

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke )  
Energy Ohio, Inc. to Establish and Adjust ) Case No. 09-1946-EL-RDR  
the Initial Level of its Distribution )  
Reliability Rider. )

OPINION AND ORDER

The Public Utilities Commission of Ohio, having considered the record in this matter and being otherwise fully advised, hereby issues its opinion and order.

APPEARANCES:

Amy B. Spiller and Elizabeth H. Watts, 155 East Broad Street, Columbus, Ohio 43215, on behalf of Duke Energy Ohio, Inc.

Amy B. Spiller, Room 2500, Atrium II, P.O. Box 960, Cincinnati, Ohio 45201, on behalf of Duke Energy Indiana, Inc.

Mike DeWine, Ohio Attorney General, by William L. Wright, Section Chief, Stephen A. Reilly, Assistant Attorney General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of Staff of the Commission.

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Ann M. Hotz and Michael E. Idzkowski, Assistant Consumers' Counsel, 10 West Broad Street, Columbus, Ohio 43215, on behalf of the residential utility consumers of Duke Energy Ohio, Inc.

Chester, Wilcox & Saxbe, LLP, by John W. Bentine, Mark S. Yurick, and Matthew S. White, 65 East State Street, Columbus, Ohio 43215, on behalf of the Kroger Company.

OPINION:

I. Background

Duke Energy Ohio, Inc. (Duke-Ohio) is an electric light company, as defined in Section 4905.03(A)(3), Revised Code, and a public utility under Section 4905.02, Revised Code. Duke-Ohio supplies electricity and natural gas to approximately 700,000 customers in southwestern Ohio (Duke Ex. 1 at 1).

By opinion and order issued July 8, 2009, in *In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in Electric Rates*, Case No. 08-709-EL-AIR, et al., (Duke

*Electric Rate Case*), the Commission approved a stipulation submitted by Duke-Ohio and other parties in that case. The stipulation, as approved, established the Distribution Reliability Rider (Rider DR-IKE) as a mechanism to recover reasonable and prudently incurred storm restoration costs associated with the September 2008 wind storm related to Hurricane Ike (2008 Storm). The stipulation further provided that Rider DR-IKE was to be set at zero, but authorized Duke-Ohio to file a separate application to establish the initial level of Rider DR-IKE. A process for the review of Duke-Ohio's application to adjust Rider DR-IKE was also established in the stipulation. By order issued January 14, 2009, in the *Duke Electric Rate Case*, the Commission also granted the application filed by Duke-Ohio to modify its accounting procedures to defer incremental operations and management (O&M) expenses associated with the 2008 Storm, with carrying costs, stating that the reasonableness of the deferred amounts and recovery, if any, will be examined in a future proceeding.

On December 11, 2009, Duke-Ohio filed the instant application to adjust Rider DR-IKE to allow recovery of the company's 2008 Storm restoration costs, along with testimony supporting the application.

On February 9, 2010, the attorney examiner issued an entry which, *inter alia*, granted the motion to intervene filed by the Ohio Consumers' Counsel (OCC) and set a procedural schedule in this case. Specifically, the entry set forth February 23, 2010, as the deadline for the filing of comments and motions to intervene. Additionally, March 25, 2010, was set as the deadline for Duke-Ohio to notify the Commission if all of the issues raised in the comments had been resolved.

Comments were filed on February 23, 2010, by Staff, OCC, and the Kroger Company (Kroger). On March 25, 2010, Duke-Ohio filed a letter stating that all of the issues raised by Staff and Kroger had been resolved, but that it was unlikely that all of the issues raised by OCC would be resolved; therefore, Duke-Ohio requested that this matter be set for hearing.

By entry issued April 14, 2010, the attorney examiner, *inter alia*, scheduled this matter for hearing on May 25, 2010, at the offices of the Commission. In this same entry, the attorney examiner granted the motion to intervene filed by Kroger.

The hearing was held on May 25 and 26, 2010, and concluded on June 7, 2010. At the hearing held on June 7, 2010, the attorney examiner granted the motion to intervene filed by Duke Energy Indiana, Inc. (Duke-Indiana). At the May 25, 2010, hearing, the attorney examiner issued an oral ruling denying the motion to quash filed by Duke-Ohio and Duke-Indiana regarding two motions for *subpoena duces tecum* filed by OCC. By entry issued June 2, 2010, the Commission denied the interlocutory appeal filed by Duke-Ohio

and Duke-Indiana regarding the attorney examiner's May 25, 2010, ruling and affirmed the attorney examiner's denial of the motion to quash.

Duke-Ohio, Staff, and OCC filed briefs on June 15, 2010, and Duke-Ohio and OCC filed reply briefs on June 21, 2010.

## II. Discussion of the Issues

### A. Cause and Duration of 2008 Storm Outages

Duke-Ohio explains that, on September 14, 2008, during the test year of the *Duke Electric Rate Case*, a wind storm resulting from Hurricane Ike struck large parts of the Midwest, including Duke-Ohio's entire greater Cincinnati service area. According to Duke-Ohio, the 2008 Storm caused the largest electric outage in the history of Duke-Ohio and its predecessor entities. Further, Duke-Ohio points out that the damage from the 2008 Storm was so severe that Governor Strickland declared a state of emergency in Ohio and requested federal assistance. (Duke Ex. 1 at 1-2; Duke Ex. 2 at 2-3.)

Leading up to the 2008 Storm, Duke-Ohio's witness Mehring explains that, during the week of September 7, 2008, the company's meteorologists monitored the storm's progress and sent forecasts to appropriate personnel. The witness states that, on the morning of September 14, 2008, prior to the event, a special notice was sent by one of Duke-Ohio's meteorologists advising of the escalation of the weather conditions. According to Mr. Mehring, this early warning allowed the company to call out additional resources before the storm hit. Mr. Mehring states that the initial evaluation and assessment of the storm began the afternoon of September 14, 2008, when Duke-Ohio called in its transmission and distribution construction crews to supplement the normal trouble shift employees. From the afternoon of September 14, 2008, into the morning of September 15, 2008, these resources responded to emergency agency calls and began assessment and restoration of complete circuit lockouts. Also, on the afternoon of September 14, 2008, Mr. Mehring explains that responders from the premise services group and the engineering/technical personnel were called in for damage assessment. On September 15, 2008, when the company realized the extent of the restoration necessary, it began to call in second-tier responders, including nonfield responders and other corporate employees. Storm meetings were held twice a day throughout the event and regular meteorology updates were given at those meetings. Mr. Mehring believes the early warning and the regular updates throughout the event aided in the overall management of the restoration. (Duke Ex. 2 at 4-5.)

Duke-Ohio attests that it documented 822,000 outages of greater than five minutes in duration due to the 2008 Storm, which affected approximately 83 percent of its customers (Duke Ex. 1 at 2). Duke-Ohio's witness Mehring explains that, due to the

massive extent of damage, it took nine days to fully restore the system. Mr. Mehring testified that the number of Duke-Ohio customers without power peaked at 492,002 on September 14, 2008. Of those customers who lost power, the company was able to restore power to: 40 percent within 48 hours; 70 percent within four days; and all customers within nine days. (Duke Ex. 2 at 5-6.)

OCC maintains that Duke-Ohio did not explain why it did not realize the extent of the damage until the day after the storm occurred. According to OCC, Duke-Ohio has not been forthcoming about the causes of the outages, the personnel used during the storm, the design of the distribution system, or the specific level of wind speed its system is designed to withstand. Therefore, OCC recommends that, before Duke-Ohio is permitted to recover any costs, the Commission require Duke-Ohio to reveal these facts and to demonstrate that it responded to the storm in a prudent manner. (OCC Ex. 1A at 44; OCC Ex. 10 at 13-15.)

With regard to the timeliness of the company's response, Duke-Ohio's witness Mehring states that the company did not delay in requesting additional crews or assistance in responding to the outages both from the Duke Energy companies and from outside contractors. The witness points out that the company could not dispatch crews on September 14, 2008, to inspect the entire distribution system because the conditions were unsafe. He argues that, even immediately after the storm, the company could not access all of the system because the streets were closed or blocked, and downed trees and debris had to be removed. In addition, he notes that they had to walk the distribution systems in the rural areas to locate faults. Mr. Mehring submits that, after critical facilities had been addressed, the company prioritized its restoration efforts to maximize the number of customers to whom service was restored. (Duke Ex. 3 at 4-5.)

