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April 12, 2007

Public Utilities Commission of Ohio
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180 E. Broad Street, 10th Floor
Columbus, Ohio 43215

In re: Case No. 03-93-EL-ATA, et. al.

Dear Sir/Madam:

Please find enclosed an original and twenty (20) copies of the Merit Brief of the Ohio Energy Group to be filed in the above-referenced matter.

Copies have been served on all parties on the attached certificate of service. Please place this document of file.

Respectfully yours,



David F. Boehm, Esq.
Michael L. Kurtz, Esq.
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MLKkw
Encl.

Cc: Jeanne W. Kingery, Esq.
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CERTIFICATE OF SERVICE

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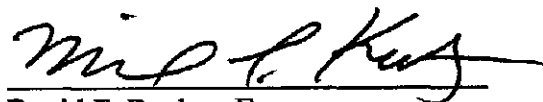
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BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

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IN THE MATTER OF THE CONSOLIDATE DUKE	:	CASE NOS.	03-93-EL-ATA
ENERGY OHIO, INC. RATE STABILIZATION PLAN	:		03-2079-EL-AAM
REMAND AND RIDER ADJUSTMENT CASES	:		03-2081-EL-AAM
	:		03-2080-EL-ATA
	:		06-1068-EL-UNC
	:		05-725-EL-UNC
	:		06-1069-EL-UNC
	:		05-724-EL-UNC
	:		06-1085-EL-UNC
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MERIT BRIEF OF
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APRIL 13, 2007

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PUBLIC UTILITIES COMMISSION OF OHIO

In The Matter Of The Consolidate Duke	:	Case Nos.	03-93-EL-ATA
Energy Ohio, Inc. Rate Stabilization Plan	:		03-2079-EL-AAM
Remand And Rider Adjustment Cases	:		03-2081-EL-AAM
	:		03-2080-EL-ATA
	:		06-1068-EL-UNC
	:		05-725-EL-UNC
	:		06-1069-EL-UNC
	:		05-724-EL-UNC
	:		06-1085-EL-UNC

**MERIT BRIEF OF
OHIO ENERGY GROUP**

I. INTRODUCTION AND SUMMARY

The Ohio Energy Group (OEG) is a non-profit corporation organized primarily to participate in regulatory proceedings before the Public Utility Commission of Ohio (Commission). The members of OEG are: Air Products & Chemicals, AK Steel Corporation, Brush Wellman, Inc., BP Products North America, Inc., DaimlerChrysler, Ford Motor Company, GE Aviation, Griffin Wheel Company, Mittal Steel USA, North Star BlueScope Steel LLC, The Proctor & Gamble Co, PPG Industries, Inc., Republic Engineered Products, Inc., V&M Star, WCI Steel Inc., Wheeling-Pittsburgh Steel Corporation and Worthington Industries. These energy intensive industrial companies collectively employ approximately 67,000 people in Ohio and spend nearly \$1 billion per year on gas and electricity to produce their products in this state. In order to maintain and grow these jobs in an increasingly

competitive national and international economy it is essential that the vital commodity of electric generation be provided at a competitive and reasonable price.

OEG supports Duke Energy Ohio (DE-Ohio) in this case. DE-Ohio has cooperated with this Commission and with its customers to try to fashion practical and beneficial solutions to the vexing problem faced by us all. That is, how to fairly price retail electric generation in a deregulated state when the wholesale electric generation market is dysfunctional.

This Commission could have followed Maryland and Illinois right over the same cliff of pure market pricing and subjected Ohio Consumers to rate increases of 72% or higher. (T.E. Vol. II at 30). Wisely, the Commission chose Rate Stabilization Plans (RSP) instead. But RSPs are a new animal. The RSP for each Ohio utility is different and the rules are still evolving. DE-Ohio's RSP was tailor made by the Commission itself and is not the result of any Stipulation. Among other things, the Ohio Supreme Court decision in this case affirms the Commission's authority to mandate RSPs which result in "*market based*" rates without the consent of any party, including the utility.

The Commission crafted RSP is working. It is providing relatively stable prices to consumers and has resulted in solid finances for DE-Ohio. Would it be better for consumers if the MBSSO price were even lower or if more than 96.2% of the MBSSO charges were by bypassable? Of course. But in any balanced transaction that is true. One side could have always done better. The Commission crafted the best deal it could for consumers. The end result is a set of rates that are market based and reasonable. As a result of this hearing, there now is sufficient evidence of record to support the Commission's original decision in full compliance with the remand instructions of the Supreme Court.

