

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Duke Energy Ohio, Inc. for the Establishment of a Charge Pursuant to Revised Code Section 4909.18.	)	)	Case No. 12-2400-EL-UNC
	)	)	
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)	)	Case No. 12-240-1-EL-AAM
	)	)	
In the Matter of the Application of Duke Energy Ohio, Inc. for the Approval of a Tariff for a New Service.	)	)	Case No.12-2402-EL-ATA
	)	)	

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**INITIAL BRIEFOF THE GREATER CINCINNATI HEALTH COUNCIL  
AND CINCINNATI BELL INC.**

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The Greater Cincinnati Health Council ("GCHC") and Cincinnati Bell Inc. ("CBI") each intervened as a party to this proceeding to protect their rights as Duke Energy Ohio customers as established in Case No. 11-3549-EL-SSO (the "ESP Case"). GCHC and CBI were signatories to the Stipulation and Recommendation<sup>1</sup> that resolved Case No. 11-3549-EL-SSO.

On August 29, 2012 Duke Energy Ohio ("Duke") filed an Application seeking approval to recover additional capacity charges over and above the market-based capacity prices that it agreed to accept in the ESP Case. The application filed by Duke Energy Ohio seeks to recover substantially more than the amount Duke agreed to accept for its legacy capacity costs in that case and would significantly increase the prices paid by customers for electric service. The Stipulation and Recommendation in the ESP Case resolved the amount that Duke Energy Ohio would be allowed to charge for capacity during its current ESP term, through May 2015, which coincides with the time period that Duke will be an FRR entity in PJM. The relief sought by Duke would essentially throw out that agreement and add over \$775 million in capacity costs to customers' bills over a three year period. Duke's attempt to recover embedded costs for capacity service relies upon several fictions - including the notion that Duke's wholesale capacity service is a "new" service, that the Commission can approve a retail rate for a wholesale service, and, most importantly, that the compensation Duke would receive for its capacity service was not fully resolved in the last ESP case. There is no legal basis for Duke's request which should be rejected by the Commission.

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<sup>1</sup> IEU-Ohio Exh. 5.

**I. The Stipulation in the ESP Case Resolved All Issues of Capacity Pricing for the Duration of Duke’s Current ESP Plan and Precludes the Recovery of Additional Amounts for Capacity Service.**

**A. Duke Agreed That Its Compensation for Capacity Service As An FRR Entity Would Be PJM Market Rates.**

In Case No. 11-3549-EL-SSO, Duke made an initial application on June 20, 2011, in which it proposed an Electric Security Plan (“ESP”) pursuant to R.C. § 4928.143.<sup>2</sup> With respect to its Standard Service Offer, Duke proposed to require all customers to pay a non-bypassable generation capacity charge, which would be calculated based upon Duke’s embedded cost of generation capacity.<sup>3</sup> Customers would have paid that capacity charge regardless of whether they purchased generation service from Duke or from a competitive retail electric supplier (“CRES”). After lengthy negotiations, the ESP Case was resolved through Commission approval of a Stipulation between Duke and most of the parties to that case. The Stipulation provided for a very different solution to capacity charges. Under the terms of the Stipulation, Duke would supply all of its capacity requirements to PJM, who would charge the Final Zonal Capacity Price (“FZCP”) to all load serving entities (“LSEs”), which would include both the winners of Duke’s wholesale generation supply auctions and CRES providers.<sup>4</sup> This arrangement would last through the term of the ESP, which was slated to cover the period from January 1, 2012 through May 31, 2015. The Stipulation also made provisions for what would occur in the event a subsequent SSO plan was not in place by June 1, 2015.

The Commission’s November 22, 2011 Opinion and Order approved the Stipulation.<sup>5</sup>

The Summary of Application described Duke’s original proposal: “Duke proposed to supply generation service through a bifurcated structure, with capacity being supplied by the company

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<sup>2</sup> Kroger Exh. 5.

<sup>3</sup> Kroger Exh. 4 (Trent testimony from Case No. 11-3549); Trent (Tr. 276-77).

<sup>4</sup> Trent (p. 92).

<sup>5</sup> Opinion and Order, Case No. 11-3549-EL-SSO, p. 51.

to all customers and the energy being procured via competitive auctions to serve the customers that choose to purchase energy from Duke. In accordance with the application, Duke would provide capacity over a nine-year, five-month period, by establishing an unavoidable capacity charge, that would be adjusted annually, which would allow the company to recover the costs of supplying capacity and a reasonable rate of return.”<sup>6</sup>

The actual resolution of the capacity issue in the ESP Case was described later in the Commission’s Order:

(b) Duke shall supply capacity to PJM, which, in turn, will charge for capacity to all wholesale supply auction winners for the applicable time periods of Duke’s ESP with the charge for said capacity determined by the PJM RTO, which is the FZCP in the unconstrained RTO region.

(c) Duke will implement it [sic] retail capacity rider (Rider RC) and retail energy rider (Rider RE) to recover the costs associated with serving its SSO load, with the aggregate sum of the revenues under Riders RC and RE equal to the auction clearing prices, as converted into retail rates. Rider RC shall recover the cost of capacity and Rider RE shall recover all remaining auction costs, including energy, market-based transmission service, and market-based transmission ancillary services. Riders RC and RE are unconditionally avoidable by all non-SSO customers. Riders RC and RE will be put into effect through updated rates for each of the PJM planning years for which all tranches for the delivery period have been approved by the Commission.