In addition, Duke-Ohio's witness Mehring maintains that it is not uncommon in the restoration process for outages to occur after the storm has passed. Since a storm leaves trees in weakened conditions, limbs may continue to fall and cause outages after the storm, and the same is true for structures left in precarious positions. Mr. Mehring insists that the condition of Duke-Ohio's system did not contribute to the number of outages; rather, the outages were a result of the excessive damage to the distribution system caused by the storm. (Duke Ex. 3 at 3-4.)

OCC submits that Duke-Ohio failed to properly report the number of customers experiencing outages, the length of time of the outages, and the number of outages (OCC Ex. 10 at 11-12). OCC's witness Yankel recommends that the Commission order a study of Duke-Ohio's procedures and reactions to the 2008 Storm (OCC Ex. 1A at 44). Duke-Ohio argues that OCC's request for a study is both irrelevant and misplaced and that OCC has no objective, factual criteria on which to base such a recommendation. Duke-Ohio avers

that there is no basis to suggest that the company's emergency response plans increased the severity or duration of the event. (Duke Br. at 24-25.)

OCC believes that Duke-Ohio's disinterest in exploring the causes for customer outages and improving its response to storm outages is inappropriate, given the serious damages suffered by its customers (OCC Ex. 10 at 15). According to OCC's witness Yankel, the economic loss and damage incurred by the customers far exceeds the costs Duke-Ohio is requesting that the customers pay (OCC Ex. 1A at 4). OCC advocates that the Commission should consider the losses already suffered by Duke-Ohio's customers from the 2008 Storm and not permit collection of any storm restoration costs (OCC Br. at 6). In response to OCC's issue regarding losses customers may have sustained during the 2008 Storm, Duke-Ohio believes that whether a customer sustained losses as a result of the storm is not relevant to whether the company is entitled to cost recovery for storm repairs (Duke Br. at 20). OCC disagrees with Duke-Ohio, stating that the Commission has relied upon equity in the past when determining whether utilities should collect costs from customers (OCC Reply Br. at 5).

There is no dispute on the record that the 2008 Storm was an unavoidable major event that caused substantial outages in Duke-Ohio's service territory. The Commission notes that, in accordance with Rule 4901:1-10-08, Ohio Administrative Code (O.A.C.), Duke-Ohio maintains an emergency plan which sets forth procedures the company must follow in situations such as the 2008 Storm. This plan is available to the Commission's outage coordinator and, in the event there is a question regarding a company's response to an emergency situation, Staff would review the situation to ensure that the plan is being properly implemented by the company. With regard to Duke-Ohio's response to the 2008 Storm, there is nothing in the record, other than unsupported statements made by OCC, which would warrant further inquiry into Duke-Ohio's implementation of its emergency plan. Therefore, the Commission finds that Duke-Ohio has sustained its burden of proof on this issue and that OCC's suggestion that the Commission initiate a study of Duke-Ohio's reaction to the 2008 Storm is without foundation. Therefore, OCC's request should be denied.

#### B. 2008 Storm Expenses Overview

Duke-Ohio's witness Wathen testified that, in accordance with the Commission's January 14, 2009, order in the *Duke Electric Rate Case*, Duke-Ohio deferred \$30,682,461 in distribution and related O&M costs incurred to repair the damage caused by the 2008 Storm, and recorded carrying costs at the most recently approved long-term debt rate of 6.45 percent (Duke Ex. 5 at 6, Atts. 1-2; Duke Ex. 1 at 4). Duke-Ohio indicates that, while the costs associated with the 2008 Storm were incurred during the test year for the *Duke Electric Rate Case*, had those costs been included in the rate case, they would have, theoretically, increased the customers' base distribution rates. Thus, rather than include

the 2008 Storm costs in the base distribution rates, Duke-Ohio requested, in the *Duke Electric Rate Case*, to narrow the scope of Rider DR-IKE to those expenses related to the 2008 Storm damage. (Duke Ex. 1 at 2-3.)

According to Duke-Ohio's witness Wathen, the actual storm restoration costs for the year 2008, excluding the costs associated with Hurricane Ike, were significantly higher than the amount included in base rates in 2008. For example, Mr. Wathen offers that a reasonable estimate of storm costs included in base rates for 2008 for distribution O&M is approximately \$1,583,148; however, the actual storm costs incurred for the year 2008, excluding the costs related to Hurricane Ike, for distribution O&M were \$5,360,922. Therefore, Mr. Wathen asserts that all of the storm restoration costs associated with the 2008 Storm were incremental to the storm costs being recovered in base rates in the year 2008. (Duke Ex. 5 at 3-5.)

OCC's witness Yankel advocates that Duke-Ohio should forgo 100 percent of the restoration costs for the 2008 Storm. According to Mr. Yankel, while he is not saying that the costs were not incurred or that the costs were not, to some extent, prudent, he questions the reasonableness of requesting recovery of such costs. (OCC Ex. 1A at 7.) OCC believes that Duke-Ohio should have been better prepared to deal with the storm. Moreover, OCC states that it is not clear from the record that Duke-Ohio had appropriate cost containment measures in place to ensure the efficiency of the restoration efforts. (OCC Ex. 10 at 3; OCC Br. at 21.)

OCC's witness Yankel submits that a utility should not be allowed to collect imprudently incurred costs, costs associated with other jurisdictions, or costs that should be capitalized, as opposed to expensed. Moreover, Mr. Yankel points out that a utility has built into its rates a certain allowance for storm-related expenses and it should not be expected that full recovery, or any recovery, will occur, during times when the expenses exceed those built into rates. The witness points out that, when storm costs are less than what is built into rates, the utility does not request a decrease in rates; thus, there should be no expectation of recovery when expenses exceed what is built into rates. (OCC Ex. 1A at 4.) OCC maintains that, while in recent years Duke-Ohio may have exceeded its test-year amount for storm restoration, there may have been other years where Duke-Ohio benefited by having a test-year amount that exceeded the actual storm restoration costs. Therefore, OCC insists that, in order to meet Duke-Ohio's burden of proof on this issue, Duke-Ohio must provide comparisons of test-year amounts to actual costs for more than just recent years. (OCC Br. at 10.) Mr. Yankel also points out that a spokesperson for Duke Energy Indiana, Inc. (Duke-Indiana) stated that it will not seek recovery of the costs associated with the 2008 Storm and that, while Duke Energy Kentucky, Inc. (Duke-Kentucky) has requested deferral of the 2008 Storm costs, it has not requested recovery. (OCC Ex. 1A at 4-5.)

In contrast, Duke-Ohio submits that its existing base distribution rates do not include the 2008 Storm costs. Furthermore, Duke-Ohio maintains that OCC's witness Yankel failed to justify his erroneous conclusion that Duke-Ohio may have over-recovered storm costs in the past. Duke-Ohio notes that, at the time of the 2008 Storm, the base rates included about \$2 million for O&M storm costs. According to Duke-Ohio, in the intervening years, it has incurred O&M storm costs well in excess of the amount included in base rates. (Duke Br. at 22.)

Furthermore, Duke-Ohio avers that, contrary to OCC's assertions, foreign jurisdictions cannot dictate this Commission's authority (Duke Br. at 23). OCC replies that, in the past, the Commission has looked at the treatment of customers by utilities in other states to gauge reasonableness. See *In the Matter of the Application of Cincinnati Bell Telephone Company for Approval of a Retail Pricing Plan Which May Result in Future Rate Increases and for a New Alternative Regulation Plan*, Case No. 96-899-TP-ALT, Opinion and Order (November 4, 1999). In addition, OCC argues that the Commission has found that trends in other states are relevant, especially in a state where a company has an affiliate. See *In the Matter of the Review of SBC Ohio's TELRIC Costs for Unbundled Network Elements*, Case No. 02-1280-TP-UNC, Entry on Rehearing (April 21, 2004). (OCC Reply Br. at 4.)

