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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Commission's Review)
And Adjustment of the Fuel and Purchased)
Power and System Reliability Tracker)
Components of Duke Energy Ohio, Inc.,)
and Related Matters)

Case No. 07-723-EL-UNC

In the Matter of the Application of Duke)
Energy Ohio, Inc. to Adjust and Set its)
2008 System Reliability Tracker.)

Case No. 07-975-EL-UNC

REPLY BRIEF OF DUKE ENERGY OHIO, INC.

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INTRODUCTION:

In this proceeding, the Office of Ohio Consumers' Counsel (OCC) chooses to oppose a stipulation (Stipulation) contested by no other party to these proceedings and for no apparent purpose other than a desire to direct unconstructive criticism at Duke Energy Ohio (DE-Ohio). Despite OCC's dubious opposition, this Commission should not lose sight of the fact that through the Stipulation DE-Ohio has agreed to implement *all but one* of Liberty Consulting Group's (Liberty's) recommendations regarding its managerial practices. Moreover, through the Stipulation DE-Ohio also agreed to preserve for later evaluation by a subsequent auditor the one recommendation made by Liberty with which DE-Ohio cannot agree.

To support its opposition to the Stipulation, OCC repeatedly intimates, where it does not baldly assert, that DE-Ohio is evading and has, historically, avoided¹ or resisted² recommendations made by the independent auditors selected by this Commission. These intimations and assertions do not withstand even casual examination.

Finally, OCC complains that certain commitments contained in the Stipulation are inappropriate because those commitments are similar, or even identical to, matters previously addressed within Commission Orders.³ DE-Ohio finds it highly ironic – given OCC's efforts to paint DE-Ohio as recalcitrant – that OCC chastises DE-Ohio and the parties to the Stipulation for addressing every recommendation made by the Auditor.

With no opposition to the Stipulation but that of OCC, and with OCC's opposition as obviously insubstantial as it is, DE-Ohio submits that this Commission should adopt the Stipulation as submitted for its consideration.

¹ January 7, 2008 Initial Post-Hearing Brief ("OCC's Brief"), p. 2.

² OCC's Brief, p. 7.

³ OCC's Brief, pp. 18-19.

ARGUMENT:

I. The Commission Should Ignore OCC's Unfair and Unfounded Criticisms of DE-Ohio as it Evaluates The Stipulation.

OCC's opposition to the Stipulation is founded upon OCC's distortions of the positions of others. OCC grossly mischaracterizes both Liberty's Audit Report and DE-Ohio's response thereto in an effort to somehow convince this Commission that adoption of the Stipulation will harm Ohio consumers.

For example, OCC claims that Liberty issued its Recommendation I in response to DE-Ohio's "operational losses"⁴ – something Liberty most certainly did *not* assert – or even suggest.⁵ Similarly, OCC claims that Liberty's audit of DE-Ohio reveals that DE-Ohio's treatment of matters that affect the FPP calculation has "needlessly raised costs that residential customers would pay."⁶ Of course, OCC fails to cite any evidentiary support for this absurd statement.

In fact, Liberty's Recommendation I merely recommends that DE-Ohio formalize certain Commercial Asset Management (CAM) Group operating procedures. Liberty explained why it believes formal guidance documents have significance and, in fairness to DE-Ohio, Liberty also reported DE-Ohio's explanation why it had not previously formalized such procedures in writing.⁷

Remarkably, OCC not only manufactures a non-existent basis for Liberty's Recommendation No. 1, but also manufactures non-existent resistance by DE-Ohio to that recommendation. Although OCC states that this Recommendation "illustrates the Company's

⁴ OCC's Brief, p. 7.

⁵ Liberty Consulting Group's October 31, 2007, Final Report, Management/Performance Audit and Financial Audit, Duke Energy Ohio, Case No. 07-723-EL-UNC, ("Audit Report"), pp. I-1 – I-9.

⁶ OCC's Brief, p. 5.

