DUKE ENERGY OHIO EXHIBIT______

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for Administration of the Significantly Excessive Earnings Test under Section 4928.143(F), Revised Code, and Rule 4901:1-35-10, Ohio Administrative Code.	))))))	Case No. 13-0804-EL-UNC

DIRECT TESTIMONY OF

PEGGY A. LAUB

ON BEHALF OF

DUKE ENERGY OHIO, INC.

April 15, 2013

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I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Peggy A. Laub. My business address is 139 East Fourth Street, Cincinnati, Ohio 45202.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Duke Energy Business Services LLC, an affiliate service company of Duke Energy Ohio, Inc., (Duke Energy Ohio or Company) as Manager, Accounting in the Rates Department.

Q. PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL QUALIFICATIONS.

A. I earned a Bachelor of Business Administration degree, with a major in accounting, from the University of Cincinnati in 1984.

Q. PLEASE SUMMARIZE YOUR WORK EXPERIENCE.

A. In 1981, I began my career with The Cincinnati Gas & Electric Company, the predecessor of Duke Energy Ohio, as a co-operative education student in the Accounting Department. In 1984, I was employed full-time in the Tax Department. I progressed through various positions to Coordinator, State & Local Taxes. In 1998, I was transferred to the Regulated Business Unit's financial group. In 2000, I was transferred to Fixed Assets Accounting and I was promoted to manager in 2002. In May 2006, following the merger with Duke Energy Corporation, I transferred to the Midwest U.S. Franchised Electric & Gas accounting group. In November 2008, I transferred to Midwest Wholesale Accounting as Manager, Accounting. In May 2010, I transferred to the Rate

Department and to my current position as Manager, Accounting.

Q. PLEASE DESCRIBE YOUR DUTIES AS MANAGER, ACCOUNTING.

A. As Manager, Accounting, I am responsible for the preparation of financial and accounting data used in retail rate filings and various other rate recovery mechanisms for Duke Energy Ohio and Duke Energy Kentucky, Inc.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO (COMMISSION)?

A. Yes. I have previously testified in a number of cases before this and other regulatory commissions.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. I will first provide a brief overview of the Significantly Excessive Earnings Test (SEET) and then I will discuss the SEET calculation of Duke Energy Ohio and the attachments supporting the calculation.

II. <u>BACKGROUND</u>

Q. WHY IS IT NECESSARY FOR DUKE ENERGY OHIO TO SHOW THAT IT DOES NOT HAVE SIGNIFICANTLY EXCESSIVE EARNINGS?

A. On May 1, 2008, the Governor signed into law Amended Substitute Senate Bill No. 221 (SB 221). This bill amended various statutes in Title 49 of the Ohio Revised Code (R.C.). Among provisions of SB 221 were changes to R.C. 4928.141, which requires electric utilities to provide customers with a default standard service offer (SSO) for competitive retail electric service established through either a market rate offer (MRO) or an electric security plan (ESP).

Pursuant to R.C. 4928.142(D)(4) and 4928.143(F), the Commission is required to evaluate the earnings of each electric distribution utility's approved MRO or ESP to determine whether the adjustments in the MRO or ESP result in significantly excessive earnings. R.C. 4928.143(E) addresses the issue of significantly excessive earnings in the context of an ESP having a term longer than three years.

Q. ARE DUKE ENERGY OHIO'S RATES FOR COMPETITIVE RETAIL ELECTRIC SERVICE BASED ON AN ESP OR MRO?

A. Duke Energy Ohio is currently providing an SSO of competitive retail electric services pursuant to an ESP that was approved by the Commission on November 22, 2011. The terms of the ESP are set forth in a Stipulation and Recommendation that the Commission modified slightly in its November 2011 Opinion and Order.

Q. DID THE ESP STIPULATION THAT THE COMMISSION APPROVED ON NOVEMBER 22, 2011, ADDRESS THE ADMINISTRATION OF THE SEET TO DUKE ENERGY OHIO?

A. Yes. As set forth in Attachment H of the ESP Stipulation, the parties agreed that, beginning in 2013, the Commission would implement the SEET by May 15 of each year as follows:

> [Duke Energy Ohio's] return on ending common equity would be computed using [Duke Energy Ohio's] actual data reported on FERC Form 1 financial statements for the calendar year at issue, subject to only the following adjustments:
>
> - Net Income
>   - Eliminate all impacts related to the purchase

accounting recorded pursuant to the Duke Energy/Cinergy merger.