In the *Duke Electric Rate Case*, the Commission approved a stipulation by the parties in that case which permitted Duke-Ohio to establish Rider DR-IKE as a mechanism to recover reasonable and prudently incurred storm restoration costs associated with the 2008 Storm. While Rider DR-IKE was initially set at zero, Duke-Ohio was authorized in that case to file the instant application in order to present evidence supporting its proposal for the initial level of Rider DR-IKE. By agreeing to the creation of Rider DR-IKE for the purpose of recovering reasonable and prudently incurred storm restoration costs, the stipulating parties, one of which was OCC, acknowledged that there were, in fact, costs that Duke could at least request that the Commission consider for recovery through a rider mechanism. For OCC to now advocate that 100 percent of the 2008 Storm costs should be forgone by Duke-Ohio, without even examining such costs, seems somewhat disingenuous. With the requirement that any costs recovered through Rider DR-IKE are reasonable and appropriate, we will proceed to consider Duke-Ohio's request in this case and the evidence of record to determine if Duke-Ohio has met its burden of proof.

C. Summary of Parties' Positions Regarding Expenses to be Recovered

Duke-Ohio's witness Wathen explains that, generally, the company is proposing to include the following costs in Rider DR-IKE: distribution O&M; certain administrative and general accounts, including labor, office supplies and expenses, benefits, and other administrative and general accounts used to record storm restoration costs; and payroll taxes associated with the labor costs (Duke Ex. 5 at 7).

According to Duke-Ohio's witness Mehring, the expenses incurred as part of the restoration from the 2008 Storm were almost ten times the company's average annual storm-related costs. He attests that the 2008 Storm expenses were \$32.5 million, of which \$31.8 was O&M costs and payroll taxes, and \$0.7 million was for capital-related expenses. Mr. Mehring states that the company is only asking for recovery of the distribution-related O&M costs and is not seeking recovery of the capital costs in this proceeding. According to Mr. Mehring, the expenses from the storm, as proposed in the application, can be divided into the following four cost categories: internal labor for Duke-Ohio and its affiliates (\$15.3 million); third-party contractor labor (\$14 million); materials and supplies (\$0.7 million); and costs of logistical support for the field crews (\$1.7 million). Before carrying costs, the witness submits that, in its initial application, Duke-Ohio requests recovery of the distribution share of the O&M costs amounting to \$30,682,461. (Duke Ex. 2 at 9-10.)

Based on its review, Staff recommends that the recovery amount, proposed in the application, be decreased by \$1,033,130 to \$29,649,330 (Staff Ex. 2 at 2-3, Att. 1-2). Upon consideration of Staff's comments, Duke-Ohio's witness Wathen testified that the company will reduce its request for recovery through Rider DR-IKE to \$29,355,562. According to the witness, this amount includes the reduction requested by Staff, as well as additional adjustments for supervisory and service company labor and other miscellaneous items totaling \$293,767.65. (Duke Ex. 6 at 3.) In addition to the reduction recommended by Staff and the additional \$293,767.65 reduction, Duke-Ohio's witness Wathen testified that, in the course of responding to discovery, the company found it applied a formula for estimating fringe benefit costs on overtime labor that inappropriately included certain costs as incremental that were not truly incremental. Therefore, Duke-Ohio has adjusted its request to account for this error and has reduced the beginning balance of the regulatory asset by \$800,461. According to Mr. Wathen, the company also made a number of other miscellaneous adjustments that total \$81,858. (Duke Ex. 6 at 8, 10.)

Accordingly, taking the above adjustments into consideration, Duke-Ohio requests recovery in this case of \$28,473,244 in costs resulting from the 2008 Storm. (Duke Ex. 6 at 8, 10.) Therefore, Duke-Ohio's revised actual expenses in the four cost categories are: internal labor for Duke-Ohio and its affiliates (\$12,898,598); third-party contractor labor (\$13,202,611); costs of logistical support for the field crews (\$1,597,025); and materials and supplies (\$775,010). (Duke Ex. 3 at 6-7.)

Staff believes that, with the adjustment it recommends, as well as the further adjustments agreed to by Duke-Ohio, which reduce the recovery amount to \$28,473,244, Staff has reasonable assurance that the 2008 Storm damage expenses to be recovered in Rider DR-IKE are reasonable (Staff Ex. 2 at 2-3, Att. 1-2; Staff Br. at 5-6).



OCC witness Yankel offers that he reviewed nonfield-related costs and costs associated with salaried personnel. The witness points out that, while Duke-Ohio agreed in its responses to interrogatories to remove certain charges, Duke-Ohio initially requested recovery for such items as \$7,349 for massages in support of the call center staff and \$42,058.60 for gravel. (OCC Ex. 1A at 9-10.) Mr. Yankel states that, based on his review of the documentation, of the \$28,473,244 that Duke-Ohio requests recovery of in this case, he recommends the Commission approve recovery of no more than \$5,135,181. In summary, Mr. Yankel recommends the following items be deducted from the amount requested by Duke-Ohio: \$3,279,446 for supplemental compensation to salaried employees; \$307,872, which was paid to Duke-Ohio by Duke-Kentucky; \$1,063,785, which is an estimate of the amount paid to Duke-Ohio by Duke-Indiana; \$2,748,442, which was billed by a contractor to Duke-Ohio, rather than the appropriate affiliate; \$6,969,446, which OCC believes includes charges which may not have been incurred for work done in Ohio; and \$8,969,072 for charges that should be removed from the O&M accounts and should be capitalized. (OCC Ex. 1A at 42.) Therefore, OCC believes that Duke-Ohio should only be allowed to receive \$5,135,181 of the \$28,473,244 proposed by the company (OCC Br. at 20).

#### D. Consideration of Evidence Concerning Expenses

After reviewing the record in this case, the Commission finds that each party categorized the expenses allegedly incurred by Duke-Ohio as a result of the 2008 Storm and presented evidence in this case relating to those expenses in a different manner. Therefore, for purposes of our consideration of the record and determination of whether Duke-Ohio has sustained its burden to prove that it reasonably and prudently incurred \$28,473,244 in costs related to the 2008 Storm, we will divide the costs into two categories: Labor Expenses; and Operations and Maintenance, and Capital Accounts. Under Labor Expenses, we will consider Duke-Ohio's request to recover \$27,698,234 for: internal labor for Duke-Ohio and its affiliates; third-party contractor labor; and the costs of logistical support for the field crews. Under Labor Expenses, we will also consider OCC's proposal that Duke-Ohio not be allowed to recover \$14,368,991 for: supplemental compensation to salaried employees; amounts paid to Duke-Ohio by Duke-Kentucky and Duke-Indiana; amounts billed by a contractor to Duke-Ohio, rather than the appropriate affiliate; and for charges which OCC advocates may not have been incurred for work done in Ohio. Under Operations and Maintenance, and Capital Accounts, we will consider Duke-Ohio's request to recover \$775,010 in materials and supplies, and OCC's request that certain costs Duke-Ohio placed in the O&M account be capitalized.

##### 1. Labor Expenses

Duke-Ohio's witness Mehring testified that, on September 14, 2008, Duke-Ohio and its affiliates, Duke-Kentucky and Duke-Indiana, began implementing their emergency plans to respond to the storm damage. According to Mr. Mehring, of the Duke Energy

employees and contractors responding to the storm: more than 1,200 assessed damage, prepared material for the field, assigned jobs to crews, removed damaged vegetation, repaired downed lines and equipment, and provided support services; and 450 worked in the call center. In addition, Duke-Ohio and Duke-Kentucky retained approximately 1,230 contractors and employees from utilities in other states not affected by the storm, including 570 employees and contractors from Duke Energy Carolinas. (Duke Ex. 2 at 8.) Mr. Mehring explains that the costs for logistical support include food, lodging, transportation, and miscellaneous expenses. The witness states that the costs for this category were calculated by taking the number of people working on the storm restoration efforts per day, which was provided by operations, times a daily per person amount, which was based on field input. (Duke Ex. 2 at 10.)

Mr. Freeman, with Duke Energy, explains that, when a Duke-Indiana employee performs work for Duke-Ohio, Duke-Indiana will not be compensated for those services in the form of revenue flowing between the two companies; rather, consistent with the affiliate rules, there is an entry in the books of Duke-Indiana to reduce the expenses for the company. According to Mr. Freeman, this reduction in expenses would then become relevant in Duke-Indiana's next rate case. (Tr. at 411-412.) In response, OCC points out that an accounting entry will only prevent double recovery if it is included in the company's test year (OCC Reply Br. at 14).

