

03-93-EL-ATA
03-2079-EL-AAM
03-2080-EL-ATA
03-2081-EL-AAM
05-724-EL-UNC
05-725-EL-UNC
06-1068-EL-UNC
06-1069-EL-UNC
06-1085-EL-UNC

EXHIBITS FILED ON 4/24/07 WITH TRANSCRIPT VOL. 1 FOR HEARING HELD ON 4/10/07
BEFORE JEANNNE KINGERY AND SCOTT FARKAS

1 BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

2 - - -

3 In the Matter of the :
4 Consolidated Duke Energy : Case Nos. 03-93-EL-ATA
5 Ohio, Inc., Rate : 03-2079-EL-AAM
6 Stabilization Plan : 03-2081-EL-AAM
7 Remand and Rider : 03-2080-EL-ATA
8 Adjustment Cases. : 05-724-EL-UNC
 : 05-725-EL-UNC
 : 06-1068-EL-UNC
 : 06-1069-EL-UNC
 : 06-1085-EL-UNC

8 - - -

9 PROCEEDINGS

10 before Ms. Jeanne Kingery and Mr. Scott Farkas,
11 Hearing Examiners, at the Public Utilities Commission
12 of Ohio, 180 East Broad Street, Room 11-C, Columbus,
13 Ohio, called at 10:00 a.m. on Tuesday, April 10,
14 2007.

15 - - -
16 REMAND RIDER - VOLUME I
17 - - -

18
19
20 ARMSTRONG & OKEY, INC.
21 185 South Fifth Street, Suite 101
22 Columbus, Ohio 43215-5201
23 (614) 224-9481 - (800) 223-9481
24 Fax - (614) 224-5724

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	06-1085-EL-UNC	05-725-EL-UNC	03-2080-EL-ATA
	06-1069-EL-UNC	05-724-EL-UNC	03-2079-EL-AAM
Case Number	06-1068-EL-UNC	03-2081-EL-AAM	03-93-EL-ATA

Transcript Vol I

The following exhibit(s) were prefiled and can be located with the pleadings:

Exhibits	Date Filed
DE-OHIO REMAND RIDER EXHIBITS	
1 - Direct Testimony of Charles R. Whitlock	
2 - Supplemental Direct Testimony of Charles R. Whitlock	
3 - Direct Testimony regarding FPP of William Don Wathen, Jr.	
4 - Direct Testimony regarding AAC of William Don Wathen, Jr. <i>06-1085-EL-UNC</i>	<i>Sept 5, 2006</i>
5 - Supplemental Testimony regarding ACC of William Don Wathen, Jr.	<i>Feb 28, 2007</i>
COMMISSION-ORDERED REMAND RIDER EXHIBITS	
1 - Confidential Report of the Financial and Management/ Performance Audit of the Fuel and Purchased Power Rider of Duke Energy - Ohio	<i>Oct 12, 2006</i>
1A - Report of the Financial and Management/Performance Audit of the Fuel and Purchased Power Rider of Duke Energy - Ohio	<i>Oct 12, 2006</i>
1B - 10/20/06 letter from Larkin & Associates, PLLC	<i>Oct 24, 2006</i>
JOINT REMAND RIDER EXHIBIT	
1 - Stipulation	<i>April 9, 2007</i>

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)
The Cincinnati Gas & Electric Company to) Case No. 05-725-EL-UNC
Modify its Quarterly Fuel and Purchase)
Power Component of its Market Based)
Standard Service Offer.)

In the Matter of the Application of) Case No. 05-724-EL-UNC
The Cincinnati Gas & Electric Company to)
Adjust and Set its System Reliability Tracker)
Market Price)

In the Matter of the Application of)
Duke Energy Ohio, Inc. to Modify its) Case No. 06-1068-EL-UNC
Quarterly Fuel and Purchase Power)
Component of its Market Based)
Standard Service Offer)

In the Matter of the Application of)
Duke Energy Ohio, Inc. to Adjust and Set its) Case No. 06-1069-EL-UNQ
System Reliability Tracker)

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DIRECT TESTIMONY OF

CHARLES R. WHITLOCK

ON BEHALF OF

THE CINCINNATI GAS & ELECTRIC COMPANY

D/B/A DUKE ENERGY OHIO, INC.

DATE: September 1, 2006

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ATTACHMENTS:

CRW-1 Projected Rider SRT Purchases and Reserve Margin for 2007

I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Charles R. Whitlock, and my business address is 139 East Fourth
3 Street, Cincinnati, Ohio 45202.

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

5 A. I am employed by Duke Energy Americas, an affiliate of Duke Energy, as
6 President, Commercial Asset Management ("CAM").

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
8 **BACKGROUND.**

9 A. I am a graduate of the University of Alaska at Anchorage with a Bachelor of
10 Business Studies Degree in Accounting. I am also a graduate of the Mahler
11 School Advanced Management Skills Program and the Center for Creative
12 Leadership Developing Strategic Leadership Program. I have also taken
13 advanced course work in the area of business management at Harvard University.
14 I joined Cinergy in May 2000 as a power trader for Cinergy Services. Prior to
15 joining Cinergy, I was a Senior Power Trader with Statoil Energy. I also held
16 various positions with Vitol Gas and Electric which included responsibilities for
17 energy trading, marketing and risk management. I was named to my current
18 position in April 2006.

