BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio to Adjust and Set Its Gas and Electric Recovery Rate for SmartGrid Deployment Under Riders AU and Rider DR-IM	)))))	Case No. 09-543-GE-UNC
In the Matter of the Application of Duke Energy Ohio for Tariff Approval	))	Case No. 09-544-GE-ATA
In the Matter of the Application of Duke Energy Ohio to Change its Accounting Methods	)))	Case No. 09-545-GE-AAM

REPLY COMMENTS OF DUKE ENERGY OHIO, INC.

Now comes Duke Energy Ohio, Inc. (Duke Energy Ohio or Company) and submits its Reply Comments in response to the comments submitted by the Staff of the Public Utilities Commission (Staff) and the Office of the Ohio Consumers' Counsel (OCC) and The Kroger Company (Kroger), or collectively (Parties). The comments of the Parties are provided in response to the Attorney Examiner's Entry, dated August 19, 2009 in this matter.

STAFF'S COMMENTS

Staff conducted an audit of the Company's SmartGrid program including the Company's rate calculations for Rider Distribution Reliability-Infrastructure Modernization (DR-IM) and Rider Advanced Utilities (AU). After conducting extensive discovery and onsite visits, the Staff developed a number of findings and recommendations with respect to the Company's filing as set forth below. The Company's reply comments are provided following each category of findings and recommendations.

Rider DR-IM and Rider AU Revenue Requirement Calculation – Staff made a number of findings and recommendations regarding the Company's calculation for the SmartGrid Riders (Rider DR-IM and Rider AU) as summarized below:

1. Eliminate costs included in distribution rate case (See, Staff's Findings and Recommendations at pages 3 & 4).
2. Exclude all costs related to Envision Center (Id, at pages 4, 8, and 9).
3. Exclude costs for 20,759 Badger modules (Id, at page 4).
4. Recover retirement and replacement costs of gas meters incompatible with Badger modules through the "normal ratemaking and accounting process" (Id, at page 5 & 6).
5. Reclassify certain communication equipment costs (Id, at page 6).
6. Reclassify certain materials and supplies (Id, at page 6).
7. Exclude costs for demand-side management (Id, at page 6).
8. Revise depreciation rates to be consistent with those approved in retail rate cases (Id, at page 7).
9. Correct error in electric depreciation expense (Id, at page 7).
10. Adjust Rider AU to include depreciation on Electronic Data Processing – Gas (Id, at page 7).
11. Adjust the debt rate used in Rider DR-IM for post in-service carrying costs (PISCC) (Id, at page 8).
12. No offset for deferred balances with the associated deferred taxes (Id, at page 8).
13. Adjust deferred taxes on liberalized depreciation to reflect proposed changes in plant (Id, at page 8).
14. Adjust annualized depreciation expense to reflect proposed changes in plant (Id, at pages 8-9).

15. Adjust annualized amortization of PISCC to reflect proposed changes in plant (Id, at page 9).

16. Adjust debt rate used for calculating carrying costs on deferred O&M (Id, at page 9).

17. Adjust annualized property taxes to reflect proposed changes in plant (Id, at page 9).

18. Adjust revenue requirement for Rider DR-IM to reflect commercial activities tax (CAT) on operating income (Id, at page 9).

19. Re-file Rider AU and Rider DR-IM to reflect recommended changes (Id, at page 10).

DUKE ENERGY OHIO'S RESPONSE

The Company agrees with and accepts most of the Staff's recommendations related to the revenue requirement calculation of Rider DR-IM and Rider AU. However, some of the figures referred to in the Staff's proposed changes are incorrect and will need to be modified accordingly. Additionally, the Company disagrees with several of Staff's proposed changes. Specifically, and corresponding with the numeric designations above, the following corrections and comments are provided:

1. The Company agrees that all costs included in its electric distribution rate case should be eliminated from the Rider DR-IM filing; however, the Company disagrees with the amount to be excluded. The amount to be excluded for electric meters is $42,578 rather than Staff's recommended amount of $47,721.