⁷ Audit Report, p. I-8.

resistance to adopt auditor recommendations"⁸ OCC fails to indicate – or even to acknowledge – that through the Stipulation *DE-Ohio actually agrees to adopt Liberty's recommendation* and to create the recommended CAM guidance documents.⁹

All OCC's arguments, and the purported bases for its arguments, prove to be entirely hollow when examined. For example, the *facts* surrounding Recommendation No. 1 are that even though Liberty recommended that DE-Ohio formalize the CAM organization's procedures, Liberty at the same time commended DE-Ohio in its conclusions, stating that:

- DE-Ohio's CAM organization is staffed with individuals possessing a broad cross-section of skills that effectively match the overall requirements of the organization.¹⁰
- The Traders in the CAM organization are motivated by incentives that relate to the overall performance of the organization, rather than by incentives tied to the specific trades for which they are responsible.¹¹
- The CAM organization is guided by a particularly effective set of procedures that cover the areas of Risk Management and Delegation of Authority.¹²

OCC ignores Liberty's conclusions – just as it ignored DE-Ohio's agreement to implement Liberty's recommendation – because these *facts* are entirely inconsistent with OCC's misguided attack on DE-Ohio.

OCC not only mischaracterizes the bases of Liberty's recommendations and DE-Ohio's responses to those recommendations, but also mischaracterizes even the very recommendations themselves. For example, OCC asserts that Recommendation No. II-2 is a recommendation "... regarding the Company's discontinuation of its active management activities for coal

⁸ OCC's Brief, p. 7.

⁹ Stipulation, ¶4.

¹⁰ Audit Report, p. I-7, Conclusion no. 1.

¹¹ Id., Conclusion no. 2.

¹² Id., Conclusion no. 3.

procurement. . ."¹³ Recommendation II-2, however, *does not* recommend the discontinuation of DE-Ohio's Active Management program – a program that even OCC grudgingly acknowledges¹⁴ this Commission recently concluded is reasonable.¹⁵ Instead, Recommendation II-2 suggests only that DE-Ohio demonstrate the economic effectiveness of the Active Management Program – a recommendation that, again, *DE-Ohio has expressly addressed through the Stipulation*. Specifically, DE-Ohio has agreed to work with Staff to design and implement, in time for review by the next auditor, the business records DE-Ohio shall maintain to demonstrate the effectiveness of Active Management.¹⁶

Next, OCC proves willing to mischaracterize the evidence in a failed attempt to manufacture non-existent "operational losses" resulting from DE-Ohio's Active Management program.¹⁷ As this Commission is aware, DE-Ohio's "Active Management" program involves DE-Ohio's management of three portfolio commodity components – its coal supplies, emission allowances, and purchased power supply. Ignoring Liberty's acknowledgement that DE-Ohio was able to demonstrate, for the month of December, 2006 for example, that losses incurred as a result of DE-Ohio's management of its coal supply were more than offset by the overall savings created when emission allowances and purchased power positions were considered in addition to the coal positions,¹⁸ OCC focuses upon 2006-2007 losses related solely to DE-Ohio's coal supplies in order to contend that an operational loss exists.

¹³ OCC's Brief, p. 7.

¹⁴ OCC's Brief, p. 8.

¹⁵ *In re Duke Energy Post-Remand Rider Cases*, Case Nos. 05-724-EL-ATA, *et al.* Order (November 20, 2007), pp. 13-15.

¹⁶ Stipulation, ¶¶4 and 6.

¹⁷ OCC's Brief, pp. 5 and 8.

¹⁸ Audit Report, p. II-15.

OCC also ignores the Supplemental Testimony of DE-Ohio's Witness Charles R. Whitlock who explains that the negative coal margin listed in Liberty's audit report is not indicative of the total net Rider FPP cost to consumers.¹⁹ Mr. Whitlock explains that to measure the net cost, the entire portfolio, including coal emission allowances, and purchased power must be reviewed.²⁰ Liberty's discussion of the negative coal margin does not include any analysis or discussion regarding offsetting transactions involving the other portfolio commodities. Additionally, Mr. Whitlock explained that the negative coal margin discussed in Liberty's report reflects a combination of items including accounting gains and losses, conversion of financial products or hedges to physical inventory and quality fuel swaps.²¹ In other words, Active Management, in and of itself, did not generate \$16.7 million in negative coal margins. Moreover, it does not result in the Rider FPP price increasing by \$16.7 million. Similarly, OCC does not even acknowledge – let alone attempt to contest – Liberty's statement that DE-Ohio believes that much of the imputed coal management loss is unrelated to the Active Management program but instead results from costs associated with normal fuel management activities.²² Nor does OCC acknowledge Liberty's finding that the prices DE-Ohio paid for its coal declined more during the audit period than the price paid by any other Ohio electric utilities.²³