The original RSP Order should be affirmed and this case should be closed.

II. PROCEDURAL BACKGROUND

On December 9, 2003, the Commission issued an Entry that requested DE-Ohio to file an RSP. On January 26, 2004 DE-Ohio filed its RSP that addressed the Commission's stated goals for rate stabilized MBSSOs: (1) rate certainty for consumers; (2) financial stability for the utility; and (3) the further development of competitive markets. DE-Ohio's RSP contained a market price for its service and a market price to compare for competitive retail electric service. On May 19, 2004, DE-Ohio and many parties filed a Stipulation and Recommendation purporting to resolve all issues in the case.

On September 29, 2004, the Commission issued an Opinion and Order that substantially modified the Stipulation, effectively rejecting it by requiring material modifications as a condition for approval.

On October 29, 2004, DE-Ohio filed an Application for Rehearing. In that Application, DE-Ohio presented three proposals. First, DE-Ohio requested that the Commission reconsider its decision and adopt the Stipulation. Next, DE-Ohio presented its Alternative Proposal that included a revised market price for its MBSSO service. Finally, the Company's third proposal was to adopt its previously submitted competitive market option.

On November 23, 2004, the Commission issued its Order on Rehearing that ultimately resulted in a Commission mandated MBSSO. The Commission increased the price to compare component of the MBSSO but also made more charges bypassable. The Commission then directed DE-Ohio to file proposed tariffs consistent with the November Entry, to be effective January 1, 2005.

On May 23, 2005, following additional Orders by the Commission, the OCC filed an appeal to the Supreme Court of Ohio, opposing the Commission's November 23, 2004 Entry on Rehearing.

On November 22, 2006, the Supreme Court of Ohio issued its Opinion affirming in part and remanding in part the Commission's Order. The Court affirmed the Commission's authority to mandate an RSP and set a "*market based*" standard service offer, without the consent of any party including the utility, but remanded the case to the Commission for further consideration of two specific issues. The Court required the Commission to: (1) explain its conclusion that its modifications to the SRT and IMF on Rehearing are reasonable and identify the evidence it considered to support its findings; and (2) compel disclosure of the previously requested information regarding "*side agreements*."

III. ARGUMENT

A. Remand Issue One: Evidentiary Basis For SRT And IMF Charges.

1. There Is Sufficient Evidence To Support The Previously Approved SRT And IMF Charges.

The first issue that the Supreme Court remanded concerned the evidentiary basis to support DE-Ohio's SRT and IMF charges. The Court did not question the charges themselves, or the Commission's authority to impose them, but concluded there was inadequate record evidence to support the Commission order.

This remand issue was thoroughly addressed by Company witness John P. Steffen at pages 18-27 of his direct testimony. In that testimony, Mr. Steffen explained the conceptual rationale for the SRT and IMF charges as well as their computational formulation. According to Mr. Steffen, these charges compensate the Company for its obligation to stand ready to serve all consumers who

do not shop. (Steffen Dir. Test. at 20). DE-Ohio believes that giving Ohio consumers the first call on its generation at a set price is a benefit that should be paid for. (*Id.* at 21). The accounting verification of this price was fully addressed by Mr. Steffen. (*Id.* at 20-27). While we expect that the Duke companies will discuss the computation of the SRT and IMF in detail, for our purposes suffice it to say that Mr. Steffen's testimony meets the Court's requirement that these charges be supported by substantial evidence.

2. **OCC's Proposal To Set The "Market Based" Standard Service Offer On The Results Of A Traditional Cost-Of-Service Rate Case Is Unworkable At This Time, Will Result In Uncertain Pricing, And Goes Well Beyond The Remand.**

OCC witness Neil Talbot addressed MBSSO issues. Mr. Talbot criticized the DE-Ohio RSP as being neither purely cost-based nor purely market-based. (Talbot Dir. Test. at 6). Mr. Talbot concluded that the component pieces of the MBSSO have no consistent conceptual basis, even though he rendered no opinion regarding the reasonableness of the total rate resulting from the accumulated MBSSO pieces. This analytical framework is the opposite of Staff's. According to Staff witness Cahaan, the individual pieces of this RSP should not be viewed in isolation and the primary consideration must be the total rate package that results from the individual components. (Cahaan Dir. Test. at 6).

Mr. Talbot believes DE-Ohio's MBSSO should be scrapped by eliminating completely the RSC and IMF charges. (T.E. Vol. II at 94). In its place, he would install a "market based" generation rate based entirely on DE-Ohio's historic accounting costs. In other words, a traditional rate case. (T.E. Vol. II at 96). Mr. Talbot presented no economic rationale as to how setting rates based on historic actual costs meets the "market based" standard of ORC §4928.14.

