

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Ohio	)	
Edison Company, The Cleveland Electric	)	
Illuminating Company, and The Toledo	)	
Edison Company For Authority to	)	Case No. 12-1230-EL-SSO
Establish a Standard Service Offer	)	
Pursuant to R.C. § 4928.143 in the Form	)	
Of an Electric Security Plan.	)	

**DIRECT TESTIMONY  
OF  
DANIEL J. DUANN, Ph.D.**

**On Behalf of  
The Office of the Ohio Consumers' Counsel**  
*10 West Broad Street, Suite 1800  
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***May 21, 2012***

## **LIST OF ATTACHMENTS**

ATTACHMENT DJD-A

List of Testimonies Filed Before PUCO

ATTACHMENT DJD-B

List of Professional Publications

1 ***Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND JOB TITLE.***

2 ***A1.*** My name is Daniel J. Duann. My business address is 10 West Broad Street, Suite  
3 1800, Columbus, Ohio, 43215-3485. I am a Principal Regulatory Analyst with  
4 the Office of the Ohio Consumers' Counsel ("OCC").  
5

6 ***Q2. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND***  
7 ***PROFESSIONAL EXPERIENCE.***

8 ***A2.*** I received my Ph.D. degree in public policy analysis from the Wharton School,  
9 University of Pennsylvania. I also have a M.S. degree in energy management and  
10 policy from the University of Pennsylvania and a M.A. degree in economics from  
11 the University of Kansas. I completed my undergraduate study in business  
12 administration at the National Taiwan University, Taiwan, Republic of China. I  
13 am a Certified Rate of Return Analyst conferred by the Society of Utility and  
14 Regulatory Financial Analysts in April 2011.  
15

16 I was a Utility Examiner II in the Forecasting Section of the Ohio Division of  
17 Energy, Ohio Department of Development, from 1983 to 1985. From 1985 to  
18 1986, I was an Economist with the Center of Health Policy Research at the  
19 American Medical Association in Chicago. In 1986, I joined the Illinois  
20 Commerce Commission as a Senior Economist in its Policy Analysis and  
21 Research Division. I was employed as a Senior Institute Economist at the  
22 National Regulatory Research Institute ("NRRI") at The Ohio State University

1 from 1987 to 1995. My work at NRRI involved many areas of utility regulation  
2 and energy policy. I was an independent business consultant from 1996 to 2007.

3  
4 I joined the OCC in January 2008 as a Senior Regulatory Analyst. I was  
5 promoted to my current position in November 2011. My responsibilities are to  
6 assist the OCC in participating in various regulatory proceedings that include rate  
7 cases, alternative regulation, cost recovery filings, and service reliability by Ohio  
8 utilities. Specifically, I have participated and prepared comments in a number of  
9 proceedings related to the Significantly Excessive Earnings Test ("SEET") and  
10 the reliability performance standards, including those proceedings involving the  
11 three electric distribution utilities ("EDUs") that are applicants in this case (Ohio  
12 Edison Company ("Ohio Edison"), The Cleveland Electric Illuminating Company  
13 ("CEI"), and The Toledo Edison Company ("Toledo Edison") (hereinafter  
14 collectively, "FirstEnergy").

15  
16 ***Q3. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY TO THE PUBLIC***  
17 ***UTILITIES COMMISSION OF OHIO OR ANY OTHER AGENCY OR***  
18 ***GOVERNMENTAL ENTITY?***

19 ***A3.*** Yes. I have submitted expert testimony on behalf of OCC to the Public Utilities  
20 Commission of Ohio ("PUCO" or "Commission") in a number of cases involving  
21 electric, gas, and water companies. A list of these cases is included in Attachment  
22 DJD-A. I have also testified before the Ohio Division of Energy, the Illinois

Commerce Commission, and the Senate Committee on Energy and Public  
Utilities of the California Legislature.