Staff states that its review of the expenses for the repair of the storm damage included inspection of sampled invoices from contractors, material requisitions, and payroll records (Staff Ex. 2 at 2). Staff's witness Hecker explains that, in his audit of the storm costs, he requested a detailed list of transactions making up the total charged for each of the following categories used by the company: external contracts; company and affiliate labor; material; and logistics. From these lists, Mr. Hecker randomly selected source documents to identify specific invoices, material acquisitions, and timesheets to examine the reasonableness of the expenses and accuracy of the data. According to the witness, his audit revealed that labor expenses needed to be reduced by \$986,244.62 and contractor expenses need to be reduced by \$46,866.32. Mr. Hecker explains that the majority of the adjustments for labor expense were for straight-time employees because these expenses, and the associated overhead costs, would have been incurred whether there was a storm or not and would have been included in base rates. Other adjustments were made to the labor expense because, in the timesheets that he chose randomly, the witness found employees whose hours on their timesheets were lower than the actual amount charged. With regard to the adjustments for contractor expenses, Mr. Hecker attests that some of the invoices revealed that the work being billed was done for storm repairs in Kentucky and Indiana or on other projects outside of the storm; thus, these expenses should not have been charged to Ohio customers. (Staff Ex. 1 at 2-4.)

OCC submits that Staff's review was too brief and perfunctory to identify all of the problems with Duke-Ohio's costs in this case. OCC points out that Mr. Hecker, testifying in support of Staff's position, stated that he actually reviewed a couple hundred items out of tens of thousands of invoices and timesheets. OCC notes that Duke-Ohio offered that Staff sampled more than 8,000 lines of data; however, Mr. Hecker stated that he only reviewed a couple hundred items. Pointing to Mr. Hecker's statement that he could not put a percentage on the number of items in his random sampling, OCC opines that Staff's method of review was simply random, with no methodological or statistically purposeful sense. Moreover, OCC remarks that Staff's witness Hecker admitted that there is a possibility of other undiscovered discrepancies. (OCC Reply Br. at 2, 9-10; Tr. at 98, 120-121, 134-135, 137.)

As stated previously, Duke-Ohio requests that it be permitted to recover \$27,698,234 in labor expenses through Rider DR-IKE. Conversely, OCC advocates that Duke-Ohio not be allowed to recover \$14,368,991 of the requested \$27,698,234 in associated labor expenses relating to: supplemental compensation to salaried employees; affiliate labor expenses; and third-party contractor labor expenses. The Commission, in determining what labor expenses resulting from the 2008 Storm are appropriate for recovery through Rider DR-IKE and whether Duke-Ohio met its burden of proof, considered the following issues raised on the record: internal labor expenses and supplemental compensation; affiliate labor expenses; and contractor labor expenses.

a. Internal Labor Expenses and Supplemental Compensation

Duke-Ohio's witness Mehring testified that the daily direct labor rates were determined based on timesheets that were entered into the payroll system for work performed for storm-related activities. He explains that the direct labor cost was then loaded with fringe benefit costs, supervision costs, which were calculated as a percent of labor, and transportation costs. In addition, Mr. Mehring indicates that the direct labor cost total includes the cost of all Duke-Ohio support labor used for the restoration efforts, including personnel from outside of power delivery and internal labor from departments such as the call center, information technology, purchasing, and warehousing. (Duke Ex. 2 at 9.)

OCC indicates that Duke-Ohio is collecting some level of overtime costs through the rates established in the *Duke Electric Rate Case*. Therefore, OCC advocates that, unless the level of overtime currently being recovered in base rates is subtracted from the overtime costs the Commission finds proper in this case, Duke-Ohio will be collecting a test-year amount of overtime charges twice in one year. Furthermore, OCC argues that Duke-Ohio has not demonstrated that it has actually incurred all of the internal overtime costs that it claims, particularly if the overtime represents work by salaried employees who are not paid overtime when they work overtime. (OCC Ex. 10 at 10-11.)

In response to OCC's concerns regarding overtime charges, Duke-Ohio's witness Wathen offers that the amount of overtime approved in the *Duke Electric Rate Case* was approximately \$3.7 million and the total electric distribution overtime actual charges for the year 2008, excluding the 2008 Storm charges, were \$5.3 million. Mr. Wathen states that the overtime charges related to the 2008 Storm were \$3.5 million. Therefore, the witness asserts that the amount of storm-related overtime requested in this proceeding is incremental to the overtime collected in base rates. (Duke Ex. 6 at 7.)

In addition, OCC witness Yankel goes on to advocate that any extra payment to salaried employees because of the 2008 Storm is inappropriate. In his review, Mr. Yankel found that there were two types of direct compensation noted by the company that were paid to salaried employees because of the 2008 Storm, supplemental and regular hour pay. The witness found that there were 223 salaried employees that received only a fixed amount of supplemental pay, 238 salaried employees that received both supplemental pay and pay based on the number of hours worked, and 46 salaried employees that received only pay based on the number of hours that they worked, as if they were hourly employees. (OCC Ex. 1A at 10.)

According to Mr. Yankel, \$855,796 of supplemental compensation was given to salaried employees and \$371,196 was paid on an hourly basis to salaried employees. Mr. Yankel argues that the total extra compensation given to salaried employees, \$1,226,992, is inappropriate and Duke-Ohio should not be allowed to recover this amount through Rider DR-IKE. In addition, Mr. Yankel advocates that the labor loader and supervision costs applied to the \$1,226,992 supplemental compensation to salaried employees should be removed from recovery in this case. Accordingly, the witness calculates that the request for recovery in this case should be reduced by \$3,279,446, which consists of the direct payroll cost of \$1,226,992, and the associated labor loader and supervision costs of \$939,863 and \$1,112,591, respectively. Mr. Yankel submits that, if Duke-Ohio wishes to compensate its salaried employees for extra hours worked during the 2008 Storm, it can do so, but ratepayers should not have to fund this supplemental compensation. (OCC Ex. 1A at 15-17.) Rather, OCC advocates that Duke-Ohio's shareholders should incur the costs of this supplemental pay because it was an unnecessary expense (OCC Br. at 11; OCC Reply Br. at 13).

In response to OCC, Duke-Ohio's witness Mehring states that, as a general proposition, salaried employees are not paid overtime. However, he explains that there are unusual circumstances that may require salaried employees to work excessive hours; therefore, in recognition of, and to reward, those employees, Duke Energy has a supplemental pay policy. According to the witness, it is at management's discretion to give salaried employees some compensation in addition to their regular salaries for their effort. (Duke Ex. 3 at 8.) Duke-Ohio's witness Clippinger also notes that there is a

threshold of additional hours that must be worked first before supplemental pay is provided (Tr. 359).

As noted by Duke-Ohio's witness, paying salaried employees overtime is not the general practice of Duke-Ohio and awarding salaried employees supplemental compensation, in addition to their regular salaries, is totally within the discretion of the company. Upon review of the record, the Commission finds that Duke-Ohio has not shown that it is appropriate and reasonable for the company to recover the discretionary supplemental pay awarded salaried employees through Rider DR-IKE. In considering the appropriate costs resulting from the 2008 Storm restoration effort to be recovered through Rider DR-IKE, the Commission agrees that the discretionary supplemental pay awarded salaried employees should not be included. The formula utilized by OCC to arrive at the supplemental compensation it recommends be deducted from the costs to be recovered was not contested in this case. Therefore, the Commission finds that the recovery amount requested by Duke-Ohio should be reduced by \$3,279,446.

b. Affiliate Labor Expenses

OCC asserts that Duke-Ohio's documentation of the 2008 Storm costs was so haphazard and unreliable that it can not be relied on to meet Duke-Ohio's burden of proof that the costs included in the application were prudently incurred. OCC points out that, when comparing the spreadsheets of the labor costs incurred by Duke-Indiana and Duke-Ohio, it is clear that Duke-Indiana tracked three items: regular hours, overtime hours, and supplemental pay. However, Duke-Ohio's spreadsheet tracked only two items: an hourly rate of pay and supplemental pay. Thus, OCC argues that it is impossible to tell from the Ohio data whether any of the labor charged was regular hours. OCC points out that, when questioned about the Ohio data, Duke-Ohio's witness Clippinger testified first that all labor in Ohio was overtime and then later testified that some of the labor for Ohio was regular time. (OCC Br. at 18-19; Tr. at 66; Tr. at 357.)

