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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The Cincinnati Gas & Electric Company To Modify its Non-Residential Generation Rates to Provide for Market-Based Standard Service Offer Pricing and to Establish a Pilot Alternative Competitively-Bid Service Rate Option Subsequent to Market Development Period.	)	Case No. 03-93-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc., to Adjust and Set its System Reliability Tracker Market Price.	)	Case No. 05-724-EL-UNC
In the Matter of the Application of The Cincinnati Gas & Electric Company to Modify its Fuel and Economy Purchased Power Component of its Market-Based Standard Service Offer.	)	Case No. 05-725-EL-UNC
In the Matter of the Application of Duke Energy Ohio, Inc., to Modify its Fuel and Economy Purchase Power Component of its Market-Based Standard Service Offer.	)	Case No. 06-1068-EL-UNC
In the Matter of the Application of Duke Energy Ohio, Inc. to Adjust and Set its System Reliability Tracker Market Price.	)	Case No. 05-724-EL-UNC
In the Matter of the Application of Duke Energy Ohio, Inc. to Adjust and Set the Annually Adjusted Component of its Market-Based Standard Service Offer.	)	Case No. 06-1085-EL-UNC

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APPLICATION FOR REHEARING OF
OHIO PARTNERS FOR AFFORDABLE ENERGY
AND MEMORANDUM IN SUPPORT

Colleen L. Mooney
David C. Rinebolt
Ohio Partners for Affordable Energy
231 W. Lima Street
Findlay, Ohio 45839-1793

December 20, 2007

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APPLICATION FOR REHEARING OF OHIO PARTNERS FOR AFFORDABLE ENERGY

Pursuant to R.C. §4903.10 and Ohio Adm. Code 4901-1-35, Ohio Partners for Affordable Energy ("OPAE") hereby applies to the Public Utilities Commission of Ohio ("Commission") for rehearing of the Commission's November 20, 2007 Opinion and Order in the above-captioned cases filed by The Cincinnati

Gas & Electric Company ("CG&E"), now Duke Energy Ohio, Inc. ("Duke"). The Commission's November 20, 2007 Opinion and Order is unreasonable and unlawful in the following respects.

1. The Commission acted unreasonably and unlawfully when it found that the stipulation and recommendation filed on April 9, 2007 in these cases is the product of serious bargaining among the parties.
2. Given the stipulation's treatment of returns on construction work in progress ("CWIP"), the Commission acted unreasonably and unlawfully when it found that the stipulation benefits ratepayers, serves the public interest, and does not violate any important regulatory principle or practice.
3. Given the stipulation's treatment of the use of DENA assets, the Commission acted unreasonably and unlawfully when it found that the stipulation benefits ratepayers, serves the public interest, and does not violate any important regulatory principle or practice.
4. The Commission acted unreasonably and unlawfully when it found that the stipulation benefits ratepayers, serves the public interest, and does not violate any important regulatory principle or practice when the stipulation fails without sufficient reason to adopt the recommendations of the management/performance auditor.

The reasons supporting OPAE's Application for Rehearing are set forth in the attached Memorandum in Support pursuant to Ohio Adm. Code 4901-1-35(A).

Respectfully submitted,

Colleen Mooney

Colleen L. Mooney
David C. Rinebolt
Ohio Partners for Affordable Energy
231 West Lima Street
PO Box 1793
Findlay, OH 45839-1793
419-425-8860 -- Phone
419-425-8862 -- FAX
e-mail: DRinebolt@aol.com
cmooney2@columbus.rr.com

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MEMORANDUM IN SUPPORT OF APPLICATION FOR REHEARING

I. The Commission acted unreasonably and unlawfully when it found that the stipulation and recommendation filed on April 9, 2007 in these cases is the product of serious bargaining among the parties.

