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VIA OVERNIGHT DELIVERY

PUCO

November 15, 2006

Docketing Division  
Public Utilities Commission of Ohio  
180 East Broad Street  
Columbus, OH 43215

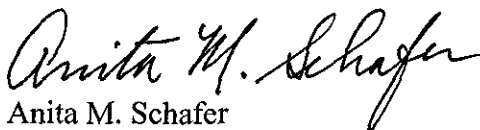
Re: Case No. 05-725-EL-UNC, et al.

Dear Docketing Division:

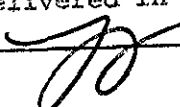
Enclosed please find an original and eighteen copies of the Redacted Version of the Supplemental Testimony of Charles R. Whitlock. Please stamp file and return to me the extra three copies of the filing. Also enclosed you will find an original and eighteen copies of a Motion for Protective Order and the Confidential Version of the Supplemental Testimony of Charles R. Whitlock. Please stamp file and return to me in the envelope provided the extra copies of the motion.

Should you have any questions please do not hesitate to call me at 513-287-3842.

Very truly yours,

  
Anita M. Schafer  
Senior Paralegal

Enclosure

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REDACTED VERSION

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BEFORE

**PUCO THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of	)	
The Cincinnati Gas & Electric Company to	)	Case No. 05-725-EL-UNC
Modify its Quarterly Fuel and Purchase	)	
Power Component of its Market Based	)	
Standard Service Offer.	)	
In the Matter of the Application of	)	Case No. 05-724-EL-UNC
The Cincinnati Gas & Electric Company to	)	
Adjust and Set its System Reliability Tracker	)	
Market Price	)	
In the Matter of the Application of	)	
Duke Energy Ohio, Inc. to Modify its	)	Case No. 06-1068-EL-UNC
Quarterly Fuel and Purchase Power	)	
Component of its Market Based	)	
Standard Service Offer	)	
In the Matter of the Application of	)	
Duke Energy Ohio, Inc. to Adjust and Set its	)	Case No. 06-1069-EL-UNC
System Reliability Tracker	)	

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**SUPPLEMENTAL DIRECT TESTIMONY OF****CHARLES R. WHITLOCK****ON BEHALF OF****DUKE ENERGY OHIO**

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DATE: November 16, 2006

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## **ATTACHMENTS**

Attachment CRW-1

## **I. INTRODUCTION**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Charles R. Whitlock and my business address is 139 East Fourth  
3 Street, Cincinnati, Ohio 45202.

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

5 A. I am employed by Duke Energy Americas, an affiliate of Duke Energy, as  
6 President, Commercial Asset Management ("CAM").

7 **Q. ARE YOU THE SAME CHARLES R. WHITLOCK WHO PREVIOUSLY**  
8 **FILED TESTIMONY IN THIS PROCEEDING?**

9 A. Yes.

## **II. PURPOSE OF TESTIMONY**

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**  
11 **PROCEEDING?**

12 A. The purpose of my supplemental testimony is to respond to certain Management  
13 Audit Recommendations contained in pages 1-9 through 1-10 of the *Report of the*  
14 *Financial And Management/Performance Audit of the Fuel and Purchased Power*  
15 *Rider of Duke Energy Ohio*. Specifically, I address the Auditor's  
16 recommendations with respect to: 1.) Treatment of margins realized from the  
17 [REDACTED] 2.) DE-Ohio's active management of the coal,  
18 emission allowance, and forward power purchases portfolio; 3.) Requiring coal  
19 suppliers to permit the resale of coal; and 4.) The purchase of reserve capacity  
20 from the Midwest generating assets, previously owned by DENA (DENA Assets).

### **III. DISCUSSION**

1 **Q. HAVE YOU REVIEWED THE AUDITOR'S REPORT OF THE**  
2 **FINANCIAL AND MANAGEMENT/PERFORMANCE AUDIT OF THE**  
3 **FUEL AND PURCHASED POWER RIDER OF DUKE ENERGY OHIO?**

4 A. Yes.

5 **Q. DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**  
6 **REGARDING THE TREATMENT OF NET MARGINS DERIVED FROM**  
7 **[REDACTED]?**

8 A. Yes. The Auditor recommends that DE-Ohio pass through the entire margin  
9 related to the [REDACTED] and concludes that the total margin from the  
10 re-sale of this coal during the audit period was \$[REDACTED].

