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April 27, 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 Reply 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,

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BEFORE THE
PUBLIC UTILITIES COMMISSION OF OHIO

In The Matter Of The Consolidated Duke Energy Ohio, Inc. Rate Stabilization Plan Remand And Rider Adjustment Cases	:	Case Nos.	03-93-EL-ATA
	:		03-2079-EL-AAM
	:		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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REPLY BRIEF OF
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APRIL 27, 2007

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REPLY BRIEF OF
OHIO ENERGY GROUP

The Ohio Energy Group (OEG) submits this Reply Brief to the arguments of the Ohio Office of Consumers' Counsel (OCC) and the Ohio Marketers Group (OMG).

A. Response to OCC

1) The 2005 Option Agreements Are Appropriate Business Transactions In A Deregulated Electric Market And Did Not Cause Any Of The Harm Alleged by the OCC.

According to the OCC, the 2005 agreements giving Duke Energy Retail Sales, LLC (DERS) the option to supply all of the electric energy requirements of 23 commercial and industrial customers at a set price over the three year period 2006-2008 are problematic in three ways. According to OCC's

Initial Brief, these 2005 Option Agreements: a) caused the ratepayers of DE-Ohio to pay higher electric rates; b) had a devastating effect on the development of the competitive market; and c) were in reality a way for DE-Ohio and its affiliates to purchase support for the May 19, 2004 Stipulation and subsequent pricing proposals by providing discounts and reimbursements of certain standard service offer charges established by the Commission in its November 23, 2004 Entry on Rehearing. None of the allegations made by OCC are correct.

a) The 2005 Option Agreements Did Not Cause Any Ratepayer Of DE-Ohio To Pay Higher Rates.

Counsel for the OCC makes the claim that the ratepayers of DE-Ohio somehow funded the option payments of DERS through higher electric rates.

> *"The revelations regarding the Companies concessions to a few large customers – no doubt funded by the increases proposed for customers not represented in the real negotiations – should alter the Commission's approach to these cases and invigorate negotiations that involve all parties."* OCC Initial Brief at 45.
>
> *"The Company's treatment of its customers is highly discriminatory. Only Customer Parties received discounts on their electric service, leaving other customers (including directly comparable customers) with higher standard service offer rates."* OCC Initial Brief at 61.
>
> *"The Commission should understand that the Customer Parties' support for the Company's proposals was bought by the Duke-affiliated companies out of the pocketbooks of customers (for instance, residential customers) who did not receive the Company's favored attention and have instead paid the excessive standard service offer rates proposed by Duke Energy Ohio."* OCC Initial Brief at 70.

The claim of OCC's counsel that the DERS option payments were somehow funded out of the pocketbooks of utility ratepayers has absolutely no evidentiary support. The expert witness for the OCC reached the exact opposite conclusion. Ms. Hixon testified that she found no evidence that any amount of the option payments were recovered in utility rates.

"Q. In any of your discovery, in any of your investigation, in any of your anything have you uncovered the attempt of the utility to try to recover in rates any of the option payments or any of the amounts at issue here?

A. In the review and discovery I have done I have not found that". TE Vol. III at 136.

On the cross-subsidy issue, DE-Ohio witness Mr. Steffen reached the same conclusion as OCC witness Ms. Hixon. There was no cross subsidy.

*"Importantly, DE-Ohio is not subsidizing DERS and DE-Ohio's MBSSO customers are not paying for any of the costs of the commercial [*option*] contracts. These contracts are not related to the establishment of DE-Ohio's MBSSO."* Steffen Dir. Test. at 36.

The claim of OCC counsel that DE-Ohio ratepayers somehow funded the DERS option payments is reckless and wrong.

b) The Option Agreements Did Not Have An Adverse Effect On The Development Of A Competitive Market.

Counsel for the OCC believes that the option of DERS to competitively serve 23 commercial and industrial customers at a market price during 2006-2008 had a devastating effect on the development of a competitive market.