2. The Company respectfully disagrees with the Staff's recommendation regarding the Envision Center. Duke Energy Ohio believes the Envision Center provides a meaningful benefit to customers insofar as it provides a meaningful benefit to customers, insofar as it is a means to educate customers and provide a platform for Duke Energy Ohio to research the full capability of the SmartGrid program.

3. The Company accepts Staff's finding with respect to inventory costs. However, the Company believes the number of gas modules installed during the first three months of 2009 provides a reasonable estimate of an appropriate supply. As indicated in the Company's response to a Staff data request, Staff-DR-13-002, the Company installed 7,235 gas modules during the first three months of 2009. The costs for maintaining inventory at this level should be allowed and the gas module additions included in the filing should be reduced by $732,322 rather than the $922,427 adjustment proposed by Staff.
4. Duke Energy Ohio disagrees with Staff's recommendation to recover the cost of replacing incompatible gas meters through the "normal ratemaking and accounting process." The forty-five year life approved by the Commission for gas meters is an average service life. As such, many meters have longer lives and many have shorter lives. The meters that were replaced as incompatible to the gas module would not necessarily have been replaced for many years to come. They were replaced solely to accommodate installation of the gas module as part of the SmartGrid Project. Although alternate solutions are possible, the Company determined that the replacement of incompatible meters is the optimal solution for implementing the gas SmartGrid.
5. Duke Energy Ohio agrees with this Staff comment regarding the reclassification of certain communication equipment.
6. Duke Energy Ohio agrees with this Staff comment regarding the reclassification of certain materials and supplies.

7. Duke Energy Ohio agrees with this Staff comment regarding the exclusion of certain demand side management costs.

8. Duke Energy Ohio agrees with Staff's recommendation to revise its depreciation rates to be consistent with the latest approved electric distribution rate case.

9. Duke Energy Ohio agrees with Staff's recommendation with regard to the correction of an error in the calculation of electric depreciation expense.

10. Duke Energy Ohio agrees to adjust its Rider AU to include depreciation on Electronic Data Processing – Gas.

11. Duke Energy Ohio agrees with Staff's recommendation to revise its rate for calculating Post In-service Carrying Charges (PISCC) and, consistent with its recommendations regarding depreciation (Item 8, above), the Company will use the long-term debt rates per the most recently approved electric distribution rate case at the time.

12. Duke Energy Ohio agrees to not offset deferred balances with associated deferred taxes.

13. Duke Energy Ohio agrees to adjust deferred taxes on liberalized depreciation to reflect proposed changes in plant.

14. Duke Energy Ohio agrees to adjust annualized depreciation expense to reflect proposed changes in plant.

15. Duke Energy Ohio agrees to adjust annualized amortization of PISCC to reflect proposed changes in plant.

16. With respect to Staff's recommendation that Duke Energy Ohio adjust its debt rate for calculating carrying costs on deferred Operations and Maintenance expense, Duke

Energy Ohio agrees to use the appropriate debt rate as ordered by the Commission in Duke Energy Ohio's most recent electric distribution rate case. See response to Item 11 above.

17. Duke Energy Ohio agrees to adjust annualized property taxes to reflect proposed changes in plant.

18. Duke Energy Ohio agrees to adjust its revenue requirement for Rider DR-IM to reflect commercial activities tax on operating income.

19. In response to Staff's recommendation that the Company re-file Rider AU and Rider DR-IM to reflect recommended changes, Duke Energy Ohio proposes to submit the updated riders upon resolution of those issues reflected in the tariffs.

Allocation of Costs Between Gas and Electric

Staff made a number of findings and recommendations regarding the Company's calculation for the SmartGrid Riders (Rider DR-IM and Rider AU) as summarized below:

1. Exclude allocation of common costs to "gas-only" customers (page 11).

2. Implement different Rider AU charges for "combination" and "gas-only" customers beginning in year 2 (page 11).

The Company cannot accept the Staff's recommendation to segregate customers taking electric service from Duke Energy Ohio from customers only taking gas service from the Company. Such a practice is neither practical, nor consistent with traditional ratemaking principles. If it made sense to segregate out customers to accommodate this recommendation, then it would also make sense to separate out customers in rural areas from customers in urban areas as costs are greater for distribution service to rural customers. Such distinctions are not good policy and do not advance good ratemaking principles.

