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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke)
Energy Ohio for Approval of the Second)
Amended Corporate Separation Plan) Case No. 09-495-EL-UNC
Under Section 4928.17, Revised Code, and)
Chapter 4901:1-37, Ohio Administrative)
Code.)

COMMENTS OF DUKE ENERGY OHIO, INC. ON THE FINAL
REPORT OF COMPLIANCE AUDIT OF DUKE ENERGY OHIO

INTRODUCTION

Pursuant to Am. Sub. Senate Bill 221 (SB 221), electric distribution utilities must operate pursuant to corporate separation plans. Consistent with this requirement, Duke Energy Ohio, Inc. (Duke Energy Ohio or Company) submitted an amended corporate separation plan in its proposal for an electric security plan (ESP).¹ Pursuant to the Stipulation and Recommendation filed in connection with Duke Energy Ohio's ESP, the Company agreed to annual audits of its amended corporate separation plan.² The Stipulation and Recommendation was approved on December 17, 2008.³

Additionally, the Public Utilities Commission of Ohio (Commission) issued rules for, among other things, corporate separation on December 17, 2008.⁴ These rules required each electric distribution utility to file an application for approval of a corporate separation plan that addressed specific elements. On June 11, 2009, and as clarified on

¹ See *In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of an Electric Security Plan*, Case No. 08-920-EL-SSO, Part F of Application (August 1, 2008).

² *Id.* Stipulation and Recommendation (October 28, 2008).

³ *Id.* Entry and Order (December 17, 2008).

⁴ See *In the Matter of the Adoption of Rules for Standard Service Offer, Corporate Separation, Reasonable Arrangements, and Transmission Riders for Electric Utilities pursuant to Section 4928.14, 4928.17, and 4905.31, Revised Code, as Amended by Amended Substitute Bill No. 221*, Case No. 08-777-EL-ORD.

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June 22, 2009, Duke Energy Ohio filed its application for approval of a second amended corporate separation plan, in accordance with Rule 4901:1-37-05(A), O.A.C.⁵

By Entry dated August 26, 2009, the Commission issued a request for proposals to perform an audit of the Company's corporate separation plan. By Entry dated September 30, 2009, the Commission selected Silverpoint-Vantage to conduct the audit. *The Final Report Compliance Audit of Duke Energy Ohio on Behalf of Public Utility Commission of Ohio* (Audit Report) was filed on March 29, 2010.

To assist the Commission in its review of the Audit Report of Duke Energy Ohio, a procedural schedule was established via an April 8, 2010, Entry, allowing for the submission of comments and reply comments. Set forth below are the comments of Duke Energy Ohio to the six recommendations contained in the Audit Report. The Company expressly reserves the right to file reply comments in response to the comments of other parties to this proceeding.

COMMENTS

Recommendation 1 – Future cost allocation manuals (CAM) submitted by Duke Energy Ohio should include all agreements that describe the allocation of costs among its affiliates.

The auditors concluded that Duke Energy Ohio's CAM complies with the provisions of Rule 4901:1-37-08, O.A.C., with one exception. Specifically, the auditors opined that a Receivables Loan Agreement was omitted from the CAM.⁶ The auditors thus recommended that the CAM include all agreements describing cost allocation

⁵ See *In the Matter of the Application of Duke Energy Ohio for Approval of the Second Amended Corporate Separation Plan Under Section 4928.17, Revised Code and 4901:1-37 Ohio Administrative Code*, Case No. 09-495-EL-UNC.

⁶ See Audit Report, Finding II-F7, page 20.

between the Company and its affiliates.⁷ Duke Energy Ohio submits that the Receivables Loan Agreement has been incorporated into its CAM. The Company further commits to maintain its CAM in accordance with Rule 4901:1-37-08, O.A.C.

Recommendation 2 – Develop and maintain a formal affiliate transaction accounting manual.