***Q4. WHAT DOCUMENTS HAVE YOU REVIEWED IN THE PREPARATION OF  
YOUR TESTIMONY?***

***A4.*** I have reviewed the Stipulation and Recommendation (“Stipulation”) and William  
Ridmann’s Direct Testimony filed on April 13, 2012, and Mr. Ridmann’s  
Supplemental Testimony filed on April 23, 2012 in this proceeding and the  
responses to OCC discovery regarding the SEET. I have also reviewed the 2009  
and 2010 SEET filings by the three EDUs of FirstEnergy. In addition, I have  
reviewed the Commission’s January 11, 2011 Opinion and Order in the 2009 AEP  
Ohio’s SEET proceeding (PUCO Case No. 10-1261-EL-UNC), and filings related  
to SEET mentioned in my testimony.

***Q5. PLEASE SUMMARIZE YOUR QUALIFICATIONS SPECIFIC TO YOUR  
TESTIMONY IN THIS PROCEEDING.***

***A5.*** I am a trained economist with over twenty years of experience in studying and  
analyzing the regulation of electric utilities in the United States. A list of my  
professional publications is included in Attachment DJD-B. I am familiar with  
the applicable law regarding the SEET (R.C. 4928.143(F)) and the Commission’s  
January 11, 2011 Opinion and Order in the 2009 AEP Ohio SEET Case. I have  
participated in the SEET Workshop proceeding (PUCO Case No. 09-786-EL-

1 UNC), and the 2009 and 2010 AEP Ohio SEET cases (PUCO Case Nos. 10-1261-  
2 EL-UNC and 11-4571-EL-UNC, respectively).

3  
4 ***Q6. WHAT IS THE PURPOSE OF YOUR TESTIMONY?***

5 ***A6.*** The purpose of my testimony is to explain and support OCC's position on one  
6 particular provision of the proposed Stipulation. That provision relates to the  
7 SEET and is found in Paragraph B(3) of the Stipulation (the "SEET Provision").  
8 I recommend that the Commission either reject the Stipulation or modify  
9 Paragraph B(3) of the Stipulation to require that the impact of deferred carrying  
10 charges not be excluded (for example, all deferred interest income should be  
11 included) from the calculation of FirstEnergy's return on equity ("ROE") for the  
12 purposes of the SEET. I conclude that the SEET Provision as proposed in the  
13 Stipulation does not benefit customers and the public interest and is inconsistent  
14 with the Commission's current practice regarding the application of the SEET.

15  
16 ***Q7. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE***  
17 ***SIGNIFICANTLY EXCESSIVE EARNINGS TEST.***

18 ***A7.*** The significantly excessive earnings test for a utility with an electric security plan  
19 ("ESP") is set forth in R.C. 4928.143(F) as follows:

20 With regard to the provisions that are included in an electric  
21 security plan under this section, the commission shall consider,  
22 following the end of each annual period of the plan, if any such  
23 adjustments resulted in excessive earnings as measured by whether

1 the earned return on common equity of the electric distribution  
2 utility is significantly in excess of the return on common equity  
3 that was earned during the same period by publicly traded  
4 companies, including utilities, that face comparable business and  
5 financial risk, with such adjustments for capital structure as may be  
6 appropriate. Consideration also shall be given to the capital  
7 requirements of future committed investments in this state. The  
8 burden of proof for demonstrating that significantly excessive  
9 earnings did not occur shall be on the electric distribution utility. If  
10 the commission finds that such adjustments, in the aggregate, did  
11 result in significantly excessive earnings, it shall require the  
12 electric distribution utility to return to consumers the amount of the  
13 excess by prospective adjustments; provided that, upon making  
14 such prospective adjustments, the electric distribution utility shall  
15 have the right to terminate the plan and immediately file an  
16 application pursuant to section 4928.142 of the Revised Code.  
17 Upon termination of a plan under this division, rates shall be set on  
18 the same basis as specified in division (C)(2)(b) of this section, and  
19 the commission shall permit the continued deferral and phase-in of  
20 any amounts that occurred prior to that termination and the  
21 recovery of those amounts as contemplated under that electric  
22 security plan. In making its determination of significantly  
23 excessive earnings under this division, the commission shall not

consider, directly or indirectly, the revenue, expenses, or earnings  
of any affiliate or parent company.