(d) Duke shall implement its conditionally avoidable supplier cost reconciliation rider (Rider SCR) to recover any difference between the payments made to suppliers for SSO service and the amount of revenue collected from Riders RC and RE.<sup>7</sup>

This arrangement is confirmed by Duke’s Supplier Agreement<sup>8</sup> which provides at § 3.1(b)<sup>9</sup> that SSO suppliers would purchase capacity from Duke at the FZCP. This notably contrasts with

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<sup>6</sup> Opinion and Order, p. 8.

<sup>7</sup> Opinion and Order, pp. 11-12 (balance of paragraph (d) omitted).

<sup>8</sup> Attachment F to the Stipulation.

<sup>9</sup> “[D]uring the Term, each SSO Supplier shall purchase from Duke Energy Ohio (and, unless Duke Energy Ohio directs otherwise, provide payment for the same to PJM in accordance with Section 6.2(b)) the Capacity at the Final Zonal Capacity Price for the unconstrained portion of the RTO region necessary to fulfill the Capacity obligation associated with such SSO Supplier’s SSO Supplier Responsibility Share pursuant to the PJM Agreements;” (Stipulation, Attachment F, page 16 of 96). Section 6.2(b) of the Supplier Agreement explains why the Stipulation was

Duke's current position that only PJM charges for capacity at the FZCP (with Duke apparently believing that it can charge others, *i.e.*, distribution customers, an additional amount for use of the exact same capacity).

The same capacity pricing scenario applies to CRES providers who supply shopping customers. The Commission's Order approving the Stipulation described how shopping customers would pay for capacity:

Duke shall supply capacity resources to PJM, which, in turn, will charge for capacity resources to all CRES providers in its service territory for the term of the ESP, with the exception of those CRES providers that have opted out of Duke's FRR plan, for the period during which they opted out. During the term of the ESP, PJM shall charge CRES providers for capacity as determined by the PJM RTO, which is the FZCP in the unconstrained RTO region, for the applicable time periods of its ESP. When computing the capacity allocations for PJM, Duke shall use an allocation formula in common use in PJM.<sup>10</sup>

The Stipulation also contained a provision for the generation supply of PIPP customers. In Section VII.D, Duke committed to enter into a supply contract with FES and committed that "it will continue to supply the capacity at the FZCP for the unconstrained RTO region."

The Stipulation further confirms that Duke agreed to accept FZCP prices as its sole means of compensation for capacity in provisions dealing with the post-ESP time period. In § I.B of the Stipulation, provisions are made for the contingency that Duke's next SSO application is rejected or so modified by the Commission that Duke withdraws it. It states that "the auction-based pricing and cost-recovery provisions of the SSO structure under which Duke

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amended to reflect that PJM would charge for capacity: "For Capacity purchased from Duke Energy Ohio at the Final Zonal Capacity Price for the unconstrained portion of the RTO region by an SSO Supplier pursuant to Section 3.1(b), such SSO Supplier shall, unless Duke Energy Ohio directs otherwise, be invoiced and submit payment for such Capacity on behalf of Duke Energy Ohio directly to PJM in accordance with the billing practices set forth in the PJM Agreements." (Stipulation, Attachment F, page 35 of 96). This provision leaves no doubt that PJM is billing on behalf of Duke and that SSO Suppliers are paying Duke for capacity through a bill issued by PJM.

<sup>10</sup> Opinion and Order, p. 18, ¶ (4).

Energy Ohio is operating as of May 31, 2015 shall **persist**<sup>11</sup> until a subsequent SSO is approved. It goes on to describe the auction process for SSO supply, which is followed by a description of the handling of capacity:

For purposes of this paragraph, the Parties also agree that, for so long as Duke Energy Ohio is a Fixed Resource Requirements (FRR) entity under PJM Interconnection LLC, (PJM), it will provide capacity at the Final Zonal Capacity Price (FZCP) in the unconstrained regional transmission organization (RTO) region. For the period during which Duke Energy Ohio participates in PJM's Reliability Pricing Model (RPM) and Base Residual Auction (BRA), the capacity price is the FZCP for the DEOK load zone region, and capacity shall be provided pursuant to the PJM RPM process.

In previous briefing, Duke has attempted to discount this paragraph by arguing that it only addresses the period after the current ESP term which expires May 31, 2013. While technically correct as to the time frame in which this paragraph would apply, Duke ignores the fact that this paragraph also describes what Duke had agreed to *during* the ESP period, as this is a "preservation of the status quo" provision. The purpose of this section was to maintain the existing situation until such time as a new SSO was approved. By stating that the cost recovery provisions of the SSO would "persist," by definition it described what was to have occurred between January 1, 2012 and May 31, 2015. That scenario could only "persist" if it already existed.

Section IV.A of the Stipulation addressed how capacity would be priced for shopping customers:

Consistent with Section II.B, above, the Parties agree that Duke Energy Ohio shall supply capacity resources to PJM, which, in turn, will charge for capacity resources to all CRES providers in its service territory for the term of the ESP, with the exception of those CRES providers that have opted out of Duke Energy Ohio's FRR plan, for the period during which they opted out. The Parties further agree that, during the term of the ESP, Duke Energy Ohio shall charge CRES providers for capacity as determined by the PJM RTO, which is the FZCP in the unconstrained RTO region, for the applicable time periods of its ESP. When computing the capacity allocations for PJM, Duke Energy Ohio shall use an allocation formula in common use in PJM.