Despite the admitted differences in the rules of the utility commissions in the various states in which Duke Energy operates, the auditors recommend that the Duke Energy operating utility companies be subject to a single accounting manual. They thus recommend the implementation of a generic document for use by the several operating utility companies.⁸ Duke Energy Ohio respectfully disagrees with this recommendation as it is both impractical and unnecessary.

Significantly, the auditors found that the existing system and methods pursuant to which Duke Energy Ohio operates are sufficient to ensure proper accounting as between the Company and its affiliates.⁹ They further acknowledged that not all jurisdictions within which Duke Energy utility companies operate require the creation of a uniform accounting manual.¹⁰ Because of the jurisdictional differences, it would be impractical to implement a generic document to which all of the operating utility companies would be subject.

Furthermore, through this recommendation, the auditors appear to be advocating for the imposition of North Carolina requirements upon a public utility regulated by this Commission. There is no rational or legal basis for imposing another state's regulatory requirements upon the Company. In this regard, Duke Energy Ohio observes that the

⁷ *Id.*, Recommendation II-R1, page 20.

⁸ *Id.*, Finding III-F3, page 34.

⁹ *Id.*, at page 31.

¹⁰ *Id.*, at page 35.

Commission has implemented very detailed and specific rules pertaining to the operation of Ohio electric distribution utilities and, more specifically, their interaction with affiliated companies. As demonstrated by the auditors' admission that the existing Ohio rules are sufficient and proper controls, the Company should not now be compelled to adopt requirements that this Commission has not found to be necessary. Indeed, imposing requirements from foreign jurisdictions upon Ohio electric distribution utility companies will only yield inconsistency and confusion.

Despite its concern with a recommendation that attempts at multi-state standardization, Duke Energy Ohio reiterates its intent on complying with this Commission's rules on corporate separation implemented pursuant to SB 221.

Recommendation 3 – Develop a plan, as part of the next Energy [sic] Security Plan discussions, to determine if further insulation from Duke Energy Ohio ratepayers or complete separation of risks associated with Duke Energy Ohio-owned generation assets is appropriate.

With this recommendation, the auditors propose that Duke Energy Ohio develop a plan around ring-fencing that will be resolved and implemented as part of, but before the effective date, of the next standard service offer. The auditors specifically propose that the Company be required to perform a variety of tasks prior to the submission of its next ESP, such as conducting a risk assessment of its generation system, identifying means to insulate ratepayers further or to separate ownership of its assets, and to develop solutions for resolution prior to the termination of the current ESP.

Of course, these suggestions are entirely outside of the standard legal procedures followed by the Commission. The first proposal, to require a risk assessment, is in actuality an effort to usurp the Company's own decision-making process. Certainly, Duke Energy Ohio will conduct whatever assessments are necessary prior to the

submission of its next application for approval of a standard service offer (SSO). With regard to the proposal that Duke Energy Ohio identify a means to insulate ratepayers or to separate ownership, the Company would note that it did include such a proposal in the application that resulted in its current ESP but that such proposal was not included in the Stipulation and Recommendation that was submitted to the Commission for approval. If deemed appropriate, the Company may choose to include such a proposal in its next application. The auditors finally indicate that the resolution of any such proposal should occur before the application is ever submitted to the Commission. This astonishing proposal seems to imply that potential parties to the Company's next SSO proceeding would have to work together to prepare the Company's application. The Company has no disagreement with discussing such issues in the course of its SSO proceeding, but does not believe that it would be appropriate to settle this issue before it is ever proposed by the Company.

Recommendation 4 – Duke Energy Ohio should clarify with Staff its position regarding the appropriate treatment of transactions between the regulated and non-regulated portions of Duke Energy Ohio.