"The record contains ample evidence that the Company's discrimination that favored certain large customers has had a devastating effect on the development of the competitive market." OCC Initial Brief at 59.

"The side deals between Duke Energy Ohio and the Customer Parties have devastated the market." OCC Initial Brief at 60.

"The Commission's intent to foster competition has been seriously undermined by the side agreements. The dealings that helped settle the Post-MDP Service Case must cease in order to promote reasonable rates for all customers and to encourage competition." OCC Initial Brief at 70.

According to OCC, in 2004 the percentages of commercial, industrial, and residential customers shopping competitively for generation were 22.04, 19.87 and 4.91 percent. By the end of 2006, these

percentages had fallen to 8.40, 0.36 and 2.32 percent. (OCC Initial Brief at 59-60). OCC believes that the 2005 Option Agreements caused this decline. OCC's linkage between the Option Agreements and the decline of shopping in DE-Ohio's service territory is based on speculation, simplistic reasoning, and the failure to consider other more important events.

Between 2004 and 2006 two very important things occurred that are far more likely than the Option Agreements to have resulted in the decline in the shopping percentages: 1) the market price for electricity rose substantially; and 2) the shopping incentives approved by the Commission in Case No. 99-1658-EL-ETP expired.

DE-Ohio witness Mr. Rose testified at length regarding the increase in the market price of generation between 2004 and 2006 and how this caused substantial load to return to DE-Ohio's MBSSO pricing. (Rose Dir. Test. at 11-13). For example, the annual average on-peak Forward Price for the next year into the Cinergy Hub has risen steadily since 2002. Rose Ex. 1 shows that pricing to be:

2002 $30.8/MWH

2003 $37.4/MWH

2004 $45.5/MWH

2005 $63.2/MWH

2006 $63.7/MWH

OCC apparently did not consider that the 40% increase in on-peak pricing between 2004 and 2006 might have caused less consumers to shop for generation competitively.

At the same time that market prices were increasing, the shopping incentives approved by the Commission in CG&E's Transition Plan case expired at the end of 2005. The Commission described the "*significant shopping incentives*" as follows:

"Section 4928.40, Revised Code, provides for the establishment of shopping incentives to induce customers to switch to a certified supplier to obtain their generation supply. The goal of the incentive is to achieve at least a 20 percent switching rate by December 31, 2003. CG&E states that the stipulation creates such shopping incentives by granting shopping credits greater than the projected market price of power. Per the stipulation, such credits are equal to or greater than CG&E's unbundled generation component to the first 20 percent of customers that switch to a certified supplier to obtain their generation supply (CG&E Ex. 60 at 11-14)."

* * *

"The Commission finds that the stipulation provides appropriate shopping incentives to achieve a 20 percent load switching contemplated by Section 4928.40(A), Revised Code. We believe CG&E's forward looking wholesale prices of power used to estimate future retail power markets are more appropriate than CG&E purchased power costs from past years. Further, the record lacks sufficient evidence to support Shell's recommendation of a shopping credit of $0.055 per kWh. The stipulation's $0.05 shopping credit for the first 20 percent of residential customer load that switches exceeds the unbundled rate for generation and, therefore, should help ensure that residential customers have an incentive to shop. The first 20 percent load switched from the remaining customer classes will also have an adequate incentive to shop inasmuch as shopping credits will equal 100 percent of the unbundled generation rate. We believe that these significant shopping incentives will effectively foster early competition by providing significant motivation to customers to switch retail generation suppliers." Case No. 99-1658-EL-ETP August 31, 2000 Order at 42-44.

The double-whammy impact of a 40% increase in market prices between 2004-2006 and the end of significant shopping incentives in 2005 undoubtedly had an effect on the customer switching statistics cited by OCC. These two fundamental factors probably explain the 53% reduction in residential shopping between 2004 and 2006 shown by OCC's statistics despite the fact that there are no residential option agreements.