The Commission found that the stipulation filed April 9, 2007 in these cases was the product of serious bargaining by knowledgeable parties. Opinion and Order at 27. The Commission stated that all parties were invited to all negotiation sessions, had closely followed many cases related to Duke's rate plan, and had been involved in many levels of discussion over a long period of time. The Commission declared that there was no connection between the April 9, 2007 stipulation and the stipulation in Case No. 03-93-EL-ATA, et al. The Commission stated that the signatory parties to the April 9, 2007 stipulation confirmed that there were no side agreements related to the April 9, 2007 stipulation. Id. The Commission also found that the stipulation was supported by representatives of all stakeholder groups--residential consumers by People Working Cooperatively ("PWC") and the City of Cincinnati, industrial consumers by the Ohio Energy Group ("OEG"), and commercial interests by the Ohio Hospital Association ("OHA") and that other groups, such as marketers, did not oppose the stipulation. The Commission claimed that the Office of the Ohio Consumers' Counsel ("OCC") and OPAE were involved in the discussions and were not successful in obtaining a result to which they could agree but the lack of agreement by two parties should not cause the entire stipulation to be rejected as if serious bargaining had not occurred. According to the Commission, to do so would give those two parties veto power over the result. Id.

Contrary to the Commission's finding, serious bargaining among the parties did not take place at the settlement negotiations for the April 9, 2007 stipulation. The Supreme Court has already confirmed that attendance and discussion at settlement negotiations does not satisfy the criterion that serious bargaining take place. In remanding Case No. 03-93-EL-ATA, et al. to the Commission for further consideration,

the Court questioned whether the existence of side agreements supports a finding that serious bargaining has taken place among parties to settlement discussions. *Ohio Consumers' Counsel v. Pub. Util. Comm.* (2006), 111 Ohio St.3d 300. As the Court stated, if CG&E and one or more of the signatory parties to the stipulation agree to a side financial arrangement or some other consideration to sign the stipulation, that information would be relevant to a determination whether all parties engaged in serious bargaining. The existence of side agreements between CG&E and the signatory parties could be relevant to the integrity and openness of the negotiation process. Id. Any concessions or inducements apart from the terms agreed to in the stipulation have relevance when deciding whether the settlement negotiations were fairly conducted. If there were special considerations in the form of side agreements among the signatory parties, one or more parties may have gained an unfair advantage in the bargaining process, and the open settlement discussions are compromised. Id.

The Commission cites the signatory parties' statement that there were no side agreements related to the April 9, 2007 stipulation. The Commission has ignored the Supreme Court's finding that the Commission must look beyond the stipulation itself to determine if serious bargaining has taken place. The Commission cannot satisfy the Court's order with a narrow statement that there were no side agreements related to the one document. The question is whether there are side agreements undermining the settlement process. The question is whether any concessions or inducements apart from the terms agreed to in the stipulation result in the settlement negotiations being unfairly conducted. The evidence of record in the remand cases clearly demonstrates that the answer to these questions is affirmative.

The Commission is wrong that there is no connection between the stipulation in Case No. 03-93-EL-ATA, et al., and the April 9, 2007 stipulation. The evidence on remand in Case No. 03-93-EL-ATA, et al., demonstrates that the side agreements affect the signatory parties to the April 9, 2007 stipulation. The evidence of the side agreements was essentially ignored by the Commission on remand. The Commission avoided a discussion of the concessions and inducements given to signatory parties and how those concessions and inducements undermined the settlement process. If the Commission had properly considered the evidence of the side agreements on remand, the Commission would have recognized the obvious connection between the stipulation rejected on remand and the April 9, 2007 stipulation. The April 9, 2007 stipulation is simply the furtherance of the side agreements that benefit a handful of customers at the expense of whole classes of customers. The April 9, 2007 stipulation was submitted by CG&E and five other parties, all of whom supported the Case No. 03-93-EL-ATA, et al. stipulation.