In its Comments, the Staff refers to 1,354 gas customers who are not Duke Energy Ohio electric customers. In fact, Duke Energy Ohio has about 25,000 accounts that are 'gas-only' accounts. The 1,354 'gas-only' customers alluded to in the Staff's Comments are residents of Adams County, Ohio, a community that is outside Duke Energy Ohio's territory. Although it is not clear in the Staff's Comments, the Company believes that the Staff is recommending that only those customers taking gas service outside Duke EnergyOhio's electric service territory are eligible for different Rider AU rates. Most of the 25,000 gas-only accounts are for customers who will benefit from both the electric and gas elements of the SmartGrid program.

Although it is important to distinguish between 'gas-only' customers outside Duke Energy Ohio's electric service territory and those 'gas-only' customers (*i.e.*, accounts) inside the electric service territory, the Staff's recommendation is still unacceptable. The Staff's recommendation is at odds with traditional ratemaking principles insofar as it singles out selected customers in a rate class to be treated different from other customers in the same class. Typically, customers whose consumption characteristics are considered to be similar are grouped into a rate class. Residential customers, for example, consume natural gas in a fairly consistent manner. Thus, the rate for one residential customer is the same as any other. Under the regulatory model that has existed for decades, it does not matter whether one residential customer is taking service one block away from the city-gate, where only a short length of main (and the concomitant investment) is needed to provide service to this customer, and another lives miles from the city-gate where a significant investment is necessary to provide service to this customer. Traditionally, such costs are spread across all customers – the theory being that such investments are for the system rather than for individual or groups of customers.

In the case of the 1,354 customers in Adams County who are gas-only customers, the Staff's recommendation, if followed to its natural conclusion, suggests that Duke Energy Ohio should, in its next rate case, carve out that group of customers from all other customers because of the difference in investment required to serve these customers. The fact that these customers are farther from Duke Energy Ohio's main service territory means that it costs more to serve them but, since the Company is bound by traditional regulation and in fairness to all customers, these customers are charged no more than any other gas customer on the Duke Energy Ohio distribution system.

To summarize, the Company perceives the Staff's recommendation to only suggest that those customers in Adams County, Ohio, outside of Duke Energy Ohio's electric service territory be eligible for a separate Rider AU rate but, for the reasons discussed above, the Company disagrees with the Staff's recommendation to create separate Rider AU rates for these 'gas-only' customers.

Ongoing Audit Activities – In its comments, Staff recommends working with the Company to establish a "convenient and timely" process for future audits. Staff also recommends that a collaborative process with stakeholders, including Staff, be established to determine how to measure and account for prospective operational benefits associated with SmartGrid and that the Company be required to file an accounting of such benefits on an ongoing basis.

The Company agrees to work with the Staff to establish a mutually agreeable audit process for its SmartGrid program. The Company also agrees to collaborate with Staff and stakeholders to measure and account for identifiable prospective operational benefits and agrees to a reasonable ongoing process for accounting for such benefits as part of the annual filing for

Rider DR-IM and Rider AU rates.

Calculating the DR-IM Rider – Staff proposes that a reasonable method be devised that recognizes 'the full range of operational benefits in a timely manner' (Id, at page 14) so that the costs included in the revenue requirement calculation be recognized 'net of benefits.' Staff goes on to suggest that estimates of the operational benefits be incorporated into the Company's first application for Rider DR-IM and states that "recognizing future benefits from the inception of the rider allows for timely recovery of costs, while at the same time recognizing future fully 'used and useful' status."