11 **Q. DOES DE-OHIO AGREE WITH THE AUDITOR'S RECOMMENDATION?**

12 A. No. DE-Ohio believes that the recommendation is too broad. A portion, but not  
13 all, of the benefits realized under the [REDACTED] should flow through  
14 to non-residential Rider FPP consumers.

15 **Q. PLEASE EXPLAIN THE [REDACTED].**

16 A. In March and April 2002, DE-Ohio entered into two contracts with [REDACTED]  
17 for the delivery of specific amounts and types of coal during 2002, 2003, 2004  
18 and 2005. In August 2003, [REDACTED] defaulted on these agreements, failing to  
19 deliver as contractually obligated. After extensive negotiation, [REDACTED]  
20 [REDACTED] DE-Ohio and [REDACTED] reached a financial settlement  
21 ([REDACTED]) regarding the default on the prior contracts.  
22 [REDACTED] agreed to deliver a specific quantity of NYMEX quality coal going

1 forward in 2006, 2007 and 2008 at a [REDACTED]

2 [REDACTED].

3 **Q. PLEASE EXPLAIN WHY DE-OHIO BELIEVES ONLY A PORTION OF**  
4 **THE MARGINS DERIVED FROM THE [REDACTED]**  
5 **SHOULD FLOW THROUGH TO NON-RESIDENTIAL RIDER FPP**  
6 **CONSUMERS.**

7 A. As I previously mentioned, the two original contracts with [REDACTED] required  
8 delivery of coal during 2002, 2003, 2004, and 2005. Rider FPP was effective  
9 beginning January 1, 2005 for non-residential consumers and January 1, 2006 for  
10 residential consumers. Prior to January 1, 2005, DE-Ohio's market price included  
11 fuel prices frozen at the level approved by the Commission in Case No. 99-1658-  
12 EL-ETP. In other words, prior to January 1, 2005, neither the [REDACTED]  
13 [REDACTED] were passed through to  
14 consumers. Accordingly, the portion of the [REDACTED] that  
15 corresponds to the coal that was to be delivered prior to January 1, 2005, is  
16 remuneration for damages sustained by DE-Ohio, not retail consumers. This  
17 portion of the [REDACTED] should not flow through Rider FPP.  
18 However, a portion of the [REDACTED] does replace coal  
19 deliveries that were to have occurred in 2005. Consequently, some of the costs  
20 incurred during 2005 were partially borne by non-residential Rider FPP  
21 consumers. Therefore, the affected Rider FPP consumers should share in the  
22 respective margins on [REDACTED] based upon  
23 the portion of the original contract delivery for 2005.

1   **Q.   PLEASE EXPLAIN HOW DE-OHIO PROPOSES TO FLOW THROUGH**  
2   **A PORTION OF THE [REDACTED]**  
3   **TO RIDER FPP CONSUMERS.**

4   A.   Assuming [REDACTED] does not default on the [REDACTED] DE-Ohio estimates  
5   that 19.3% of benefit of the [REDACTED] should flow through to non-  
6   residential Rider FPP consumers via a credit to the Rider FPP market price. Since  
7   [REDACTED] previously defaulted on its original delivery contract, it would be  
8   imprudent to pass through the full benefit of the [REDACTED] prior to actual receipt  
9   of the [REDACTED]. Therefore, on a going forward basis, we propose to pass  
10   through the appropriate share of such credits as the margins are realized.

11           As previously mentioned, the [REDACTED] became effective in  
12   November 2005 and was for future deliveries in 2006, 2007, and 2008. To date,  
13   [REDACTED] has complied with the [REDACTED]. Therefore, value  
14   associated with the margins on coal already delivered under the [REDACTED] and  
15   proportional to the defaulted 2005 deliveries, is owed to non-residential Rider  
16   FPP consumers. DE-Ohio proposes to credit this proportional amount to non-  
17   residential consumers through Rider FPP following the Commission's approval in  
18   this case.