The City of Cincinnati signed the April 9, 2007 stipulation. The City of Cincinnati signed a settlement agreement with CG&E under which the City agreed to withdraw from Case No. 03-93-EL-ATA, et al. Under the agreement, CG&E provided the City with one million dollars ($1,000,000) in total consideration for certain amendments to three electricity agreements between CG&E and the City. OCC Remand Ex. 6. The settlement agreement was conditioned upon the City not opposing the stipulation filed in Case No. 03-93-EL-ATA. The settlement agreement also would terminate on the day that the Commission issues an order unacceptable to CG&E in carrying out the terms of the stipulation in Case No. 03-93-EL-ATA. Id. at 2. This provision could easily be

extended to support for the April 9, 2007 stipulation. The City of Cincinnati's support for the April 9, 2007 stipulation can be seen as a product of its separate side agreement with CG&E. It is also not clear that the City of Cincinnati serves as a representative of the residential class, as the Commission claims, when the City's agreements with CG&E concern the City as a customer, not as a representative of the residential class.

The other signatory party, which the Commission cites as representing the residential class, is People Working Cooperatively ("PWC"). PWC operates demand-side management programs funded by CG&E. PWC's primary purpose in these proceedings is to assure that funding promised by CG&E will be continued and extended through the end of the market development period. PWC Motion to Strike (April 27, 2007). PWC represents the interests of consumers only to the extent that those interests coincide with the funding PWC receives from CG&E for its projects. Because PWC showed no concern for the impact of the stipulation on residential customer bills, its support for the stipulation should not be construed as support from the residential class.

It should also be noted that members of OEG and OHA have side agreements with Duke that could have influenced their support for the April 9, 2007 stipulation. The same is true of the Industrial Energy Users-Ohio, who did not sign the April 9, 2007 stipulation but are cited by the Commission as not opposing it.

The April 9, 2007 stipulation has no support from marketers, residential customers or any other customer group that will be subject to its terms. OCC, which, by statute, represents all residential customers, opposed the stipulation, as did OPAE, which has served as an advocate for residential and low-income customers since its

founding in 1996. OPAE also represents the interests of its member agencies located in the CG&E service territories that are commercial customers of CG&E. It is ridiculous for the Commission to dismiss OCC and OPAE as simply two parties who failed to achieve a satisfactory result in the settlement process. OCC and OPAE are the two parties representing the vast majority of Duke's customers. They are the two parties representing customers without side agreements and without special inducements. They are the two parties representing customers who will actually pay all the charges set forth in the applications and stipulation. They are the parties actually concerned about the stipulation's terms. The Commission must heed the Supreme Court's warning. The signatory parties to the stipulation have concessions, inducements and special interests outside the terms of the stipulation; the signatory parties have no concern for the stipulated terms.

If the signatory parties are not subject to the terms of the stipulation, the stipulation cannot be the product of serious bargaining. Serious bargaining does not take place when the stipulation hardly affects the stipulating parties and when they have side agreements that undermine its terms. The April 9, 2007 stipulation is not the bargain made by the signatory parties; their agreements with Duke are elsewhere, where the Commission still refuses to look.

The Ohio Supreme Court has affirmed the Commission's rate stabilization plan concept solely on the basis of stipulations supported by a wide range of parties to the cases. In *Constellation NewEnergy, Inc. v. Pub. Util. Comm.*, 104 Ohio St.3d 530, 2004-Ohio-6767, the Court affirmed the Commission's finding in approving a rate plan

on the basis of the reasonableness of a stipulation supported by all customer classes. As the Court stated in a subsequent case involving the rate plan of FirstEnergy Corp.:

> The absence of a stipulation signed by customer groups factually distinguishes this case from *Constellation*. In *Constellation* we also noted that "no entire customer class was excluded from settlement negotiations and that the following classes were represented and signed the stipulation: residential customers, low-income customers, commercial customers, industrial customers, and competitive retail electric service providers." When it enacted R.C. 4928.14, the General Assembly anticipated that at the end of the market-development period, customers would be offered both a market-based standard service as required by R.C. 4928.14(A) and service at a price determined through a competitive-bidding process as required by R.C. 4928.14(B); one very narrow exception contained in R.C. 4928.14(B) permits the commission to determine that a competitive-bidding process is not required. In *Constellation,* the customer groups, by stipulation, agreed to accept a market-based standard service offer and waive any right to a price determined by competitive bid. Those facts are not present in this case.