19 **Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS PRESIDENT,**
20 **COMMERCIAL ASSET MANAGEMENT.**

21 A. I am responsible for the commercial asset management operations. Specifically, I
22 have responsibility to maintain the safe, reliable and economic supply of fuel,

CHARLES R. WHITLOCK DIRECT

1 power, emission allowances and capacity to Duke Energy Ohio's (DE-Ohio)
2 Market Based Standard Service Offer ("MBSSO") consumers. I also have
3 responsibility for the commercial risk management of all components of DE-
4 Ohio's non-MBSSO generation which includes risk associated with power prices,
5 fuel prices, emission allowance ("EA") prices, congestion and weather.

6 **II. PURPOSE OF TESTIMONY**

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
8 **PROCEEDING?**

9 **A.** The purpose of my testimony is to provide an overview of how DE-Ohio manages
10 its resource requirements associated with the Fuel and Purchase Power Rider
11 ("Rider FPP") and the System Reliability Tracker ("Rider SRT"). I will provide
12 testimony regarding the basis for the costs provided to Mr. Wathen for inclusion
13 in Rider FPP and address some of the issues raised in the 2005 Audit of Rider
14 FPP. In the next section of my testimony, I will discuss the Company's plans for
15 meeting its obligations under Rider SRT. Then, I will make some
16 recommendations with respect to the Company's future resource purchases.
17 Finally, I am sponsoring Attachment CRW-1.

18 **III. PORTFOLIO OPTIMIZATION**

19 **Q. ONE OF THE AUDITOR'S RECOMMENDATIONS IN THE 2005 AUDIT**
20 **WAS THAT DE-OHIO "ECONOMICALLY MANAGE FUEL, POWER,**
21 **AND EMISSION ALLOWANCES FORWARD FOR THE BALANCE OF**
22 **THE RSP PERIOD." IS THE COMPANY FOLLOWING THIS**
23 **RECOMMENDATION?**

CHARLES R. WHITLOCK DIRECT

1 A. Yes. A significant area of my responsibility is to "economically manage" the
2 portfolio of resources used to meet the Company's MBSSO load obligation
3 through 2008.

4 Q. PLEASE EXPLAIN THE TERM "ECONOMIC MANAGEMENT."

5 Economic management refers to the way CAM manages market risk for our
6 MBSSO consumers. This management consists of CAM using the transactable
7 forward markets in power, fuel and emission allowances to meet our forecasted
8 load obligation under the MBSSO. Purchasing or contracting for enough
9 resources to meet our MBSSO load requirements is sometimes referred to as
10 being "balanced."

11 Both Rider FPP and Rider SRT are impacted by our ability to
12 economically manage our resources. Volatility in the price of resources and
13 volatility in MBSSO load affect the costs we include in Rider FPP. As forecasts
14 of demand and prices for energy, fuel, and emission allowances change, the
15 expected least cost mix of generation and purchased power required to serve the
16 Rider SRT and Rider FPP load changes. Changes in prices and load result in the
17 buying or selling of the fuel, emission allowances, and contracts for power. The
18 mix of generation and purchased power is monitored daily and adjusted subject to
19 the ability to transact in the market. We continue to refine our portfolio of
20 resources through this buying and selling up to the date for physical delivery of
21 the contracted resource (*i.e.*, fuel, emission allowances, or power). Any gains or
22 losses on the fuel, emission allowances, and energy will be tracked for the benefit
23 of the consumer. This active portfolio management results in the least cost supply

CHARLES R. WHITLOCK DIRECT

1 to our Rider SRT and Rider FPP consumers. We manage our non-MBSSO
2 commitments in the same manner.

3 IV. RIDER FPP DISCUSSION

4 Q. WHAT IS RIDER FPP?

5 A. The Commission approved Rider FPP as the mechanism that facilitates the direct
6 pass through of the Company's fuel costs needed to power its generation plants,
7 the cost of energy bought on the open market, and the cost of emission
8 allowances. I am responsible for acquiring the fuel, energy, and emission
9 allowances that are included in the Rider FPP.

10 Q. AT THE TIME OF THE 2005 AUDIT, CERTAIN DE-OHIO PLANTS
11 WERE BEING TRANSFERRED TO DE-KENTUCKY. THE ORDER IN
12 THE LAST AUDIT INDICATED THAT THE METHODOLOGY FOR
13 THE ALLOCATION OF FUEL COSTS AND/OR FUEL CONTRACTS
14 WERE TO BE REVIEWED IN THIS AUDIT. PLEASE EXPLAIN THAT
15 METHODOLOGY.

16 A. On January 1, 2006, Miami Fort Unit 6, East Bend Unit 2, and the Woodsdale
17 Units 1-6 were transferred from DE-Ohio to Duke Energy Kentucky (DE-
18 Kentucky).

19 No coal contracts were transferred with Miami Fort 6 as a result of this
20 transaction. Miami Fort Station has two inventories one for Miami Fort Unit 8
21 and another for Miami Fort Unit 5, Unit 6, and Unit 7. Miami Fort Unit 6 pays for
22 fuel consumed at Miami Fort station based on the weighted-average cost of
23 inventory related to the pile maintained for Units 5, 6, and 7.

CHARLES R. WHITLOCK DIRECT

1 At East Bend, certain coal contracts were transferred from DE-Ohio to
2 DE-Kentucky. The contracts were allocated based on projected burns of
3 scrubber coal. Criteria utilized to split the coal were 1) avoidance of re-pricing,
4 and 2) unit compatibility. Coal from Oxford Mining was appropriate to burn at
5 East Bend, so those scrubber coal contracts were allocated for use at East Bend.
6 High sulfur coal contracts of Peabody Arclar mine and Foundation Cumberland
7 mine were also assigned to DE-Kentucky on a pro rata basis.