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<sup>11</sup> Stipulation, § I.B (emphasis added).

Duke has attempted to argue around this provision by pointing out an amendment that was made to it after the filing of the Stipulation.<sup>12</sup> In the second sentence, “PJM” was substituted for “Duke Energy Ohio” to reflect that PJM is the entity that actually bills the LSE for capacity.<sup>13</sup> This amendment was nothing more than a technical change - described as an “inadvertent typographical error”<sup>14</sup> by Duke - not a substantive difference in how service was provided or priced. The reason given for the change was to be consistent with other provisions of the Stipulation providing that PJM would be the entity that would charge CRES providers for capacity. This change did not authorize Duke to recover any amount of compensation other than the FZCP; it merely recognized that PJM does Duke’s capacity billing for it. In this hearing, Duke’s witnesses acknowledged that PJM is the entity that performs the billing and collection function for Duke and that Duke receives exactly the same amount as compensation as PJM collects from the LSEs.<sup>15</sup> Duke’s FRR Plan filing with the FERC on August 16, 2010 also stated that Duke would serve alternative retail electric suppliers serving switched load at the RPM price as provided in the RAA.<sup>16</sup> Duke made no distinction between what alternative suppliers would pay and what it would charge, nor did it inject PJM as a billing intermediary to mask that Duke was the real party being compensated by the LSEs.

Of course, the Commission’s conclusion as to how Duke would be compensated for capacity during the ESP period is confirmed by *all* of the witness testimony that addressed that aspect of the stipulation. Duke’s current position is based on revisionist history and is designed

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<sup>12</sup> Motion and Memorandum in Support of Duke Energy Ohio, Inc. to Admit an Amendment to the Stipulation as Joint Exhibit 1.1 and Request for Expedited Treatment, filed Nov. 16, 2011 (Kroger Exh. 6).

<sup>13</sup> Trent (Tr. 362-63).

<sup>14</sup> Kroger Exh. 6, p. 4.

<sup>15</sup> See testimony of Trent (Tr. 57-58, 347-49); Niemann (Tr. 600-01; 2725); Garrett (Tr. 1202); Wathen (Tr. 2775).

<sup>16</sup> FES Exh. 7, pp. 12-13; Trent (Tr. 65-66).

to create a loophole that does not exist. Three witnesses directly addressed capacity pricing in their testimony in support of the Stipulation and they unanimously interpreted the Stipulation as constraining the compensation that Duke would receive for capacity.

Duke witness William Don Wathen, Jr. clearly explained the situation:

**Q. PLEASE DESCRIBE HOW RIDER RC IS CALCULATED.**

A. Rider RC is the mechanism to establish the capacity component of Duke Energy Ohio's ESP. As described above, the total cost of capacity included in the SSO supply procured in the CBP auction is product of the FZCP multiplied by the days in the delivery period multiplied by Duke Energy Ohio's reliability obligation as determined by Schedules 8.0 (discussing RPM) and 8.1 (discussing FRR) of the Reliability Assurance Agreement of PJM's tariffs. As agreed to in the Stipulation, the total dollar amount of capacity costs applicable to the delivery period is allocated to the rate classes in the following manner: Rate TS and Rate DP are allocated total capacity costs based on a 1 CP allocation. All other rate classes are allocated the capacity costs based on an average of the 1 CP allocation and an allocation based on kWh sales. The methodology is illustrated in Exhibit 2, page 1, of Attachment B to the Stipulation. The allocation of Rider RC was the subject of negotiation among the parties to these proceedings and the allocation methodology I have described herein is the product of these negotiations.

Once the costs have been allocated to the rate classes, the costs are again grossed up for applicable losses and then the rates are calculated using existing rate blocks for each class. The dollar amount to be recovered in each rate block is based on the relative share of base generation revenue derived from each rate block. The methodology for this part of the Rider RC rate design is illustrated in Exhibit 2, page 2, of Attachment B to the Stipulation.<sup>17</sup>

The method of pricing capacity under the Stipulation was vastly different from what Duke had originally proposed, as Mr. Wathen clearly described:

**Q. HOW IS THE RIDER RC, AGREED TO IN THE ESP STIPULATION, DIFFERENT THAN THE RIDER RC ORIGINALLY PROPOSED BY THE COMPANY IN ITS JUNE 20, 2001, APPLICATION?**

A. As originally proposed and as described by my Direct Testimony, the Rider RC was to be predicated upon a formula rate for developing the fixed costs, including a reasonable rate of return, associated with the Company's Legacy Generating Assets that, under the Company's proposal, would have been effectively dedicated to Ohio customers. Essentially, **Rider RC would have been a 'cost-based' charge for the**

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<sup>17</sup> Supplemental Testimony of William Don Wathen, Jr., filed Oct. 28, 2011, at pp. 8-9 (FES Exh. 22).

