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FILE

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In The Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Electric Distribution Rates	)	Case No. 08-709-EL-AIR
In the Matter of the Application of Duke Energy Ohio, Inc. for Tariff Approval	)	Case No. 08-710-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods	)	Case No. 08-710-EL-AAM

OBJECTIONS TO THE STAFF REPORT OF INVESTIGATION SUBMITTED BY DUKE ENERGY OHIO, INC.

On January 27, 2009, the Utilities and Service Monitoring and Enforcement Departments (Staff) of the Public Utilities Commission of Ohio (Commission) filed its Staff Report of Investigation (Staff Report) in the above-captioned proceeding. Pursuant to Section 4909.19, Ohio Revised Code, and Rule 4901-1-28, Ohio Administrative Code, (O.A.C.), Duke Energy Ohio, Inc. (DE-Ohio or Company) hereby submits its Objections to the Staff Report (Objections) in which DE-Ohio specifically identifies areas of controversy with respect to certain findings, conclusions, or recommendations contained in the report or failure of the report to address certain items. DE-Ohio reserves the right to supplement or modify these Objections in the event that the Staff makes additional findings, conclusions, or recommendations or modifies its position with respect to any findings, conclusions, or recommendations contained in the Staff Report.

REVENUE REQUIREMENTS

1. The Company objects to the Staff's determination of Revenue Requirements in this proceeding in that the Staff's determination has significantly understated the magnitude of the revenue increase to which the Company is entitled, which was set forth and fully supported by schedules and work papers in the Company's Application filed on July 25, 2008, in this proceeding.

RATE OF RETURN

Capital Structure

2. DE-Ohio objects to the use of hypothetical capital structure for determining the Company's overall rate of return on rate base. The Staff's proposal departs from the Commission's traditional position for establishing capital structure; it is at odds with its positions taken in other recent rate proceedings and workshops; encourages undesired financing behavior, and disregards the plain facts in this case as to the Company's actual capital structure. DE-Ohio has fulfilled its regulatory commitment to maintain a strong balance sheet and to measure its return on actual outstanding equity as opposed to an imputed total. The Staff's recommendation undermines the Company's goal of ensuring its financial integrity by maintaining a strong equity ratio, thereby putting the Company and its ratepayers at greater risk.

The current economic crisis has constrained access to credit and has increased the cost of debt. DE-Ohio will likely be able to lower debt rates by moving more gradually toward a balanced capital structure. The Company's rates should not be established on a hypothetical capital structure during this unprecedented financial crisis when raising additional debt would be more costly than under normal economic conditions.

Cost of Common Equity

3. DE-Ohio objects to the cost of equity used by Staff in its cost of capital analysis because Staff failed to apply generally accepted methods for accurately estimating the cost of equity as follows:

(a) Staff did not consider the evidence submitted by DE-Ohio in support of the Company's proposed cost of equity.

(b) Staff has overweighted the importance of the Capital Asset Pricing Model (CAPM) results in arriving at its final ROE range recommendation. Staff neglected to take into account the risks inherent due to the current economic crisis and financial market instability, including the risks identified in the preceding objection. Less weight should be accorded to the CAPM results under present economic circumstances. The betas employed in the Staff's CAPM analysis are estimated over five-year historical periods and therefore the impact of the ongoing financial crisis is not appropriately captured in the five-year historical betas.

(c) Staff neglected to account for the possibility that a lower return on equity creates the risk that the financial community may view the outcome negatively, making it more difficult to access capital at a reasonable cost, ultimately costing customers more when those costs are reflected in rates.

(d) Staff only considered the Discounted Cash Flow (DCF) and CAPM models for estimating the cost of equity and did not consider other models proposed by DE-Ohio.

(e) Staff estimates the Market Risk Premium (MRP) from historical data using the *total* return, rather than the *income* return, on government bonds.

RATE BASE

Working Capital

4. DE-Ohio objects to Staff's recommendation that no allowance should be made for working capital in rate base simply because DE-Ohio did not file a lead/lag study. DE-Ohio does not object to this Staff recommendation to the extent that the recommendation applies solely to the cash component of working capital. Indeed, DE-Ohio does not seek to include cash working capital in rate base and DE-Ohio did not file a lead/lag study for this reason. DE-Ohio does object, however, to Staff's recommendation because it also impacts non-cash working capital. DE-Ohio has significant non-cash working capital investment that is properly included in rate base even in the absence of a lead/lag study.