However, a variation of Mr. Talbot's historic cost proposal may be valid in a future RSP. Establishing "market based" rates based upon projected long run costs is grounded in sound economics

may meet the statutory requirements. Given the substantial deference afforded by the Supreme Court to the Commission in enforcing ORC §4928.14 in this and the other RSP cases, and given the fact that there is no reliable market index for multi-year retail generation service, using projected long-run cost as a proxy for market may give the Commission an additional tool to protect consumers. While new MBSSO pricing models, such as Mr. Talbot's, may be appropriate in a future RSP, they are not appropriate here. This case is only to consider the matters remanded by the Supreme Court.

Mr. Talbot's new MBSSO construct (a full blown generation rate case based on historic costs) goes well beyond the scope of this limited proceeding. Also, Mr. Talbot has no idea under his proposal what the resulting price to consumers will be. (T.E. Vol. II at 96-97). He doesn't know whether his concept will result in higher or lower prices to consumers. His response to this uncertainty is that "*I would let the chips fall where they may.*" (T.E. Vol. II at 95, 96). While the OCC can be unconcerned with the real world ramifications of its proposals, the Commission is not so unfettered. The rate decisions of this Commission affect the economy of the state and the standard of living of its citizens. Right now the prudent thing to do is to approve the existing RSP through 2008.

The issue here is whether the SRT and IMF components of the MBSSO are based on substantial evidence. They are. Issues regarding future MBSSO calculation methods should be deferred.

B. Remand Issue Two: Did The Side Agreements Affect The Seriousness Of The Bargaining Process For The Stipulation To Such An Extent That The Stipulation Is Invalid.

1. The Stipulation Was Effectively Rejected And Is No Longer of Any Consequence.

OCC witness Beth Hixon filed 74 pages of testimony concerning "*side agreements.*" These "*side agreements*" consisted of a contract between DE-Ohio and the City of Cincinnati, a series of Option Agreements between DERS and certain industrial and commercial customers, and the extension of a wholesale power supply arrangement between DERS and Constellation New Energy for retail

delivery to Kroger. Ms. Hixon discussed these contracts in great detail. However, one critical point was missing: she did not attempt to show how any of these contracts affected the seriousness of the Stipulation bargaining process.

Having won a Supreme Court remand, the OCC then proceeded to ignore the Court's Order. It is understandable why the OCC did not attempt to prove that the agreements tainted the Stipulation bargaining process. First, there is no Stipulation. The Commission Order on Rehearing imposing the RSP on DE-Ohio so changed the Stipulation as to render it of no consequence. The Company and Staff both reached this same conclusion. (Steffen Dir. Test. at 5; Cahaan Dir. Test. at 12). Second, many, if not all, of the allegedly offensive agreements became effective after the Stipulation was signed. (Steffen Dir. Test. at 36). Events occurring after the Stipulation was signed could not have affected the Stipulation itself. Third, DERS was not a party to the Stipulation and its actions were appropriately shielded from the utility under the corporate separation rules. (Steffen Dir. Test. at 36-37). No ratepayer of DE-Ohio has paid or will pay a penny more because of the option payments made by DERS in its independent business deals. (Steffen Dir. Test. at 38; T.E. Vol. III at 137).

The Commission has provided discovery to OCC on "*side agreements*" well beyond a technical reading of the Court's Order would require. But OCC has failed to prove its case. There is no Stipulation, tainted or otherwise, and none of the "*side agreements*" had any bearing on the RSP imposed by the Commission in its Order on Rehearing.

2. **The OCC's Recommendations Regarding Additional Commission Actions Should Be Rejected.**

On pages 73-74 of her testimony Ms. Hixon listed four recommendations for future Commission action. None of these four recommendations should be adopted.

First, Ms. Hixon recommended the *“prohibition of the discriminatory treatment and anticompetitive activities that accompanied Duke Energy Ohio’s RSP proposals, as adopted and modified by the Commission.”* This recommendation is so general and self evident as to be meaningless. If Ms. Hixon is saying that the law should be followed, we agree. It was.

