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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

Consolidated Duke Energy Ohio, Inc.,)	Case Nos.	03-93-EL-ATA
Rate Stabilization Plan Remand, and)		03-2079-EL-AAM
Rider Adjustment Cases)		03-2081-EL-AAM
)		03-2080-EL-ATA
)		05-725-EL-UNC
)		06-1069-EL-UNC
)		05-724-EL-UNC
)		06-1085-EL-UNC
)		06-1068-EL-UNC

SUPPLEMENTAL TESTIMONY OF

WILLIAM DON WATHEN, JR.

ON BEHALF OF

DUKE ENERGY OHIO

- _____ Management policies, practices, and organization
- _____ Operating income
- _____ Rate base
- _____ Allocations
- _____ Rate of return
- _____ Rates and tariffs
- x Other – Supplemental Testimony

February 28, 2007

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I. INTRODUCTION

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

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

4 **Q. ARE YOU THE SAME WILLIAM DON WATHEN, JR., WHO FILED**
5 **DIRECT TESTIMONY IN CASE NUMBER 06-1085-EL-UNC, ONE OF**
6 **THE ABOVE CAPTIONED CONSOLIDATED CASES?**

7 A. Yes, I am.

8 **Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?**

9 A. I am providing supplemental testimony to provide some historical context to the
10 Annually Adjusted Component ("Rider AAC") of the Company's Market-Based
11 Standard Service Offer ("MBSSO") that was approved in Case No. 03-93-EL-
12 ATA.

II. RIDER AAC CALCULATION

14 **Q. PLEASE DESCRIBE THE EVOLUTION OF THE ANNUALLY**
15 **ADJUSTED COMPONENT OF THE COMPANY'S MARKET-BASED**
16 **STANDARD SERVICE OFFER.**

17 A. On May 19, 2004, the Company filed a Stipulation and Recommendation
18 (Stipulation) in the MBSSO case, which was signed by most of the parties to the
19 case, including the Commission Staff. This Stipulation contained a non-
20 bypassable Provider of Last Resort (POLR) charge comprised of two components:
21 the Rate Stabilization Charge (RSC) and the Annually Adjusted Component. The

1 RSC was to be 15% of the generation charge known as little g.¹ Rider AAC
2 consisted of a return on and recovery of costs associated with the following:
3 Emission Allowances, Reserve Margin, Environmental Compliance, Homeland
4 Security and Tax Changes.

5 **Q. DID THE STIPULATION SEEK RECOVERY OF THE ENTIRE**
6 **AMOUNT OF THE POLR CHARGE?**

7 A. No. The Stipulation contained a gradual increase in Rider AAC, beginning with a
8 non-residential charge set at 8% of little g in 2005 with automatic annual
9 increases of a minimum of 6% of little g, or annual increases of up to 8% if the
10 Company provided sufficient support for the increase. The residential Rider AAC
11 would be set at 6% of little g in 2006 with a maximum increase of 7% in 2007 and
12 8% in 2008. Stipulation Exhibit 1 demonstrated a calculation for Rider AAC that
13 would produce a charge of over 14% of little g based on data for the twelve
14 months ended of June 2004.

15 **Q. DID THE COMMISSION APPROVE THE STIPULATION AS FILED?**

16 A. No. In addition to other changes, the Commission in its Opinion and Order
17 reduced the amount to be recovered through Rider AAC in 2005 from the amount
18 reflected in the Stipulation, \$60,172,267, to \$53,757,267 in its Order. Further,
19 Rider AAC was to be 100% bypassable by all consumers.

20 **Q. WHAT WAS THE COMPANY'S RESPONSE TO THE COMMISSION'S**
21 **OPINION AND ORDER?**

¹ "Little g" is the term used to describe the net unbundled generation rate remaining after the regulatory transition charge is deducted.

1 A. The Company filed an Application for Rehearing asserting a number of
2 assignments of error. In addition, the Company requested that the Commission
3 reinstate the Stipulation, as filed and without modification, or adopt an
4 Alternative Proposal attached to the Request for Rehearing.

5 **Q. DID THE COMPANY PROPOSE CHANGES TO THE RIDER AAC**
6 **CALCULATION IN ITS ALTERNATIVE PROPOSAL?**

7 A. Yes. The Company suggested removing the cost of emission allowances from the
8 Rider AAC calculation and, instead, recover these costs through the Fuel and
9 Purchased Power Tracker ("Rider FPP"). It also proposed recovering the Reserve
10 Margin component through two separate riders: (i) the System Reliability Tracker
11 (SRT) to recover the cost of purchasing capacity in the market to meet a 15%
12 planning reserve margin and (ii) the Infrastructure Maintenance Fund (IMF) to
13 compensate it for committing its generation capacity to serve MBSSO consumers
14 through 2008. Residential consumers would not be subject to the IMF or the
15 AAC in 2005. In addition, the Alternative Proposal would make Rider AAC
16 bypassable for some consumers who switch suppliers, up to the first 50% of non-
17 residential consumers and up to the first 25% of residential consumers.