8 **Q. WERE THERE ANY CONTRACTS RELATED TO WOODSDALE?**

9 A. No. Woodsdale is a gas unit and no contracts were assigned as part of the transfer
10 to DE-Kentucky.

11 **Q. THE ORDER IN CASE NO. 05-806-EL-UNC SETTling THE AUDIT**
12 **ALSO ADDRESSED THE ALLOCATION OF MARGINS ON COAL**
13 **SALES. PLEASE EXPLAIN THE CRITERIA USED FOR ALLOCATING**
14 **THE COAL MARGIN FOR TRANSACTIONS MADE AFTER JANUARY**
15 **1, 2005.**

16 A. The Order directed the parties to the last Audit to discuss the "criteria for the
17 equitable assignment of benefits and costs of coal contract sales margins for
18 contracts executed on or after January 1, 2005." The criteria being used to
19 incorporate margins on coal sales in Rider FPP is to subtract the gain or loss
20 associated with contracts for coal sales made after January 1, 2005, from the
21 monthly fuel cost in the Rider FPP calculation. In this way, the average fuel cost
22 included in the Rider FPP market price incorporates the gain or loss on the sale of
23 coal contracts executed after January 1, 2005.

CHARLES R. WHITLOCK DIRECT

1 V. RIDER SRT DISCUSSION

2 Q. PLEASE DESCRIBE RIDER SRT.

3 A. Rider SRT allows the Company to track and collect costs associated with meeting
4 its MBSSO load obligation plus a fifteen percent (15%) reserve margin. The
5 Company is the sole holder of the provider of last resort ("POLR") obligation and,
6 consequently, must have the resources to stand ready to serve all retail load in its
7 service territory. Rider SRT includes costs incurred by DE-Ohio to ensure that
8 we can provide safe and reliable service to all consumers in our service territory.
9 The expectation for safe and reliable service should be no different than if we
10 were still under traditional regulation.

11 Q. PLEASE EXPLAIN THE 2007 RIDER SRT PLAN.

12 A. DE-Ohio proposes to maintain a reserve margin of 15 percent of the projected
13 retail load served in its certified territory by any entity for 2007. DE-Ohio agrees
14 to make purchases to achieve that reserve, keeping records sufficient for
15 Commission staff audit, and will recover the associated costs from consumers that
16 do not avoid the Rider SRT. The management of this reserve will include the
17 purchase and sale of capacity for non-residential consumers that leave or return to
18 the MBSSO at the higher of the MBSSO price or the monthly-average hourly
19 LMP price.

20 As in previous years, the estimate of purchases required to meet our
21 reserve margins begins with our capacity position which is shown on the last page
22 of Attachment CRW-1. This calculation compares the load in our service
23 territory, switched and non-switched, plus 15% for reserves, to our generation

CHARLES R. WHITLOCK DIRECT

1 capacity. To the extent that the load plus reserves exceeds capacity, this excess is
2 the amount of capacity we need to purchase in order to meet our reserve margin
3 requirements for 2007.

4 The remaining pages of Attachment CRW-1 are a summary of the
5 products that we have purchased or expect to purchase to meet the 2007
6 requirements.

7 **Q. DO YOU BELIEVE THAT THE COMMISSION SHOULD ENCOURAGE**
8 **THE COMPANY TO MAKE RELIABILITY PURCHASES FOR MORE**
9 **THAN ONE YEAR?**

10 Yes. As I discussed earlier regarding economic management and balancing our
11 resources earlier, DE-Ohio believes that it is beneficial to purchase capacity
12 instruments for periods longer than a year and to do so would enable DE-Ohio to
13 take advantage of reliability and pricing opportunities in the market that would
14 accrue to the benefit of MBSSO consumers. Purchasing products over various
15 periods of time creates a reliability hedge for MBSSO consumers. It also permits
16 MBSSO consumers to benefit from low prices in the market that may not be
17 available at a later date. There is no economic reason to restrict capacity
18 purchases to a single calendar year. DE-Ohio is asking the Commission to
19 approve this approach in this proceeding.

20 **Q. YOUR ESTIMATED COST FOR RESERVE PURCHASES IN 2006 HAS**
21 **FALLEN SIGNICANTLY SINCE THE COMPANY MADE ITS INITIAL**
22 **2006 RIDER SRT FILING. WILL YOU EXPLAIN WHAT CHANGED?**

CHARLES R. WHITLOCK DIRECT

1 A. Clearly, the estimated costs for 2006 were much higher than we actually
2 experienced. We originally estimated that reliability purchases for the year would
3 be \$24 million. In our filing for the fourth quarter of 2006, our most recent
4 estimate is approximately \$4 million. The primary reasons for this difference are
5 a change in both products and prices of products needed to obtain the reserve
6 margin. Product changes include the elimination of the Daily Fixed Call Option
7 with Unit Contingency (outage insurance), base-load, and mid-merit tolls from the
8 plan. This change accounts for \$16 million of the variance. The Fixed Strike
9 Energy Options procured were bought for less than originally estimated. For
10 example, the summer daily \$100 call options were valued at \$14.50/MW in the
11 original plan but our actual costs were \$5.25/MW. We were also able to purchase
12 Capacity at prices lower than we anticipated in the original filing.

13 With the ability to true-up these costs, the total costs incurred and revenue
14 collected from consumers should be nearly even with consumers by the end of
15 year.