- Eliminate all impacts of refunds to customers pursuant to R.C. 4928.143(F).
- Eliminate all impacts of mark-to-market accounting.
- Eliminate all impacts of material, non-recurring gains/losses, including, but not limited to, the sale or disposition of assets.
- Eliminate all impacts of material, non-recurring revenue or expenses.
- Eliminate all impacts of parent, affiliated, or subsidiary companies and, to the extent reasonably feasible and prudently justified in the opinion of Duke Energy Ohio, eliminate the impacts of its natural gas distribution business.
- Only Rider ESSC revenue received while the Company directly owns the Legacy Generation Assets will be included in the SEET review. For the SEET review involving the year in which the Legacy Generation Assets are transferred, the Company's net income will be adjusted to exclude the impact of all revenue collected from Rider ESSC after the date of the transfer.

- Common Equity
  - Common Equity used in the calculation will be the beginning and ending average common equity of Duke Energy Ohio on a stand-alone basis except that a thirteen month average common equity balance may be used for a review of the SEET for the year in which the Company completes the transfer of its Legacy Generation assets.
  - Equity will be adjusted to eliminate the acquisition premium recorded to equity pursuant to the Duke Energy/Cinergy merger.
  - Eliminate the cumulative effect of the Net Income adjustments

Q. DOES THE ESP STIPULATION IN CASE NO. 11-3549-EL-SSO, *ET AL.*, DEFINE "SIGNIFICANTLY EXCESSIVE EARNINGS"?

A. Yes. The ESP Stipulation indicates that if Duke Energy Ohio's actual annual return on ending common equity, as adjusted pursuant to Attachment H of the Stipulation, does not exceed 15%, the Company's return on common equity is not "significantly in excess of the return on common equity" of other publicly traded companies facing comparable business and financial risks.

III. COMMISSION'S FINDING AND ORDER AND ENTRY ON REHEARING

Q. WHAT GUIDELINES DID THE COMPANY FOLLOW WHEN PREPARING ITS 2012 SEET FILING?

A. The Company has followed the guidelines found in the relevant provision of its November 22, 2011, ESP Stipulation, which were upheld by the Commission's November 22, 2011, Finding and Order in Case No. 11-3549-EL-SSO, *et al.*

Additionally, to the extent not reflected in Attachment H of the ESP Stipulation, the Company has incorporated into its SEET the Commission's recommendations from Case No. 09-789-EL-UNC.[1]

Q. PLEASE IDENTIFY THE ADDITIONAL RECOMMENDATIONS AS IDENTIFIED BY THE COMMISSION IN CASE NO. 09-786-EL-UNC.

A. The Commission's orders in that case generally defer to the Company's ESP Stipulation. For example, the Commission left the issue of earnings from off-system sales to be determined on a case-by-case basis. Consistent with Attachment H and the ESP Stipulation, the Company included <u>all</u> profits from off-system sales in its earnings calculation. Because this issue was addressed in the ESP Stipulation and the Company has already taken the most conservative view by including such profits, there is no further need to address this issue.

As I discuss further below, the Commission also directed utilities to: (1) base average equity balances on the average of the balances at the beginning and at the end of the year (Commission's Entry on Rehearing, page 6); (2) adjust out

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[1] *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities, Case No. 09-786-EL-UNC, Entry on Rehearing, at p. 7 (August 25, 2010).*

all impacts from affiliates and other services (*i.e.*, gas distribution) (Commission's Finding and Order, page 12); and, (3) addresses deferrals and other certain factors, as described in the Commission's Finding and Order.[2] These directives were also incorporated into Attachment H of the ESP Stipulation.

Q. DID THE COMPANY HAVE ANY ESP-RELATED DEFERRALS IN 2012 THAT IMPACTED EARNINGS?

A. No.

Q. WILL YOU DESCRIBE THE OTHER INFORMATION THAT THE COMMISSION DIRECTED COMPANIES TO PROVIDE AS PART OF THEIR SEET REVIEWS?

A. On page 29 of its June 30, 2010, Order, the Commission provided a list of factors it identified as worthy of its consideration in any SEET review. The listed factors include the following:

- the electric utility's most recently authorized return on equity,
- the electric utility's risk, including:
    - whether the electric utility owns generation;
    - whether the ESP includes a fuel and purchased power adjustment or similar adjustments;
    - the rate design and extent to which the electric utility remains subject to weather and economic risk;
    - capital commitments and future capital requirements;

[2] *In the Matter of the Investigation into the Development of the Significantly Excessive Earnings Test Pursuant to Amended Substitute Senate Bill 221 for Electric Utilities*, Case No. 09-786-EL-UNC, Finding and Order at p. 29 (June 30, 2010).