OCC's witness Yankel points out that approximately half of the \$15.3 million Duke-Ohio was initially requesting to recover for internal labor costs resulted from employees of Duke-Ohio affiliates. According to Mr. Yankel, these costs are not fair because Duke-Ohio is being charged for work performed by employees of Duke-Ohio's affiliates and those employees are already being paid by ratepayers in other jurisdictions. Mr. Yankel submits that, at a minimum, there should be an offset of the amount of money paid by Duke-Kentucky and Duke-Indiana for Duke-Ohio employees that performed work in those jurisdictions. When he tried to assemble data on the amount paid to Duke-Ohio by affiliates, Mr. Yankel claims that Duke-Ohio refused to answer discovery requests that dealt with other jurisdictions. Thus, to support his contention with regard to Duke-Kentucky, Mr. Yankel points to a data request in Kentucky, which attributes \$307,872 in labor costs to Duke-Ohio for supporting Duke-Kentucky in its 2008 Storm restoration

efforts. For the costs paid to Duke-Ohio by Duke-Indiana, Mr. Yankel reviewed the information he gleaned from a statement made by Duke-Indiana's spokesperson that Duke-Indiana's total costs for the 2008 Storm were \$17 million. By using a ratio of the Duke-Indiana costs of \$17 million to the estimated costs for Duke-Kentucky, Mr. Yankel estimates that the amount of payments to Duke-Ohio from Duke-Indiana was \$1,063,785. Therefore, Mr. Yankel believes that, at a minimum, the request in this case should be reduced by \$1,371,657, which consists of payments to Duke-Ohio of \$307,872 from Duke-Kentucky and \$1,063,785 from Duke-Indiana. (OCC Ex. 1A at 5, 17, 19-20.) In addition, OCC submits that the Commission should require that these payments from the affiliates to Duke-Ohio be flowed through to customers (OCC Br. at 14).

Furthermore, in comparing the costs charged by Duke-Carolina to its affiliates for assistance on 2008 Storm restoration, OCC notes that Duke-Ohio was charged more for the same employees than Duke-Indiana was charged. Duke-Ohio's witness Clippinger explains that the per hour rate charged Duke-Ohio was a blended rate of overtime and regular time. OCC notes that the blended rate added to the supplemental pay charged to Duke-Ohio was higher per hour than the overtime rate plus the supplemental pay charge to Duke-Indiana. When questioned about this, Duke-Ohio's witness Clippinger states that the Duke-Carolina employees were deployed to Indiana first and then to Ohio, after the overtime charges started. OCC believes that, for whatever reason, Duke-Carolina charged Duke-Ohio more for the same employees than it charged Duke-Indiana and the charges to Duke-Ohio are not reasonable; therefore, because Duke-Ohio cannot explain the basis for the higher charges to Ohio, the costs should be disallowed. (OCC Br. at 16-18; OCC Exs. 13A and 14A; Tr. at 356-376.)

After reviewing the record on the issue of affiliate compensation, the Commission finds that Duke-Ohio did not sustain its burden to prove that all of the affiliate-related costs which it proposed should be recovered through Rider DR-IKE. OCC has submitted evidence that calls to question whether \$1,371,657 of those charges should be allowed and Duke-Ohio provided no evidence to rebut OCC's calculation. Accordingly, the Commission finds that the costs requested by Duke-Ohio for recovery through Rider DR-IKE should be reduced by \$1,371,657 in order to address this issue.

c. Contractor Labor Expenses

According to Duke-Ohio's witness Mehring, the cost of contractor support was calculated by aggregating the contractor invoices charged to the storm event (Duke Ex. 2 at 9).

In its audit, Staff determined that there needed to be adjustments for contractor expenses, finding that some of the invoices revealed that the work being billed was done

for storm repairs in Kentucky and Indiana or on other projects outside of the storm; thus, these expenses should not have been charged to Ohio customers. (Staff Ex. 1 at 4.)

With regard to specific contractor invoices which are included in the request for recovery in this case, OCC's witness Yankel describes numerous invoices from one contractor where it appears that the invoices have no connection with the 2008 Storm restoration in Ohio and there is no clear demarcation of the jurisdiction in which the restoration work was performed. The witness suspects these invoices either because: they were sent to a Duke-Ohio affiliate, rather than Duke-Ohio; the project codes reference a state other than Ohio; or the location of the work is listed as a state other than Ohio. He points out that, on many of the invoices, the location of the work was whited out; thus, while some of the invoices appeared to have letters (i.e., "y" or "cky") that would indicate that the location was in Kentucky, it is uncertain where the project was located. In addition, the witness notes that some of the invoices had project descriptions that were clearly not related to the 2008 Storm; however, Duke-Ohio, in its May 11, 2010, filing agreed to remove those invoices from its request in this case. According to Mr. Yankel, of the invoices totaling \$563,322.26 for this one contractor, only \$32,733.48 could definitely be attributed to Ohio, \$261,600 should not be charged to Ohio, and it is uncertain whether the remaining \$269,000 should be charged to Ohio. (OCC Ex. 1A at 30-36.) Mr. Yankel also states that there were invoices from other contractors where the receipts submitted by the contractors indicate that the work might not have been done in Ohio, because the invoice is for items such as food, laundry, transportation, and field materials in Kentucky; however, Mr. Yankel acknowledges that a crew or a contractor could have worked in more than one jurisdiction. (OCC Ex. 1A at 37-39, 41.)

OCC's witness Yankel claims that it appears from a sampling he did of contractor invoices included in the request for recovery in this case that the companies responsible for some of those invoices were either Duke-Indiana or Duke-Kentucky. He argues that Duke-Ohio has not met its burden of proof and demonstrated that all of the \$13,202,611 associated with contractor restoration, for which Duke-Ohio is requesting recovery, actually occurred in Ohio. Mr. Yankel recommends that the requested \$13,202,611 be reduced by \$2,748,442 to account for those invoices that reference a Duke-Ohio affiliate as the responsible utility. In addition, since Duke-Ohio was one of three affiliates located in different states that incurred costs resulting from the 2008 Storm, Mr. Yankel recommends that only one-third of the costs be recovered from Ohio ratepayers; thus, the witness recommends that two-thirds, or \$6,969,446, of the remaining amount be removed because Duke-Ohio did not substantiate where the costs were incurred. With these reductions, Mr. Yankel submits that Duke-Ohio should only be allowed to recover \$3,484,723 for contractor services. (OCC Ex. 1A at 28-30, 41.)

In response to OCC's concern about certain invoices reflecting charges for services, such as lodging and meals, in another state, Duke-Ohio points out that it is not surprising,

with a staging area and lodging across the river in Kentucky, that some Ohio crews took care of some daily needs in Kentucky (Duke Br. at 19). Duke-Ohio argues that OCC's proposal that two-thirds or \$6,969,446 of the Ohio costs should be removed from this request is unreasonable and arbitrary. Duke-Ohio submits that the manner in which Mr. Yankel arrives at this figure by referencing that there were three Duke Energy companies affected by the storm lacks any mathematical, objective, or defined criteria. (Duke Br. at 15.)

It is evident from our review of the record, including both Staff's audit and OCC's attestations, that there are discrepancies in the documentation for contractor expenses which should have been billed to affiliates in other states and not billed to Duke-Ohio. While we understand that these disparities may have occurred due to the emergency nature of the 2008 Storm, the Commission believes that Duke-Ohio failed to prove that the total amount of contractor labor costs it is requesting under Rider DR-IKE is reasonable. The Commission believes that Duke-Ohio has not presented evidence to support its contention that all of these contractor costs were reasonably incurred and subject to recovery under Rider DR-IKE. We acknowledge that the record reflects that Duke-Ohio hired third-party contractors to assist with restoration efforts resulting from the 2008 Storm and we agree that Duke-Ohio should be permitted to recover appropriate contractor costs; however, Duke-Ohio has failed to substantiate what those actual costs are. Therefore, we are left with either disallowing all contractor costs or decreasing the requested contractor costs based upon the record of evidence, which permits Duke-Ohio to recover a portion of the contractor costs. Upon consideration, we find that the appropriate result is to make a downward adjustment to the contractor expenses requested in this case to account for the discrepancies.