16 **VI. MISCELLANEOUS ISSUES**

17 **Q. DO YOU HAVE ANY COMMENTS ON THE PURCHASING OF**
18 **RESOURCES BEYOND 2008?**

19 A. Yes, DE-Ohio filed an application on August 2, 2006, in Case No. 06-986-EL-
20 UNC, to extend the MBSSO beyond December 31, 2008. Extending the MBSSO
21 through 2010 will enable DE-Ohio to update the Rider FPP market price so that
22 reliable service at a stable price can continue to be offered to consumers of DE-
23 Ohio.

CHARLES R. WHITLOCK DIRECT

1 At the present time, we are not actively managing our position beyond
2 2008, subject to the outcome of the extension or Commission approval in this
3 case. With Commission approval, the Company will begin to purchase fuel and
4 the other components of Rider FPP and Rider SRT beyond 2008 at current market
5 prices to the benefit of MBSSO consumers.

6 **Q. PLEASE EXPLAIN ANY NEW DEVELOPMENTS WITH REGARD TO**
7 **THE LEGACY DUKE ENERGY NORTH AMERICA ("DENA")**
8 **ASSETS.**

9 The legacy DENA assets, now owned by DE-Ohio, are located in MISO and PJM.
10 There has been no change regarding their disposition and they are being
11 dispatched into the market by MISO and PJM, as appropriate. In the previous
12 SRT case, DE-Ohio agreed not to include the legacy DENA assets as capacity
13 instruments to satisfy SRT reserve margin capacity absent Commission approval.
14 DE-Ohio requests such approval in this case to the extent that capacity purchases
15 from legacy DENA assets are purchased at the market price and represent a
16 benefit to MBSSO consumers. There is no reason to treat the legacy DENA
17 assets in a different manner than any other generating capacity available in the
18 market. The MBSSO consumer should expect that we pursue all economic means
19 of obtaining generating capacity to meet their needs. Excluding viable assets
20 because they are DENA legacy assets is illogical and would be imprudent.

21 **VII. CONCLUSION**

22 **Q. DO YOU HAVE ANY FINAL COMMENTS REGARDING RIDER FPP OR**
23 **RIDER SRT BEING ADDRESSED IN THIS FILING?**

CHARLES R. WHITLOCK DIRECT

1 A. I believe that DE-Ohio is prudently obtaining and utilizing its resources to meet
2 its MBSSO obligations for the Rider FPP and the Rider SRT. We have complied
3 with all of the applicable directives included in the Order settling the Audit of the
4 Rider FPP, in Case No. 05-806-EL-UNC, and with the directives included in the
5 Order approving the Stipulation reached in Case No. 05-724-EL-UNC. We use
6 reasonable methods for allocating costs and have mechanisms in place to ensure
7 that consumers are paying only for the Company's actual costs.

8 Q. WAS ATTACHMENT CRW-1 PREPARED BY YOU OR UNDER YOUR
9 SUPERVISION?

10 A. Yes.

11 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

12 A. Yes.

13

CHARLES R. WHITLOCK DIRECT

CONFIDENTIAL PROPRIETARY
TRADE SECRET

DUKE ENERGY OHIO

Summary of Protected 2007 Capacity and Purchased Power Costs
Incurred to Serve SRT Customers

Total Estimated Capacity Costs and Jurisdictional Allocation

Line No.	Description	JANUARY (A)	FEBRUARY (B)	MARCH (C)	APRIL (D)	MAY (E)	JUNE (F)	JULY (G)	AUGUST (H)	SEPTEMBER (I)	OCTOBER (J)	NOVEMBER (K)	DECEMBER (L)	Total (M)	Line No.	
1	Daily Fixed Sine Energy Firm LO Call Options					211,200	140,800	352,000	404,800					1,108,800	1	
2	Mid-Merit Gas Tolling Agreement															2
3	Regulatory Capacity Purchase	210,000	210,000	300,000	240,000	540,000	1,250,000	1,500,000	1,875,000	700,000	180,000	360,000		7,155,000	3	
4	Existing Henry County Capacity Purchase	39,550	39,550	39,550	39,550	39,550	39,550	39,550	39,550	39,550	39,550	39,550	39,550	474,600	4	
5	Total Applicable to Retail Customers	\$ 39,550	\$ 249,550	\$ 339,550	\$ 279,550	\$ 780,750	\$ 1,430,350	\$ 1,891,550	\$ 2,319,350	\$ 739,550	\$ 219,550	\$ 399,550	\$ 39,550	\$ 8,738,400	5	

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TRADE SECRET

DUKE ENERGY OHIO

Projected Purchased Capacity

Line No.	Description (A)	Amount (B)	Description (C)	Amount (D)	Line No.	Month
February			July			March
1	MWs	150	MWs	1000	1	April
2	Capacity Charge/Kw/Month	\$ 0.50	Capacity Charge/Kw/Month	\$ 1.50	2	
3	CG&E's Capacity Charge	\$ 210,000	CG&E's Capacity Charge	\$ 1,500,000	3	
4	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 210,000</u>	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 1,500,000</u>	4	May
March			August			April
5	MWs	150	MWs	1250	5	
6	Capacity Charge/Kw/Month	\$ 0.40	Capacity Charge/Kw/Month	\$ 1.50	6	
7	CG&E's Capacity Charge	\$ 100,000	CG&E's Capacity Charge	\$ 1,875,000	7	
8	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 300,000</u>	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 1,875,000</u>	8	May
April			September			June
9	MWs	600	MWs	1,400	9	
10	Capacity Charge/Kw/Month	\$ 0.40	Capacity Charge/Kw/Month	\$ 0.50	10	
11	CG&E's Capacity Charge	\$ 240,000	CG&E's Capacity Charge	\$ 700,000	11	July
12	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 240,000</u>	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 700,000</u>	12	
May			October			August
13	MWs	1350	MWs	450	13	
14	Capacity Charge/Kw/Month	\$ 0.40	Capacity Charge/Kw/Month	\$ 0.40	14	September
15	CG&E's Capacity Charge	\$ 540,000	CG&E's Capacity Charge	\$ 180,000	15	
16	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 540,000</u>	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 180,000</u>	16	
June			November			October
17	MWs	1000	MWs	900	17	November
18	Capacity Charge/Kw/Month	\$ 1.25	Capacity Charge/Kw/Month	\$ 0.40	18	
19	CG&E's Capacity Charge	\$ 1,250,000	CG&E's Capacity Charge	\$ 360,000	19	
20	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 1,250,000</u>	Estimated Monthly Costs Recoverable Via System Reliability Tracker - Rider SRT	<u>\$ 360,000</u>	20	
Total Purchased Capacity Charge				<u>\$ 7,155,000</u>	21	

