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The Public Utilities Commission of Ohio

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November 16, 2006

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

RE: *In the Matter of the Transmission Rates Contained in the Rate Schedules of Duke Energy Ohio and Related Matters*, Case No. 05-727-EL-UNC

Dear Docketing Division:

Enclosed please find the Staff's Review and Recommendation in response to the Commission's request that Staff examine the costs included in Duke Energy-Ohio's Transmission Cost Rider (TCR).

Sincerely,

Robert Fortney

Robert Fortney
Chief, Rates and Tariffs Division
Public Utilities Commission of Ohio

Enclosure
Cc: Parties of Record

RF:djb

Staff's Review and Recommendations

Duke Energy Ohio
Case No. 05-727-EL-UNC

By Entry issued November 29, 2005, in Case No. 05-727-EL-UNC, the Commission directed the Staff to further review the costs in Duke Energy-Ohio's (Company) application to determine the appropriateness of the costs the Company has included in its Transmission Cost Rider (Rider TCR or Rider). The Staff was further directed to assess the Company's operating practices within the Midwest Independent System Operator (MISO), to ensure the costs which may be controlled or influenced by those operating practices have been minimized.

Summary

The Staff finds that the costs included in the Rider are FERC-approved regional transmission organization (RTO), transmission or ancillary service costs that are assessed to the Company as a result of the Company providing service to retail customers in Ohio and are appropriately included in the rider. Many of the costs vary on a monthly basis and are appropriately included in a Rider that is updated and reconciled on a periodic basis.

Staff finds that the Rider includes certain costs that may be controllable by the Company. Staff, through discussions with the Company and MISO, has been informed that there are incentives in place to minimize these controllable costs. However, Staff believes that the Company's operating practices and procedures should be evaluated on an on-going basis. The Staff finds that, although these costs may be included in the Company's Rider and subject to the automatic approval process, a biennial review of these costs should be performed to determine if the Company's management and operating processes minimize controllable costs. Following the review, any necessary adjustments should be included in the next update filing. The costs Staff believes are controllable are generally the MISO market-related costs, such as net congestion costs[1], revenue

[1] Per Case No. 06-1068-EL-UNC, the Company is proposing to transfer net congestion and losses to Rider FPP (Fuel and Purchased Power). If the transfer is approved these costs will be audited as part of the Company's Rider FPP.

sufficiency guarantee (RSG) costs, and uninstructed deviation costs. See Exhibit I for a summary of Staff's findings.

Staff recommends that on a biennial basis, beginning with its update filing for rates to become effective June 2007, the Company should provide a detailed report of each of the costs identified as controllable by the Staff, including all actions taken by the Company to minimize these costs. The Staff recommends that the Commission Order include a list of the costs to be reviewed as well as a list of issues that the Company should address in its next update. See Exhibit II below.

In addition, the Commission Staff will perform an audit of the costs recovered by the Rider to verify the accuracy of the charges and to ensure that the costs included reflect only those charges assessed to the Company to provide service to its retail customers in Ohio. This audit will be performed with each update filing. However, the Company's filing on October 16, 2006, updated on November 3, 2006, is the first filing that includes a reconciliation adjustment. As a result of the large amount of data that must be reviewed, Staff's audit of the reconciliation adjustment will not be complete within the 45-day review period. At this point in its audit, Staff has found no reason to suspend the rates. Staff will continue its review over the next several months and any necessary adjustments will be made in the next update filing.

Discussion

Administrative Costs

Administrative costs are assessed by MISO to recover the expenses incurred to construct and operate its RTO facilities in accordance with its FERC-approved tariff. Administrative costs are assessed to all transmission customers or market participants and are generally based on the level of load required or generation injected or withdrawn from the system. These costs include:

Schedule 10
This is MISO's main administrative fee schedule for MISO Cost Recovery. It is assessed to transmission customers and owners. Each month, MISO determines two rates, a "Reserved Capacity Rate" and an "Energy Rate" for application under this section. The two rates are necessary because each will be multiplied by a different type of billing determinant. The Reserved Capacity Rate will be

multiplied by billing units of Reserved Capacity, and the Energy Rate will be multiplied by billing units of MWhs of scheduled energy based on reserved load and usage of transmission service.

