not require Duke to provide capacity service to its competitors. The Commission did not impose capacity rates on Duke. There was no “taking” and, hence, no duty to provide compensation. There was only a voluntary arrangement where Duke offered up its capacity and agreed to accept the PJM market price.

Even if Duke had been forced to accept market prices against its will (which it was not), that would not constitute a “taking.” As explained by several other parties in their initial briefs, the Ohio General Assembly dictated that generation service would be competitive many years ago. The legislation gave all electric distribution companies the opportunity to recover “transition costs,” *i.e.*, the difference between their prudently incurred costs to provide generation service and those costs that would be recoverable in a competitive market.[[7]](#footnote-7) Duke’s predecessor, The Cincinnati Gas & Electric Co., relinquished its claim to transition costs and the market development period during which transition charges could be charged ended years ago. If there was ever a “taking” with respect to converting generation service from a regulated service to a non-regulated service subject to market forces, Duke’s predecessor had a full and fair opportunity to be compensated for that. Duke cannot go back in time now.

Duke voluntarily became an FRR entity. There is no governmental requirement for Duke to provide the capacity to support the entire load in its footprint. The requirement comes from the private contractual arrangements that Duke assumed by joining PJM. A state compensation mechanism only comes into play *if* the state requires shopping customers or CRES providers to buy capacity service from Duke and establishes a compensation mechanism for that capacity. Otherwise, the PJM tariff requires Duke to accept market based prices. Duke wrongly assumes that the government has required it to supply capacity and that the government is dictating the prices it may charge. Duke is wrong on both counts. Ohio did not force Duke to join PJM. Ohio did not require Duke to supply capacity to competitors. Ohio did not set the PJM market prices. There is no constitutional taking or due process issue here.

# V. THE ESP LAWFULLY ADDRESSED CAPACITY PRICING AND DUKE IS IMPROPERLY ATTEMPTING TO UNDERMINE THE ESP STIPULATION.

It is obvious from the clear terms of the ESP Stipulation, the unambiguous and uncontested testimony of Duke and Staff witnesses at the hearing to confirm the ESP Stipulation, and numerous other facts and circumstances, as explained in every Intervenor’s initial brief, that all pertinent issues surrounding capacity charges were resolved in the ESP Case. Duke’s initial brief did not even bother to address any of that, perhaps because it understands it would be futile to do so. Instead of claiming that the ESP Stipulation does not govern capacity pricing, Duke now tries the tactic of claiming that the capacity provisions of the ESP Stipulation were unlawful. That claim is nonsense and relies on a simplistic and artificial approach to a distinction between wholesale and retail service. This argument itself violates the terms of the ESP Stipulation. Duke agreed in the Stipulation that “the settlement package does not violate any important regulatory principle or practice.”[[8]](#footnote-8) Now Duke claims that it does. Duke also promised “to support the Stipulation and to do nothing, directly or indirectly, to undermine the Stipulation or the Commission’s approval of it.”[[9]](#footnote-9) Now Duke is disregarding that agreement and attempting to jettison significant terms of the ESP Stipulation.

Duke argues that only the statutorily prescribed components identified in R.C. 4928.143 may be included in an SSO plan.[[10]](#footnote-10) Then it contends that capacity is not a subject that is permitted. Duke’s argument is wrong for two reasons: it is now too late to contest the contents of the ESP; and Duke is wrong on the merits of what the SSO statutes allow to be included in an ESP.

In *Columbus Southern Power*, there was no settlement and the Commission decided the terms of the ESP over some parties’ objection. That led to an appeal in which the Ohio Supreme Court found certain errors in the ESP plan. In this case, no one objected to any provision in the ESP, no one sought rehearing and no one appealed. There is no basis to challenge anything about the ESP plan now. At the time, Duke obviously did not think anything in the ESP plan was improper. It agreed to and accepted the plan and supported it with testimony that the ESP Stipulation did not violate any regulatory principles. Any attempt by Duke to disavow portions of the ESP plan as unlawful now is certainly untimely and barred by *res judicata*, waiver and/or estoppel. Duke cannot claim *not* to be trying to alter or undermine the ESP Stipulation when it is arguing that portions of it are not legally authorized. Duke is not standing fully behind the ESP Stipulation as it said it would do. And, if Duke can contend now that capacity issues were not properly included in the ESP Stipulation, what other feature of the ESP Stipulation might Duke try to disavow in the future? Having failed to withdraw the ESP or seek rehearing and appeal the Commission’s Order approving the ESP Stipulation, Duke cannot now be heard to complain about the content of any portion of it.

