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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of Aligning Electric Distribution Utility Rate Structure With Ohio's Public Policies to Promote Competition, Energy Efficiency, and Distributed Generation.	)))))	Case No. 10-3126-EL-UNC

DUKE ENERGY OHIO'S COMMENTS IN RESPONSE TO COMMISSION QUESTIONS

On December 29, 2010, the Public Utilities Commission of Ohio (Commission) issued an entry indicating its interest in reviewing the basic structure of rate designs and considering whether modifications to electric distribution utilities' rate structures would better align utility performance with desired public policy outcomes. The Commission additionally noted its interest in determining what modifications should be adopted, if change is warranted.

The Commission, in its entry, ordered all electric utilities to file comments addressing a series of questions, to aid it in framing issues that should be considered. The following are the responses of Duke Energy Ohio, Inc. (Duke Energy Ohio or Company).

Question 1

Are there fundamental operational distinctions between natural gas and electric utilities that must be considered in determining whether and how to eliminate or mitigate the throughput incentive in electric distribution rates?

Duke Energy Ohio Response:

The electric distribution system is similar to the natural gas distribution system in that the revenue requirements in both systems are almost exclusively attributable to fixed costs and both are designed to accommodate the respective classes' maximum local loads. Although the natural gas distribution system does have some pressure regulation equipment that is somewhat comparable to the electric distribution transformers at the customer location, there are some differences in the costs and nature of the equipment.

In addition, it is more likely for load growth to drive a need for investment to expand the electric distribution system than the gas distribution system. This is a difference between electric and gas systems that can affect the level of incremental investment required.

And finally, gas load volatility is higher than that for electric loads due to the weather. This can lead to operational differences between the gas and electric distribution systems.

Question 2

Are there factual or policy considerations that suggest electric distribution rate design should be constructed differently from natural gas?

Duke Energy Ohio Response:

Yes. Among the more important differences, throughput (*i.e.*, MCF or kWh sales) for gas is generally much more sensitive to weather influences. Also, electricity typically has higher growth in volumetric sales than natural gas. These exogenous factors are considerations that should be weighed when designing an effective and fair decoupling mechanism.

Another difference that should be a consideration is the metering capabilities of gas and electric meters. With full implementation of smart metering technology, electric distribution utilities will have the capability of recording monthly peak demands for all customers, including residential customers. Insofar as demand is the most significant factor in determining the magnitude of investment in electric distribution facilities, the ability to bill customers based on demand for electricity may allow electric distribution utilities to better align rates to match with cost causation.

Question 3

If the Commission adopts a decoupling rate design, which rate design should it use: SFV, decoupling adjustment, lost revenue recovery adjustment, or some combination of these?

Duke Energy Ohio Response:

Duke Energy Ohio would like to caveat its answer by stating that, absent a detailed description of the mechanism and how precisely the mechanism will work, it is extremely difficult to recommend any form of a decoupling rate design.

Duke Energy Ohio supports a mechanism that decouples volumetric sales from utility earnings. In the Company's view, a formula rate plan would be the superior method for this purpose. A proper formula rate plan would compare actual earnings for a year to a target earnings level, potentially with some rate of return collar, and would allow the Company to achieve its required rate of return in a manner that eliminates some of the volatility associated with weather, economic swings, and growth.

In its last gas distribution rate case, Case No. 07-589-GA-AIR, Duke Energy Ohio accepted a Staff recommendation that more closely resemble straight-fixed variable (SFV) rate design as a form of decoupling. This case illustrates that, when structured properly by appropriately factoring in the impacts of the design, an SFV rate design (or something

more like the "modified SFV" from Case No. 07-589-GA-AIR) can be an effective step toward decoupling.

Whatever decoupling mechanism is adopted, if any, ease of use and transparency should also be considerations in the choice of design. Various decoupling adjustments (*i.e.*, a simple reconciliation to fixed cost recovery) can be relatively straight-forward and efficient relative to more complex designs. Any rate design changes (*i.e.*, structural to the rates and charges) should be supported by competent studies and analysis that seek to fully understand cost causality.

Question 4

If the Commission adopts a decoupling rate design in electric distribution rates:

(a) Should that rate design be applied only to residential rate classes? What other rate classes should be considered?

(b) How often should the Commission require the utility to update its distribution revenue requirement?

(c) Should the company's return on equity be reduced to reflect a reduced risk to the Company?

Duke Energy Ohio Response:

(a) If the Commission should choose to adopt a SFV rate design, Duke Energy Ohio believes that it should apply only to residential customers and customers receiving service on Rate Class DM because they are fairly homogenous. The Company believes that regardless of the mechanism or rate design that is used to eliminate the utility throughput incentive, it should not be applied to rate classes in which it will cause significant shifting of costs or rate swings between the customers within the class, absent the appropriate cost justification. Duke Energy Ohio also believes

that at the time of applying the decoupling mechanism or rate design intended to reduce the throughput incentive, the Commission should also address reevaluation of the cost of service that is currently used for the existing rate classes.