Duke-Ohio has requested recovery through Rider DR-IKE of \$13,202,611 for contractor services. Upon consideration of the evidence before us in this case, the Commission finds that OCC's proposal that the contractor expenses be reduced by \$2,748,442 to \$10,455,169, in order to take into account those invoices that reference a Duke-Ohio affiliate as the responsible party, is reasonable. Furthermore, upon consideration of the reasonableness of permitting Duke-Ohio to recover the remaining \$10,455,169 for contractor services through Rider DR-IKE, we find that there is sufficient evidence to suggest that, at most, Duke-Ohio may reasonably only recover one-third of this remainder; the other two-thirds should be allocated to the states of Indiana and Kentucky. The Commission notes that no party disputes the contention that Duke-Ohio should at least be permitted to recover one-third of the remaining \$10,455,169 contractor-services costs. Therefore, the Commission finds that the remaining \$10,455,169 should be further reduced by two-thirds, or \$6,970,112, in order to account for other charges for which there is no evidentiary support for recovery. Accordingly, the Commission concludes that Duke-Ohio's request for recovery of \$13,202,611 for contractor services



should be reduced by \$9,717,564, such that Duke-Ohio should be permitted to recover \$3,485,047 for contractor services.

d. Conclusion - Labor Expenses

Upon review of the record in this case, the Commission finds that Duke has not shown that the labor expenses incurred for restoration from the 2008 Storm were appropriately coded and the evidence of record has shed sufficient doubt on whether some of the labor expenses were appropriately allocated to Ohio. While it appears that Duke-Ohio attempted to reconcile the accounts after the emergency situation had passed, Duke-Ohio did not substantiate, on the record, that all of the labor expenses were appropriately allocated as they should have been. For example, it appears that, initially, all of the labor costs charged to Ohio were overtime hours and, while the company may have attempted to correct this accounting after the fact, Duke-Ohio fails to provide evidence on the record to support its contention that the accounts have been fully reconciled.

As acknowledged by the company, Duke-Ohio's current base rates include an allowance for storm-related expenses. While the Commission agreed that the storm costs could be deferred and reviewed at a later time to determine if the costs were prudently incurred and thus be recovered through Rider DR-IKE, such deferral authority was in no way a guarantee that Duke-Ohio would be permitted to recover all of the costs, or, in fact, any of the costs. As we stated in our January 14, 2009, order in the *Duke Electric Rate Case*, which granted deferral authority, the reasonableness of the deferred amounts and recovery, if any, will be examined in a future proceeding. Since the case at hand is the future proceeding envisioned for review of the costs, the burden of showing that the costs for which Duke-Ohio requests recovery are reasonable and were, in fact, incurred in the restoration of electric service for the 2008 Storm in the state of Ohio, rests solely on the company in this case. While Duke-Ohio has provided the numbers and a minimal level of information alleging that the labor expenses incurred were for Ohio customers, the record reflects that there are inconsistencies and inaccuracies in the company's accounting procedures that the company has neither explained, rebutted, nor discounted. Given these facts, the Commission cannot support recovery of alleged labor expenses which the company has not proven.

Therefore, while the Commission agrees that the record supports the recovery by Duke-Ohio of a portion of the labor expenses requested by the company, the Commission finds that Duke-Ohio did not prove that the total amount of labor expenses it requested, \$27,698,234, was reasonable and prudently incurred. Accordingly, upon review of the record in this case, the Commission concludes that, as delineated in detail in the previous Labor Expense section of this order, Duke-Ohio's request for recovery of labor expenses through Rider DR-IKE must be reduced to \$14,368,667, which includes a reduction of:

\$3,279,446 for supplemental compensation; 1,371,657 for affiliate labor; and 9,717,564 related to contractor labor.

## 2. Operations and Maintenance, and Capital Accounts

Duke-Ohio's witness Mehring states that the material and supply costs were calculated from what was actually recorded in the ledger from the company's storerooms during the time of the storm restoration efforts (Duke Ex. 2 at 10). Mr. Mehring explains that, as a result of the 2008 Storm, 707 distribution poles and 499 transformers had to be replaced. In addition, the storm damage required the replacement of 862 crossarms, 171,278 feet of electric wires, 53,134 connectors, 4,728 insulators, 12,877 fuses, and 314 arresters. The damage resulting from the 2008 Storm also required a total of 31,880 splices and 942 cutouts, according to Mr. Mehring. (Duke Ex. 2 at 6; Duke Ex. 3 at 5.)

OCC notes that Duke-Ohio did not account for the locations of the 31,880 splices and the 942 cutouts that were made during the restoration efforts for the 2008 Storm, nor did it document the teams who completed this work or the time consumed in completing the work. Therefore, OCC argues that it is not possible to ensure that the splices and cutouts for which Duke-Ohio is requesting recovery were actually done. OCC notes that Duke-Ohio only estimated the number of splices and cutouts done as evidenced by Duke-Ohio's witness Mehring's statement that those numbers reported were obtained from the material management system. (OCC Br. at 19-20; Tr. at 58.)

OCC asserts that Duke-Ohio charged excessive costs incurred in response to the 2008 Storm to the O&M expense accounts, when replacement costs, installation costs, and possibly other costs should have been charged to capital accounts. OCC argues that, if Duke-Ohio can not demonstrate that all of the replacement costs were properly charged to capital accounts and all of the repair costs were properly charged to expense accounts, the Commission should deny the collection of the costs from customers. For example, OCC notes that many of the items identified by Duke-Ohio included the replacement of poles, transformers, and other damaged equipment. According to OCC, these items are capital items and should be allocated to a capital account; however, Duke-Ohio charged all costs, including these costs, to the O&M expense accounts. OCC submits that, in accordance with the stipulation approved in the *Duke Electric Rate Case*, Duke-Ohio may only collect from customers, through Rider DR-IKE, incremental operational expenses associated with the storm restoration activities, not capital costs. Therefore, OCC believes that Duke-Ohio is attempting to collect costs that the Commission stated could not be collected. (OCC Ex. 10 at 4-5.)

Furthermore, OCC argues that if the premise services group, the engineering/technical personnel, the normal trouble shift employees, and the second tier-responders were primarily support staff during the storm response, then the costs

associated with their work should be allocated in proportion to the field work charges, and appropriately made to the capital accounts and the O&M accounts based on the actual field work completed. OCC submits that Duke-Ohio charged almost no costs to the capital accounts; however, Duke-Ohio reported a large amount of capital item replacements. Therefore, OCC comments that more of the field work labor costs, as well as the same percentage of support work labor costs, should have been charged to capital accounts. (OCC Ex. 10 at 8.)

Duke-Ohio's witness Clippinger asserts that the company's replacement of units of property was appropriately capitalized and repairs were appropriately charged to the O&M accounts. Ms. Clippinger explains that, if Duke-Ohio installs a unit of property, then the unit of property and the labor and other costs associated with the installation of that property must be charged to the capital accounts. According to the witness, the type of equipment installed will determine whether the item is recorded as capital or expense. For example, she explains that, if a pole is replaced, the costs would be capitalized; however, if an overhead line is repaired by installing a line splice, the costs are expensed. With respect to the 2008 Storm restorations, Ms. Clippinger explicates that the company used both internal and external labor that were not necessarily familiar with the charging practices of the company. Therefore, the witness attests that, in order to allow personnel to focus on the restoration efforts, they were instructed to charge all of their efforts to the O&M accounts. Ms. Clippinger also states that the materials used for service restoration were initially charged to the O&M accounts. However, the witness notes that, in October 2008, the units of property and the associated labor costs were moved from the O&M accounts to the capital accounts. (Duke Ex. 4 at 3-4.)