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TRADE SECRET

DUKE ENERGY OHIO

Projected Daily Fixed Strike Energy Firm Liquidated Damages Call Option

Line No.	Description	Amount	Description	Amount	Line No.
	(A)	(B)	(C)	(D)	
May			July		
1	Days	22	Days	20	1
2	Daily Hours	16	Daily Hours	16	2
3	MW's Optioned	200	MW's Optioned	200	3
4	MW's Subject to Reservation Charge	70,400	MW's Subject to Reservation Charge	64,000	4
5	Charge Per MWH	\$ 3.00	Charge Per MWH	\$ 5.50	5
6	Cost per kW-month Capacity		Cost per kW-month Capacity	\$ -	6
7	Capacity Charge	<u>\$ 211,200</u>	Capacity Charge	<u>\$ 352,000</u>	7
June			August		
8	Days	23	Days	23	8
9	Daily Hours	16	Daily Hours	16	9
10	MW's Optioned	200	MW's Optioned	200	10
11	MW's Subject to Reservation Charge	35,200	MW's Subject to Reservation Charge	73,600	11
12	Charge Per MWH	\$ 4.00	Charge Per MWH	\$ 5.50	12
13	Cost per kW-month Capacity	\$ -	Cost per kW-month Capacity	\$ -	13
14	Capacity Charge	<u>\$ 140,800</u>	Capacity Charge	<u>\$ 404,800</u>	14
			<u>SUMMARY</u>		
			Total Daily Call Options Capacity Charge	<u>\$ 1,108,800</u>	15

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DUKE ENERGY OHIO
Capacity Position for 2007

Updated on August 14, 2006

	2007											
Native	January	February	March	April	May	June	July	August	September	October	November	December
Supply	4,105	4,105	4,105	4,033	4,033	4,005	4,005	4,005	4,005	4,033	4,033	4,105
Maintenance *	-	(558)	(1,193)	(1,356)	(1,334)	(94)	-	(228)	(833)	(929)	(1,206)	(211)
Supply with Maintenance Considerations	4,105	3,547	2,912	2,677	2,699	3,911	4,005	3,777	3,172	3,104	2,827	3,894
Native and Switched Peak Demand	(3,602)	(3,417)	(3,194)	(2,867)	(3,537)	(4,300)	(4,407)	(4,408)	(3,995)	(3,094)	(3,287)	(3,407)
Call Option & RTP	11	1	1	1	1	16	25	25	16	1	1	11
Purchases	50	50	50	50	50	50	50	50	50	50	50	50
CG&E Native Load Capacity Position	564	181	(231)	(139)	(787)	(323)	(327)	(556)	(757)	61	(409)	548
Margin	15.7%	5.3%	-7.2%	-4.8%	-22.3%	-7.5%	-7.5%	-12.7%	-19.0%	2.0%	-12.4%	16.1%
Capacity Position @ 15% Reserve Margin	25	(311)	(710)	(569)	(1317)	(966)	(984)	(1213)	(1354)	(403)	(902)	39

(*) - represents the maintenance schedule based upon economics and resource constraints. Also this uses the highest weekly volume during the month. The schedule has some flexibility and might be adjustable for peak days.
Please note: All residential customers and non-residential customers who have not opted-out are included in this analysis.

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BEFORE

PUCO THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)	
The Cincinnati Gas & Electric Company to)	Case No. 05-725-EL-UNC
Modify its Quarterly Fuel and Purchase)	
Power Component of its Market Based)	
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Adjust and Set its System Reliability Tracker)	
Market Price)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. to Modify its)	Case No. 06-1068-EL-UNC
Quarterly Fuel and Purchase Power)	
Component of its Market Based)	
Standard Service Offer)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. to Adjust and Set its)	Case No. 06-1069-EL-UNC
System Reliability Tracker)	

SUPPLEMENTAL DIRECT TESTIMONY OF

CHARLES R. WHITLOCK

ON BEHALF OF

DUKE ENERGY OHIO

DATE: November 16, 2006

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ATTACHMENTS

Attachment CRW-1

I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Charles R. Whitlock and my business address is 139 East Fourth
3 Street, Cincinnati, Ohio 45202.

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

5 A. I am employed by Duke Energy Americas, an affiliate of Duke Energy, as
6 President, Commercial Asset Management ("CAM").