In making this recommendation, the auditors note that Duke Energy Ohio changed its treatment of transactions between the regulated and nonregulated portions of Duke Energy Ohio. Specifically, the auditors report that Duke Energy Ohio did apply an overhead labor cost multiplier to such transactions during the first half of 2008 but did not do so after the Company converted its accounting system in mid-2008. In substantiating its change in policy, Duke Energy Ohio stated that the application of an

affiliate overhead loader was not applicable to transactions involving a single legal entity.¹¹ The auditors ask, therefore, that the Company clarify its position on this issue.¹²

The Company does not dispute the facts reported in the Audit Report, except in one instance. The auditors, in attempting to explain the effect of applying or not applying an affiliate overhead loader, incorrectly stated that the Company was not following transfer pricing requirements with regard to labor in transactions between regulated and non-regulated segments of Duke Energy Ohio. The auditors explained that the regulated portion of Duke Energy Ohio had charged more than \$100,000 in labor to the non-regulated side in the first six months of 2009. Further, they stated, labor charges from the non-regulated to regulated segment were more significant.¹³ The auditors are incorrect in their understanding of the facts. Under the Company's accounting system, each payroll company can only have one business unit associated with it. All employees of Duke Energy Ohio are paid out of the same payroll company, regardless of whether they are serving regulated or non-regulated functions. After unproductive labor is recorded to the associated company, the Company allocates those amounts to split the activity among regulated and non-regulated, and between electric and gas so that it achieves a reasonable split for regulatory and segment reporting. This recording of unproductive and subsequent allocation appeared to the auditors as if the non-regulated segment of Duke Energy Ohio was actually charging the regulated segment of Duke Energy Ohio for transactions.

Other than this factual issue, for purposes of clarification, Duke Energy Ohio would underline that the regulated and non-regulated segments of its business are all

¹¹ Id. at page 58.

¹² Id.

¹³ Id. at page 58.

parts of a single entity. Therefore, transfers between such segments should be made at cost.

Recommendation 5 – Duke Energy Ohio should keep PUCO Staff informed of future changes to Service Company cost distribution methods.

Although the auditors do not criticize the conduct of Duke Energy Ohio in respect of affiliate transactions and cost distribution, they recommend that the Company, upon request, inform Commission Staff of changes to cost distribution methodology by providing other jurisdictional independent audit reports.¹⁴

In responding to this recommendation, Duke Energy Ohio expressly commits to respond to any inquiry or audit initiated by this Commission. However, Duke Energy Ohio objects to producing irrelevant audit reports in their entirety from other jurisdictions as they cannot dictate Duke Energy Ohio's business practices.

Recommendation 6 – Duke Energy Ohio should keep PUCO Staff informed of improvements to Service Company charging practices.

In this recommendation, the auditor's reference audits performed in other jurisdictions and note that changes stemming from those audits will have an impact on Duke Energy Ohio and its cost of providing regulated service. Therefore, the auditors recommend that, upon request, the Company apprise the Commission and Commission Staff of changes made prior to the next Ohio audit, by making audit reports from other states available to Commission staff and future auditors.

Duke Energy Ohio regularly discusses relevant issues with Commission Staff and invariably responds to questions concerning not only corporate separation but many other topics. Duke Energy Ohio will certainly continue to respond to such inquiries. The Commission is aware that changes relating to service company distribution of costs occur

¹⁴ Id., at page 74.

on a regular basis. Duke Energy Ohio does not see any need to deliver audit reports from other states to Commission Staff. All such information will, to the extent relevant to Ohio regulation, be a part of the next corporate separation audit. Thus, while Duke Energy Ohio will continue its policy of responding to Staff queries and fully cooperating with the Commission in its regulatory efforts, Duke Energy Ohio does not believe that delivery of complete out-of-state audit reports and other similar material would be appropriate.

CONCLUSION

Duke Energy Ohio appreciates the opportunity to provide formal comments to the Audit Report and further expressly reserves the right to file additional comments in response to the comments of other parties. Based on the findings in the Audit Report and Duke Energy Ohio's responses thereto, the Company respectfully requests that the Commission approve Duke Energy Ohio's Second Amended Corporate Separation Plan and close this proceeding.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that a copy of the foregoing document was served on the following, via overnight delivery, postage prepaid on 29, 2010.


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