Ohio Consumers' Counsel v. Pub. Util. Comm., 2006-Ohio-2110 ¶18. The Court made it clear that the stipulation signed by a wide range of parties was the determining factor that allowed the Court to affirm the Commission's orders. The Court made a strong distinction between Commission orders that could be made pursuant to a stipulation supported by a wide range of parties and orders that could not be made absent such a stipulation. In the same opinion, the Court also stated:

> In contrast to the customer groups in *Constellation*, the customer groups here did not agree to the FirstEnergy rates, and most customer groups, including the OCC, which represents all residential customers, opposed them. Under these circumstances, the PUCO had no authority to adopt the rate-stabilization plan without also ensuring that a reasonable means for customer participation had been developed.

Id. ¶19.

In short, the Court has affirmed the Commission's rate stabilization orders on the basis of customer agreement in a stipulation. The Court has explicitly stated that such

customer agreement is the determining factor in the Court's affirmation of the Commission's rate stabilization orders.

The April 9, 2007 stipulation clearly does not represent the views or satisfy the interests of the residential class or any other class. The Commission acted unlawfully and unreasonably when it found that serious bargaining took place among the parties when the stipulation is not an agreement representative of the customer classes and when the Commission failed to consider the extent to which the existence of the side agreements from the remanded case, Case No. 03-93-EL-ATA, et al. affected the signatory parties to the stipulation in these cases.

II. Given the stipulation's treatment of returns on Construction Work in Progress ("CWIP"), the Commission acted unreasonably and unlawfully when it found that the stipulation benefits ratepayers, serves the public interest, and does not violate any important regulatory principle or practice.

The Commission found that its approval of the annually adjusted component ("AAC") was based on Duke's calculations, which clearly showed CWIP as a factor in the AAC, with no reference to percentage completion. The Commission also found that, in the present market environment, ratemaking standards, such as the limitation on earning a return on CWIP, are not dispositive of the outcome in these proceedings. Therefore, the Commission found that the stage of completion of CWIP should not, under these specific circumstances, be a bar to Duke's earning a return on CWIP. Opinion and Order at 24.

The April 9, 2007 stipulation fails to benefit ratepayers and the public interest and violates important regulatory practice and principle by allowing for the recovery of a return on CWIP through Duke's AAC. The stipulation is also contrary to the

recommendation of the management/performance auditor that a return on CWIP be excluded from the AAC. Commission-Ordered Ex. 1 at I-9.

The inclusion of a return on CWIP results in unreasonable AAC charges. First, a return on CWIP would not traditionally have been allowed in ratemaking proceedings. A revenue requirement determined through a traditional regulatory cost calculation would require that any CWIP be at least 75% complete before the Commission would consider allowing a return on it. Duke has not demonstrated that the CWIP portion of the environmental compliance net plant is or will be at least 75% complete (or any other percentage) during the time that the AAC is being collected.

Second, under a traditional regulatory paradigm, Duke might propose allowing a return on CWIP that customers would pay up front during plant construction. After construction is complete, the customers have a claim that the return on CWIP will provide lower capital costs at a future date when the plant is in service. The current regulatory paradigm does not provide any assurance of lower capital costs for customers at a future date.

The Commission states that the traditional regulatory treatment does not apply in the present market environment. In fact, the ACC itself has no place in the market environment. As OCC witness Michael P. Haugh pointed out, the "new" formula used by Duke to determine a market price for standard service generation simply seeks cost-based recovery that is similar to the traditional methodology for the treatment of CWIP, but without any limitation regarding the percentage of completion for additions to environmental plant and without any assurance of lower capital costs in the future. OCC Ex. R.R. 1 at 7. Duke is seeking for itself the best of both worlds: cost recovery

using traditional revenue requirement methodology (such as CWIP) instead of a market approach, but disregard for traditional ratemaking rules governing cost recovery such as those that governed CWIP. Id. In a market environment, CWIP would not be earned at all. A return on the plant would not occur until the plant is fully operational. Thus, in a market environment, CWIP is inappropriate.