7 **Q. ARE YOU THE SAME CHARLES R. WHITLOCK WHO PREVIOUSLY**
8 **FILED TESTIMONY IN THIS PROCEEDING?**

9 A. Yes.

II. PURPOSE OF TESTIMONY

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
11 **PROCEEDING?**

12 A. The purpose of my supplemental testimony is to respond to certain Management
13 Audit Recommendations contained in pages 1-9 through 1-10 of the *Report of the*
14 *Financial And Management/Performance Audit of the Fuel and Purchased Power*
15 *Rider of Duke Energy Ohio*. Specifically, I address the Auditor's
16 recommendations with respect to: 1.) Treatment of margins realized from the
17 Appalachian Fuel Settlement; 2.) DE-Ohio's active management of the coal,
18 emission allowance, and forward power purchases portfolio; 3.) Requiring coal
19 suppliers to permit the resale of coal; and 4.) The purchase of reserve capacity
20 from the Midwest generating assets, previously owned by DENA (DENA Assets).

III. DISCUSSION

1 **Q. HAVE YOU REVIEWED THE AUDITOR'S REPORT OF THE**
2 **FINANCIAL AND MANAGEMENT/PERFORMANCE AUDIT OF THE**
3 **FUEL AND PURCHASED POWER RIDER OF DUKE ENERGY OHIO?**

4 **A. Yes.**

5 **Q. DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**
6 **REGARDING THE TREATMENT OF NET MARGINS DERIVED FROM**
7 **THE APPALACHIAN FUEL (APPALACHIAN) SETTLEMENT?**

8 **A. Yes. The Auditor recommends that DE-Ohio pass through the entire margin**
9 **related to the Appalachian Settlement and concludes that the total margin from the**
10 **re-sale of this coal during the audit period was \$959,626.**

11 **Q. DOES DE-OHIO AGREE WITH THE AUDITOR'S RECOMMENDATION?**

12 **A. No. DE-Ohio believes that the recommendation is too broad. A portion, but not**
13 **all, of the benefits realized under the Appalachian Settlement should flow through**
14 **to non-residential Rider FPP consumers.**

15 **Q. PLEASE EXPLAIN THE APPALACHIAN SETTLEMENT.**

16 **A. In March and April 2002, DE-Ohio entered into two contracts with Appalachian**
17 **for the delivery of specific amounts and types of coal during 2002, 2003, 2004**
18 **and 2005. In August 2003, Appalachian defaulted on these agreements, failing to**
19 **deliver as contractually obligated. After extensive negotiation, on or about**
20 **November 8, 2005, DE-Ohio and Appalachian reached a financial settlement**
21 **(Appalachian Settlement) regarding the default on the prior contracts.**
22 **Appalachian agreed to deliver a specific quantity of NYMEX quality coal going**

1 forward in 2006, 2007 and 2008 at a discount of \$5.55 per ton from the prevailing
2 NYMEX price.

3 **Q. PLEASE EXPLAIN WHY DE-OHIO BELIEVES ONLY A PORTION OF**
4 **THE MARGINS DERIVED FROM THE APPALACHIAN SETTLEMENT**
5 **SHOULD FLOW THROUGH TO NON-RESIDENTIAL RIDER FPP**
6 **CONSUMERS.**

7 A. As I previously mentioned, the two original contracts with Appalachian required
8 delivery of coal during 2002, 2003, 2004, and 2005. Rider FPP was effective
9 beginning January 1, 2005 for non-residential consumers and January 1, 2006 for
10 residential consumers. Prior to January 1, 2005, DE-Ohio's market price included
11 fuel prices frozen at the level approved by the Commission in Case No. 99-1658-
12 EL-ETP. In other words, prior to January 1, 2005, neither the original
13 Appalachian coal costs, nor the replacement coal costs were passed through to
14 consumers. Accordingly, the portion of the Appalachian Settlement that
15 corresponds to the coal that was to be delivered prior to January 1, 2005, is
16 remuneration for damages sustained by DE-Ohio, not retail consumers. This
17 portion of the Appalachian Settlement should not flow through Rider FPP.
18 However, a portion of the settlement with Appalachian does replace coal
19 deliveries that were to have occurred in 2005. Consequently, some of the costs
20 incurred during 2005 were partially borne by non-residential Rider FPP
21 consumers. Therefore, the affected Rider FPP consumers should share in the
22 respective margins on sales of coal under the Appalachian Settlement based upon
23 the portion of the original contract delivery for 2005.

1 **Q. PLEASE EXPLAIN HOW DE-OHIO PROPOSES TO FLOW THROUGH**
2 **A PORTION OF THE APPALACHIAN SETTLEMENT COAL MARGINS**
3 **TO RIDER FPP CONSUMERS.**

4 A. Assuming Appalachian does not default on the Settlement, DE-Ohio estimates
5 that 19.3% of benefit of the Appalachian Settlement should flow through to non-
6 residential Rider FPP consumers via a credit to the Rider FPP market price. Since
7 Appalachian previously defaulted on its original delivery contract, it would be
8 imprudent to pass through the full benefit of the Settlement prior to actual receipt
9 of the coal discounts. Therefore, on a going forward basis, we propose to pass
10 through the appropriate share of such credits as the margins are realized.

11 As previously mentioned, the Appalachian Settlement became effective in
12 November 2005 and was for future deliveries in 2006, 2007, and 2008. To date,
13 Appalachian has complied with the terms of the Settlement. Therefore, value
14 associated with the margins on coal already delivered under the Settlement, and
15 proportional to the defaulted 2005 deliveries, is owed to non-residential Rider
16 FPP consumers. DE-Ohio proposes to credit this proportional amount to non-
17 residential consumers through Rider FPP following the Commission's approval in
18 this case.