19   **Q.   PLEASE   EXPLAIN   HOW   DE-OHIO   CALCULATED   THE**  
20   **PROPORTIONAL SHARE OF THE [REDACTED] TO**  
21   **BE FLOWED THROUGH TO NON-RESIDENTIAL RIDER FPP**  
22   **CONSUMERS.**

1 A. The calculation of the allocation is set forth in Attachment CRW-1 to my  
2 supplemental testimony. As I previously mentioned, the [REDACTED]  
3 is for [REDACTED], replacing  
4 deliveries that did not occur in 2003, 2004 and 2005. The 2005 deliveries, had  
5 they occurred, amounted to 40.57 % of the total quantity of coal under the  
6 defaulted contracts. Of the 40.57% of coal, that would have been delivered,  
7 approximately 47.6 % of that would have been allocated to non-residential Rider  
8 FPP consumers. Therefore, DE-Ohio is proposing to flow through the margins on  
9 19.3% of the coal to be delivered under the [REDACTED] to non-  
10 residential FPP consumers (40.57% times 47.6%).

11 **Q. DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**  
12 **REGARDING DE-OHIO'S ACTIVE MANAGEMENT OF FUEL, POWER**  
13 **AND EMISSION ALLOWANCES?**

14 A. Yes. The Auditor recommends that DE-Ohio adopt "traditional utility  
15 procurement strategies related to the procurement of coal, power, and emission  
16 allowances and cease its 'active management' through the balance of the RSP  
17 period."

18 **Q. DOES DE-OHIO AGREE WITH THE AUDITOR'S**  
19 **RECOMMENDATION?**

20 A. No. The Auditor's recommendation contradicts the stipulation and Commission's  
21 Opinion and Order in Case No. 05-806-EL-UNC. The active management of the  
22 emission allowance, fuel and forward power purchases portfolio is a "best  
23 practice" management technique that was specifically agreed to in the December



1 2005 Stipulation and approved by the Commission in its February 2006 Opinion  
2 and Order.

3 The Auditor made a similar recommendation, regarding “regulated utility  
4 industry practice,” in the previous Rider FPP audit report and it was not adopted  
5 by this Commission. As DE-Ohio explained in its supplemental testimony in its  
6 last Rider FPP case, an actively managed portfolio allows gross margins to be  
7 continuously locked-in based on market signals. In turn, DE-Ohio is able to  
8 maximize the value of its generating asset portfolio while managing these  
9 inherent risks in the most cost effective manner relative to daily changes in the  
10 market.

11 **Q. PLEASE EXPLAIN WHY THE AUDITOR’S PROPOSED PERIODIC**  
12 **MANAGEMENT TECHNIQUE IS IMPRUDENT.**

13 **A.** The Auditor recommends that DE-Ohio no longer seek to flatten its position on a  
14 daily basis, but rather “adjust its SO<sub>2</sub> position on no more than a quarterly basis  
15 unless specific events dictate otherwise.” The Auditor offers no opinion on what  
16 constitutes “specific events” which would warrant adjusting the position on a  
17 more frequent basis.

18 Essentially, the Auditor is now recommending that DE-Ohio make a  
19 speculative bet every 90 days in the coal, emission allowance, and power markets.  
20 DE-Ohio believes that the Auditor’s recommended approach poses a significant  
21 risk to consumers. For instance, if DE-Ohio locks in a price by purchasing coal  
22 on a date certain and the price subsequently falls while power prices escalate,  
23 consumers cannot benefit from coal purchases at the lower price. Similarly, if the

1 price of coal rises while forward power prices decline, consumers cannot benefit  
2 from the sale of the coal at the higher price in the market. In either scenario,  
3 consumers would suffer.

4 Additionally, the Auditor's recommendation fails to recognize that DE-  
5 Ohio is not a regulated utility for the sale of electricity. It is not permitted to  
6 recover generation investments plus a reasonable return through the regulatory  
7 process, nor is it permitted to recover increases in many other costs not included  
8 in Rider FPP. Rider FPP is fully avoidable by all consumers that purchase  
9 generation from a competitive retail electric service provider. Traditional  
10 regulated utility practice is not appropriate for managing all of the risks inherent  
11 in a deregulated environment.