When it entered the Option Agreements in 2005 DERS effectively bet that the market price of generation would fall between 2006-2008 (whether it made a good or bad bet won't be known until 2008). If the market price falls, then the options will be in the money and DERS can economically exercise its option rights. If this occurs, then the shopping statistics will dramatically swing the other

way as DERS, not DE-Ohio, will be the generation supplier for the 23 commercial and industrial accounts.

c) The 2005 Option Agreements Are Valid Business Transactions and Were Not Used To Purchase Intervenor Support for the May 19, 2004 Stipulation and Could Not Have Influenced the November 23, 2004 Entry on Rehearing.

In an oft repeated theme in their brief, the lawyers for OCC claim that the 2005 Option Agreements are worthless, that they have no valid business purpose, and that they were merely the vehicle through which the Duke-related companies purchased support for the May 19, 2004 Stipulation and unduly influenced the Commission's November 23, 2004 Entry on Rehearing. How a series of options to buy/sell electric generation executed in the first half of 2005 could have influenced the May 19, 2004 Stipulation (which was effectively rejected by the Commission) or the November 23, 2004 Entry on Rehearing remains a mystery. Timing issues alone make the OCC's argument particularly challenging. Nevertheless OCC argues:

> *"The Duke-affiliated companies (formerly the Cinergy-affiliated companies) used affiliates of Duke Energy Ohio to accomplish the side deals that obtained support for the Company's pricing proposals."* OCC Initial Brief at 38.
>
> *"The support stated for the Company's proposals, touted even in argument before the Supreme Court of Ohio, was tainted by the Company's incentives extended to a few large customers in return for their support for Company proposals."* OCC Initial Brief at 44.
>
> *"The revelations regarding the Companies concessions to a few large customers — no doubt funded by the increases proposed for customers not represented in the real negotiations — should alter the Commission's approach to these cases and invigorate negotiations that involve all parties. The OCC was not 'left by the wayside ... because [its] interests [were] not negotiable,' but left because there were no meaningful negotiations as long as the Company conducted negations in which it "purchased" its support from a small number of customers.* OCC Initial Brief at 45.
>
> *"The support stated for the Company's New Proposal, which was commented upon in the decision by the Supreme Court of Ohio, was tainted by the incentives provided by the Company to a few large customers in return for their support for the New Proposal. Only the Consumer Parties that entered into the Pre-PUCO Order Agreements were part of the second*

round of negotiations, and the support gained by the Company came from Customer Parties that negotiated to insulate themselves from charges proposed in the New Proposal." OCC Initial Brief at 50-51.

"The Company's handling of the Post-MDP Service Case in which the Company obtained support by arranging reimbursements for payments to the Company demonstrates that the standard service offer rates are not tightly based upon costs." OCC Initial Brief at 62.

"The side agreements deal with the Company's settlement of the Post-MDP Service Case as well as subsequent and related reimbursement to Customer Parties for their payments to the Company for generation-related service." OCC Initial Brief at 62.

"The Commission should understand that the Customer Parties' support for the Company's proposals was bought by the Duke-affiliated companies out of the pocketbooks of customers (for instance, residential customers) who did not receive the Company's favored attention and have instead paid the excessive standard service offer rates proposed by Duke Energy Ohio." OCC Initial Brief at 70.

"The Commission should re-evaluate this case given the overwhelming evidence demonstrating that signatories to the Stipulation, who largely became the supporters of the Company's New Proposal, were given inducements to settle that lessened or eliminated the impact of new charges on these parties." OCC Initial Brief at 70.

The OCC lawyers refuse to accept what the OCC witness was forced to concede: that options are legitimate business tools in a competitive commodity market and OCC has absolutely no idea whether DERS overpaid or underpaid for the 23 Option Agreements. Because there is no evidence to suggest that the options were unfairly priced, there is no evidence for the OCC's lawyers to assume that the options are anything other than arm's-length commercial transactions.

Ms. Hixon testified that:

"Q. Okay. Let me turn to the option agreements. You would agree, wouldn't you, that options are legitimate business tools in a competitive commodity market?