- indicators of management performance and benchmarks to other utilities;
- innovation and industry leadership with respect to meeting industry challenges to maintain and improve the competitiveness of Ohio's economy, including research and development expenditures, investments in advanced technology, and innovative practices; and
- the extent to which the electric utility has advanced state policy.

Q. WHAT IS THE COMPANY'S MOST RECENTLY APPROVED RETURN ON COMMON EQUITY?

A. The Company's most recently approved return on common equity is 10.63% for its jurisdictional electric distribution service in Ohio. This return was not necessarily approved for general electric distribution rates but it was established for use in determining the rate to be used in any riders requiring a rate of return.

Q. DOES THE COMPANY OWN GENERATING RESOURCES?

A. The Company directly owned approximately 3,800 megawatts of fossil generation at the end of calendar year 2012.

Q. DOES THE COMPANY HAVE A RECOVERY MECHANISM FOR FUEL COSTS IT INCURS AT ITS OPERATING PLANTS?

A. No.

Q. DOES THE COMPANY HAVE A RECOVERY MECHANISM FOR RECOVERY OF PURCHASE POWER EXPENSES?

A. Yes. The Company procures 100% of the competitive generation services provided to its SSO load through an auction process approved in the ESP Stipulation. The Company recovers the cost of this procured power via riders and passes all revenue through to the suppliers. Duke Energy Ohio makes no profit or loss on power procured via the auction process that is ultimately delivered to its SSO customers.

Q. DESCRIBE THE COMPANY'S RATE DESIGN.

A. The Company's rate design for noncompetitive service has been essentially the same since its unbundled rates became effective on January 1, 2001. The ESP Stipulation eliminated some riders that existed at the end of 2011 and added certain new riders for competitive retail services. As a result, there are new rates for competitive retail services based on allocation methods and rate design processes that were agreed to in the Company's ESP Stipulation and approved by the Commission in that case. Depending on the rate class, some customers may have energy based rates, demand based rates, or a combination of both. All customers have some form of a customer charge and some non-residential customers have demand ratchets intended to encourage efficient use of resources. For customers who shop, it is not possible for the Company to know the essentially infinite number of rate design options that may be offered by their competitive retail electric service (CRES provider).

Q. DESCRIBE THE EXTENT TO WHICH WEATHER AND ECONOMIC RISKS IMPACT THE COMPANY.

A. In its most recent approved retail gas distribution rate case (Case No. 07-589-GA-AIR, *et al.*), the Company was allowed to mitigate some of its weather risk by moving a much larger share of non-commodity portion of its residential rate into a monthly charge. Although weather can still impact the Company's earnings, this "decoupling" of weather from non-commodity revenue goes a long way toward mitigating that risk. The use of a mostly straight fixed-variable method of decoupling is less common for electric companies; however, some regulators provide for measures which can still decouple sales from earnings whether the volatility in sales is driven by weather or economic factors. As part of the ESP Stipulation, Duke Energy Ohio agreed to file an application to implement a decoupling mechanism for its non-demand-metered customers. The Commission approved the Company's subsequent application toward that end in early 2012, and the Company began accruing a deferral related to the decoupling mechanism. The decoupling mechanism excludes all demand-metered sales but will mitigate the impact of certain sales losses, particularly due to compliance with Ohio's energy efficiency mandates. I should note that the approved decoupling mechanism is based on weather-normalized sales; consequently, the Company is still exposed to weather-related earnings risks.

Q. WILL YOU ADDRESS THE CAPITAL COMMITMENTS AND CAPITAL REQUIREMENTS?

A. As provided in the Company's April 15, 2013, Application, the capital budget requirements for future electric committed investments in Ohio for remainder of the current ESP period are $258 million for 2013 and $204 million for 2014.

Q. ARE YOU SPONSORING ANY INFORMATION REGARDING MANAGEMENT PERFORMANCE AND BENCHMARKS TO OTHER UTILITIES?

A. Yes. First, it is important to realize that there is no data that compares the Duke

Energy Ohio operating company to its peers. As such, and in an effort to address the Commission's prior directive, reference is made to the information - on a corporate-wide basis - that does not exist. Attachment PAL-7 is a summary of how Duke Energy Corporation's returns compare to some of its peers. The data represented in this chart represents a comparison of total shareholder return (TSR) which is defined as the sum of dividends and share appreciation divided by a starting price. In this attachment, the first set of numbers shows the TSR for stocks from January 1, 2010, through December 31, 2012. The second set of numbers shows TSR for stocks purchased from January 1, 2011, through December 31, 2012. The third set of numbers shows TSR for stocks purchased from January 1, 2012, through December 31, 2012.