Under the circumstances of an application requesting recovery of a typically regulated concept such as CWIP, it is obvious that traditional regulatory practices can and should be used to ensure reasonable standard service offer rates, which must be filed pursuant to R.C. §4909.18 and conform to a just and reasonable standard. CWIP should be removed from the "Return on Environmental Plant" calculation in Duke's filing for purposes of setting a reasonable AAC charge in conformance with the just and reasonable standards of R.C. §4909.18. Mr. Haugh removed the $244,413,759 CWIP amount from the "Return on Environmental Plant" calculation of Duke witness Wathen's at Attachment WDW-2, Schedule 2. This reduces the "Pre-Tax Return" to $53,938,303 and reduces the "Total Environmental Compliance Increase" to $50,429,411. OCC Ex. R.R. 1 at 11. The removal of the CWIP portion of the Environmental Plant reduces the revenue requirement for the 2007 AAC to $45,246,994. Id.; MPH Attachment 1.

There is no "market environment" for retail electric generation to serve Ohio's residential and small commercial customers. Retail competition is non-existent for these customers in CG&E-Duke's service area. Therefore, any determination of a rider amount or overall generation price must necessarily involve a proxy for a market price. There is no reason why standards for CWIP should not apply; in fact, standards

must be applied in order for the AAC to meet the just and reasonable standard required by R.C. §4909.18 for standard service offers.

III. Given the stipulation's treatment of the use of DENA assets, the Commission acted unreasonably and unlawfully when it found that the stipulation benefits ratepayers, serves the public interest, and does not violate any important regulatory principle or practice.

The Commission stated that, under the stipulation, the Duke Energy North America ("DENA") assets were to be used only on an emergency basis where capacity to meet Duke's operational requirements is necessary with less than seven days advance notice. Opinion and Order at 20. The Commission also found that the pricing mechanism proposed in the stipulation was reasonable. Id. at 21.

OCC witness Haugh testified that Duke has not demonstrated that use of the DENA assets benefits customers. The use of the DENA assets may result in system reliability tracker ("SRT") costs that do not provide reasonably-priced retail electric service for Ohio customers. OCC Ex. R.R. 1 at 15. Duke should be allowed to purchase capacity from the DENA assets only in an emergency situation and only if Duke demonstrates that the DENA assets clearly offered a better price or a better product for customers than that offered in the open market. The DENA capacity should be used only as a last resort and only if there is a pre-determined reasonable method to set the price for the capacity from the DENA assets. OCC Ex. R.R. 1 at 15-16.

The Commission's Opinion and Order does not provide a reasonable method to set the price for the capacity from the DENA assets. Therefore, the Commission has not provided adequate protection for ratepayers against Duke's overcharging for the DENA assets. The approved stipulation allows Duke to determine the "market price" by

either using the midpoint of broker quotes, the average price of third-party transactions, or another method determined by Duke and the Staff. In reality, there are usually very few broker quotes. OCC R.R. Ex. 2 at 4. The problem with the stipulated method is that there is a limited market. If there are very few or no transactions, then there is only speculation about the market price. Given the lack of transactions in the capacity market, the market price for capacity would be determined with limited or no market data. This is not an acceptable solution for determining the market price of the DENA assets, nor does it provide a reasonable cost for capacity for Duke customers. OCC Ex. R.R. 1 at 14.

Contrary to the Commission, the guidelines for formulating a price for the DENA assets need to be more stringent. If there are limited broker quotes and transactions in the capacity market, there will be too much uncertainty regarding the true market price. The formula set forth in the April 9, 2007 stipulation should not be used unless there is a minimum number of broker quotes and transactions to determine the price of the DENA capacity. A minimum of three bids and offers from three separate brokers is needed, and a minimum of three third-party transactions should be required. Finally, when formulating a price, there needs to be a cap on the amount Duke is charging to the customers who are paying the SRT. The price should be capped at the median price Duke has paid for capacity during the time frame in which the emergency occurs. This cap should be implemented if any capacity from the DENA assets is used. OCC R.R. Ex. 2 at 6. Given that the price of capacity in a true emergency can be extremely high, there is good reason to cap the price.