A. Generally, yes. " TE Vol. III at 118.

* * *

"Q. So is there anything wrong just in – is there anything wrong with an option agreement to buy or sell electricity in a deregulated market? Is there anything inherently wrong with it?

A. No." TE Vol. III at 121.

* * *

> *"Q. Okay. So sitting here today you cannot – let me start again. Since you did no forward price forecast at any time of what electricity prices are expected to be, and since you've looked at none of the usage characteristics of these option customers, you don't really have any idea as to whether or not DERS overpaid, underpaid, paid a reasonable amount for these options; isn't that correct?*
>
> *A. No. Since I have not done the analysis, I do not have any conclusion or judgment as to that."* TE Vol. III at 129-130.

OCC's lawyers have focused on only one side of the equation – what DERS paid for the options. But OCC's lawyers never focused on the value received by DERS – the ability to competitively serve billions of kWh per year at a set price anytime during 2006-2008. This is a tremendous value to DERS and DERS rightfully paid for this consideration. The 23 commercial and industrial option counter-parties would have been foolhardy in the extreme to have given away such valuable option rights for free. The amount of consideration paid and received for each option contract was individually negotiated. These were arm's length transactions. It should come as no surprise that under Ohio law the adequacy of the consideration exchanged in a commercial transaction is not subject to second guessing by the courts.

> *"It is axiomatic that courts, as a general rule, will not inquire into the adequacy of consideration once consideration is said to exist."* Rogers v. Runfola & Associates, 57 Ohio St.3d 5, 6, 565 N.E.2d 540, 542 (1991); *"In Ohio, consideration is either a benefit to the promisor or a detriment to the promisee ... The court will find consideration for an agreement is sufficient if it be such as could be valuable to the party."* Costanzo v. Nationwide Insurance, 161 Ohio App. 3d 759, 769, 832 N.E.2d 71, 79 (2005).

This Commission should respect the same rule of law.

OCC is led astray by the fact that the options are priced with reference to certain MBSSO components. The Option Agreements provide for discounts applied to a baseline determined by reference to DE-Ohio's rates. This pricing structure is based upon publicly available information and as noted in its Merit Brief at p. 19 merely reflects DERS' marketing plan. If the pricing structure were simply in dollars, then this confusion would have been avoided. There would be no issue. But the

option to serve MBSSO load understandably made reference to MBSSO pricing. This is not surprising and this is not wrong.

The operative order setting forth the required terms and conditions of DE-Ohio's MBSSO service was issued on November 23, 2004. The Commission issued this order under its independent authority to set market based rates pursuant to ORC §4928.14. Many months later, the 2005 Option Agreements were executed and were priced with reference to certain of the MBSSO rate components established by the Commission months earlier. That's all. The 2005 Option Agreements did not, and could not have influenced the terms and conditions of the Commission's November 23, 2004 Order.

2) OCC's *De Novo* MBSSO Pricing Plan Goes Well Beyond The Scope Of The Remand.

As to MBSSO pricing, the Court held that *"the Commission is required to thoroughly explain its conclusion that the modifications on rehearing are reasonable and identify the evidence it considered to support its findings."* Ohio Consumers' Counsel v. Pub. Util. Comm'n, 111 Ohio St., 3d 300, 309 (2006). This instruction focused on the evidentiary basis for the IMF and SRT. As explained in our Merit Brief at pp. 4-5, we believe that Mr. Steffen more than adequately satisfied the requisite evidentiary burden.

OCC seeks to move well beyond the scope of remand and turn this into a *de novo* MBSSO proceeding. The *de novo* MBSSO determination suggested by OCC is to use measurable and verifiable costs as a proxy for market-based rates.

> *"The objective should be to approve a good proxy for market-based rates based upon measurable and verifiable costs."* OCC Initial Brief at 13.
>
> *"The Commission's best alternative – and the direction that the Commission seems to have begun in the Post-MDB Service Case – is to devise better defined and more tightly constructed cost-based rates that would provide a reasonable proxy for market-based rates."* OCC Initial Brief at 14.