Q. HAS THE COMPANY BEEN INNOVATIVE IN ADVANCING STATE POLICY?

A. Yes. It is the state's policy, among other things, to encourage demand-side management, time-differentiated pricing, and implementation of advanced metering infrastructure. R.C. Section 4928.02.

Since receiving the Commission's approval to do so in December 2008, the Company continues in its deployment of SmartGrid infrastructure in its service territory. The Company has obtained approval for pilot testing of time-differentiated rates and is providing service to a limited number of customers who will respond to peak-time rebates, and differentiated price schedules. All of these efforts serve to advance the state's policy and will encourage demand-side management. Duke Energy Ohio is a leader in this area.

IV. SCHEDULES SPONSORED BY WITNESS

Q. PLEASE DESCRIBE ATTACHMENT PAL-1.

A. Attachment PAL-1 is a schedule showing that the Company's return earned on average electric common equity for the year ended December 31, 2012, is (2.76%).

Q. PLEASE DESCRIBE ATTACHMENT PAL-2.

A. Attachment PAL-2 is a schedule showing the calculation of the Company's adjusted electric net income for the calendar year 2012. The source of the utility operating income for the twelve months ended December 31, 2012, is the Company's 2012 FERC Form 1 report, pages 114 to 117. Pursuant to Attachment H of the ESP Stipulation, purchase accounting recorded as a result of the Duke Energy/Cinergy merger, all impacts of refunds to customers pursuant to R.C. 4928.143(F), all impacts of mark-to-market accounting, all impacts of material, non-recurring gains/losses, all impacts of material, non-recurring revenue or expenses, and all impacts of the natural gas were eliminated. As shown on the attachment, no refunds were returned to customers during the twelve months ended December 31, 2012. Equity in earnings of subsidiary companies was also eliminated so that the return earned on average common equity would be on a Duke Energy Ohio stand-alone basis.

Q. PLEASE DESCRIBE ATTACHMENT PAL-3.

A. Attachment PAL-3 is a summary of the items eliminated from net income. The schedule shows, by Company account, the impact on net income of eliminating purchase accounting, mark-to-market accounting, non-recurring gains and/or losses, material non-recurring revenues and expenses and the equity in earnings of subsidiary companies.

Q. PLEASE DESCRIBE ATTACHMENT PAL-4.

A. Attachment PAL-4 is an exhibit showing the calculation of the Company's average electric common stock equity as of December 31, 2012. The attachment shows the common stock equity balances as of December 31, 2011, and December 31, 2012, and the calculation of the average electric common equity balance as of December 31, 2012, to be used in determining if Duke Energy Ohio has significantly excessive earnings. Pursuant to the ESP Stipulation, the following items were eliminated in calculating the ending balance for each calendar year: (1) impacts of purchase accounting recorded pursuant to the Duke Energy/Cinergy merger; (2) all impacts of mark-to-market accounting; and, (3) all impacts of material, non-recurring gains and/or losses.

Q. PLEASE DESCRIBE ATTACHMENT PAL-5.

A. Attachment PAL-5 is a schedule showing the calculation of a net plant allocation factor used to allocate total average common equity to electric operations. The gas and electric plant data is from the Company's 2012 FERC Form 1, pages 200-201. The schedule shows that based on net plant, 77.92% of the Company's average common equity should be allocated to electric operations.

Q. PLEASE DESCRIBE ATTACHMENT PAL-6.

A. Attachment PAL-6 is a summary of assumptions used in this filing, most of which are from paragraph 28 of the ESP Stipulation. I have discussed all of the other relevant assumptions in my testimony.

Q. PLEASE DESCRIBE ATTACHMENT PAL-7.

A. Attachment PAL-7 is a summary showing Duke Energy Corporation's TSR in comparison to some of its peer companies in the Philadelphia Utility Index.

V. CONCLUSION

Q. DOES DUKE ENERGY OHIO HAVE SIGNIFICANTLY EXCESSIVE EARNINGS THAT WOULD REQUIRE A REFUND TO CUSTOMERS?

A. No. As shown on Attachment PAL-1, Duke Energy Ohio's return earned on average electric common equity is negative 2.76%. Since, the return on average electric common equity is less than the 15% specified in the ESP Stipulation, the Company does not have significantly excess earnings and, therefore, no refund to customers is warranted.

Q. WERE ATTACHMENTS PAL-1, PAL-2, PAL-3, PAL-4, PAL-5, PAL-6 AND PAL-7 PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.