12 In its previous audit report in Case No. 05-806-EL-UNC, this same  
13 Auditor recommended that DE-Ohio true-up the allowance allocations and the  
14 auction proceeds on an annual basis. Clearly, with its present recommendation of  
15 a 90-day position adjustment, followed by the caveat of "unless specific events  
16 dictate otherwise," the Auditor recognizes the benefits of a more frequent position  
17 review.

18 Finally, it is important to note that DE-Ohio manages these variables for  
19 Rider FPP consistent with its management of these variables for all of its sales of  
20 deregulated electricity.

21 **Q. WHAT ARE THE BENEFITS OF AN ACTIVE MANAGEMENT**  
22 **PROCUREMENT APPROACH OVER "TRADITIONAL UTILITY**  
23 **PROCUREMENT STRATEGIES?"**

**CHARLES R. WHITLOCK SUPPLEMENTAL DIRECT**

1 A. The benefits of active management are that DE-Ohio may make rational  
2 economic decisions based on the market price of coal, power and emission  
3 allowances, and reduce market price risk on behalf of consumers. DE-Ohio will  
4 enter into transactions based on market commodity prices and all of the benefits  
5 of these transactions are credited to consumers. Just as there are examples where  
6 a bet on prices at a date certain will yield lower costs than active management,  
7 there are also examples where the same bet will yield higher costs. The risk lies  
8 in when to place the bet. Active management limits the market risk and reduces  
9 volatility in Rider FPP. In this case, the Auditor agrees, at page 2-14 of the report  
10 that DE-Ohio's active management techniques with respect to "quality swaps"  
11 have resulted in a substantial savings for Rider FPP consumers. Similarly, the  
12 Auditor found that if DE-Ohio had engaged in active management with respect to  
13 flattening its emission allowance position beginning on October 1, 2005, and prior  
14 to the Commission's Order in February 2006, in the last FPP case, DE-Ohio  
15 would have lowered consumer costs by over \$14 million in one short period. It is  
16 clear that active management is commercially sound and provides benefits to  
17 consumers, relative to "traditional utility procurement strategies."

18 **Q. DOES THE AUDITOR MAKE ANY FURTHER RECOMMENDATIONS**  
19 **REGARDING DE-OHIO'S ACTIVE MANAGEMENT PHILOSOPHY?**

20 A. Yes, the Auditor also states that DE-Ohio should "develop and implement a  
21 portfolio strategy such that it purchases coal through a variety of short, medium  
22 and long-term agreements with appropriate supply and supplier diversification  
23 with credit worthy counterparties."

1    **Q.    IS DE-OHIO PURCHASING COAL THROUGH A VARIETY OF SHORT,**  
2           **MEDIUM AND LONG-TERM AGREEMENTS WITH APPROPRIATE**  
3           **SUPPLY AND SUPPLIER DIVERSIFICATION WITH CREDIT**  
4           **WORTHY COUNTERPARTIES?**

5    A.    Yes. DE-Ohio does in fact have short, medium and long-term contracts in its  
6           portfolio with multiple suppliers and requires all suppliers to meet specific credit  
7           requirements. This recommendation is simply a result of the Auditor's  
8           misunderstanding of DE-Ohio's portfolio management.

9    **Q.    DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**  
10           **REGARDING THE RESALE OF COAL BY DE-OHIO?**

11   A.    Yes, the Auditor recommends that as long as the Rider FPP is in effect, coal  
12           suppliers should not be required to allow the resale of their coal.

13   **Q.    DOES DE-OHIO IN FACT REQUIRE THE POTENTIAL TO RESELL**  
14           **COAL AS A CONDITION TO CONSIDER OFFERS FROM SUPPLIERS?**

15   A.    No, it does not. DE-Ohio does include the resale of coal as a condition on its  
16           RFPs but does not exclude an offer from consideration if the supplier will not  
17           permit the resale of coal.