Schedule 16
This administrative fee is designed to recover costs associated with administering the Financial Transmission Rights (FTRs) markets. It is assessed to FTR holders (which are usually Load Serving Entities (LSE) based on the number of FTRs they own. The rate for this schedule is set each month.

Schedule 17
This administrative fee is designed to recover the costs of MISO's market operations. It is assessed to market participants for all activity in the market, including injections, withdrawals, imports, exports, and virtual transactions. The rate for this schedule is set each month.

Schedule 10 FERC
This administrative fee is designed to recover FERC annual charges. It is assessed to transmission customers based on the MWh of transmission service.

Staff has determined that these administrative costs are not controllable by the Company and are incurred by the Company as a result of providing service to its retail customers in Ohio. Staff finds that these costs are appropriately included in the Rider. However, the amount of the costs to be passed through shall be audited to ensure that only actual costs associated with serving retail customers in Ohio are passed through to Ohio retail customers.

Traditional Transmission/Ancillary Service (AS) Costs

Schedule 1 (Scheduling, System Control & Dispatch Service),
This ancillary service must be purchased by transmission customers. The schedule is contained in the MISO Open Access Transmission Tariff (OATT) and the rates are uniform for all customers and are based on the sum of transmission owner revenue requirements for these services.

Schedule 2 (Reactive Supply & Voltage Control)
This ancillary service must be purchased by transmission customers. MISO calculates rates for each pricing zone in the Transmission System. The charges collected under this Schedule 2 represent a pass through of costs, based on the annual cost-based revenue requirements or cost-based rates of those Qualified Generators providing service pursuant to Schedule 2.

Schedule 3 (Regulation and Frequency Response)

This ancillary service must be purchased by transmission customers. The Regulation and Frequency Response Service Purchase Obligation for load located in Reliability First Corporation (RFC) territory[2]. The rates for this service are contained in the Company's FERC-approved OATT.

Schedules 5 & 6 (Operating Reserves-spinning & supplemental)
These ancillary services must be purchased or the transmission customer must make alternative comparable arrangements to satisfy its Spinning and Supplemental Reserve Service Purchase Obligations in RFC territory. The rates for this service are contained in the Company's FERC-approved OATT.

MISO is currently developing ancillary service markets for Regulation and Operating Reserves (Spinning and Supplemental). Once these markets are established it is expected that the Company's current ancillary service schedules may be eliminated or modified to reflect the market based structure of the offered services.

Schedule 9 (Network Integration Transmission Service)
This is the standard transmission schedule to recover embedded costs of the transmission system. Schedule 9 rates are calculated using Attachment O of the MISO OATT; however, each company has its own rates to recover its specific revenue requirement. A transmission customer must pay for transmission usage under the MISO OATT.

These costs have historically been included in the retail rate tariffs of the Company. Prior to Senate Bill 3 (SB3) and the unbundling of rates, the Company was required to file for rate increases at this Commission to recover transmission revenue requirements. As a result of the unbundling of rates the transmission and AS rates were unbundled and are now based on the transmission and AS rates approved by FERC.

In MISO, a transmission owner's revenue requirement is automatically adjusted once a year based upon a FERC-approved formula rate included in the MISO OATT as Attachment O. The transmission rates are effective beginning July 1 of each year and are adjusted each year.

As a result of the automatic adjustment of these rates, Staff finds that they are appropriately included in a Rider that is also periodically adjusted. These are necessary costs to provide service to its Ohio retail customers and are not controllable by the Company.

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[2] Formerly, the East Central Area Reliability Council ("ECAR").

MISO Uplift Costs

Revenue Sufficiency Guarantee (RSG)
RSG costs are still under review and the Staff makes no recommendation at this time in regard to appropriateness of the inclusion of these costs in its Rider TCR. However, Staff does recommend that the Company be authorized to include these costs in the Rider until the Commission makes its determination of the appropriateness of such costs. Any necessary adjustments should be made in the update filing subsequent to the Commission determination.