***Q8. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE PURPOSE OF  
THE SIGNIFICANTLY EXCESSIVE EARNINGS TEST.***

**A8.** It is my understanding that the SEET provides an important protection to the  
electric utility's consumers against excessive rate increases under an ESP. The  
SEET ensures that significantly excessive earnings resulting from an ESP will be  
returned to the customers who paid what ultimately were determined to be  
excessive rates. In a sense, the SEET is an important customer protection tool  
available to the Commission to "rectify" a prior decision on an ESP that resulted  
in "significantly excessive" earnings to the regulated utility.

***Q9. WHAT PROVISION IN THE PROPOSED STIPULATION ADDRESSES  
THE SIGNIFICANTLY EXCESSIVE EARNINGS TEST?***

**A9.** Paragraph B(3) of the Stipulation (pages 23-24) addresses how the ESP will be  
treated in regards to the SEET. Specifically, the Stipulation provides that:

Any charges billed through Rider DCR will be included as revenue  
in the return on equity calculation for purposes of SEET and will  
be considered an adjustment eligible for refund. For each year  
during the period of this ESP, adjustments will be made to exclude  
the impact: (i) of a reduction in equity resulting from any write-off  
of goodwill, (ii) of **deferred carrying charges**, and (iii) associated

1 with any additional liability or write-off of regulatory assets due to  
2 implementing this ESP 3 or the ESP in Case No. 10-388-EL-SSO.

3 The significantly excessive earnings test applicable to plans greater  
4 than three years and set forth in R.C. § 4928.143(E) is not  
5 applicable to this two-year ESP. (Emphasis added).

6  
7 ***Q10. DO YOU HAVE ANY CONCERNS REGARDING THIS PROVISION IN THE***  
8 ***PROPOSED STIPULATION?***

9 ***A10.*** Yes.

10  
11 ***Q11. PLEASE EXPLAIN YOUR CONCERNS REGARDING THE IMPACT OF***  
12 ***SUCH A PROVISION ON THE SIGNIFICANTLY EXCESSIVE***  
13 ***EARNINGS TEST?***

14 ***A11.*** This provision of the Stipulation specifically provides for the exclusion of the  
15 impact of deferred carrying charges from the calculated ROE for Ohio Edison,  
16 CEI and Toledo Edison for the purposes of the SEET. I have two concerns  
17 regarding this SEET Provision. First, this provision will erode the protection of  
18 customers under the SEET statute from excessive ESP rates and therefore, it does  
19 not benefit customers and the public interest. Second, this SEET Provision is  
20 inconsistent with the Commission's current practice of including deferrals in the  
21 calculation of the ROE of Ohio EDUs when applying the SEET.

1   ***Q12. PLEASE EXPLAIN WHY THE EXCLUSION OF DEFERRED CARRYING***  
2       ***CHARGES IN THE CALCULATION OF THE RETURN ON EQUITY FOR***  
3       ***PURPOSES OF THE SIGNIFICANTLY EXCESSIVE EARNINGS TEST***  
4       ***DOES NOT BENEFIT CUSTOMERS AND THE PUBLIC INTEREST?***

5   ***A12.*** Based on my review of the SEET filings made by FirstEnergy in prior years, the  
6       exclusion of the deferred carrying charges can be a significant “dilution” of the  
7       effects of the SEET legislation. With the proposed SEET Provision in the  
8       Stipulation, the deferred interest income (as part of the deferred carrying charges)  
9       will not be treated as income.<sup>1</sup> This is contrary to FirstEnergy’s financial  
10      statement presentations in which deferred interest income is otherwise reported in  
11      the net incomes of FirstEnergy’s three EDUs. Depending on the amounts of the  
12      deferred interest income being excluded, the ROEs of the three utilities calculated  
13      under this provision may be much lower than the ROEs reported in the  
14      FirstEnergy EDU’s financial statements. The lower calculated ROEs, as a result  
15      of the exclusion of deferred carrying charges, may not exceed the SEET  
16      threshold; therefore, a SEET refund may not be required, thus defeating the  
17      intended purpose of the SEET.