Second, and more importantly, Duke is absolutely wrong about what may be included in an ESP. Duke contends that capacity is a wholesale service and, therefore, cannot be addressed in an ESP, which it claims is limited to retail service. An ESP is one of two approved methods to provide an SSO, the terms and conditions on which an electric distribution utility will offer retail electric service to non-switching customers. Nothing in the Ohio Revised Code prohibits an ESP from addressing wholesale services as they relate to the SSO.

Ohio law requires an ESP to “include provisions relating to the supply and pricing of electric generation service.”[[11]](#footnote-11) The statute does not distinguish between wholesale and retail components of generation service in this regard. The statute specifically authorizes an ESP to include “the cost of purchased power under the offer, including the cost of energy and capacity.”[[12]](#footnote-12) Duke’s SSO is based entirely upon purchased power, obtained through an auction process, so it was appropriate and necessary for the ESP to state the terms on which Duke would acquire and resell such power, including capacity. Purchased power, including capacity, is a wholesale transaction between Duke and the auction winners, not between Duke and consumers, so the ESP statute makes it necessary to address the wholesale terms on which Duke would obtain capacity for use in the SSO.

An SSO is also required to “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.”[[13]](#footnote-13) One cannot provide a firm supply of electric generation service without generation capacity.

Under Duke’s ESP, all of its customers are supplied by the winners of periodic auctions. The winners of those auctions must enter into supply contracts with Duke covering both capacity and energy. Duke chose to bill its SSO customers using two rate elements – Rider RC for capacity and Rider RE for energy.[[14]](#footnote-14) It was Duke’s idea to bifurcate its retail electric service into these two price components, one for capacity and one for energy. Having done so, in order to explain how the rates for the Rider RC component of its SSO retail electric service would be calculated, it was necessary to discuss how Duke would provide/obtain and pay/be compensated for capacity.[[15]](#footnote-15) Rider RC is not just a collection mechanism, it is also the price that Duke agreed to charge its retail customers for capacity. Duke agreed that the revenue generated by Rider RC (together with any necessary adjustments made through Rider SCR) would reflect *exactly* what PJM charged the SSO auction winners for capacity on Duke’s behalf. Thus, it was necessary in the ESP to address how Duke would supply capacity to the auction winners through PJM, how PJM would charge the suppliers, what the auction winners would charge Duke for capacity pursuant to its supply contracts, and how Duke would convert those capacity charges into retail rates. Rider RC could not be explained or justified without each step of the transaction being explained. This was not only authorized under the ESP statute, it was necessary.

It was also appropriate for the ESP Stipulation to address capacity sales to CRES suppliers. Ohio law requires that an SSO be provided on a “comparable and nondiscriminatory basis.”[[16]](#footnote-16) If all customers or their suppliers are required to purchase capacity service from Duke, for the SSO to be on a comparable and nondiscriminatory basis, the terms on which SSO customers buy capacity would have to be the same as those for non-SSO customers. Since Duke’s plans require all customers to use its capacity (a result naturally flowing from Duke’s membership in PJM where Duke is required to supply all capacity for all customers in its footprint), SSO customers and/or suppliers could not be charged different amounts for the exact same capacity service that Duke supplies to shopping customers through their CRES providers. Thus, it was necessary and appropriate for the ESP Stipulation to address how CRES providers would pay for capacity to assure that SSO customers were treated on a “comparable and nondiscriminatory” basis to others.

Even if Duke was correct that capacity charges cannot be included in an ESP, that would still provide no basis for the relief Duke seeks. If the capacity issues were removed from the ESP Stipulation, the capacity prices would still be exactly the same under the default PJM rules. That would also remove any question whether the Commission has required anyone to purchase capacity from Duke and the prerequisite within the RAA for even considering application of a state compensation mechanism would be absent. In that case, the default compensation provisions of the RAA would control and wholesale suppliers would purchase capacity from Duke at the FZCP, exactly what the ESP Stipulation said.