The use of DENA assets should be limited only to an emergency situation and only if CG&E-Duke demonstrates that the DENA assets clearly offered a better price or a better product for customers than that offered in the open market. The DENA capacity should be used only as a last resort and only if there is a pre-determined reasonable method to set the price for the capacity from the DENA assets. The stipulated methodology to formulate a "market price" for the DENA assets does not provide proper protections for customers. The stipulation's treatment of the DENA assets is harmful to ratepayers and against the public interest; it also violates important regulatory principles and practices by allowing for the use of DENA assets and recovery of costs through the SRT without adequate limitations and safeguards.

IV. The Commission acted unreasonably and unlawfully when it found that the stipulation benefits ratepayers, serves the public interest and does not violate any important regulatory principle or practice when the stipulation fails without sufficient reason to adopt the recommendations of the management/performance auditor.

The April 9, 2007 stipulation proposed to accept some, but not all, of the management/performance auditor's recommendations. By presenting this suspect stipulation to the Commission, Duke was able to choose the audit recommendations that it was willing to implement, and ignore those that it chose to ignore. The Commission's approval of the stipulation unreasonably allowed Duke's preferences.

As discussed above, the stipulation ignored the management/performance auditor's recommendation to disallow the recovery of a return on CWIP. The stipulation also rejected the management/performance auditor's recommendation regarding the use of DENA assets. Commission-Ordered Ex. 1 at 6-5.

The stipulation disregarded other audit recommendations without any justification other than Duke's desire to disregard them. For example, the auditor recommended that Duke discontinue its active management practices and adopt a traditional utility procurement strategy related to the procurement of coal, emission allowances and forward power purchases. Id. at I-9. The April 9, 2006 stipulation stated that the auditor's recommendation that active management practices be discontinued will be withdrawn. Jt. Ex. R.R. 1 at 5. The Commission stated that the evidence of record convinced it that an active management approach allows Duke to take advantage of market fluctuations, thereby lowering the overall cost to customers. Opinion and Order at 15. The Commission did not adequately address the auditor's concern that active management be discontinued. There was no basis on the record to disregard the auditor's recommendation.

The auditor also recommended that Duke present several alternative sensitivity analyses of key variables (i.e., emission allowance prices and market coal prices) in its transaction review and approval process. Duke should maintain detailed documentation of all emission allowance prices, market coal prices, and power purchase transactions to enable the next auditor to review adequately the management of the procurement process for coal, emission allowances and power purchases. If the auditor discovers that Duke's management of the procurement process for coal, emission allowances, and power purchases has resulted in imprudently incurred costs, then those imprudent costs should be refunded to customers.

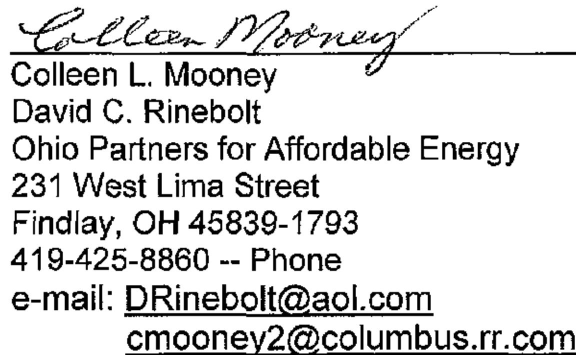
The Commission disregarded these audit recommendations as well as the auditor's recommendations to disallow the recovery of a return on CWIP, to place limits

on the use and pricing for the DENA assets, and to cease active management. By disregarding these audit recommendations, the stipulation failed to benefit ratepayers and serve the public interest; the stipulation also violated important regulatory principles and practices. The Commission allowed Duke to select the audit recommendations that Duke wanted to follow, and ignore the recommendations that Duke disliked. The Commission should have rejected the stipulation to the extent that it allowed Duke to ignore without good cause the reasonable recommendations of the management/ performance auditor.

V. Conclusion

Wherefore, OPAE respectfully requests that the Commission grant OPAE's application for rehearing for the reasons set forth in the memorandum in support.