18  
19      As the application of SEET requires a comparison of the EDU’s ROE with the  
20      ROEs of other public companies with comparable risk, it is my opinion that the  
21      reported financial results (such as net income) should be used in calculating the

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<sup>1</sup> See, for example, PUCO Case No. 11-4553-EL-UNC, Direct Testimony of Kevin R. Burgess Attachment KRB-2.

1 ROE for SEET purpose. The reported net income provides a consistent and  
2 representative measurement of the earnings of the EDU for comparison.  
3 Extraordinary items or one-time events may be excluded from the net income for  
4 SEET purpose. But deferrals, and the deferred interest income in particular, are  
5 not extraordinary or one-time events. Accordingly, they should not be excluded  
6 in calculating the ROE for purposes of the SEET.

7  
8 ***Q13. HAS THE COMMISSION ADDRESSED HOW DEFERRALS ARE TO BE***  
9 ***TREATED IN REGARDS TO THE SIGNIFICANTLY EXCESSIVE***  
10 ***EARNINGS TEST?***

11 ***A13.*** Yes. The Commission has held that deferrals should not be excluded from the  
12 electric utility's ROE calculation for the purposes of the SEET. Specifically, the  
13 Commission held in its Opinion and Order in AEP Ohio's 2009 SEET case that:

14 Unlike OSS or extraordinary or non-recurring items, deferrals  
15 should not be excluded from the electric utility's ROE as requested  
16 by AEP-Ohio. Consistent with generally accepted accounting  
17 principles, deferred expenses and the associated regulatory liability  
18 are reflected on the electric utility's books when the expense is  
19 incurred. Subsequently, with the receipt of deferred revenues,  
20 there is an equal amortization of the deferred expenses on the  
21 electric utility's books, such that there is no effect on earning in  
22 future years. Accordingly, we are not persuaded by the arguments

of AEP-Ohio to adjust CSP's 2009 earnings to account for certain  
significant deferred revenue.<sup>2</sup>

**Q14. IS THE STIPULATION'S EXCLUSION OF DEFERRED INTEREST  
INCOME FOR PURPOSES OF THE SIGNIFICANTLY EXCESSIVE  
EARNINGS TEST CONSISTENT WITH PRIOR COMMISSION PRACTICE  
REGARDING DEFERRALS?**

**A14.** No. Such an exclusion of deferred interest income is inconsistent with the  
Commission's decision in the 2009 AEP Ohio SEET proceeding. As indicated  
above, in that decision the Commission relied on regulatory principle and practice  
and specifically held that deferrals must be included in the calculation of the ROE  
for the year of the deferral (for purposes of the SEET).

**Q15. DID THE STIPULATION IN FIRSTENERGY'S 2010 ESP CASE PROVIDE  
FOR THE EXCLUSION OF DEFERRED CARRYING CHARGES (SUCH AS  
DEFERRED INTEREST INCOME) FOR THE PURPOSE OF THE  
SIGNIFICANTLY EXCESSIVE EARNINGS TEST?**

**A15.** Yes.<sup>3</sup>

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<sup>2</sup> Case No. 10-1261-EL-UNC, Opinion and Order at 31 (January 11, 2011).

<sup>3</sup> FirstEnergy ESP 2 Case, Case No. 10-388-EL-SSO, Stipulation and Recommendation at 17 (March 23, 2010).

1 **Q16. DID THE APPROVAL OF THE STIPULATION IN FIRSTENERGY'S 2010**  
2 **ESP CASE PREDATE THE COMMISSION'S HOLDING THAT**  
3 **DEFERRALS SHOULD NOT BE EXCLUDED FROM AN ELECTRIC**  
4 **UTILITY'S RETURN ON EQUITY CALCULATION FOR THE PURPOSES**  
5 **OF THE SIGNIFICANTLY EXCESSIVE EARNINGS TEST?**

6 **A16.** Yes. The stipulation in the most recent FirstEnergy ESP Case was approved on  
7 August 25, 2010, and the Opinion and Order in the 2009 AEP SEET Case was  
8 issued on January 11, 2011.