18 **Q. WAS THE SUBJECT OF CONSTRUCTION WORK IN PROGRESS**
19 **(CWIP) ADDRESSED IN THE MBSSO CASE?**

20 A. Yes. In his initial Direct Testimony, filed on April 15, 2004, Company witness
21 John P. Steffen included, as an Attachment, an illustration of the formula to be
22 used to calculate the Rider AAC, using a revenue requirement type calculation.
23 Attachments JPS-2 through JPS-7 were included in the May 19, 2004, Stipulation

1 as Stipulation Exhibit 1. The Commission's Staff extensively reviewed these
2 calculations and did not dispute the accuracy of the figures presented or the
3 methodology used. That formula, initially called the "POLR Charge
4 Calculation," included a provision for a return on the entirety of its investment in
5 environmental compliance plant, including CWIP (See Attachments JPS-4, in
6 Case No. 03-93-EL-ATA, *et al.*).

7 **Q. IN THE MBSSO CASE, DID ANY PARTY OBJECT TO THE INCLUSION**
8 **OF CWIP IN THE RIDER AAC REVENUE REQUIREMENT**
9 **CALCULATION?**

10 A. Yes. The Ohio Consumers' Counsel (OCC) did object to including CWIP in
11 Rider AAC. In its Request for Rehearing, OCC asserted one assignment of error
12 related to the establishment of the procedure to increase Rider AAC, asserting that
13 the calculation does not meet the requirements of the Ohio Revised Code. OCC
14 contended that any changes to Rider AAC required a full traditional rate case
15 review pursuant to the Ohio Revised Code, under which CWIP is only permitted
16 under certain circumstances.

17 **Q. DID THE COMMISSION ADDRESS OCC'S ISSUE IN THE MBSSO**
18 **CASE?**

19 A. Yes. In its November 23, 2004, Entry on Rehearing, the Commission directly
20 addressed OCC's objection to the Rider AAC calculation. Responding to OCC's
21 objection, the Commission wrote, beginning on page 19 of the Entry on
22 Rehearing, that "competitive retail electric services, including a firm supply of
23 electric generation service, shall be provided to customers at market-based rates,

1 rather than establishing such services through the traditional rate-based
2 approach...”

3 **Q. UNDER ITS TRADITIONAL REGULATED RATE MAKING**
4 **PARADIGM, THE COMMISSION ONLY PERMITTED CWIP IN RATE**
5 **BASE IN CERTAIN CIRCUMSTANCES. WHY DO YOU BELIEVE THE**
6 **COMMISSION ALLOWED CWIP EXPENDITURES IN THE MARKET-**
7 **BASED POLR CHARGE?**

8 A. Admittedly, it has been difficult to reshape the mindset of regulators, advocates,
9 and even utilities away from the traditional concepts of establishing retail
10 generation prices. However, with the passage of Senate Bill 3, the traditional
11 regulatory framework no longer applies to the establishment of prices for
12 generation in Ohio. The applicability of traditional ratemaking regulations, such
13 as the limit on CWIP at issue here, must be set aside because we are not dealing
14 with traditional cost based regulation – instead, we have a “new” formula to
15 determine a market price, just as the Commission wrote on page 19 of its Entry on
16 Rehearing. The Rider AAC formula has been explicitly defined, and extensively
17 litigated, throughout the record of the MBSSO case and specifically included a
18 provision for CWIP.

19 Electric generation in Ohio is deregulated. The MBSSO price can be
20 based on factors not necessarily included, or even considered, in traditional rate-
21 making regulation, as long as the price is not discriminatory or set below cost for
22 the purpose of destroying competition.

1 A. The Commission has to look no further than its own November 23, 2004, Entry
2 on Rehearing in the MBSSO case to establish the validity of the Company's Rider
3 AAC calculation, including the recovery of a return on all of its environmental
4 CWIP. In my opinion, traditional regulation should not apply to market-based
5 formula rates and, consequently, any attempt to impose traditional regulatory
6 rules on the Rider AAC calculation, or to any part of the MBSSO formula for that
7 matter, is misguided and should be rejected by the Commission. The Company's
8 Rider AAC revenue requirement calculation follows the pricing formula approved
9 by the Commission in its November 23, 2004 Entry on Rehearing, and, therefore,
10 should be approved.

11 It is worth noting that the Company has made substantial new investment
12 in environmental compliance equipment even since the time of the initial POLR
13 proposal. The investment in CWIP has increased by over \$70 million; similarly,
14 net plant has increased by over \$70 million as well.

15 Also, the Commission should allow the Company to true-up Rider AAC
16 revenues for 2007 beginning January 1, 2007, with a carrying cost.

17 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

18 A. Yes.

19
20