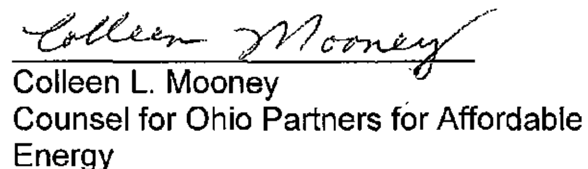
Respectfully submitted,



Colleen L. Mooney
David C. Rinebolt
Ohio Partners for Affordable Energy
231 West Lima Street
Findlay, OH 45839-1793
419-425-8860 -- Phone
e-mail: DRinebolt@aol.com
cmooney2@columbus.rr.com

CERTIFICATE OF SERVICE

I hereby certify that a copy of this Application for Rehearing and Memorandum of Support was served electronically upon the parties of record identified below on this 20th day of December 2007.



Colleen L. Mooney
Counsel for Ohio Partners for Affordable Energy

PARTIES

Paul Colbert
Cincinnati Gas & Electric Company
139 E. Fourth St. 25th Floor
Atrium II Building
Cincinnati, Ohio 45201-0960
paul.colbert@duke-energy.com
anita.schafer@duke-energy.com
rocco.d'ascenzo@duke-energy.com

Jeffrey Small
Office of the Consumers' Counsel
10 W. Broad Street, 18th Floor
Columbus, Ohio 43215
small@occ.state.oh.us

Daniel J. Neilsen
McNees, Wallace & Nurick
21 East State Street
Columbus, Ohio 43215
dneilsen@mwncmh.com

Michael Kurtz
Boehm, Kurtz & Lowry
36 E. Seventh St. Ste. 1510
Cincinnati, Ohio 45202
mkurtz@bkllawfirm.com

Thomas McNamee
Attorney General's Office
Public Utilities Commission Section
180 E. Broad Street, 9th Floor
Columbus, Ohio 43215-3793
Thomas.McNamee@puc.state.oh.us

David Boehm
Boehm, Kurtz & Lowry
36 E. Seventh St. Ste. 1510
Cincinnati, Ohio 45202
dboehm@bkllaw.com

Howard Petricoff
Vorys, Sater, Seymour & Pease
52 East Gay Street
Columbus, Ohio 43216-1008
mhpetricoff@cssp.com

Michael Dortch
Kravitz, Brown & Dortch
145 E. Rich Street
Columbus, Ohio 43215
mdortch@kravitzllc.com

Mary W. Christensen
100 East Campus View Blvd. 360
Columbus, Ohio 43235
Mchristensen@Columbuslaw.org

Rick Sites
Ohio Hospital Association
155 E. Broad Street, 15th Floor
Columbus, Ohio 43215-3620
www.ohanet.org

Barth Royer
Bell, Royer & Sanders
33 South Grant Avenue
Columbus, Ohio 43215
broyer@brscolaw.com

Thomas J. O'Brien
Bricker & Eckler
100 South Third Street
Columbus, Ohio 43215
tobrien@bricker.com

Craig Goodman
National Energy Marketers
3333 K Street NW, Suite 110
Washington, DC 20007
cgoodman@energymarketers.com

Shawn Leyden
PSEG Energy Resources
80 Park Plaza, 19th Fl.
Newark, NJ 07102
shawn.leyden@pseg.com

Arthur E. Korkosz
FirstEnergy Solutions
76 South Main Street
Akron, Ohio 44308
KorkoszA@FirstEnergyCorp.com

Theodore Schneider
Murdock, Goldenberg, Schneider
700 Walnut Street, Ste. 400
Cincinnati, Ohio 45202
tschneider@mgsglaw.com

Noel M. Morgan
215 East Ninth Street, Ste. 200
Cincinnati, Ohio 45202
nmorgan@lascinti.org

Donald Marshall
4465 Bridgetown Road, Ste. 1
Cincinnati, Ohio 45211
eagleenergy@fuse.net

Dane Stinson, Bailey Cavalieri
10 W. Broad Street, Suite 2100
Columbus, Ohio 43215
dane.stinson@baileycavalieri.com