9  
10 **Q17. SHOULD THE COMMISSION TREAT FIRSTENERGY'S DEFERRALS**  
11 **DIFFERENTLY FROM AEP OHIO'S DEFERRALS FOR THE PURPOSES**  
12 **OF THE SIGNIFICANTLY EXCESSIVE EARNINGS TEST?**

13 **A17.** No. Deferrals should be included in calculating the ROEs of FirstEnergy's three  
14 EDUs for the purpose of the SEET. FirstEnergy's customers should have the  
15 protection of the SEET with the deferrals included in the SEET calculation.

1 ***Q18. HAS FIRSTENERGY PROVIDED ANY SUPPORT IN ITS APPLICATION***  
2 ***OR THE PROPOSED STIPULATION FOR NOT APPLYING THE***  
3 ***COMMISSION'S CURRENT PRACTICE OF INCLUDING DEFFERALS***  
4 ***FOR PURPOSES OF THE SIGNIFICANTLY EXCESSIVE EARNINGS***  
5 ***TEST?***

6 ***A18.*** I did not find any specific support or justifications in the Stipulation or  
7 testimonies for a position that current Commission practice should not be  
8 applicable to the future SEET proceedings of FirstEnergy's three EDUs.  
9

10 ***Q19. PLEASE SUMMARIZE YOUR RECOMMENDATION.***

11 ***A19.*** I recommend that the Commission either reject the Stipulation and  
12 Recommendation filed on April 13, 2012 in this proceeding or modify Paragraph  
13 B(3) of the Stipulation to require that all deferred carrying charges (such as  
14 deferred interest income) be included in the calculation of FirstEnergy's ROE for  
15 the purposes of the SEET.  
16

17 ***Q20. DOES THIS CONCLUDE YOUR TESTIMONY?***

18 ***A20.*** Yes. However, I reserve the right to supplement my testimony in the event that  
19 FirstEnergy, PUCO Staff or other parties submit additional testimonies or if new  
20 information or data in connection with this proceeding becomes available.

## **CERTIFICATE OF SERVICE**

I hereby certify that a true copy of the foregoing *Direct Testimony of Daniel J. Duann* was served electronically to the persons listed below on this 21<sup>st</sup> day of May, 2012.

/s/ Larry S. Sauer  
Larry S. Sauer  
Assistant Consumers' Counsel

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## **ATTACHMENT DJD-A**

### **List of Testimonies Filed Before PUCO**

1. *Application of The Dayton Power and Light Company for Approval of Its Electric Security Plan*, Case No. 08-1094-EL-SSO.
2. *Application of Ohio American Water Company to Increase Its Rates for Water and Sewer Service Provided to Its Entire Service Area*, Case No. 09-391-WS-AIR.
3. *Application of Aqua Ohio, Inc. for Authority to Increase its Rates and Charges in its Masury Division*, Case No. 09-560-WW-AIR.
4. *Application of Aqua Ohio, Inc. for Authority to increase its Rates and Charges in its Lake Erie Division*, Case No. 09-1044-WW-AIR.
5. *In the Matter of the Fuel Adjustment Clauses for Columbus Southern Power Company and Ohio Power Company*, Case Nos. 09-872-EL-FAC and 09-873-EL-FAC.
6. *In the Matter of the Application of Columbus Southern Power Company for Approval of an Electric Security Plan; an Amendment to its Corporate Separation Plan; and the Sale or Transfer of Certain Generating Asset (Remand)*, Case Nos. 08-917-EL-SSO et al.
7. *In the Matter of the Application of The East Ohio Gas Company d/b/a Dominion East Ohio for Approval of Tariffs to Modify and further Accelerate its Pipeline Infrastructure Replacement Program and to Recover the Associated Costs et al.*, Case Nos. 11-2401-GA-ALT and 08-169-GA-ALT.
8. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to 4928.143, Ohio Rev. Code in the Form of an Electric Security Plan (ESP)*, Case Nos. 11-346-EL-SSO, et al.
9. *In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Merge and Related Approval (ESP Stipulation)*, Case Nos. 10-2376-EL-UNC, et al.
10. *In the Matter of the Application of Ohio American Water Company to Increase Its Rates for Water and Sewer Service Provided to Its Entire Service Area*, Case No. 11-4161-WS-AIR.