(b) With respect to SFV rate design, Duke Energy Ohio believes updates should be done at the time of base rate cases and, with respect to other forms of decoupling, Duke Energy Ohio does not believe the calculation should be performed more frequently than annually.

(c) The utility's allowed return on equity should adequately compensate investors for risk and permit the utility to attract capital on reasonable terms and maintain financial integrity. Investors have an expectation that prudently-incurred costs will be recovered in a timely manner, so mechanisms that improve the pace of cost recovery (such as decoupling) do not necessarily reduce overall risk to investors. Nevertheless, if it is determined that the decoupling or rate design that has been established significantly lowers the company's risk profile, then it may be appropriate to adjust the company's allowed return on equity.

Question 5

If the Commission adopts some element of a decoupling rate design:

(a) Should adjustment be made on a total revenue, per customer revenue, or some other basis?

(b) Should adjustments be normalized for weather?

(c) Should the Commission adopt any special features to shield consumers from volatile adjustments (e.g., caps, collars, bands)?

Duke Energy Ohio Response:

(a) Although Duke Energy Ohio believes that the SFV rate design is a form of rate design that will effectively eliminate the throughput incentive, it does not require

that any adjustments be made and the lost margins that would continue on the variable component could be handled through the energy efficiency or demand-side management riders of the respective electric distribution utilities.

With respect to how Duke Energy Ohio would propose to apply the decoupling adjustment, please see the response to Question 3.

(b) Duke Energy Ohio is somewhat at a disadvantage in having to comment on mechanisms that are not complete in scope. It has been the Company's experience that "weather normalization"in the context of decoupling means that the utility will retain weather risk. Provided that the weather normalization methodology truly eliminates the potential impacts of weather, then Duke Energy Ohio would propose that a decoupling mechanism adjustment tied in any way to kWh sales should be weather normalized.

(c) Duke Energy Ohio believes that the Commission should adopt a collar or band of tolerable variances that would not require an annual adjustment. By adopting a collar or a band of acceptable variance, it would reduce the volatility that customers could experience under decoupling on an annual basis. Additionally, annual decoupling true-ups/adjustments have the potential to negatively affect the price responsiveness of customers and become counter-productive to the goals of energy efficiency. For example, an annual true-up after a year in which the utility over-collected revenues will lower prices and could send price signals that will actually increase sales. This growth in sales will increase the likelihood of the utility over collecting again.

Question 6

If the Commission determines that a decoupling rate design should be implemented to eliminate or mitigate the throughput inventive in electric distribution rates:

(a) When should this change occur (i.e., in what types of actions before the Commission should this change be implemented)?

(b) Should it be phased in?

(c) Over what period of time?

Duke Energy Ohio Response:

(a) The best time to implement a major change in rate design would be at the time of the next rate case when a cost of service study would be available to ensure that costs are being assigned to each rate class appropriately.

(b) No.

(c) Not applicable, as Duke Energy Ohio does not believe in a phase-in approach.

Question 7

In order to review the various decoupling rate designs, the Commission will need necessary data such as that included in Appendix B. Is the data in Appendix B:

(a) Burdensome?

(b) Appropriate?

(c) A comprehensive list of the necessary data?

(d) Proprietary?

Duke Energy Ohio Response:

(a) The data are difficult to calculate, particularly items 12 through 15. Those items require a bill-by-bill analysis. A program must be run against the annual billing

records. That said, the calculations are quite doable, but the utility should be given sufficient time to write and run the program and analyze the data.

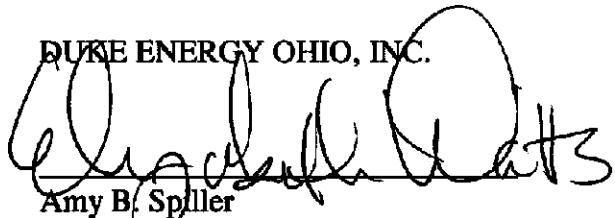
(b) The data are appropriate; cost studies for SFV designs should be required.

(c) Typical bill impacts of the rate design for different size customers should also be calculated. The Company should estimate the number of customers that will see increases and decreases of various percentages.

(d) Duke Energy Ohio believes that the data in Appendix B would not be proprietary, as no individual customer data would be released.

Respectfully submitted,

DUKE ENERGY OHIO, INC.



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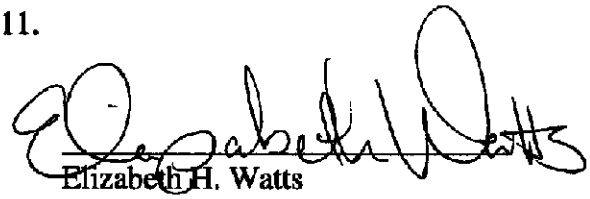
CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Comments of Duke Energy Ohio in Response to Commission Questions has been served to the parties by regular U. S. Mail, overnight delivery, or electronic delivery this 11th day of February, 2011.



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