No matter how profound OCC's dissatisfaction with DE-Ohio's Active Management program may be, OCC should not be permitted to use these proceedings to collaterally attack a decision of this Commission that is not yet two months old, or to mount baseless attacks against DE-Ohio. The *fact* is that DE-Ohio and other parties to these proceedings have expressly agreed,

¹⁹ Supplemental Testimony of Charles R. Whitlock at 7,

²⁰ *Id.*

²¹ *Id.*

²² Audit Report, pp. II-14.

²³ Audit Report, p. II-5.

through the Stipulation, that DE-Ohio will comply with Liberty's recommendation regarding the "Active Management" program. DE-Ohio has committed to work with Commission Staff to develop documentation permitting the auditing of active management transactions included within Rider FPP including: (1) a clear and comprehensive set of procedures that address the portions of the portfolio that are subject to transaction and the specific triggers that allow identified portions and magnitudes of the portfolio to be traded; (2) an effective system of controls over the procedures; (3) the daily positions, market conditions and other relevant decision-making criteria; and (4) actual transactions conducted, including rationale for any transactions not conforming to the documented procedures.²⁴ This Stipulation provision does far more than blindly commit to adopt Liberty's recommendation regarding Active Management. This language expressly sets forth the manner in which DE-Ohio is going to comply. The Stipulating Parties, including the Staff of the Commission, having negotiated and agreed upon this specific language, were satisfied that this provision directly and appropriately addressed Liberty's recommendation regarding Active Management. Two Parties have stated for the record that they do not oppose the Stipulation. The logical conclusion from this no-opposition is that those Parties do not have any significant issue with this provision. OCC should acknowledge these facts rather than mischaracterize the actions of the company and the findings and recommendations of the independent auditor.

Similarly, OCC's criticism of DE-Ohio regarding coal sample security procedures once again ignores the fact that through the Stipulation *DE-Ohio agrees to implement Liberty's recommendations on this subject*. Here, OCC's Brief deliberately invites the reader to believe

²⁴ Stipulation, Joint Ex. 1, ¶6.

that DE-Ohio has in the past ignored substantially identical recommendations by prior auditors regarding the same issue.

In fact, however, the Auditor's recommendation to which OCC alludes in its brief concerned an entirely different aspect of coal sample security. In the 1999 Audit Report to which OCC cites, the Auditor recommended only that the Company label coal samples in a manner that would conceal the source of the sample.²⁵ DE-Ohio implemented the Auditor's recommendation in 1999, just as it will implement Liberty's 2006 recommendation now. OCC's gross distortion of historic fact to support an assertion that DE-Ohio is "insufficiently motivated to act on such recommendations because Duke Energy views the cost of coal . . . as a cost that is flowed through to customers . . . "26 is an unfair and inaccurate attempt to paint DE-Ohio as a recalcitrant participant in the audit process in order to conceal the utter lack of substance to OCC's opposition to the Stipulation. In the Stipulation at issue, DE-Ohio has committed to evaluate the need and opportunities for coal sample security at all its generating stations.²⁷ DE-Ohio is willing to commit that it has already undertaken steps to comply with this provision, which thus far includes the procurement of lockboxes to store coal samples prior to transport, which have a single access point, and in which only the laboratory personnel responsible for sending samples for testing will have the key. The samples are sent in sealed containers in which any indication of tampering would be self-evident. The samples are transported along with chain of custody forms documenting who has handled the samples.

²⁵ See Liberty Consulting Group's March 5, 1999, Final Report, Management/Performance Audit, Cincinnati Gas & Electric Co., Case No. 07-103-EL-EFC (the "1999 Audit Report") pp. IV-5.

²⁶ OCC's Brief, p. 10.

²⁷ Stipulation, Joint Ex. 1, ¶7.