# VI. THERE IS ONLY ONE POSSIBLE INTERPRETATION OF THE STIPULATION.

Duke claims that the Commission is not bound by the Stipulation, but only speaks through its orders. But in this case, the Commission already spoke through the ESP Order approving the ESP Stipulation without material modification. The ESP Stipulation and the ESP Order are effectively one and the same for purposes of this case. Duke says that the controlling meaning is what the Commission understood it was approving. What the Commission thought it was approving had to be based on the language of the Stipulation itself and the undisputed testimony presented in support of it *before* it approved the ESP Stipulation. In their initial briefs, GCHC/CBI and other parties have presented in detail the unmistakably clear testimony of Duke’s witnesses, Wathen and Jansen, and Staff Witness Turkenton which explain how Duke would be compensated for capacity. Notably absent from Duke’s brief is any explanation of how its testimony in support of the ESP Stipulation can be reconciled with its current position. That is because it cannot.

# VII. CONCLUSION

The Commission cannot allow Duke to recover its legacy costs for its FRR capacity service obligation, or authorize it to defer the difference between such costs and the amount being received pursuant to PJM's auction-based rate. Duke may only be compensated for capacity as provided in the ESP Stipulation. The Commission must deny the Application.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of the foregoing was delivered by electronic mail, on this 26th day of July, 2013, to the parties listed below.

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1. RAA, Schedule 8.1, Section D.8 (emphasis added). [↑](#footnote-ref-1)
2. There certainly appears to be significant doubt whether the AEP Ohio decision is proper under Ohio law. GCHC and CBI were not parties to that proceeding and defer to the arguments of other parties in that case. Certainly, if the AEP Ohio decision was wrong, it would be improper to apply its principles to Duke. Nevertheless, even if AEP Ohio was properly decided, it still provides no basis for Duke to avoid its clear agreement to charge market rates for capacity. [↑](#footnote-ref-2)
3. Duke objected to AEP Ohio seeking rehearing of Duke’s ESP Order because it might potentially prejudice AEP Ohio in a case that had not yet been decided. Despite taking that position then, now that the Commission has decided the AEP Ohio case, Duke is complaining that the AEP Ohio case was decided more favorably to AEP Ohio than the terms of Duke’s settlement. The outcome of the AEP Ohio case had no effect on the agreed outcome of Duke’s case. If Duke’s concern is really about regulatory consistency, perhaps it should be challenging the AEP Ohio decision rather than its own. [↑](#footnote-ref-3)
4. R.C. § 4928.143(C)(2)(a). [↑](#footnote-ref-4)
5. R.C. § 4905.10. [↑](#footnote-ref-5)
6. An application for rehearing must be filed within 30 days of the order complained of. No appeal can be brought without first seeking rehearing and a notice of appeal must be filed within 60 days of the denial of an application for rehearing. R.C. § 4903.11. [↑](#footnote-ref-6)
7. R.C. § 4928.39. The right to recover transition revenues terminated at the end of the market development period, after which the utility is “fully on its own in the competitive market.” R.C. § 4928.38. [↑](#footnote-ref-7)
8. ESP Stipulation, p. 3. [↑](#footnote-ref-8)
9. ESP Stipulation, p. 41, ¶ AA. [↑](#footnote-ref-9)
10. *In re Application of Columbus Southern Power,* 128 Ohio St. 3d 512, 2011-Ohio-1788. [↑](#footnote-ref-10)
11. R.C. § 4928.143(B)(1). [↑](#footnote-ref-11)
12. R.C. § 4928.143(B)(2)(a). [↑](#footnote-ref-12)
13. R.C. § 4928.141(A). [↑](#footnote-ref-13)
14. In addition, Rider SCR is designed to reconcile any over or under recovery of actual supplier costs through Riders RC and RE due to variations in load or customer classes arising from the conversion of wholesale costs into retail rates. [↑](#footnote-ref-14)
15. Because of the circuitous nature of Duke’s SSO offering, it is both the buyer and seller of capacity. It first sells capacity to PJM and/or auction winners, then buys that capacity from the auction winners through supply contracts, then sells the capacity again to SSO customers. The price of capacity in each transaction is exactly the same. [↑](#footnote-ref-15)
16. R.C. § 4928.141. [↑](#footnote-ref-16)