**capacity needed to serve all customers.** In the ESP, the same amount of capacity is needed to serve all of Duke Energy Ohio's customers; however, pursuant to the Stipulation, the only nexus between the Company's own generation and the capacity used to serve load is through the Company's Fixed Resource Requirement (FRR) obligations in PJM. Consequently, rather than customers paying for capacity at Duke Energy Ohio's embedded cost of service for the nine-year and five-month period proposed in the Application, **they will now be paying market-based prices for capacity in perpetuity.**<sup>18</sup>

This statement that customers would pay market-based prices, rather than embedded cost of service, was not a mistake or slip of the tongue. Mr. Wathen confirmed it later in the same Supplemental Testimony:

**Q. PLEASE EXPLAIN THE MEANING AND IMPACT OF THIS CHANGE FROM USING A COST-BASED CHARGE FOR CAPACITY AS PROPOSED BY THE COMPANY IN ITS APPLICATION TO AN AUCTION-DETERMINED RETAIL CAPACITY PRICE.**

A. At a basic level, this change means that customers will be paying a market price for capacity instead of the cost-of-service based charge proposed by Duke Energy Ohio in its Application. The Company's Application in these proceedings proposed a long-term ESP, with a non-bypassable cost of service-based price to determine the retail price for capacity. As explained in Duke Energy Ohio's Application, the Company's embedded cost to maintain and operate its fleet of Legacy Generating Assets was not reflective of the current and near-term market price for capacity. The ephemeral inequity between the Company's embedded cost of service and the lower current market price stimulated a robust level of switching among all customer classes in the Company's service territory. As a result, fewer customers are taking the Company's SSO price necessary, at least for the short term, to support Duke Energy Ohio's continued ownership, operation, and maintenance of generating assets dedicated to serve customers. The results of Duke Energy Ohio's annual significantly excessive earnings test (SEET) during the current ESP reflect the Company's significantly declining rate of return since the inception of the current ESP and it spotlights the dire implications of this disconnect between market prices and embedded costs.

During the settlement discussions of this case, the Parties made it clear that a market price for the SSO service was preferred. This necessitated a change to the Company's proposed Rider RC. The change to Rider RC in the ESP means that customers will pay a market price for capacity at the FZCP for the FRR duration and will pay a market price for capacity established by competitive auction following that term. **In either case, the price for capacity will be without reference to Duke Energy Ohio's cost of service.** The Company is agreeing to implement a full CBP to determine the retail price for its SSO. This allows customers in Duke Energy Ohio's service

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<sup>18</sup> *Id.*, p. 10 (emphasis added).

territory to receive the benefit of the current lower-priced capacity market and puts Ohio firmly on the path towards a full competition.<sup>19</sup>

Mr. Wathen was not alone in his understanding that Duke had committed to charge market-based prices for capacity for the full term of the ESP. Duke Energy Ohio President Julia S. Janson said the same thing:

In the Stipulation and Recommendation, the parties recognized Duke Energy Ohio's obligations as an FRR entity and, for the term of the ESP, Duke Energy Ohio will supply capacity resources to PJM, which, in turn, will charge wholesale suppliers for capacity. But the charge applicable to these wholesale suppliers will not reflect Duke Energy Ohio's costs of service as defined above. Rather, the charge will be predicated upon PJM's capacity market pricing structure. To clarify, Duke Energy Ohio bears the obligation to provide the capacity resources necessary to serve all customers in our footprint for the term of the ESP and **the Company will be compensated for capacity resources based upon competitive PJM prices.**<sup>20</sup>

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These provisions reflect a significant departure from Duke Energy Ohio's proposal, in its Application, to seek recovery of its costs to provide capacity and a rate of return.<sup>21</sup>

The ESP, as detailed in the Stipulation, also recognizes our customers' right to choose their generation supplier. In this regard and consistent with the interaction between Duke Energy Ohio and wholesale suppliers, **competitive retail electric service (CRES) providers will also be charged for capacity based upon PJM's capacity market pricing structure.** Significantly, therefore, all suppliers will be charged the same rate for capacity during the term of this ESP, with the limited exception of those CRES providers that opted out of the Company's FRR plan for the first five months of 2012.<sup>22</sup>

Despite Duke's current denials, Ms. Janson testified that Duke's *compensation* for capacity (not just the price PJM would charge) would be based upon competitive PJM prices.<sup>23</sup> Mr. Wathen and Ms. Janson's explanation of how Duke would be compensated for its capacity was confirmed by the testimony of Staff witness, Tamara S. Turkenton:

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<sup>19</sup> *Id.*, pp. 12-13 (emphasis added).

<sup>20</sup> Janson Supplemental Testimony, Case No. 11-3549-EL-SSO, filed Oct. 28, 2011, pp. 4-5 (IEU-Ohio Exh. 6) (emphasis added); *see also* Trent (Tr. 304).

<sup>21</sup> *Id.*, p. 5, lines 19-21.

<sup>22</sup> *Id.*, pp. 5-6 (emphasis added).

<sup>23</sup> Trent (Tr. 305). Duke is not proposing to change anything in the Janson testimony in Case No. 11-3549. Trent (Tr. 393-94).

The Stipulation enhances the development of competition for generation service in the Duke service areas as Duke has committed to charging the prevailing market price for capacity. Although Duke will be operating under a Fixed Resource Requirements (FRR) capacity construct in PJM starting January 1, 2012, it has committed to charge the prevailing Reliability Pricing Model (RPM) Final Zonal Capacity Price (FZCP) in the unconstrained region of PJM to all CRES providers in its service territory and to all winning CBP suppliers of its SSO load during the period it is under the FRR construct.<sup>24</sup>

Duke's present contention that Ms. Turkenton was "mistaken"<sup>25</sup> rings hollow. What Ms. Turkenton said is exactly the same as what the Stipulation, Mr. Wathen and Ms. Janson said about capacity. If Ms. Turkenton was supposedly mistaken, Mr. Wathen and Duke sat idly by and failed to challenge or correct anything she said.<sup>26</sup>

The Stipulation, the testimony of the witnesses in support of the Stipulation, and the Commission's Order approving the Stipulation leave no doubt that Duke had committed to supply all of the capacity necessary to serve customers in its service territory and that it agreed it would only receive PJM market-based compensation for that capacity.