18   **Q.    WHY IS THE ABILITY TO RESELL COAL A BENEFIT TO**  
19           **CONSUMERS?**

20   A.    As part of the active management of coal inventories, the ability to resell coal  
21           permits DE-Ohio to manage price risk by selling an "expensive" coal, based on  
22           the then market price of coal and emission allowances, and burning a  
23           comparatively less expensive coal, also based on market prices. Consumers

1 benefit from the sale transaction because any resulting margin is credited against  
2 the fuel cost in the calculation of the Rider FPP market price, and the exposure to  
3 market volatility is greatly reduced. In its report, the Auditor goes so far as to  
4 quantify this benefit and recognized that DE-Ohio's active management with  
5 respect to quality swaps of coal created a \$14 million credit for Rider FPP  
6 consumers.

7 **Q. DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**  
8 **REGARDING THE PURCHASE OF RESERVE CAPACITY FROM THE**  
9 **LEGACY DENA ASSETS FOR INCLUSION IN RIDER SRT?**

10 A. Yes. The Auditor recommends that the legacy DENA Assets should not be  
11 eligible for inclusion in Rider SRT.

12 **Q. DOES DE-OHIO AGREE WITH THIS RECOMMENDATION?**

13 A. No.

14 **Q. PLEASE EXPLAIN WHY DE-OHIO BELIEVES THE DENA ASSETS**  
15 **SHOULD BE AVAILABLE FOR INCLUSION IN CAPACITY**  
16 **PURCHASES AS PART OF THE RIDER SRT?**

17 A. The purpose of the SRT is to ensure adequate capacity to meet DE-Ohio's  
18 obligation as provider of last resort (POLR). At present, this obligation requires  
19 DE-Ohio to maintain a 15% capacity reserve margin. There are limited assets  
20 located in the MISO footprint that meet MISO's designated network resource  
21 (DNR) requirements. Consumers should have access to every possible economic  
22 option with respect to available generating assets. The risks to its consumers are  
23 substantial and increasingly likely if DE-Ohio does not have access to market

1 price capacity during a time of need. This is particularly true if a capacity  
2 purchase must be made in the spot market where prices are exceptionally volatile.  
3 It is in the consumer's best interest if DE-Ohio has the ability to avoid such a risk  
4 through a readily available and reasonably priced alternative regardless of the  
5 source of supply.

6 Additionally, on a daily operational level, the ability to include the DENA  
7 Assets makes sense. MISO requires approximately 4% daily reserve margin from  
8 market participants such as DE-Ohio. DE-Ohio should be permitted to satisfy its  
9 reserve margin in the most economic manner. Limiting the options through  
10 which DE-Ohio may satisfy its capacity obligation by arbitrarily excluding  
11 specific generators from consideration can only increase the cost to consumers, if  
12 the capacity is available at all.

13 DE-Ohio transacts to meet its capacity requirements in the long-term  
14 market. While DE-Ohio cannot predict that reasonably priced capacity will be  
15 unavailable in the long-term capacity market, there is no economic justification to  
16 deprive consumers of the opportunity to purchase the most reasonably priced  
17 capacity available simply because the capacity stems from a DENA Asset.

18 In short, if the DENA Assets provide the most economic option, it does  
19 not make sense to exclude them from consideration.

20 **Q. WHAT IS THE AUDITOR'S JUSTIFICATION FOR RECOMMENDING**  
21 **THAT THE DENA ASSETS SHOULD NOT BE INCLUDED AS PART OF**  
22 **RIDER SRT CAPACITY PURCHASES?**

1 A. First, the Auditor does not believe consumers are paying more for capacity in the  
2 market than if purchased from the DENA Assets. Second, the Auditor believes  
3 that purchases from affiliates are problematic and reduces competitive bid offers.  
4 Third, the Auditor believes the auditing of affiliate transactions is burdensome.  
5 Fourth, the Auditor believes that given the condition of the capacity market, DE-  
6 Ohio should be able to sell its legacy DENA capacity on the open market.

7 **Q. WHAT IS YOUR RESPONSE TO THESE CRITICISMS?**

8 A. DE-Ohio recognizes the issues of documenting a market price for a transaction,  
9 where it owns the capacity purchased. DE-Ohio accepts the burden of  
10 demonstrating its purchases at a market price by comparison to other capacity  
11 available in the market. DE-Ohio is constantly probing the market and making  
12 decisions identifying the best offers for its consumers. If DE-Ohio is permitted to  
13 consider DENA Assets for capacity purchases through Rider SRT, DE-Ohio will  
14 commit to providing the Commission in future audit proceedings with a written  
15 record of the concurrent bids and offers to show that the market price for capacity  
16 is equal to or greater than the market price associated with a capacity purchase  
17 from the DENA Assets.