The Company cannot accept the Staff's proposal to incorporate "future benefits" into the revenue requirement calculation for Rider DR-IM (or for Rider AU) which is based exclusively on historical data. Staff is apparently attempting to introduce a new sliding scale standard for 'used and useful' suggesting now that the degree to which an asset is used and useful is only proportional to the benefits derived. The Staff has singled out Duke Energy Ohio for this standard insofar as it has already approved similar rider mechanisms for other utilities without requiring prepayment of benefits to ratepayers. Furthermore, while the Staff has invoked the 'used and useful' standard for utility regulation, it neglected to acknowledge the requirement that costs and benefits are 'known and measurable.' To the best of its knowledge and ability, the Company has provided the Staff and Intervenors estimates of its projected costs and benefits for the SmartGrid program; however, those estimates are based upon 'known and measurable' standards to the extent possible.

All of the realized and measurable future benefits of the SmartGrid program will be passed on to customers as they are realized. The nature of the Rider DR-IM and Rider AU revenue requirement calculation and any future retail electric and/or gas distribution rate cases will ensure that all operational benefits accrue to the benefit of retail ratepayers. Although the Company made its best efforts to estimate the prospective benefits of the SmartGrid program, the estimates are just that – estimates. It would be unfair to the Company to include prospective estimated benefits but not prospective estimated costs.

Conditions for Ongoing Recovery of Rider DR-IM

Staff recommends that ongoing recovery of SmartGrid costs via Rider DR-IM should be subject to the following conditions:

1. Customers should have access to full pricing and usage data by means other than the internet (Id, at page 15).

2. Duke Energy Ohio should offer optional time-differentiated rates for generation service on a 'revenue neutral' basis (Id, at page 16).

3. Duke Energy Ohio should provide customers opting for time-differentiated pricing with information to measure the impact of taking service under the optional time-differentiated price versus the Company's standard service offer price (Id, at page 16).

4. Customers who opt to take service under the "dynamic" price should be able to pay the lower of the bill calculated under the "dynamic" price or the standard service offer for a pilot period of 6 months (Id, at page 16).

The Company is currently engaged in an ongoing collaborative process with all interested stakeholders (SmartGrid Pricing Collaborative) regarding access to pricing data and potential new rate designs that can take advantage of the full capability of SmartGrid. As part of the settlement in Case No. 08-920-EL-SSO, reflected in the October 27, 2008, Stipulation and Recommendation, the Company committed to implement time-differentiated rates before December 31, 2009, and the Company will do so as soon as practicable and with the cooperation of the SmartGrid Pricing Collaborative. The proposal to make the time-differentiated pricing "revenue neutral" should be modified to require that the proposal be "earnings neutral" or "margin neutral." The requirement to make the pricing revenue neutral creates the potential for the Company to earn more on time-differentiated pricing than on fixed pricing. The reason for this is that nature of time-differentiated pricing is to encourage customers to shift consumption from periods of high market prices to lower market prices. The customer behavior can result in the Company spending less on fuel, emission allowances, capacity purchases, *etc*. Those savings can be passed on to customers in a manner which leaves the Company earnings neutral but not necessarily revenue neutral.

Regarding the proposal to allow customers to measure the difference in taking optional time-differentiated pricing versus the Company's fixed price standard generation service offer, the Company proposes to address this issue as part of the SmartGrid Pricing Collaborative process discussed earlier.

Finally, the Staff's proposal to allow customers to "game" the Company's rates in such a way to ensure that it always gets the lower of time-differentiated pricing or the standard service offer is patently unfair not to mention that it would create an enormous burden on the Company to administer and maintain appropriate billing data. Such a proposal cannot be made without ensuring that the Company can recover its lost margins that may result from this 'pilot' and any incremental costs to administer and bill for the program. The consequence of ensuring that the Company is held harmless is that all customers not taking service under time-differentiated pricing will have to make up the lost margins. There is no plausible argument to make that this is a fair proposal to the Company or to its customers. At present, implementing such a billing scheme would delay implementation of other more practical and beneficial billing provisions.

Momentary Interruption Data – The Staff's final recommendation was that the Company be required to conduct a study to determine how processing momentary average interruption frequency index data (MAIFI) will impact Rider DR-IM. The Staff further recommends that the

Company file the results of the study within sixty days following the order in this proceeding.

The Company is currently engaged in ongoing informal discussions with the Commission Staff which may obviate the Staff's request in this proceeding. To the extent Staff continues to assert the need for such a study, the Company agrees to provide a study based upon further clarification as to its content.