**B. The Stipulation Resolved All Issues Raised in the ESP Case, Including What Compensation Duke Would Receive For Its Capacity.**

The Stipulation made it clear that it resolved all of the issues raised by Duke's Application in the ESP case.<sup>27</sup> The preamble to the Stipulation states:

WHEREAS, all of the related issues and concerns raised by the Parties have been addressed in the substantive provisions of this Stipulation, and reflect, as a result of such discussions and compromises by the Parties, an overall reasonable resolution of all such issues;

It is undisputed that Duke's Application in Case No. 11-3549 proposed to charge capacity to end users at embedded cost. The original proposal for Rider RC was a cost-based retail charge, but

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<sup>24</sup> Turkenton Direct Testimony, Case No. 11-3549-EL-SSO, filed Oct. 28, 2011, pp. 3-4 (FES Exh. 23).

<sup>25</sup> Wathen (Tr. 1410).

<sup>26</sup> GCHC Exh. 1 (transcript of ESP Stipulation hearing during appearance of Ms. Turkenton).

Ms. Turkenton practically begged to be asked a question, but no one did. (GCHC Exh. 1, p. 57).

<sup>27</sup> Trent (Tr. 289-91, 385-86).

the Stipulation resulted in Rider RC being an amount calculated to recover the market based wholesale rate.<sup>28</sup> The Stipulation provided in Section II.B that Duke would supply all of its capacity necessary to serve its SSO load to PJM which would charge the wholesale supply auction winners the FZCP and in Section IV.A (consistent with Section II.B) that Duke would supply capacity to PJM for CRES providers that did not opt out of Duke's FRR plan at the same rate.<sup>29</sup> Rider RC is the mechanism whereby the capacity charges paid by wholesale supply auction winners are converted to retail rates.<sup>30</sup> While Duke contends that it does not intend to alter the terms of the Stipulation, its proposal invariably does - the Stipulation leaves no room for Duke to charge end users for capacity at embedded cost when the retail rate, Rider RC, was set to equal the wholesale capacity charges paid by auction winners. Rider RC and Rider RE together were to be the entire retail rates for Duke providing retail generation service to its SSO customers.<sup>31</sup> Retail rates, by definition, include all wholesale inputs to the retail service, so there is no room for Duke to impose an additional charge on retail customers for wholesale services on top of the full retail rate.

Despite its clear agreement otherwise, Duke is now attempting to bifurcate pricing of its capacity service by charging one rate component, the FZCP, to wholesale auction winners and CRES providers, and a second rate component, the difference between embedded cost and the FZCP (net of margins from energy sales and ancillary services) from retail distribution

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<sup>28</sup> Trent (Tr. 90-91).

<sup>29</sup> Trent (Tr. 292-94). Section IV.A is effectively applicable to all CRES providers because none opted out of Duke's FRR plan. Trent (Tr. 369-70).

<sup>30</sup> Trent (Tr. 293).

<sup>31</sup> Trent (Tr. 358-59).

customers.<sup>32</sup> This, in and of itself would violate Duke's own concept of how the capacity market works. Duke contends that capacity is a non-competitive wholesale service.<sup>33</sup> While it seems to be confused as to exactly who its customer is for wholesale capacity service (it is either PJM or the wholesale auction winners and CRES providers ("LSEs")),<sup>34</sup> even Duke understands that retail customers are not its capacity service customers.<sup>35</sup> Duke admits that it does not provide capacity service directly to retail customers,<sup>36</sup> but it is still improperly attempting to charge wholesale service to retail customers.<sup>37</sup> But, charging retail customers directly for capacity was what Duke had proposed in its original ESP application in Case No. 11-3549.<sup>38</sup> And, as the testimony in support of the Stipulation explained, that plan was replaced by the one outlined in the Stipulation.

Duke argues that the ESP Stipulation only addressed how much PJM would charge auction winners and CRES providers for capacity, but did not specify how much Duke would receive for wholesale capacity service.<sup>39</sup> This contention is absurd. PJM was not a party to the ESP Case.<sup>40</sup> Neither Duke nor any other party had authority to bind PJM as an independent entity. Duke could only impose any restrictions on what PJM did if PJM was acting as Duke's agent (which is exactly the case). Pursuant to Duke's Supplier Agreement, Exhibit F to the Stipulation, PJM acts as the billing agent for Duke to charge auction winners for the capacity that

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<sup>32</sup> Trent (Tr. 122-23). Even though the charge would supposedly be for a wholesale service, for which it is already compensated by the LSE, Duke has characterized its additional end user charge as a "retail" charge. Trent (Tr. 402, 410).

<sup>33</sup> Trent (Tr. 31; 124-25).

<sup>34</sup> Trent (Tr. 351).

<sup>35</sup> Trent (Tr. 353).

<sup>36</sup> Trent (Tr. 353).

<sup>37</sup> Trent (Tr. 352, 370).

<sup>38</sup> Trent (Tr. 80-81, 377).