The Office of Consumers Counsel (OCC) filed comments on June 5, 2006 in regard to RSG costs. The comments note that on April 25, 2006, the FERC issued an order in Docket No. ER04-691, questioning MISO's assessment of RSG charges and RSG allocations to customers. FERC directed MISO to recalculate RSG charges since April 1, 2005 based upon FERC findings and issue refunds and charges as necessary. On May 17, 2006, FERC extended the time for MISO to comply until such time as the matters are considered on rehearing. OCC requested the Commission to review the RSG charges and suspend modification to the TCR Rider pending the outcome of such review.

On June 14, 2006, the Commission issued an Entry suspending the proposed rates until such time that the Commission orders otherwise and directed Staff to continue its review of the costs included in the Rider TCR.

On October 26, 2006, FERC issued its *Order on Rehearing* in Docket No. ER04-691-074 and reversed its decision that required MISO to issue certain refunds related to RSG.

In addition, the Company has stated in its Application, filed October 16, 2006, that any refunds ordered by FERC and, are due to its retail customers, will be included in its Rider TCR. In addition, the Staff believes the structure of the Rider TCR, which includes a true-up mechanism, already ensures the Company will pass through to its retail customers any refunds or credits issued by MISO. The true-up mechanism will capture any additional costs or credits assessed to the Company as a result of any final FERC decision.

Revenue Neutrality Uplift (RNU)
MISO is a not-for-profit entity and as a result maintains revenue neutrality at the end of the day. When MISO is not revenue neutral it must uplift certain costs across its entire footprint to maintain revenue neutrality. These costs are assessed to all load in the MISO footprint. The Company has no control over

these costs and they are assessed to the Company as a result of providing service to its Ohio retail customers.

Market Related Costs

Net Congestion

This cost/credit is directly related to the MISO's energy markets and the use of Locational Marginal Pricing (LMP) to price electricity. Congestion cost is one of three components of LMP (the other two are energy and marginal losses) and is incurred by the Company to provide service to its Ohio retail customers. In addition to being assessed congestion costs/credits based on the LMP, the Company is also allocated FTRs which entitles the Company to a revenue stream based on the value of the FTRs. Congestion cost/credit is netted against FTR credits/cost to produce a net result. Staff finds that this net amount, whether positive or negative, is appropriately included the Rider.

However, Staff also finds that the Company may have some control over the FTRs that it is allocated or acquires, and the FTR portfolio that it manages. Staff *recommends that the Company's management practices and policies be audited* to ensure that such policies and practices will minimize net congestion costs.

In the October 16, 2006 Rider TCR update filing, the Company indicated that it has proposed to transfer net congestion and losses to its Fuel and Purchase Power Rider (Rider FPP). The Company states that there is a clearer nexus between such costs and Rider FPP[3]. These transfer of these costs to Rider FPP, if approved by the Commission, would be included in Rider FPP beginning January 1, 2007.

Net Losses

This cost is directly related to the MISO energy markets and the use of LMP to price electricity. Marginal Losses is a component of the LMP price along with energy and congestion. Transmission losses have historically been included in rates as an average cost. Under LMP pricing in MISO, marginal losses are utilized. As a result of using marginal losses to establish LMP prices, MISO collects a surplus of loss revenues. Such surplus is allocated back to the market participants and thus Net Losses included in the Rider are a net result of marginal loss charges and the allocation of the marginal loss surplus. Staff finds that the Company incurs these costs as a result of providing service to its Ohio retail customers.

[3] The Company has proposed to transfer net congestion and losses to Rider FPP in Case No. 06-1068-EL-UNC.

Staff finds that the Company may have some control over net losses and as a result Staff recommends that the Company's management practices and policies be audited to ensure that such policies and practices will minimize net losses.

In the October 16, 2006 Rider TCR update filing, the Company indicated that it has proposed to transfer net congestion and losses to its Fuel and Purchase Power Rider (Rider FPP). The Company states that there is a clearer nexus between such costs and Rider FPP. These transfer of these costs to Rider FPP, if approved by the Commission, would be included in Rider FPP beginning January 1, 2007.