OCC's Comments

OCC offered a number of comments on the Company's Application for Rider DR-IM and Rider AU.

Common Cost Allocation – OCC suggests that a greater portion of common costs be allocated to electric versus gas customers. OCC further recommends that the Commission establish a hearing process to determine the appropriate allocation of SmartGrid costs between gas and electric customers.

The Company believes it has properly allocated common costs between gas and electric customers in its Application subject to the agreed-to changes proposed by the Staff. Insofar as the allocation of common plant is a subject of this proceeding, the Company sees no reason to create a separate redundant proceeding to address an issue that should be resolved in this proceeding.

Netting of SmartGrid Benefits Against Costs – OCC offers two proposals regarding the recognition of benefits derived from the SmartGrid program. First, it proposes that the Commission require Duke Energy Ohio "to demonstrate how it will be diligent in identifying and recording" the SmartGrid benefits. Second, it proposes that the Commission require Duke Energy Ohio to develop a process that ensures that all SmartGrid savings occurring during 2009 will be credited against the cost of SmartGrid deployment.

Since the Company will be making annual filings for recovery of SmartGrid deployment costs which will include an audit by the Commission and a hearing process, the OCC's first recommendation is essentially unnecessary. As part of its annual review, the Company will identify all of the benefits and costs of the SmartGrid deployment. To the extent there are questions unanswered in the annual filings, the Commission and any Intervenor, including the OCC, may submit discovery requests and present its case accordingly. Thus, the OCC's first recommendation is already addressed in the annual review process.

The OCC's proposal to include SmartGrid savings occurring in 2009 is also premature. The next annual review process will be for actual activity occurring during 2009. The Company will incorporate SmartGrid savings that are realized and traceable in its Rider DR-IM and Rider AU revenue requirement calculation at that time. No additional directive from the Commission is required to accommodate this OCC recommendation.

The OCC's comments imply that all benefits derived from SmartGrid be reflected in the revenue requirement calculations for Rider DR-IM and Rider AU. While the Company will make every effort to reflect identifiable and measurable cost savings in the rider calculations, all parties should be reminded that not all of the benefits of SmartGrid are quantifiable and/or easily tracked. To illustrate some of the SmartGrid benefits, the OCC includes, as an example, an experience Duke Energy Ohio recently had when it avoided an extended outage as a result of the installation of new SmartGrid equipment. The benefit of avoiding this outage is clearly more than economic. In this particular event, the Company may have avoided some costs associated with urgently dispatching crews to repair whatever caused the outage; however, the larger and more conspicuous benefit to customers is that an outage was avoided. This is the type of benefit which clearly helps make SmartGrid a desirable program but is not easily quantifiable or traceable. The proposals by the Staff, OCC, and Kroger to pass along <u>all</u> benefits from SmartGrid via the Rider DR-IM and Rider AU is simply not a practical proposal. The revenue requirement calculation for both riders can only reflect realized and traceable operating and maintenance cost savings.

<u>*Stimulus Funding*</u> – OCC recommends that the Commission should monitor the allocation of stimulus money to Ohio and that any stimulus money received be credited against the Company's capital investment rather than operation and maintenance expenses.

As part of the annual review process or in a separate proceeding, the Company is willing to keep the Commission apprised of how stimulus money received is allocated to Ohio and the Company will use any stimulus money it receives to offset the revenue requirement for Rider DR-IM and/or Rider AU so long as such use is consistent with federal requirements. However, the OCC's recommendation to attribute all of any stimulus received to capital investment as opposed to operation and maintenance expense will depend on the extent to which the federal government imposes any constraints on the use of the funds. It should also be noted that, to the extent there are costs of complying with any restrictions imposed on the Company in accepting stimulus funding, only the net amount of the funding will be used to offset capital and/or operation and maintenance expenses.

<u>*Dynamic Pricing*</u> – The OCC recommends that Duke Energy Ohio be required to offer some form of dynamic pricing by December 31, 2009. This issue was discussed above in replies to the Staff's Comments.