"The Commission should tighten its review over these components, and should also take this step regarding its review of the AAC in order to formulate a measurable and verifiable cost-based proxy for market-based rates." OCC Initial Brief at 25.

"The reasonable alternative to the Company's artificial, CMO construct is to place '[g]reater reliance on actual costs – rather than the costs estimated from pricing theories and models – [that] can provide a relatively stable proxy for market prices.'" OCC Initial Brief at 30-31.

"The Commission should approve standard service offer rates that are reasonable for all customers and move to cost-based rates ... ." OCC Initial Brief at 31.

"The Commission should scrutinize the cost basis for Duke Energy Ohio's standard service offer rates as a reasonable proxy for market-based rates ... ." OCC Initial Brief at 32.

While OEG agrees that some version of cost based rates would be a reasonable proxy for the "market based rates" required by ORC §4928.14, that is a different case for a different day. That is not the purpose of this limited remand.

OCC's ambitious and welcome proposal is a major undertaking that must be put on hold for the time being.

B. Response To The Ohio Marketers Group.

1. We Agree With OMG's Conclusion That The Commission Must Evaluate The MBSSO Without Regard To The Stipulation, But Disagree With OMG's Reasoning.

In its first argument OMG asserts that the May 19, 2004 Stipulation cannot be relied upon and that the DE-Ohio MBSSO charges must stand on their own. *"As such, the Commission cannot rely on the Stipulation and must evaluate the remanded RSP rate components without regard to the Stipulation."* (OMG Initial Brief at 2). We agree with this conclusion. But we disagree with OMG's reasoning. OMG reached its conclusion based on its belief that the Stipulation failed the serious bargaining test due to the various financial arrangements which OMG asserts are sham transactions.

Earlier in this Reply Brief in response to similar assertions made by OCC we discussed in detail the legitimacy of the Option Agreements and the consideration provided to and from DERS and the counterparties. We will not repeat the arguments as to why the Option Agreements are legitimate transactions in a competitive market. While we strongly disagree with its premise (the options are a sham), we agree with OMG's conclusion – the Stipulation cannot be relied upon.

As stated in our Initial Brief at 6-7, the Stipulation was effectively rejected and is no longer of any consequence.

Staff agrees: *"No party ever recommended the final outcome in the case. No one agreed. There was no Stipulation."* (Staff Initial Brief on Remand at 15).

DE-Ohio agrees: *"The Commission rejected the Stipulation so serious bargaining relative to the Stipulation is irrelevant."* (DE-Ohio Merit Brief at 6).

Cinergy Corp. and DERS agree: *"On September 29, 2004, the Commission issued an Opinion and Order in which it offered to 'approve' the stipulation, but only with material modifications to its terms. However, as filed by the parties, the stipulation provided that all parties were released from any obligations thereunder if the Commission failed to approve the stipulation without material modification. Thus, the Commission's action effectively invalidated the stipulation and the parties believed that it ceased to exist upon issuance of the Commission's Opinion and Order."* (Cinergy Corp. and DERS Merit Brief at 5).

OCC agrees: *"CG&E's nomenclature regarding 'reinstating' the Stipulation is misplaced. ... The Commission never adopted the Stipulation, so there is nothing to reinstate."* (OCC Memorandum Contra CG&E Application for Rehearing fn. 3, November 8, 2004).

With unanimous agreement that there is no Stipulation, we agree with OMG that DE-Ohio's MBSSO must stand on its own. Therefore, the negotiation process that resulted in the Stipulation is not relevant and it is not necessary to rebut OMG's assertions of impropriety which it claims tainted the bargaining process. The question then is whether the MBSSO charges can stand on their own without regard to the Stipulation. We believe they can.

DE-Ohio witness Mr. Rose did a comprehensive stand-alone analysis of the Commission-mandated MBSSO pricing. Taking into account all of the component pieces, Mr. Rose concluded that the MBSSO pricing established in the Commission's November 23, 2004 Order was within the range of market prices at that time and remains within the range of market prices today. (Rose Dir. Test. at 2-13).