**List of Professional Publications**

**Journal Articles**

*Regulation, The Cato Review of Business & Government*, “Turning up the Heat in the Natural Gas Industry,” Vol. 19, 1996, (with Kenneth W. Costello).

*Managerial And Decision Economics*, “Designing a Preferred Bidding Procedure for Securing Electric Generating Capacity,” Vol. 12, 1991.

*The Journal of Energy and Development*, “Direct Gas Purchases by Local Distribution Companies: Supply Reliability and Cost Implications,” Vol. 14, 1989.

*Public Utilities Fortnightly*, “Alternative Searching and Maximum Benefit in Electric Least-Cost Planning,” December 21, 1989.

**Research Reports and Presentations**

The National Regulatory Research Institute, *Pricing Local Distribution Services in a Competitive Market*, 1995.

Ninth NARUC Biennial Regulatory Information Conference, Ohio State University, *The Unbundling and Restructuring of Local Distribution Services in the Post-636 Gas Market*, 1994.

The National Regulatory Research Institute, *A Survey of Recent State Initiatives on EPACT and FERC Order 636*, 1994 (with Belle Chen).

The National Regulatory Research Institute, *Restructuring Local Distribution Services: Possibilities and Limitations*, 1994.

The National Regulatory Research Institute, *The FERC Restructuring Rule: Implications for Local Distribution Companies and State Public Utilities Commissions*, 1993.

The National Regulatory Research Institute, *A Synopsis of the Energy Policy Act of 1992: New Tasks for State Public Utility Commissions*, 1993.

**List of Professional Publications**

International Symposium on Energy, Environment & Information Management, Argonne National Laboratory, *Natural Gas Vehicles: Barriers, Potentials, and Government Policies*, 1992.

The National Regulatory Research Institute, *Natural Gas Vehicles and the Role of State Public Service Commissions*, 1992 (with Youssef Hegazy).

The National Regulatory Research Institute, *Incentive Regulation for Local Gas Distribution Companies under Changing Industry Structure*, 1991 (with Mohammad Harunuzzaman, Kenneth W. Costello, and Sung-Bong Cho).

The National Regulatory Research Institute, *Discussion Papers on Competitive Bidding and Transmission Access and Pricing issues in the Context of Integrated Resource Planning*, 1990 (with Robert E. Burns, Kenneth Rose, Kevin Kelly, and Narayan Rau).

The National Regulatory Research Institute, *Gas Storage: Strategy, Regulation, and Some Competitive Implications*, 1990 (with Peter A. Nagler, Mohammad Harunuzzaman, and Govindarajan Iyyuni).

The National Regulatory Research Institute, *State Gas Transportation Policies: An Evaluation of Approaches*, 1989 (with Robert E. Burns and Peter A. Nagler).

The National Regulatory Research Institute, *Direct Gas Purchases by Gas Distribution Companies: Supply Reliability and Cost Implications*, 1989, (with Robert E. Burns and Peter A. Nagler).

The National Regulatory Research Institute, *Competitive Bidding for Electric Generating Capacity: Application and Implementation*, 1988 (with Robert E. Burns, Douglas N. Jones, and Mark Eifert).

**This foregoing document was electronically filed with the Public Utilities**

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Summary: Testimony Direct Testimony of Daniel J. Duann on Behalf of the Office of the Ohio Consumers' Counsel electronically filed by Ms. Deb J. Bingham on behalf of Sauer, Larry S.