OCC's witness Yankel believes that the \$0.7 million amount being capitalized with respect to direct labor costs is too low. Mr. Yankel asserts that all of the labor costs and the labor loadings both for internal labor and contractor labor should be capitalized. Mr. Yankel states that neither he nor Duke-Ohio has an estimate of how much of these costs should be capitalized. The witness acknowledges the duress the company was under during the 2008 Storm and understands why Duke-Ohio directed that all costs should be recorded in the O&M accounts; however, now that time has passed, there is not quality data to show what should be either O&M or capital costs. Therefore, Mr. Yankel recommends that an estimate be made to separate the costs into capital and O&M categories. Utilizing an average of the capitalization percentage used by investor-owned utilities in Kentucky that were hit by the 2008 Storm, Mr. Yankel estimates that \$8,969,072 of the requested \$28,473,244 recovery amount should be capitalized. (OCC Ex. 1A at 24-28; OCC Br. at 15-16.)

Duke-Ohio argues that OCC's proposal that the percentage of costs that should be capitalized should be based upon the average percentage applicable to two Kentucky utilities that are not Duke-Ohio's affiliates is arbitrary and fails to acknowledge certain

facts. Namely, Duke-Ohio states that OCC failed to address whether the other utilities replaced the same amount of material as Duke-Ohio. Moreover, the fact that a company subject to generally accepted accounting principles has some degree of latitude in establishing its capitalization policies means that another entity's undefined capitalization policy can not be imposed on Duke-Ohio. (Duke Br. at 15-17; Tr. at 264-265.) In addition, Duke-Ohio points out that, if \$8,969,072 is removed from O&M and capitalized, as OCC proposes, customers would actually pay more over a longer period of time, because the costs would become part of rate base and the rate of return would be equivalent to the full cost of capital applied to that rate base. However, as proposed by the company, the debt rate would be used to calculate the carrying costs over a three-year period for those amounts that remain in O&M and are amortized. (Duke Br. at 17.)

Upon consideration of the record, the Commission finds that Duke-Ohio has substantiated its claim that \$775,010 in material and supply costs is reasonable and should be included in the amount recovered through Rider DR-IKE. While OCC appears to be skeptical of the amount of costs capitalized by Duke-Ohio, OCC has not substantiated its claim that the company inappropriately charged items to the O&M accounts. Moreover, Duke-Ohio's witness, while acknowledging that the materials used for service restoration were initially charged to the O&M accounts, went on to verify that, in October 2008, the units of property and the associated labor costs were appropriately moved from the O&M accounts to the capital accounts. Therefore, we find that Duke-Ohio should be permitted to recover \$775,010 in materials and supplies and OCC's request for a reduction to the O&M expenses recovered through Rider DR-IKE should be denied.

E. Carrying Costs

OCC's witness Yankel argues that, since it has been 20 months since the 2008 Storm and it was completely within Duke-Ohio's discretion when to request recovery for these costs, the Commission should not allow recovery of accrued interest since September 2008. Moreover, OCC points out that it took Duke-Ohio 11 months to file for recovery of its claimed costs after it was given authorization to do so and, as a result, customers are being asked to pay approximately \$160,000 per month for carrying charges due to the company's delay in filing for recovery. Therefore, OCC recommends that Duke-Ohio only be allowed to collect carrying charges for the three years that costs are deferred, beginning when the Commission issues its order in this case. (OCC Ex. 1A at 43; OCC Br. at 10; OCC Reply Br. at 11.)

Duke-Ohio opposes OCC's assertion that the company should not be allowed to begin accruing carrying charges until recovery is approved in this proceeding. Duke-Ohio believes that the Commission, in its order in the *Duke Electric Rate Case*, expressly and unambiguously accepted Duke-Ohio's proposal to accrue carrying charges on the full deferred amount, citing the Commission's January 14, 2009, Finding and Order, at finding

6. Therefore, Duke-Ohio requests recovery of carrying charges at 6.45 percent from January 2009, until such time as recovery is complete. (Duke Br. at 25-26.)

In our January 14, 2009, Finding and Order in the *Duke Electric Rate Case*, the Commission considered and approved Duke-Ohio's request for authority to modify its accounting procedures to defer the O&M expenses associated with the 2008 Storm, along with carrying charges; however, we found that the determination of the reasonableness of the deferred amounts and the recovery thereof would be examined and addressed in a future proceeding. In the instant case, the Commission is now considering the reasonableness of the company's request for recovery of the deferred amounts, with carrying charges, and it is in this order that we will determine what expenses and carrying charges may be recovered. Upon consideration of the record in this case, the Commission concludes that it is reasonable to allow Duke-Ohio to recover the 2008 Storm expenses, as modified by this order, as well as the associated carrying charges beginning on January 14, 2009, which is the date that the Commission authorized Duke-Ohio to defer the expenses.

#### F. Depreciation

OCC points out that Duke-Ohio failed to recognize that all of the assets that were replaced needed to be fully depreciated. According to OCC, although the new assets must be added to rate base, Duke-Ohio should also subtract from rate base any of the depreciation remaining on the assets that were removed. OCC submits that Duke-Ohio has not demonstrated that its failure to address depreciation of replaced assets was just and reasonable. (OCC 10 at 9.)

In response, Duke-Ohio's witness Wathen points out that the company follows composite depreciation accounting, which has historically been used and approved by the Commission in past rate cases. The witness explains that the composite method of accounting does not recognize losses on assets retired prior to their estimated life; the result being that, over the entire life cycle, the portion of costs not recouped prior to average life is balanced by the cost recouped subsequent to average life. Therefore, Mr. Wathen asserts that, if the depreciation remaining on assets removed is subtracted from rate base, it would be inconsistent with composite depreciation accounting. Mr. Wathen also notes that the Commission approves depreciation rates from periodic depreciation studies conducted by the company, which analyze components of the business, including the over and under impacts of retirements in the development of depreciation rates. (Duke Ex. 6 at 7.)

The Commission finds that it is acceptable for Duke-Ohio to follow the composite depreciation method of accounting. Therefore, we conclude that OCC's request on this issue is without merit and should be denied.

G. Rate Design

According to Mr. Wathen, in order to minimize ratepayer impact while allowing the company to have a reasonable recovery period, Duke-Ohio proposes to recover the costs over a three-year period and implement the rate on a per bill basis using the cost-of-service study from the *Duke Electric Rate Case* to allocate the costs among the rate classes. Mr. Wathen contends that, because the costs are distribution related, transmission service (TS) customers should be excluded from the calculation and a standard distribution allocation factor to allocate to the various customer classes should be used. Therefore, the witness proposes that the allocation factor be based on the class system peak, i.e., the average of the 12-monthly peaks. According to Duke-Ohio's witness Wathen, this allocation approach was used to allocate distribution O&M expenses in Duke-Ohio's last distribution cost-of-service study in the *Duke Electric Rate Case* and no party in that case objected to the allocation factors. Mr. Wathen states that this methodology will produce an annualized revenue requirement for each rate class that can be used to calculate the Rider DR-IKE rates. (Duke Ex. 5 at 7-9.) According to the witness, compared to the total bill, the impact of Rider DR-IKE for all customers will be less than one percent (Duke Ex. 6 at 5).

Mr. Wathen believes that, because the charge will be on a per-bill basis and the customer count is fairly predictable, it is unlikely that there will be any significant over- or under-collection during the three-year period; therefore, he states that Duke-Ohio is not proposing a true-up. However, Mr. Wathen notes that Duke-Ohio plans to file a letter in this docket at the end of the three-year period detailing the monthly balances of the regulatory asset, which shows the amortization of the asset, the accruals generated by applying the carrying cost rate, and the ending monthly balances. (Duke Ex. 5 at 10.) Staff recommends that Duke-Ohio provide Staff with the yearly balance and activity on the regulatory asset, by April 30 of each year, so that Staff can monitor the balance in the event the rate would need to be adjusted (Staff Ex. 2 at 3). In response to Staff's comments, Duke-Ohio witness Wathen states that the company will provide Staff with the requested annual reports. In addition, the company is willing to true-up Rider DR-IKE at the end of the three-year period, if the Commission deems the balance of any over or under-recovery to be material. (Duke Ex. 6 at 3.)