Using a different analysis method, Staff witness Cahaan also concluded that the MBSSO pricing was reasonable on a stand-alone basis without reference to the Stipulation. Instead of comparing the Commission-mandated MBSSO pricing to market as was done by Mr. Rose, Mr. Cahaan used as his reference point the three-part test for judging RSPs: *"protecting the consumer from the volatility and risks of the very imperfect market, assuring the EDU of financial stability, and encouraging the development of the (retail) market."* (Cahaan Dir. Test at 4). Mr. Cahaan concluded that *"the Entry on Rehearing provides for a reasonable balance among the competing goals and interests ..."* (Id. at 14).

The only testimony in this record which examined the MBSSO pricing contained in the RSP on a stand-alone basis was from Mr. Rose and Mr. Cahaan. OCC witness Mr. Talbot only looked at the component pieces of the MBSSO. He never put all of the pieces together to determine if the whole was "*market based*" as required by ORC 4928.14. Therefore, without reference to the Stipulation, the evidence fully supports reaffirmation of the November 23, 2004 Entry on Rehearing.

2. The Option Contracts Do Not Violate ORC §4928.02(G).

In its second argument at pages 19-20, OMG argues that the Option Contracts violate ORC §4928.02(G) which sets out the policy of this state to:

> *"Ensure effective competition in the provision of retail electric service by avoiding anticompetitive subsidies flowing from a noncompetitive retail electric service to a competitive retail electric service or to a product or service other than retail electric service, and vice versa."*

OMG argues that the Option Contracts are a joint marketing venture between the utility and its affiliate which requires the customer to stay with Duke/CG&E or be transferred to its affiliated CRES (DERS). According to OMG, the customer is secured for the Duke/CG&E family of companies and is excluded from shopping with any other CRES. (OMG Initial Brief at 20).

The simple response is "so what". The option contract counter parties agreed that during 2006-2008 they will purchase MBSSO service from DE-Ohio, unless DERS exercises its option rights to take over the load. If the market price of generation falls so that its options are in the money, we fully expect that DERS will do just that. This is the bargain. This is why DERS paid for the options and this is the risk the counter parties were compensated for. Competition in a competitive market is no vice.

As to any cross subsidy between the regulated and unregulated sides of Duke's operations, we repeat again that there is no evidence that any DERS costs are being recovered in the rates of DE-Ohio. (TE Vol. III at 136; Steffen Dir. Test. at 36).

3. Corporate Separation Issues Are Not Properly Before The Commission In The Remand.

In its third argument at pages 20-21, OMG argues that the Option Agreements violate the corporate separation requirements of ORC §4928.17. In support, OMG cites to a provision in the

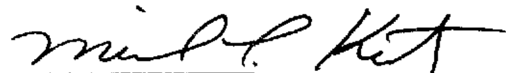
Option Contracts with the Hospitals requiring them to support a stipulation filed by the utility. According to OMG, if DERS were properly separated from DE-Ohio such a provision would not appear.

Because the allegedly offensive provision does not appear in any of the Option Contracts with the members of OEG, we are not in a position to comment in detail. But we would point out that this alleged infraction seems minor and that issues of corporate separation are not proper in this remand. If OMG feels that a corporate separation violation has occurred, then the proper remedy is for it to file a complaint.

4. There Is A Sound Evidentiary Basis For The IMF Charge.

In its final argument at pages 21-25, OMG argues that there is not a proper evidentiary basis to support the IMF charge. We addressed this issue in our Initial Brief by referring to the testimony of DE-Ohio witness Mr. Steffen. The OMG put on no witness of its own on this issue, nor did it introduce any evidence to rebut Mr. Steffen. As explained in our earlier brief, the only evidence to the contrary was put on by OCC witness Mr. Talbot and his proposal to totally eliminate the IMF and RSC charges in favor of a new rate based upon DE-Ohio's historic accounting costs is not realistic now.

Respectfully submitted,



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