<u>*Deferral of Costs Above the Rider DR-IM Rate Caps*</u> – In its conclusion, the OCC adds a recommendation that the "Commission should reject [Duke Energy Ohio's] efforts to defer costs

above the cap because 1) it was not requested in the application and 2) it would violate the ESP Stipulation and the Commission's order approving the Stipulation."

The OCC's argument that deferring costs above the cap would violate the Stipulation approved in Case No. 08-920-EL-SSO is disingenuous. The language in the Stipulation states that the Company has every right to ask for such deferral. The following is an excerpt (paragraph 13(d)) from the October 27, 2008, Stipulation and Recommendation signed by the OCC and approved by the Commission on December 21, 2008:

> *Duke Energy Ohio shall accrue Post-in-Service Carrying Charges at the most recently approved weighted average cost of long-term debt and* ***to defer depreciation and operating costs from the date that the applicable expenditures are incurred until such expenditures are included for recovery in Rider DR-IM.*** *Such regulatory assets will be included in unique subaccounts of Account 182.3, Other Regulatory Assets, and will be subject to review by all parties in the annual Rider DR-IM filing. The Parties also agree to the regulatory asset accounting treatment for replaced meters as described in Duke Energy Ohio's Application, for which recovery shall be through existing depreciation rates as they may be amended from time to time. (emphasis added)*

Inexplicably, the OCC sees ambiguity in this language where there is none.

THE KROGER CO.'S COMMENTS

In its comments on Duke Energy Ohio's Application, Kroger submits three recommendations.

1. Customers must have direct, real-time access to smart metering information at no additional charge.
2. Duke Energy Ohio should commit to developing rate designs that maximize the advantages of SmartGrid deployment.
3. Duke Energy Ohio should implement electronic billing as soon as reasonably practical.

As discussed above, the Company is currently engaged in a SmartGrid Pricing Collaborative which includes topics such as usage and pricing data availability as weighed against privacy and technical constraints. Subject to the outcome of the SmartGrid Pricing

Collaborative process, the Company will commit to work toward the objective of making such information available to all customers. The extent to which a charge for this service is necessary will depend on a number of factors that will also be addressed in the SmartGrid Pricing Collaborative; however, following settled ratemaking policy of recovering costs from the cost causer, the Company can only commit to minimizing the cost of making such service available. Otherwise, any costs incurred to make this service available will have to be borne by all customers, creating an unfair subsidy to those using this service from those who do not.

As for Kroger's recommendations to develop rate designs that maximize the advantages of SmartGrid deployment, the Company again notes that it is currently engaged in a SmartGrid Pricing Collaborative, the purpose of which is to develop rate designs that maximize the advantages of SmartGrid deployment. Kroger goes on to recommend that the Commission order that Duke Energy Ohio "conduct a study to determine rate structures that work best with the SmartGrid technology" being deployed. Since Duke Energy is an industry leader in deployment of SmartGrid technology, Duke Energy Ohio, in partnership with its collaborative members is well situated to determine such rate structures and to provide them to customers so that those customers can enjoy the benefits of being among the first in the country to take advantage of this new technology. Additionally, it is Duke Energy Ohio's intention to create and employ rate structures that are acceptable to all stakeholders. In so doing, these rate structures will be customized to meet the needs of our customers and our service territory. Duke Energy Ohio invites Kroger to participate in the process and provide its unique perspective. Finally, Kroger requests that the Commission order Duke Energy Ohio to implement an Electronic Data Interchange (EDI) to allow large commercial and industrial customers to receive bills and make payments electronically. This issue is unrelated to the SmartGrid program or the Application for

Rider DR-IM or Rider AU, therefore, the Company does not believe it should be addressed in this case.

CONCLUSION

For the reasons set forth herein, Duke Energy Ohio submits that its Application to adjust and set its gas and electric recovery rate for SmartGrid deployment under Riders DR-IM and AU should be approved as modified consistent with the Company's comments.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, on this 15th day of October 2009, the foregoing Comments by Duke Energy Ohio, Inc. have been served via First Class Mail, postage prepaid, to the following persons:

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