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November 26, 2007

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

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RECEIVED-DOCKETING DIV

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 Biennial Review of Controllable RTO Costs for Duke Energy-Ohio in response to the Commission's Finding and Order in Case No. 05-727-EL-UNC.

Sincerely,

Robert Fortney

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

Enclosure
Cc: Parties of Record

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Staff's Biennial Review of Controllable RTO Costs

Duke Energy-Ohio (DE-Ohio) Case No. 05-727-EL-UNC

Introduction

Pursuant to Commission Order dated November 28, 2006, in Case No. 05-727-EL-UNC, Duke Energy-Ohio (DE-Ohio) filed a detailed report on the RTO costs identified by the Commission as costs that may be controllable by the Company. Pursuant to Staff's Review and Recommendations of DE-Ohio's RTO costs docketed November 16, 2006, the Staff designated controllable costs include Net Congestion Costs/Credits, Net Losses, Revenue Sufficiency Guarantee Costs/Credits (RSG) and Uninstructed Deviation costs. Subsequent to the filing of Staff's Review and Recommendations, DE-Ohio proposed and was granted authority to transfer certain RTO related cost components to its Fuel and Purchase Power Rider (FPP) and out of its Transmission Cost Rider (TCR). As a result, net congestion, net losses, and RSG credits will not be discussed in this report. However, these items will be subject to review in the on-going annual FPP audits. The Staff has performed its initial biennial review of the remaining controllable costs and the results of that review are herein reported.

Controllable RTO Costs

Following is a discussion of each of the costs identified by Staff as being controllable by the Company:

Revenue Sufficiency Guarantee (RSG) Costs

RSG costs are driven by the Midwest Independent System Operator (MISO) tariff provisions requiring MISO to provide make-whole revenue payments to generators when

it is necessary for MISO to commit the generators to operate, but the Locational Marginal Price that the generator would otherwise receive is not high enough to cover the generators as offered start-up, no load and incremental energy costs. To fund these make-whole payments MISO must assess RSG charges to Market Participants (MP). The charges are categorized as day-ahead RSG charges and real-time RSG charges, depending on the time frame the make-whole generation units were committed.

Day-Ahead RSG Costs

Although DE-Ohio evaluates their position in the energy market on a daily basis, they offer all generation and bid in 100% of its projected demand on a daily basis. DE-Ohio is allocated day-ahead RSG costs based on the number of megawatts it schedules (load only) in the day-ahead market. This allocation is a simple Load Ratio Share allocation and although the Company could opt not to schedule its forecasted load day-ahead, this would not be in the best interest of the Company or its retail ratepayers. In fact, it would likely increase the need for MISO to commit additional generation in real-time, increasing RSG costs and the Company would be allocated more of the RSG costs since its real-time deviations, as discussed below, would be higher. Staff believes the Company's strategy to clear its generation and load day-ahead is in the best interest of its ratepayers, and therefore, the day-ahead RSG costs assessed by MISO are appropriately included in the rider.

Real-Time RSG Costs

Real-Time RSG costs are allocated to DE-Ohio based on its generation deviations and its load deviations. DE-Ohio forecasts its load day ahead and demand bids 100% of its expected load requirements in the day-ahead market. However, in real-time if DE-Ohio's load deviates from what was otherwise scheduled day-ahead it is assessed a portion of the real-time RSG costs.

DE-Ohio's average monthly percentage deviation between day-ahead load schedules and real-time load was 2.83% from April 2005 to December 2005, 2.67% from January 2006 thru December 2006 and 2.71% from January 2007 thru June 2007. As

stated by DE-Ohio, "load deviations occur when our actual load in real-time deviates from our projected day-ahead load. These deviations are normal in as much as it is extremely unlikely that we can exactly predict the factors that effect load such as weather. Minimizing the load deviation is a function of our ability to forecast load. The company believes it does a reasonable job of forecasting the load and cannot, at this time, foresee significant room for improvement." Staff agrees with the Company. DE-Ohio's deviation percentages have been consistently low since the start of the energy markets in MISO. Staff has no reason at this time to find that the deviation percentage levels as stated above are unreasonable. *However, Staff recommends that the Company continue to monitor and report on its load deviations between day-ahead and real-time. If DE-Ohio's strategy for scheduling 100% of its forecasted load for the next day changes resulting in higher deviation percentages, the Company should provide rationale for the changes including the RSG cost impacts.*

DE-Ohio is also assessed real-time RSG costs as a result of its generation deviations. These deviations occur mainly as a result of DE-Ohio's commitment to maintain reliability under North America Electric Reliability Control (NERC) standards, but also occur as a result of generation derates and ramp rate limitations. Currently, DE-Ohio is part of the Duke Midwest Balancing Authority (Duke BA). As a Balancing Authority (BA), it is required to comply with NERC standards for reliability. However, MISO is the central dispatch organization that is providing generation dispatch signals for DE-Ohio to follow. Since MISO is currently not the BA, but rather is dispatching generation based on a security constrained least cost approach for the entire MISO footprint, there are times when MISO's instructions, if followed, would cause DE-Ohio to violate NERC control performance standards (CPS1, CPS2 or BAAL, and DCS) and potentially risk reliability of the interconnected system. Today, such a violation can result in a substantial financial penalty. Derates and ramp rate limitations occur at the generation facilities for various reasons, but both can result in DE-Ohio not being able to follow MISO dispatch instructions, resulting in generation deviations, and ultimately, may result in an allocation of real-time RSG costs.