19 **Q. PLEASE EXPLAIN HOW DE-OHIO CALCULATED THE**
20 **PROPORTIONAL SHARE OF THE APPALACHIAN SETTLEMENT TO**
21 **BE FLOWED THROUGH TO NON-RESIDENTIAL RIDER FPP**
22 **CONSUMERS.**

1 A. The calculation of the allocation is set forth in Attachment CRW-1 to my
2 supplemental testimony. As I previously mentioned, the Appalachian Settlement
3 is for specific amounts of NYMEX quality coal at a specific price, replacing
4 deliveries that did not occur in 2003, 2004 and 2005. The 2005 deliveries, had
5 they occurred, amounted to 40.57 % of the total quantity of coal under the
6 defaulted contracts. Of the 40.57% of coal, that would have been delivered,
7 approximately 47.6 % of that would have been allocated to non-residential Rider
8 FPP consumers. Therefore, DE-Ohio is proposing to flow through the margins on
9 19.3% of the coal to be delivered under the Appalachian Settlement to non-
10 residential FPP consumers (40.57% times 47.6%).

11 **Q. DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**
12 **REGARDING DE-OHIO'S ACTIVE MANAGEMENT OF FUEL, POWER**
13 **AND EMISSION ALLOWANCES?**

14 A. Yes. The Auditor recommends that DE-Ohio adopt "traditional utility
15 procurement strategies related to the procurement of coal, power, and emission
16 allowances and cease its 'active management' through the balance of the RSP
17 period."

18 **Q. DOES DE-OHIO AGREE WITH THE AUDITOR'S**
19 **RECOMMENDATION?**

20 A. No. The Auditor's recommendation contradicts the stipulation and Commission's
21 Opinion and Order in Case No. 05-806-EL-UNC. The active management of the
22 emission allowance, fuel and forward power purchases portfolio is a "best
23 practice" management technique that was specifically agreed to in the December

1 2005 Stipulation and approved by the Commission in its February 2006 Opinion
2 and Order.

3 The Auditor made a similar recommendation, regarding “regulated utility
4 industry practice,” in the previous Rider FPP audit report and it was not adopted
5 by this Commission. As DE-Ohio explained in its supplemental testimony in its
6 last Rider FPP case, an actively managed portfolio allows gross margins to be
7 continuously locked-in based on market signals. In turn, DE-Ohio is able to
8 maximize the value of its generating asset portfolio while managing these
9 inherent risks in the most cost effective manner relative to daily changes in the
10 market.

11 **Q. PLEASE EXPLAIN WHY THE AUDITOR’S PROPOSED PERIODIC**
12 **MANAGEMENT TECHNIQUE IS IMPRUDENT.**

13 **A.** The Auditor recommends that DE-Ohio no longer seek to flatten its position on a
14 daily basis, but rather “adjust its SO₂ position on no more than a quarterly basis
15 unless specific events dictate otherwise.” The Auditor offers no opinion on what
16 constitutes “specific events” which would warrant adjusting the position on a
17 more frequent basis.

18 Essentially, the Auditor is now recommending that DE-Ohio make a
19 speculative bet every 90 days in the coal, emission allowance, and power markets.
20 DE-Ohio believes that the Auditor’s recommended approach poses a significant
21 risk to consumers. For instance, if DE-Ohio locks in a price by purchasing coal
22 on a date certain and the price subsequently falls while power prices escalate,
23 consumers cannot benefit from coal purchases at the lower price. Similarly, if the

1 price of coal rises while forward power prices decline, consumers cannot benefit
2 from the sale of the coal at the higher price in the market. In either scenario,
3 consumers would suffer.

4 Additionally, the Auditor's recommendation fails to recognize that DE-
5 Ohio is not a regulated utility for the sale of electricity. It is not permitted to
6 recover generation investments plus a reasonable return through the regulatory
7 process, nor is it permitted to recover increases in many other costs not included
8 in Rider FPP. Rider FPP is fully avoidable by all consumers that purchase
9 generation from a competitive retail electric service provider. Traditional
10 regulated utility practice is not appropriate for managing all of the risks inherent
11 in a deregulated environment.

12 In its previous audit report in Case No. 05-806-EL-UNC, this same
13 Auditor recommended that DE-Ohio true-up the allowance allocations and the
14 auction proceeds on an annual basis. Clearly, with its present recommendation of
15 a 90-day position adjustment, followed by the caveat of "unless specific events
16 dictate otherwise," the Auditor recognizes the benefits of a more frequent position
17 review.

18 Finally, it is important to note that DE-Ohio manages these variables for
19 Rider FPP consistent with its management of these variables for all of its sales of
20 deregulated electricity.

21 **Q. WHAT ARE THE BENEFITS OF AN ACTIVE MANAGEMENT**
22 **PROCUREMENT APPROACH OVER "TRADITIONAL UTILITY**
23 **PROCUREMENT STRATEGIES?"**

1 A. The benefits of active management are that DE-Ohio may make rational
2 economic decisions based on the market price of coal, power and emission
3 allowances, and reduce market price risk on behalf of consumers. DE-Ohio will
4 enter into transactions based on market commodity prices and all of the benefits
5 of these transactions are credited to consumers. Just as there are examples where
6 a bet on prices at a date certain will yield lower costs than active management,
7 there are also examples where the same bet will yield higher costs. The risk lies
8 in when to place the bet. Active management limits the market risk and reduces
9 volatility in Rider FPP. In this case, the Auditor agrees, at page 2-14 of the report
10 that DE-Ohio's active management techniques with respect to "quality swaps"
11 have resulted in a substantial savings for Rider FPP consumers. Similarly, the
12 Auditor found that if DE-Ohio had engaged in active management with respect to
13 flattening its emission allowance position beginning on October 1, 2005, and prior
14 to the Commission's Order in February 2006, in the last FPP case, DE-Ohio
15 would have lowered consumer costs by over \$14 million in one short period. It is
16 clear that active management is commercially sound and provides benefits to
17 consumers, relative to "traditional utility procurement strategies."