Finally, OCC's criticism of provision 8 of the Stipulation,²⁸ which preserves the issue surrounding the Zimmer outage extension to a later audit, need not concern this Commission. OCC obviously is not concerned that the issue may be deferred. Instead, OCC is only concerned that the Stipulation will somehow limit the information the Auditor can consider. The language of the Stipulation does not purport to do so, nor is it the intent of the provision to constrain the Auditor, as DE-Ohio's Mr. Wathen has acknowledged several times, both in Supplemental Testimony and under OCC's cross-examination.²⁹

II. The Stipulation Clearly Meets the Commission's Three-Part Test For Evaluating Stipulations.

The Commission's rules encourage parties to enter into stipulations or agreements in settlement of issues in a proceeding.³⁰ No stipulation between the parties can bind this Commission, of course, which must satisfy itself that the terms of any stipulation are reasonable based upon the evidence before it.³¹ Still, such agreements are accorded substantial weight.³²

In considering the weight to be given to, and the ultimate reasonableness of, a stipulation, this Commission uses a three-part test which has been affirmed numerous times by the Supreme Court of Ohio. Specifically, the Commission considers the following:

1. Is the settlement a product of serious bargaining among capable, knowledgeable parties?
2. Does the settlement, as a package, benefit ratepayers and the public interest?

²⁸ OCC's Brief, p. 16.

²⁹ *In re the Adjustment of DE-Ohio's Rider FPP and Rider SRT*, Case No. 07-723-EL-UNC *et al.*, (DE-Ohio Exhibit 8), Supplemental Testimony of William Don Wathen ("Wathen Supp. Testimony,") p. 5. See also, *In re the Adjustment of DE-Ohio's Rider FPP and Rider SRT*, Case No. 07-723-EL-UNC, *et al.*, Hearing Transcript Vol. II, (December 14, 2007), p. 21.

³⁰ O. A. C. 4901-1-30.

³¹ *Ohio Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St. 3d 123, 126, 592 N.E.2d 1370, 1373.

³² *Id.*, p. 125.

3. Does the settlement package violate any important regulatory principle or practice?³³

In this case, the evidence of record shows that the Stipulation satisfies all three prongs of this Commission's test. The Stipulation is a product of serious bargaining among capable, knowledgeable parties, as the Stipulation has the express support of this Commission's Staff and of the Ohio Partners for Affordable Energy (OPAE), and as both Industrial Energy Users – Ohio (IEU-Ohio) and the Ohio Energy Group (OEG) have avowed on the record they do not oppose resolution of this case on the grounds stated in the Stipulation. As this Commission is well aware, Staff, OPAE, IEU-Ohio and OEG are among the most capable and knowledgeable groups to participate regularly in Commission proceedings, and are represented by able counsel having many years of experience before this Commission.

OCC nonetheless claims that the Stipulation is not the result of serious bargaining among capable, knowledgeable parties and that support for the Stipulation is "weak."³⁴ To the contrary, the Stipulation is opposed by OCC *alone*, and as demonstrated herein, OCC itself has found it necessary to manufacture reasons for even its own opposition to the Stipulation. The fact that one Party involved in the settlement process does not advocate settlement, does not diminish the seriousness of the process or the fact that it occurred among knowledgeable parties.

Contrary to the statements of the OCC, the Stipulation as a whole is of benefit to the public interest and to consumers. It affords appropriate recovery and financial stability to DE-Ohio.³⁵ Consumers, in turn, benefit by having a reliable firm generation service at their disposal at a reasonable market price.

³³ *Id.*

³⁴ OCC's Brief, p. 12.

³⁵ Wathen Supp. Testimony p. 4.

To support its assertion that the Stipulation offers no benefit to the public or consumers, OCC tried, once again, to rely upon the contrived position that "[t]he Stipulation displays multiple instances of resistance to the expert advice provided by the Liberty auditors . . ."³⁶ Again, this argument is completely baseless. The Stipulation – on its face – requires DE-Ohio to implement all but one of Liberty's recommendations and even then the Stipulation preserves that one unadopted recommendation for review and consideration by subsequent auditors.³⁷ This hardly suggests evasion or resistance to the audit process. First of all, DE-Ohio has accepted most of the Auditor's recommendations, but it should be noted that Liberty's recommendations are just that, recommendations. There is no statutory requirement in Ohio, that simply because there is an audit report containing certain recommendations, that any Party, whether it be the utility, OCC or even the Commission itself, must blindly abide by all those recommendations in order to resolve the matter. One need only look to any rate case proceeding in which OCC has intervened to see instances where even the OCC disagrees with auditor recommendations.