18 The Auditor's concern about the reduction of competitive bid offers is  
19 simply unwarranted. The vast majority of competitive bidders are not aware of  
20 the nuances of DE-Ohio's exclusion of DENA Assets. As far as the outside world  
21 is concerned, the DENA Assets are part of DE-Ohio's generating assets. DE-  
22 Ohio is currently receiving and accepting competitive bids. There is no reason to  
23 believe that DE-Ohio will not continue to do so. Additionally, there is no reason

1 to believe that DE-Ohio's motives are nefarious and that the Company will not  
2 continue to act in the best interests of its consumers.

3 The Auditor's concerns about the added "burden" regarding the mechanics  
4 of auditing DENA transactions should not be a determining factor. DE-Ohio  
5 accepts the burden to prove the prudence of its transactions. The Auditor's  
6 reluctance to perform additional work is immaterial. DE-Ohio will provide  
7 documentation of the concurrent competitive bids during the audit period along  
8 with the purchase price for capacity from the DENA Assets. This should  
9 demonstrate the prudence of DE-Ohio's management decisions.

10 Lastly, the Auditor's position with respect to the "size of the market" and  
11 ability to sell legacy DENA capacity in the market is dubious. If the Commission  
12 does not permit DE-Ohio to purchase capacity from its DENA Assets to satisfy its  
13 Rider SRT obligations, DE-Ohio will continue to sell the capacity on the open  
14 market. However, the Auditor should recognize that it is not in the best interests  
15 of DE-Ohio's consumers to deprive them of a viable economic market option  
16 simply because of its status as a legacy DENA Asset. There is limited capacity in  
17 the MISO footprint that meets MISO's DNR requirement. Consumers should  
18 have access to all of it.

19 **Q. ARE ANY OF THE DENA ASSETS CURRENTLY BEING**  
20 **ECONOMICALLY DISPATCHED WITHIN THE MISO FOOTPRINT?**

21 A. Yes, the Vermillion generating station is in MISO and is being dispatched.

22 **Q. DO ALL OF THE DENA ASSETS MEET MISO'S DNR**  
23 **REQUIREMENTS?**

CHARLES R. WHITLOCK SUPPLEMENTAL DIRECT



1 A. Yes. All the DENA Assets meet MISO's DNR Requirements. As I mentioned  
2 previously, Vermillion is the only DENA asset actually located in MISO. The  
3 other assets are located in the PJM market. However, their location should not  
4 exclude them from consideration for Rider SRT capacity purchases. PJM DENA  
5 assets could be a more economical solution. I believe that Ohio consumers will  
6 benefit from having access to DENA Assets.

#### IV. CONCLUSION

7 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

8 A. Yes.

**Estimated Benefit to Rider FPP Non-Residential Customers**

Line No.	Description	Fuel Type		Total
		Midsulfur contract	Compliance	
1	Date signed			
2	Contract No.			
	Scheduled Shipments (tons):			
3	2002			
4	2003			
5	2004			
6	2005			
7	Total Scheduled Shipments			
	Actual Shipments (tons):			
8	2002			
9	2003			
10	Total Actual Shipments			
11	Undelivered Tonnage (line 7 - line 10)			
12	2005 Portion of Undelivered Tonnage (line 6 + line 11)			
13	2005 Load Ratio of Non-Residential Rider FPP Customers (see page 2 of 2)			
14	Net Allocable to Non-Residential Rider FPP Customers (line 12 * line 13)			

**Estimated Non-Residential Share of 2005 Rider FPP Load**

Month	Total Generation After Losses (kWh)	Sales Subject to FPP (kWh)	Percent of Total
January 2005			
February 2005			
March 2005			
April 2005			
May 2005			
June 2005			
July 2005			
August 2005			
September 2005			
October 2005			
November 2005			
December 2005			
Total			