Kroger comments that, while it does not object to Duke-Ohio recovering reasonable costs associated with the wind storm to the extent that the costs are allocated among classes using a customer allocator, Duke-Ohio's application does not properly align the design of the cost recovery mechanism with the underlying cost allocation. Kroger asserts that Duke-Ohio's proposed rate design fails to adhere to the standard principle that rate design should reflect cost causation. Kroger explains that Duke-Ohio proposes to allocate the storm costs to the customer classes based solely on class coincident peak demand and to recover the costs through a fixed monthly customer charge. Kroger believes that, while

it is appropriate to recover fixed customer costs through a fixed monthly charge, it is not appropriate to recover demand-related costs in such a manner. Kroger argues that the result of assigning costs to customer classes based on class peak demand, and then recovering the costs from customers as if they were fixed customer costs, produces a distorted and unreasonable rate impact on customers. Kroger advocates that, if the Commission finds it reasonable for costs to be assigned to customer classes based solely on class peak demand, then the costs assigned to demand-billed classes should be recovered exclusively through a demand charge and not through a monthly fixed customer charge. Kroger offers that the methodology should be based on an appropriate combination of customer and demand-related costs, consistent with the National Association of Regulatory Utility Commissioner Electric Utility Cost Allocation Manual. (Kroger Ex. 2 at 1-4, 6.) Kroger's witness Higgins submits that recovery of allowed storm damage costs from Service at Secondary Distribution Voltage (DS) and Service at Primary Distribution Voltage (DP) customers is best accomplished through a uniform demand charge levied on these two rate schedules. Upon review of Duke-Ohio's modification to its rate design to provide for such a demand charge, Mr. Higgins states that the revised Rider DR-IKE rate design appropriately incorporates such a rate design for the DP class and the DS class customers. (Kroger Ex. 1 at 3.)

Upon consideration of Kroger's comments, Duke-Ohio's witness Wathen advises that the company will modify its request with regard to the per bill customer charge. Therefore, for those customers taking service under tariffs that charge based on demand, Rider DR-IKE will be on a per kW basis. Mr. Wathen explains that this change has no impact on the relative allocation between customer classes, but it will slightly shift the impact of Rider DR-IKE among customers within those affected rate classes. (Duke Ex. 6 at 4.)

As revised by Duke-Ohio, the rate design for Rider DR-IKE provides for a uniform demand charge for DS and DP customers and a class-specific customer charge for all other classes. Upon consideration of the proposed rate design for Rider DR-IKE, as revised, the Commission finds that it is reasonable and should be approved.

#### CONCLUSION:

The Commission notes that, pursuant to the stipulation approved in the *Duke Electric Rate Case*, Duke-Ohio bears the burden of proving that the costs associated with the 2008 Storm were prudently incurred and reasonable. In the present case, we find that Duke has not met its burden with respect to all of the costs for which it is requesting recovery. For example, when considering the evidence presented by Duke regarding supplemental compensation, the Commission notes that overtime for salaried employees was not a general practice and was within the company's discretion; therefore, we have determined that it was an inappropriate expense for recovery. With respect to the

expenses incurred for contractor labor, we find that OCC demonstrated the presence of some unexplained discrepancies in the documentation provided by Duke, which called into question whether the costs Duke sought to recover for contractor expenses were prudent and reasonable. Duke requested recovery of \$28,473,244 through Rider DR-IKE. With the reductions in this order of \$14,368,667 for labor expense, the Commission has determined that, based on the record in this case, the total amount that Duke-Ohio should be authorized to recover through Rider DR-IKE is \$14,104,577, plus carrying charges on that amount beginning on January 14, 2009, at the rate of 6.45 percent. Furthermore, we find that the proposed rate design for Rider DR-IKE, as revised, which provides for a uniform demand charge for DS and DP customers and a class-specific customer charge for all other classes is reasonable and should be approved. Accordingly, the Commission finds that Duke-Ohio should work with Staff to revise its tariffs consistent with this order and then may file such revised tariffs to implement the new Rider DR-IKE in this docket. As a final matter, the Commission directs Duke-Ohio to provide Staff with the yearly balance and activity on the regulatory asset, by April 30 of each year. Duke-Ohio should work with Staff at the end of the three-year period to determine if there is a need to true-up Rider DR-IKE in order to account for any material over or under-recovery.

#### FINDINGS OF FACT AND CONCLUSIONS OF LAW:

- (1) Duke-Ohio is an electric light company, as defined in Section 4905.03(A)(3), Revised Code, and a public utility under Section 4905.02, Revised Code.
- (2) On December 11, 2009, Duke-Ohio filed its application in this case.
- (3) By entries issued February 9, 2010, and April 14, 2010, OCC and Kroger were granted intervention. At the June 7, 2010, hearing, Duke-Indiana was granted intervention.
- (4) Comments on the application in this case were filed by Staff, OCC, and Kroger on February 23, 2010. On March 25, 2010, Duke-Ohio filed a statement regarding the disputed issues.
- (5) The hearing in this matter was held on May 25 and 26, 2010, and June 7, 2010.
- (6) Duke-Ohio, Staff, and OCC filed briefs on June 15, 2010, and Duke-Ohio and OCC filed reply briefs on June 21, 2010.
- (7) Duke-Ohio's application to adjust its Rider DR-IKE charge is reasonable and should be approved, with the following modifications as further delineated in this order: the recovery



amount shall be reduced by \$14,368,667 for labor expenses. The total amount that Duke-Ohio shall be authorized to recover through Rider DR-IKE is \$14,104,577, plus carrying charges on that amount beginning on January 14, 2009, at the rate of 6.45 percent. Duke-Ohio shall provide Staff with the yearly balance and activity on the regulatory asset, by April 30 of each year. Duke-Ohio should work with Staff at the end of the three-year period to determine if there is a need to true-up Rider DR-IKE in order to account for any material over or under-recovery.

- (8) Duke-Ohio should work with Staff to revise its tariffs consistent with this order and then may file such revised tariffs to implement the new Rider DR-IKE rate in this docket.

ORDER:

It is, therefore,

ORDERED, That, with the modifications set forth in this order, Duke-Ohio's application to adjust its Rider DR-IKE is reasonable and should be approved. It is, further,

ORDERED, That Duke-Ohio take all necessary steps to carry out the terms of this order. It is, further,

ORDERED, That Duke-Ohio be authorized to file in final form four complete copies of the tariff pages consistent with this opinion and order and to cancel and withdraw its superseded tariff pages. Duke-Ohio shall file one copy in its TRF docket (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in this case docket. The remaining two copies shall be designated for distribution to the Rates and Tariffs, Energy and Water Division of the Commission's Utilities Department. It is, further,

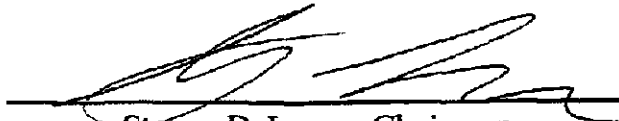
ORDERED, That the new rates for the Rider DR-IKE charge shall be effective on a date not earlier than the date upon which four complete, printed copies of the final tariff page is filed with the Commission. It is, further,

ORDERED, That Duke-Ohio shall notify its customers of the changes to the tariffs via bill message or bill insert within 30 days of the effective date of the revised tariffs. A copy of this customer notice shall be submitted to the Commission's Service Monitoring and Enforcement Department, Reliability, and Service Analysis Division at least 10 days prior to its distribution to customers. It is, further,

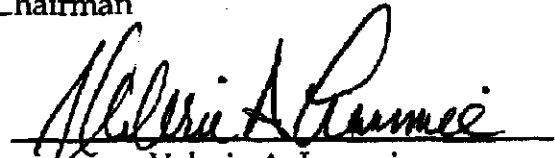
ORDERED, That nothing in this opinion and order shall be binding upon the Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this opinion and order be served upon each party of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

  
Steven D. Lesser, Chairman

  
Paul A. Centolella

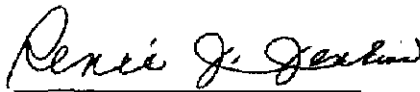
  
Valerie A. Lemmie

  
Cheryl L. Roberto

CMTP/KLS/vrm

Entered in the Journal

**JAN 11 2011**



Renee J. Jenkins  
Secretary