Staff's adjustment also conflicts with the Commission's rules. The Staff inexplicably departed from the guidelines established in the Commission's rules, O.A.C. 4901-7-01, Appendix A, by moving customer deposits from the appropriate schedule, "Miscellaneous Working Capital," Schedule B-5.1, to "Other Rate Base Items," Schedule B-6. This selective exception to the standard filing requirements unfairly impacts the Company's test year rate base.

OPERATING INCOME

Amortization Expenses

5. The Company objects to the Staff's recommended adjustment to regulatory asset amortization. The Staff made an adjustment to reduce regulatory asset amortization by adjusting tower space rental expense by $59,834 "to be consistent with the Commission's Order in Case No. 99-29-EL-AEC." (Staff Report, page 12). The Staff's proposed adjustment appears to simply mirror the same adjustment it made in the most recent DE-Ohio electric distribution case, Case No. 05-0059-EL-AIR. The underlying data in its adjustment has changed since the time of that last case, and, although this underlying data was updated in the Company's response to Staff-DR-55-001, the Staff did not to use the updated information.

Uncollectible Expense

6. The Company objects to the Staff's proposed adjustment for uncollectible expenses. Staff's adjustment incorrectly excludes a significant component of the Company's test year uncollectible expense which would increase Staff's adjustment by $1,159,724. The Staff Report also errs inasmuch as it ignores the impact of the current economic downturn on the cost of uncollectibles. The Company's Application included a proposed rider mechanism, Rider DR, that would, among other things, track the cost of uncollectibles. The Staff Report should have recommended approval of a Rider mechanism like what was proposed for Rider DR for tracking the cost of uncollectibles because the Company and Staff previously agreed in the Stipulation and Recommendation in Case No. 05-732-EL-ATA that the Company would purchase the receivables of competitive natural gas and electric marketers and that the Company would implement a tracking mechanism for uncollectibles. The Commission did not approve the tracking mechanism for electric receivables in Case No. 05-732-EL-ATA on

the grounds that the tracking mechanism for uncollectibles should be evaluated in a separate proceeding. This is an appropriate proceeding for approval of such a tracking mechanism. Because the Staff Report did not recommend approval of Rider DR, it should have considered alternative rider recovery to cope with this significant issue which, despite DE-Ohio's best collection efforts, is escalating rapidly. The Staff's failure to include such a proposal places unnecessary additional financial risk on the Company.

Labor Expenses

7. The Company objects to the Staff's proposed adjustment to test year labor expense. The Staff made a number of errors in developing its labor expense adjustment that negatively impact the Company. The errors include:

(a) Excluding all costs for Human Resources, Governance, and Shared Services in the test year labor amount. This adjustment excludes costs incurred for Legal services, Information Technology, Company executives including, but not limited to the utility President, Corporate Chief Executive Officer, Chief Financial Officer, Controller, Chief Legal Officer and other business functions shared throughout the Duke Energy Corporate structure and which are properly allocable to DE-Ohio. Staff's recommendation to exclude *all* of this cost is not only arbitrary but is patently unfair.

(b) Including expenses for incentive compensation, bonuses, and severance in its calculation of test year labor expense.

Pension & Benefits Expense

8. The Company objects to the Staff's proposed adjustment to test year pension and benefits expense. Because both Company and Staff estimate test year pension and benefits by applying a loading rate to the test year labor expense, the Staff errors, identified in Objection No. 7, are compounded. The overall impact of the Staff's pension and benefits expense is to inappropriately reduce the Company's test year pension and benefits expense.

Merger Savings Adjustment

9. The Company objects to the Staff's recommendation to exclude an adjustment to test year expense related to merger savings. The impact of Staff's proposal is to unfairly provide customers with a larger share of the merger savings than what was agreed to in the Commission-approved Stipulation settling the recent merger case, Case No. 05-732-EL-MER, *et al.*

EEI Expense

10. The Company objects to the Staff's recommended adjustment to test year Edison Electric Institute (EEI) expense. The Staff incorrectly calculated the test year EEI expense and improperly excludes amounts incorrectly allocated to the Company's gas operations. The Staff's error in its calculation of test year EEI expense negatively impacts the Company's test year revenue requirement.

<u>Commercial Activities Tax (CAT)</u>

11. The Company objects to the Staff's recommended adjustment to the test year CAT expense. The Staff improperly applied the reduced first quarter 2008 CAT rate in its calculation of test year expense while disregarding the fact that the full CAT rate will be

effective when the revised Electric Distribution rates are put into effect. The Staff's error negatively impacts the Company's test year revenue requirement.