The Company has indicated that the majority of RSG costs it is assessed results from complying with NERC control performance standards, and such compliance is the number one objective in operating its generators; maintaining reliability is the Company's top priority. Staff finds that while the company may have control over its generation and could follow MISO dispatch instruction instead of complying with NERC control performance standards, to do so could result in reliability issues as well as substantial financial penalties. Generation derates and ramp rate limitations are typically out of the Company's control, although the Company can control how quickly these events are factored into their future generation offers. Although the company does have some control over the operation of its generation, the Independent Market Monitor (IMM) for MISO is continuously reviewing and evaluating the Company's actions to ensure it is not engaging in unacceptable market behavior. To date, the Staff is unaware of any formal FERC filings by the IMM to address potential market abuse activity by DE-Ohio. Staff understands that prior to any formal action, discussions would transpire between the Company and the IMM, and possibly FERC. Again, Staff understands that although these discussions may have taken place from time to time, formal FERC proceedings have never been necessary. Given the preceding discussion, Staff believes the Company has appropriately included real-time RSG costs in the TCR. *However, Staff recommends that the Commission order the Company to collect data on all events that result in generation deviations and an allocation of RSG costs. The data should be provided to Staff as part of the Company's next biennial review filing.*

The current construct of MISO appears to be the main driver of the RSG costs allocated to DE-Ohio. Under the current construct MISO centrally dispatches generation, however, MISO is not the BA, and as a result, its dispatch instructions are not always consistent with instructions necessary for BAs, such as Duke BA, to comply with NERC standards. MISO is in the process of implementing an Ancillary Services Market (ASM) that is expected to be operational on June 1, 2008. At that time, MISO will become the Balancing Authority for the entire MISO footprint and thus it will be MISO's responsibility to comply with NERC control performance standards instead of Duke BA's responsibility. As a result, the current generation deviations associated with DE-

Ohio complying with NERC performance control standards and not following MISO instruction should not occur. It is also expected that once MISO becomes the BA for the entire footprint, dispatch of generation will become more efficient and the need to commit higher costs units during the Reliability Assessment Commitment (RAC) process will be reduced.

Pursuant to FERC Orders in Docket No. ER04-691, MISO has been ordered to resettle certain market participants that were over-charged or under-charged RSG charges since the start of the market. DE-Ohio indicates it has likely been overcharged on a net basis and will receive refunds for these overcharges. At this time, the Company is not able to determine the total amount of the refunds it will receive, however, any refunds received will be credited to the TCR. It should also be noted that the FERC Orders in this docket result in significant RSG costs being shifted to the MISO Revenue Neutrality Uplift (RNU) charge, and as a result, RSG resettlement refunds may be offset by the additional RNU charges. MISO resettlements began with the July 2007 invoices and are expected to conclude with the January 2008 invoices.

Staff would note that DE-Ohio has been very active in the RSG proceedings as an advocate for a more cost-causation based allocation of these costs. At this time, it is expected that MISO will file proposed modified RSG cost allocation tariff provisions at FERC by year-end 2007 or soon after.

Uninstructed Deviation (UD) Charges

UD charges occur when DE-Ohio dispatches its generation at a level that is 25MW different than the target sent by MISO or dispatches its generation at a level that +/-10% from the target sent by MISO, whichever is less. Similar to the real-time RSG charges discussed above, the UD charge is assessed when DE-Ohio must deviate from MISO instruction in order to stay compliant with NERC standards or as a result of generation derates or ramp rate limitations. The UD charge has been minimal since April 2005; however, since the charge is driven by the actions of DE-Ohio, it is considered a controllable cost. The Company has indicated that the majority of the UD costs it is

assessed results from complying with NERC control performance standards, and such compliance is the number one objective in operating its generators. Reliability is the Company's main concern and they will do everything possible to maintain the reliability of the system. Staff finds that while the company may have control over its generation and could follow MISO dispatch instruction instead of complying with NERC control performance standards, to do so could result in reliability issues as well as substantial financial penalties. Generation derates and ramp rate limitations are typically out of the Company's control, although the Company controls how quickly these events are factored into their future generation offers. Although the company does have some control over the operation of its generation, the Independent Market Monitor (IMM) for MISO is constantly reviewing and evaluating the Company's actions to ensure it is not engaging in unacceptable market behavior. To date, the Staff is unaware of any formal FERC filings by the IMM to address potential market abuse activity by DE-Ohio. Staff understands that prior to any formal action, discussions would transpire between the Company and the IMM, and possibly FERC. Again, Staff understands that although these discussions may have taken place from time to time, formal FERC proceedings have never been necessary. As a result, Staff finds UD costs are appropriately included in the TCR. *However, Staff recommends that the Commission order the Company to collect data on all events that result in generation deviations and an allocation of UD costs. The data should be provided to Staff as part of the Company's next biennial review filing.*

Just as is the case with RSG charges, the current construct of MISO appears to be the main driver of the UD costs allocated to DE-Ohio. Under the current construct MISO centrally dispatches generation based on a security constrained least cost approach, however, MISO is not the BA, and as a result, its dispatch instructions are not always consistent with instructions necessary for BAs, such as Duke BA, to comply with NERC standards. As previously mentioned, MISO expects to begin operating its ASM on June 1, 2008. Once this market begins, the UD charge will be eliminated. However, there will be new tariff provisions and charges created with ASM and Staff will review these charges as necessary.

Conclusion

Following Staff's review of the remaining controllable RTO costs and the management actions taken by the Company to minimize these costs, Staff finds that the Company should be authorized to include the costs/credits in its TCR, as discussed in the report.

On a biennial basis, staff will continue to review all controllable RTO costs and the Company's procedures in place for minimizing the controllable costs as long as the TCR is in effect.

In addition, all costs in the TCR will continue to be audited by the Staff with each Rider update, to ensure that only those costs incurred to provide service to retail customers in Ohio are included in the Rider.