Uninstructed Deviation

This is a penalty charge for not following MISO dispatch instructions. The Company has indicated that since it is a control area it must sometimes deviate from its instructions in order to balance the Duke balancing zone. Staff finds that this cost is controllable by the Company. Staff recommends that the Company's management practices and policies be audited to ensure that such policies and practices will minimize costs associated with uninstructed deviations.

Inadvertent Distribution

Charge/Credit based on the "cash-out" of MISO's footprint wide inadvertent energy transfer with the Eastern Interconnect. The cost/credit is allocated to all market participants in exact proportion to their Schedule 17 (Cost for market administration) cost. The Company does not have control over this cost and is assessed this charge as a result of participating in MISO's energy market to provide service to its retail customers.

Other Costs

Schedule 22

This was a transitional rate mechanism (Seams Elimination Cost Adjustment - SECA) that allowed MISO to collect revenues from transmission customers to pay PJM transmission owners. This charge was created and approved by FERC under Docket No. EL02-111-000. This rate schedule expired on April 1, 2006. However, the Company has included the cost assessed by MISO during the December 1, 2005 through April 1, 2006 period. Staff finds that the costs are appropriately included in the Rider and that the Company did not have any control of such costs.

Schedule 24

This schedule includes charges to recover costs incurred by Control Area Operators for implementing the Markets and Services pursuant to the MISO

Tariff. It is assessed to market participants for all activity in the market, including injections, withdrawals, imports, exports, and virtual transactions. Staff finds that the costs are appropriately included in the Rider and that the Company does not have any control of such costs.

Exhibit I

Summary of Staff's Findings

Cost Component	FERC-Approved	Assessed to Company as a result of serving *native load customers* in Ohio	Controllable by Company
Schedules 1,2,3,5,6	YES	YES	No
Schedules 7,8,9	YES	YES	No
Schedule 10	YES	YES	No
Schedule 10-FERC	YES	YES	No
Schedule 16	YES	YES	No
Schedule 17	YES	YES	No
Schedule 22	YES	YES	No
Schedule 24	YES	YES	No
FTR Cost/Credit*	YES	YES	Yes
Congestion Cost/Credit*	YES	YES	Yes
Net Losses*	YES	YES	Yes
Uninstructed Deviation	YES	YES	Yes
Inadvertent Distribution	YES	YES	No
RSG Distribution	YES	YES	Yes
Revenue Neutrality Uplift	YES	YES	No

* The Company is proposing to transfer these costs to Rider FPP. If the transfer is approved these costs would be audited as part of Rider FPP.

Exhibit II

Costs to be included in the biennial review include, but are not limited to:

Net Congestion (FTR revenues/credits and Congestion revenue/credit)*
Net Losses *
Real-Time RSG Costs (First Pass)
Uninstructed Deviation

Information to be filed with Duke's first update filing in 2007 and biennially thereafter shall include, but not be limited to:

For each of the costs listed above the Company shall provide a detailed description of the costs, including:

a) What drives this cost?
b) Describe in detail the MISO process or markets with which this cost is associated.
c) Describe any control the company may have over this cost.
d) What options does the company have in incurring this cost?
e) What options has the company pursued and why?
f) Has the company evaluated the potential impacts of pursuing the other options? If so, provide the expected impacts of pursuing each of those options.
g) If the company has not evaluated the other options, please do so and provide the expected impacts of these options.
h) Please provide graphically, the monthly cost since the Company began operating in MISO.
i) If these costs/revenues discussed in (h) show a decreasing or increasing trend please explain such trend.
j) If there are spikes in the trend, please explain in detail the cause of such spikes.
k) Provide any internal documents or written policy used to ensure the cost is being minimized.
l) Provide the departments/divisions/units/etc. that are involved with managing the cost and what their responsibilities are with regard to ensuring that the costs are minimized
m) Provide any additional information that could enhance the review.

* As noted in the Report, these costs may be transferred to the Company's Rider FPP. As a result, these costs would be reviewed under that Rider.