Second, Ms. Hixon recommends that the *“Commission should make all generation related charges bypassable to remove the incentive that has driven the discriminatory treatment of customers and encourage the development of a competitive market.”* As a general matter, OEG agrees that all generation-related charges should be bypassable. In this RSP, 96.2% of DE-Ohio MBSSO charges are bypassable for the first 50% of commercial and industrial customers and for the first 25% of residential customers. (T.E. Vol. II at 88). 96.2% is pretty good for an RSP. If Ohio is ever foolish enough to outsource the utility’s provider of last resort function so that it can wash its hands of any pricing responsibility by going to a pure auction model like Maryland or Illinois, then there should be a 100% bypassability for all customers. Fortunately, that is not now the case. We disagree with OCC on the importance of developing a competitive market. Our energy-intensive industrial clients need low rates, not the cold comfort of choosing among the same high prices from several marketers. It’s easy to increase the number of shoppers. Just raise rates. This would be bad economic policy and would result in angry consumers, but the marketers would be happy.

Third, Ms. Hixon recommends *“the prohibition of any reimbursements for RTC charges.”* The Commission cannot grant this request. Only the Legislature and Governor can by changing ORC §4928.37(4) which specifically allows for the payment of all or part of the RTC charges by third parties on behalf of a customer. Ms. Hixon was not aware of this statute when she filed her testimony. (T.E. Vol. III at 135).

Fourth, Ms. Hixon recommends a Commission investigation into activities related to the side agreements, including corporate separation issues and whether ratepayers were charged, directly or indirectly, for any costs associated with the Option Agreements. The Commission should decline OCC's invitation to launch such an investigation.

Throughout the first and second quarters of 2005 DERS entered into a series of Option Agreements with certain large commercial and industrial consumers. These Option Agreements are not all the same and they contain many individually negotiated pricing provisions. But all of the Option Agreements do give DERS the right to serve the customer's load based upon a set strike price formula any time through the end of 2008. The option to serve this load at a set price is a value for which DERS rightfully paid. Correspondingly, it is appropriate that the customer who gives the option be paid.

Mr. Hixon agrees that options are legitimate business tools in a competitive commodity market. (T.E. Vol. III at 118). She also agrees that there is nothing wrong with an option to buy or sell electricity in a deregulated market. (T.E. Vol. III at 121). However, unlike pork bellies or cotton, it is not possible to simply open up the Wall Street Journal to determine the market value of a customer-specific retail electric option. Indeed, the lack of even a liquid wholesale futures market for electricity is a prime indication of the dysfunctional nature of the market, thus necessitating the RSPs in the first place. If determining the value of a wholesale electricity option is difficult, then determining the value of a long-term, customer-specific retail electric option is even more so. Ms. Hixon agrees that at a minimum such a valuation would require: 1) a forward price curve from the effective date of the option through the end of 2008 for on and off-peak electricity pricing at the MISO node where the load is located; 2) an analysis of the projected energy usage, demand, load profile and load factor of the specific customer through the end of 2008; 3) the credit worthiness of the counter-party. (T.E. Vol. III at 126-130).

The OCC made no attempt whatsoever to value the DERS options. (T.E. Vol. III at 129-130). OCC has no idea whether DERS overpaid or underpaid for its options. (*Id.*) Ms. Hixon is admittedly not an expert on options (TE. Vol. II at 119) and at the hearing demonstrated only a rudimentary understanding of how options work. Even is she had made the effort, Ms. Hixon could not begin to appropriately value the options. With no evidence of impropriety, a Commission-sponsored investigation is not warranted.

Importantly, whatever amount DERS paid for its options, whether too little or too much, this is purely a Duke shareholder financial matter. No DE-Ohio ratepayer has paid or will pay one penny of the option price. (Steffen Dir. Test. at 38; T.E. Vol. III at 136-137).

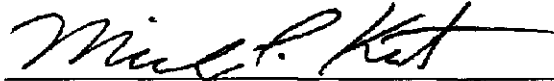
It seems that OCC's perceived problem with the option contracts is the currency they were priced in. DERS is making option payments based upon the price of certain components in the RSP. This is unfortunate in retrospect because had the options been priced strictly in dollars with no reference to RSP pricing then there would not even be a problem of appearance. In any event, OCC has not challenged the legality, legitimacy or economic validity of the options. Accordingly, there is no basis for the Commission to open an investigation.

As to whether DE-Ohio and DERS complied with the Commission's corporate separation rules, the Company has addressed this issue thoroughly in its testimony. (Steffen Dir. Test. at 32-38). We anticipate that the DE-Ohio and DERS briefs will fully address this issue.

IV. CONCLUSION

The Commission has fully carried out the remand order of the Supreme Court. The RSP Order should be affirmed and this case closed with no additional Commission actions or investigations.

Respectfully submitted,



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