<sup>39</sup> Trent (Tr. 135-36).

<sup>40</sup> Trent (Tr. 351).

they need to fulfill their generation load commitments. PJM has been charging LSEs market prices and is paying Duke those same market prices.<sup>41</sup> PJM is not billing the auction winners for its own account, but as the agent of Duke so that Duke can collect the compensation it is entitled to receive for supplying capacity to PJM. No statement in the Stipulation about what PJM will do could bind PJM in any other capacity. By agreeing in the Stipulation to what PJM would do as Duke's billing agent, Duke was also binding itself as to what it could do. Those statements can have no other meaning.

Duke already has a retail charge designed to compensate it for its capacity in the form of Rider RC. As Mr. Wathen explained in Case No. 11-3549 and again under cross-examination in this case, Rider RC, in conjunction with the true-up mechanism of Rider SRC, is designed to collect from customers exactly the amount that Duke charges PJM for capacity.<sup>42</sup> Rider RC converts the PJM market rates into end user rates by allocating capacity payments among and within customer classes. Because the size of those customer classes and their demand will inevitably vary, Rider SRC is designed to capture any differences between the amounts collected under Rider RC and the amounts billed by PJM for Duke's capacity service.<sup>43</sup> Thus, Duke has already agreed in the Stipulation exactly how much its retail SSO customers were to pay for capacity service and there is no basis to impose an additional charge on those customers for exactly the same service they are already receiving. Duke formally documented how its retail customers would pay for capacity in the retail tariff it filed for Rider RC.<sup>44</sup>

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<sup>41</sup> Trent (Tr. 346).

<sup>42</sup> Wathen (Tr. 1339-41).

<sup>43</sup> Wathen (Tr. 1341-42).

<sup>44</sup> See December 21, 2011 tariff filings in Case No. 11-3549 ("consistent with the Opinion and Order issued by the Commission on November 22, 2011").

For customers of CRES providers (*i.e.* shopping customers), Duke has no say over what those customers pay their CRES for generation service, which includes both capacity and energy. Riders RC and SRC are fully bypassable, so they do not apply to CRES customers. It is up to the CRES provider to decide whether to bill for capacity and energy separately or as part of a single price. Duke has no business interfering in that retail customer-supplier relationship; Duke explicitly agreed to accept the PJM FZCP from the CRES supplier (indirectly through PJM) as compensation for its wholesale capacity service. Duke has committed all of its capacity to meeting its PJM FRR obligation, so that capacity cannot be sold elsewhere or used to provide any other service.<sup>45</sup> Duke's provision of capacity to PJM, either as its customer or as its agent for dealing with wholesale LSE customers, cannot be deemed a different service than the capacity service received by retail customers from the LSE. It is one and the same, so Duke cannot sell the same capacity once to PJM/LSEs and a second time to retail customers. Yet, that is the shaky bedrock upon which Duke's entire case is founded.

## **II. Duke Is Not Offering A New Service, So Its Proposal Would Amount To A Rate Increase**

The capacity service Duke is providing to PJM/LSEs is not a "new" service exempt from the ratemaking statutes. Duke became an FRR entity in PJM on January 1, 2012 and remains an FRR entity today.<sup>46</sup> Duke has been providing wholesale capacity service since January 1, 2012.<sup>47</sup> The nature of the service was exactly the same from January 2012 through July 2012 as it was in August 2012 and thereafter.<sup>48</sup> Duke is not providing any new service, it is merely seeking to extract an additional payment for the same old service.<sup>49</sup> Rider RC already recovers

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<sup>45</sup> Niemann (Tr. 2723-24).

<sup>46</sup> Trent (Tr. 67, 345).

<sup>47</sup> Trent (Tr. 350).

<sup>48</sup> Trent (Tr. 355).

<sup>49</sup> Trent (Tr. 356).

capacity costs in accordance with the agreed upon rate, the FZCP.<sup>50</sup> The fact that Duke intends to create a new rider for this incremental charge makes it no less of a rate increase. Whether new rider is created or existing Rider RC is increased, the end effect is exactly the same – Duke would charge more money for exactly the same service.

**III. Even if Capacity Pricing Had Not Been Resolved In the ESP Case, Duke Is Not Entitled to Embedded Cost Recovery for Wholesale Capacity Service.**

Duke’s attempt to recover its embedded costs for capacity is rooted in provisions in the PJM Reliability Assurance Agreement (“RAA”), which governs capacity pricing for FRR entities.<sup>51</sup> However, Duke has overlooked the fundamental prerequisites for cost recovery under that agreement and cannot be allowed to charge a cost-based rate under these circumstances. Duke’s case is premised on Section D.8 of Schedule 8.1 of the RAA, a part of PJM’s FERC tariff, which states as follows:

In a state regulatory jurisdiction that has implemented retail choice, the FRR Entity must include in its FRR Capacity Plan all load, including expected load growth, in the FRR Service Area, notwithstanding the loss of any such load to or among alternative retail LSEs. In the case of load reflected in the FRR Capacity Plan that switches to an alternative retail LSE, where the state regulatory jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations, such state compensation mechanism will prevail. In the absence of a state compensation mechanism, the applicable alternative retail LSE shall compensate the FRR Entity at the capacity price in the unconstrained portions of the PJM Region, as determined in accordance with Attachment DD to the PJM Tariff, provided that the FRR Entity may, at any time, make a filing with FERC under Section 205 of the Federal Power Act proposing to change the basis for compensation to a method based on the FRR Entity’s cost or such other basis shown to be just and reasonable, and a retail LSE may at any time exercise its rights under Section 206 of the FPA.