COST OF SERVICE

12. The Company objects to the Staff's recommendation to eliminate only 75% of the subsidy/excess among the rate classes. The Staff's recommendation perpetuates an already unfair situation forcing certain groups of rate classes to subsidize other groups of rate classes.

RATE DESIGN/ TARIFFS

Residential Customer Charge

13. The Company objects to the Staff's proposed customer charge for residential customers. The Company's cost of service and rate design calculations fully support its originally proposed residential customer charge. The Staff's proposed residential customer charge does not reflect DE-Ohio's true fixed cost to serve residential customers. The Staff's proposed adjustment ignores significant distribution-related fixed costs including but not limited to allocated common plant, general plant, other distribution operating and maintenance expense (O&M), other customer accounting expense, other customer service and information, and administrative and general (A&G) expense. These expenses were included by DE-Ohio in its Application and Direct Testimony and result in the appropriate residential customer charge of $10.00.

Pole Attachment Rental (Rate PA)

14. The Company objects to Staff's recommendation to establish the pole attachment/conduit occupancy tariff rate at less than the fully-allocated cost of service. Staff's recommendation is arbitrary and the calculation includes several errors including but not limited to, an improper rate of return, an improper depreciation rate, incorrect tax expense, and the incorrect value for electric distribution plant. The net effect of the calculation errors results in an under recovery of approximately $255,043 that will be subsidized through higher rates for DE-Ohio's other electric distribution ratepayers. DE-Ohio's pole attachment rate has remained unchanged for more than sixteen years and the Staff's recommendation does not accurately reflect the cost of providing this service.

Pole Attachment Tariff Language

15. DE-Ohio objects to the Staff's recommendation to change the language contained in the terms and conditions of the pole attachment tariff. The Staff's proposed changes divest the Company of its current ability to review and approve or deny attachment requests and deny the Company the ability to charge modest penalties for unauthorized attachments. More concerning, Staff's recommendation undermines DE-Ohio's efforts to maintain the integrity of its electric delivery system by monitoring the types of attachments to its poles and compromises the safety of its system and more importantly its employees.

Similarly, DE-Ohio needs the ability to assess penalties for non-compliance with the terms of the pole attachment tariff. Although the Company agrees to perform the attachment audit proposed in the Staff Report, assuming approval of the other proposed changes to Rate PA, the Company needs the ability to enforce its tariff through penalties for unauthorized use going forward. This penalty provision should be included in the tariff in this proceeding so that all future unauthorized attachments can be assessed the fee. Otherwise, DE-Ohio's pole attachment tariff will be difficult to enforce in the future.

Economic Development or Urban Development Rider (Rider ED)

16. The Company objects to the Staff's recommendation to exclude the minimum load requirement included in the Brownfield Redevelopment portion of the proposed Rider ED. The Company believes a minimum threshold level is an appropriate condition of service under this rider and should be approved.

Customer-Owned Street Lighting Service (Rate SC)

17. The Company objects to the Staff's failure to include a recommendation regarding its proposal to phase-out Customer-Owned Street Lighting Service (Rate SC). The Company believes its proposal is appropriate and should be approved. Rate SC is duplicative of the Company's other street lighting rates and is no longer necessary.

Shopping Credit Rider (Rider SC)

18. The Company objects to the Staff's recommendation to approve DE-Ohio's request to eliminate the Shopping Credit Rider (Rider SC). DE-Ohio hereby respectfully withdraws the request to eliminate the Rider SC. At the time of DE-Ohio's application, Rider SC was dormant and set at zero. Although DE-Ohio did request the rider be eliminated as part of this proceeding, since that time, DE-Ohio has re-implemented the Rider SC as the mechanism to flow through shopping credits to non-residential customers pursuant to the terms of DE-Ohio's Electric Security Plan (ESP), Case No. 08-920-EL-SSO. Accordingly, the Rider SC is in use pursuant to DE-Ohio's ESP and should not be cancelled at this time.

Storm Damage Deferral

19. The Company agrees with the Staff's recommendation that the Company's proposed Rider DR-Ike is an appropriate method to recover the hurricane expenses. However, DE-Ohio objects to Staff's failure to recommend that the Rider DR-Ike recovery be considered in the current rate case proceeding. DE-Ohio further objects to Staff's failure to address recovery of other known and measurable storm cost recovery expenses, such as the January 2009 ice storm, through a tracking mechanism.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing was served via ordinary mail or overnight delivery on the following parties this 26th day of February 2008.

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