Finally, the Stipulation complies with all relevant and applicable regulatory principles. The Stipulation is consistent, for example, with the State of Ohio's policies regarding competitive retail electric service. The Stipulation ensures that consumers continue to have access to adequate, reliable, safe, efficient, nondiscriminatory, and reasonably priced retail electric service through DE-Ohio.

The Stipulation is, moreover, consistent with the Commission's goals for rate stabilization plans of providing (1) rate certainty for consumers; (2) financial stability for the utility; and (3) the further development of competitive markets. The Stipulation allows DE-Ohio

³⁶ OCC's Brief, p. 14.

³⁷ See Audit Report and Stipulation, *passim*.

to continue to actively manage its generation fuel, purchased power, and emission allowance positions in a manner that is beneficial both to consumers and to the Company, while permitting the Company to maintain its competitive market price. The adjustment of DE-Ohio's Riders, as provided for within the Stipulation, provides predictable revenues for DE-Ohio and predictable prices for consumers. The Stipulation should be adopted by this Commission.

In its Initial Post Hearing Brief, OCC, continues its hollow opposition to the Stipulation, arguing that the Stipulation violated important regulatory practices because “[a]dopting the Stipulation would cede Commission review of Duke Energy’s FPP and SRT charges to Company-dominated process that rejects the recommendations of Commission-appointed experts.”³⁸ OCC further claims that the Commission should be concerned that DE-Ohio “inappropriately seeks to resolve matters in the above-captioned cases that were the subject of the PUCO’s previous determinations.”³⁹ OCC is wrong on both counts.

First, as previously stated, the Auditor’s recommendations are just that, recommendations. Stipulations are often reached in Commission proceedings that involve outside auditor recommendations, without blindly adopting each and every auditor recommendation. Second, the Stipulation does not change the Commission’s annual review over DE-Ohio’s Rider FPP or SRT. Because the Commission considers and issues its Order regarding the Stipulation, it cedes no authority to any Party. OCC’s claim, once again mischaracterizes the Stipulation and the Commission’s process, and is simply an attempt at misdirection.

³⁸ OCC's Brief, p. 19.

³⁹ *Id.*

With respect to the provision in the Stipulation, which refers to the 2007 Rider SRT, DE-Ohio and the Stipulating Parties have done nothing more than agree that the under recovered 2007 Rider SRT will be included in the calculation for the 2008 Rider SRT tariff. This is completely consistent with the Commission's November 20, 2007 Opinion and Order in Case No 05-725-El-UNC *et al.*⁴⁰ OCC's opposition to this provision in the Stipulation is ill conceived. Admittedly, DE-Ohio is agreeing to do exactly what the Commission has ordered it to do, "work with staff to determine a reasonable period over which the amounts authorized by this Opinion and Order should be trued-up and collected."⁴¹ The inclusion of a stipulated provision that resolves the 2008 Rider SRT level, that directly addresses the aforementioned Commission Order in no conceivable way, violates an important regulatory policy or practice as OCC would have this Commission believe. The reason for the inclusion of this provision is simple. When DE-Ohio filed for approval of its 2008 Rider SRT in September 2007, the previous year's Rider SRT costs remained uncollected from customers. The Commission did not issue its Opinion and Order approving the 2007 Rider SRT costs until November 20, 2007, over a month and a half after DE-Ohio filed for approval of its 2008 level. This provision simply recognizes that there is only one Rider SRT, and thus only one Rider SRT price to collect from consumers. The provision merely reflects the understanding that the prior years' uncollected Rider SRT costs, would be included in the calculation of the total Rider SRT for 2008, as approved by the Commission.

⁴⁰ *In re Duke Energy Post-Remand Rider Cases*, Case Nos. 05-724-EL-ATA, *et al.* Order (November 20, 2007), pp.30-31.

⁴¹ *Id.*

CONCLUSION:

Because the Stipulation adopts all recommendations by the Auditor but one, and because the Stipulation preserves the one unadopted recommendation for further review in subsequent audits, this Commission should adopt the Stipulation submitted by the parties.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "P.A. Colbert", is written over a horizontal line.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served via overnight delivery this 15th day of January 2008, to the following:



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