As the parties appear to agree, the RAA provides for three possible methods of compensating an FRR entity for its capacity service: a state compensation mechanism; the PJM

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<sup>50</sup> Trent (Tr. 358).

<sup>51</sup> Trent (Tr. 57).

market rates; or a rate established by FERC.<sup>52</sup> Duke voluntarily agreed to give up the third option of applying to FERC for cost-based capacity prices, leaving only the first two options.<sup>53</sup>

While Duke seems to assume that it can apply to the Commission to establish a state compensation mechanism, that assumption ignores two fundamental premises of the RAA. First, the RAA only provides for the application of a state compensation mechanism to load that switches to an alternative LSE. Second, a state compensation mechanism only applies where the state requires switching customers or their LSE to compensate the FRR entity for its capacity obligations.

The RAA does not allow for the application of a state compensation mechanism to capacity prices for the FRR entity's *own* retail customers, it only applies to switching customers. Duke's own retail customers purchase capacity service from Duke as part of its SSO and already compensate Duke for that capacity through Rider RC (and to some extent Rider RSC). This has been thoroughly discussed above – Duke supplies the capacity to PJM, who bills the wholesale auction winners for capacity, Duke pays the auction winners for capacity in accordance with its supplier contracts, and then Duke converts those capacity payments into retail rates to be charged to customers as Rider RC. There can be no question that Duke has agreed exactly how much it is to be paid by the retail customer for capacity and has a retail tariff rate on file for that charge. To upset that bargain would most certainly undo the provisions of the Stipulation.

That leaves the other side of the market, shopping customers that receive their energy from a CRES provider. This is the only market segment to which Section D.8 of Schedule 8.1 of the RAA speaks. But that provision of the RAA only applies when “the state regulatory

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<sup>52</sup> Trent (Tr. 58).

<sup>53</sup> *In the Matter of the Application of Duke Energy Ohio, Inc. for Approval of the Establishment of Rider BTR and Rider RTO and Associated Tariffs*, Case No. 11-2641, et al., Stipulation and Recommendation at ¶ 20 (Apr. 26, 2012); Trent (Tr. 81-82, 409).

jurisdiction requires switching customers or the LSE to compensate the FRR Entity for its FRR capacity obligations.” Duke has been unable to point to any Ohio state law requirement for CRES providers to compensate Duke for its FRR capacity obligations.<sup>54</sup> Quite to the contrary, Duke’s own PJM expert witness concurs that the obligation of CRES providers to purchase capacity from Duke comes from participating in PJM, not because of anything required by the State of Ohio.<sup>55</sup> If Duke was not a member of PJM, there is nothing in Ohio law that would say that Duke has to supply capacity to CRES providers or that CRES providers have to compensate Duke for its capacity. Those requirements stem entirely from PJM rules, not Ohio law, hence the condition precedent to the application of a state compensation mechanism is entirely absent.

As there is no statute or regulation in Ohio requiring CRES providers to purchase capacity from the distribution company or to compensate it for its capacity, the only way in which such a requirement may have been created in Duke’s case would be through the ESP Stipulation. The ESP Stipulation should not be seen as creating any such capacity obligations, as it merely recited what is required of PJM market participants. There is no variation between the terms of the ESP Stipulation and what would occur under the default PJM rules, which is that an FRR entity has to supply capacity and LSEs have to pay the PJM rates for capacity. But, if the Order approving the ESP Stipulation is somehow viewed as an *Ohio requirement* that CRES providers must buy capacity from Duke, then that Order must also be seen as establishing the state compensation mechanism as well, which was exactly the same as the default rule under PJM rules – FZCP pricing. It must be remembered that *Duke* initially had proposed a capacity compensation scheme that was very different from how PJM operates – Duke had proposed to

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<sup>54</sup> Trent (Tr. 367-68).

<sup>55</sup> Niemann (Tr. 2721-22, 2728-29).

provide capacity directly to *retail* customers and to bill them at Duke's embedded cost.<sup>56</sup> That would have been a variance from the PJM rules and, if the parties had agreed to that proposal, there might be a state compensation mechanism in place that would supplant the PJM compensation rules. But, as we know, no one agreed to Duke's proposal and the Commission did not order it. So, there is no state compensation mechanism requiring anything different than the normal PJM rules. And, Duke is prohibited from attempting to change that, because it bound itself to the terms of the Stipulation for the duration of the ESP period (and, pursuant to Section I.B, thereafter, if it remains an FRR entity).

If the ESP Stipulation is not considered a state compensation mechanism, the Commission should not create one for Duke at this late date. As discussed above, the RAA only authorizes an FRR entity to charge capacity rates in accordance with a state compensation mechanism in the case of CRES customers. But Ohio's statutory prohibitions on rate discrimination preclude Duke from imposing additional capacity charges on shopping customers.<sup>57</sup> As discussed above, Duke agreed to fix the capacity charges to be paid by SSO customers for the term of the ESP through the Rider RC mechanism. The detailed calculations accompanying the Stipulation leave no doubt exactly how much retail SSO customers would be paying for capacity through the life of the ESP. It would be patently discriminatory to require CRES customers, who have absolutely no generation connection to Duke, to pay extra for its capacity under the guise of a belatedly constructed state compensation mechanism when SSO customers cannot be subjected to anything other than the PJM FZCP rates as converted into Rider RC in Duke's retail SSO tariffs.

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<sup>56</sup> Trent (Tr. 377).

<sup>57</sup> Revised Code §§ 4905.33, 4905.35, 4928.02(A).

#### **IV. There Is No Reason To Consider Duke's Data in Support of Its Claimed Cost of Providing Capacity Because It Is Irrelevant.**

Because Duke unconditionally agreed that all capacity prices (those paid by wholesale auction winners and those paid by CRES providers) would be calculated according to the PJM FZCP, there is no reason to consider or analyze Duke's cost evidence. It is entirely irrelevant to the prices Duke may charge for capacity. To do so would be nothing more than an academic exercise. Accordingly, GCHC/CBI will not devote any effort to analyzing the numbers. GCHC/CBI do, nevertheless, agree with other intervenors who have devoted effort to analyzing the numbers that, if Duke's embedded cost was relevant to anything, there are many errors in Duke's computations and many offsets and reduction that should be applied. GCHC/CBI will leave the details of that to other intervenors.

GCHC/CBI would note one significant factor that the Commission should consider. In Case No. 11-3549, Duke made a commitment to transfer the legacy generation assets "as soon as practicable upon its acceptance of a Commission order approving the Stipulation and upon receipt of necessary regulatory approvals."<sup>58</sup> Duke had the Commission's approval in 2011 with the ESP Opinion and Order<sup>59</sup> and received the FERC's approval in September 2012, yet it has still not transferred the legacy generation assets. Duke has offered no reason why the transfer of the legacy generation assets did not occur many months ago, as there are no regulatory barriers and it committed to doing it as soon as practicable. Once the legacy generation assets are transferred, Duke's embedded costs of those generation assets would have no relevance with respect to the appropriate rates for Duke's capacity. Duke should not be rewarded for delaying this transfer.

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<sup>58</sup> Stipulation, § VIII.A.

<sup>59</sup> Opinion and Order, p. 51.

## V. Duke Is Not Similarly Situated to AEP Ohio

Duke as much as admits that the only reason it filed this case is because the Commission approved a plan for AEP Ohio that permits it to defer the difference between its embedded cost of capacity and the PJM market rates for later collection from customers. Duke fully contemplated charging only market rates for capacity until the AEP decision.<sup>60</sup> Notably, AEP Ohio did not enter into a stipulation governing the pricing of its capacity. Duke did.<sup>61</sup> Settlements of disputed matters become enforceable agreements.<sup>62</sup> There are no changed circumstances that would justify a variance from the pricing that Duke agreed to in the ESP Stipulation. The capacity prices for the ESP period were known before Duke entered into the Stipulation.<sup>63</sup> Duke intensely studied the ESP case, modeled the PJM capacity prices as part of the process of agreeing to the ESP Stipulation, and fully understood the financial ramifications of agreeing to market prices for capacity.<sup>64</sup> It reported the Stipulation to the investment community, which recognized that it would immediately and over time diminish Duke's earnings.<sup>65</sup> Duke must be held to the terms of the overall settlement that it made, which was a global package that included both market capacity rates and the \$330 million ESSC.<sup>66</sup> Allowing Duke to avoid its agreement to charge market rates for capacity would upset the benefit of the bargain that the other parties made with Duke.

Perhaps Duke itself has best articulated why AEP Ohio's capacity case has no bearing on the rates that Duke should be allowed to charge for capacity:

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<sup>60</sup> Trent (Tr. 229).

<sup>61</sup> Trent (Tr. 384-85).

<sup>62</sup> Trent (Tr. 339, 341-42).

<sup>63</sup> Trent (Tr. 349-50).

<sup>64</sup> Savoy (Tr. 995, 998, 1000)

<sup>65</sup> DeMay (Tr. 746).

<sup>66</sup> Noewer Direct Testimony, at 9-10 (FES Exh. 3); Higgins Direct Testimony, pp. 6-7 (Kroger Exh. 1).

Despite AEP Ohio's misguided urging, the Commission should not, and does not, summarily regulate public utilities with a "one size fits all" mentality. Rather, as the Commission is accustomed to doing, its decision must be predicated upon a deliberate review of the relevant evidence in the individual case at bar. The Commission thoroughly reviewed the record and issued a detailed Opinion and Order in connection with the Duke Energy ESP Stipulation.<sup>67</sup>

As shown in Part I, the Commission's decision in Case 11-3549 followed the record in that case, which was undisputed that Duke customers would pay market rates for capacity *in perpetuity*. In exchange for that agreement, Duke received many other concessions, including the \$330 in ESSC payments, which would not have been part of the Stipulation absent the agreement upon market prices for capacity. The litigated outcome of another utility's case, based on an entirely different record, is no justification to violate the settlement of Duke's ESP case.

For these reasons, the GCHC and CBI respectfully request that the Commission deny the relief sought by Duke and enforce the complete ESP Stipulation.

Respectfully submitted,

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<sup>67</sup> Duke Energy Ohio, Inc.'s Memorandum in Opposition to the Application for Rehearing of Columbus Southern Power Company and Ohio Power Company, Case No. 11-3549-EL-SSO, filed Dec. 23, 2011, p. 4.

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Initial Brief was served upon the parties of record listed below this 28th day of June, 2013 by electronic service.

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