18 **Q. DOES THE AUDITOR MAKE ANY FURTHER RECOMMENDATIONS**
19 **REGARDING DE-OHIO'S ACTIVE MANAGEMENT PHILOSOPHY?**

20 A. Yes, the Auditor also states that DE-Ohio should "develop and implement a
21 portfolio strategy such that it purchases coal through a variety of short, medium
22 and long-term agreements with appropriate supply and supplier diversification
23 with credit worthy counterparties."

1 **Q. IS DE-OHIO PURCHASING COAL THROUGH A VARIETY OF SHORT,**
2 **MEDIUM AND LONG-TERM AGREEMENTS WITH APPROPRIATE**
3 **SUPPLY AND SUPPLIER DIVERSIFICATION WITH CREDIT**
4 **WORTHY COUNTERPARTIES?**

5 A. Yes. DE-Ohio does in fact have short, medium and long-term contracts in its
6 portfolio with multiple suppliers and requires all suppliers to meet specific credit
7 requirements. This recommendation is simply a result of the Auditor's
8 misunderstanding of DE-Ohio's portfolio management.

9 **Q. DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**
10 **REGARDING THE RESALE OF COAL BY DE-OHIO?**

11 A. Yes, the Auditor recommends that as long as the Rider FPP is in effect, coal
12 suppliers should not be required to allow the resale of their coal.

13 **Q. DOES DE-OHIO IN FACT REQUIRE THE POTENTIAL TO RESELL**
14 **COAL AS A CONDITION TO CONSIDER OFFERS FROM SUPPLIERS?**

15 A. No, it does not. DE-Ohio does include the resale of coal as a condition on its
16 RFPs but does not exclude an offer from consideration if the supplier will not
17 permit the resale of coal.

18 **Q. WHY IS THE ABILITY TO RESELL COAL A BENEFIT TO**
19 **CONSUMERS?**

20 A. As part of the active management of coal inventories, the ability to resell coal
21 permits DE-Ohio to manage price risk by selling an "expensive" coal, based on
22 the then market price of coal and emission allowances, and burning a
23 comparatively less expensive coal, also based on market prices. Consumers

1 benefit from the sale transaction because any resulting margin is credited against
2 the fuel cost in the calculation of the Rider FPP market price, and the exposure to
3 market volatility is greatly reduced. In its report, the Auditor goes so far as to
4 quantify this benefit and recognized that DE-Ohio's active management with
5 respect to quality swaps of coal created a \$14 million credit for Rider FPP
6 consumers.

7 **Q. DOES THE AUDITOR MAKE ANY RECOMMENDATIONS**
8 **REGARDING THE PURCHASE OF RESERVE CAPACITY FROM THE**
9 **LEGACY DENA ASSETS FOR INCLUSION IN RIDER SRT?**

10 A. Yes. The Auditor recommends that the legacy DENA Assets should not be
11 eligible for inclusion in Rider SRT.

12 **Q. DOES DE-OHIO AGREE WITH THIS RECOMMENDATION?**

13 A. No.

14 **Q. PLEASE EXPLAIN WHY DE-OHIO BELIEVES THE DENA ASSETS**
15 **SHOULD BE AVAILABLE FOR INCLUSION IN CAPACITY**
16 **PURCHASES AS PART OF THE RIDER SRT?**

17 A. The purpose of the SRT is to ensure adequate capacity to meet DE-Ohio's
18 obligation as provider of last resort (POLR). At present, this obligation requires
19 DE-Ohio to maintain a 15% capacity reserve margin. There are limited assets
20 located in the MISO footprint that meet MISO's designated network resource
21 (DNR) requirements. Consumers should have access to every possible economic
22 option with respect to available generating assets. The risks to its consumers are
23 substantial and increasingly likely if DE-Ohio does not have access to market

1 price capacity during a time of need. This is particularly true if a capacity
2 purchase must be made in the spot market where prices are exceptionally volatile.
3 It is in the consumer's best interest if DE-Ohio has the ability to avoid such a risk
4 through a readily available and reasonably priced alternative regardless of the
5 source of supply.

6 Additionally, on a daily operational level, the ability to include the DENA
7 Assets makes sense. MISO requires approximately 4% daily reserve margin from
8 market participants such as DE-Ohio. DE-Ohio should be permitted to satisfy its
9 reserve margin in the most economic manner. Limiting the options through
10 which DE-Ohio may satisfy its capacity obligation by arbitrarily excluding
11 specific generators from consideration can only increase the cost to consumers, if
12 the capacity is available at all.

13 DE-Ohio transacts to meet its capacity requirements in the long-term
14 market. While DE-Ohio cannot predict that reasonably priced capacity will be
15 unavailable in the long-term capacity market, there is no economic justification to
16 deprive consumers of the opportunity to purchase the most reasonably priced
17 capacity available simply because the capacity stems from a DENA Asset.

18 In short, if the DENA Assets provide the most economic option, it does
19 not make sense to exclude them from consideration.

20 **Q. WHAT IS THE AUDITOR'S JUSTIFICATION FOR RECOMMENDING**
21 **THAT THE DENA ASSETS SHOULD NOT BE INCLUDED AS PART OF**
22 **RIDER SRT CAPACITY PURCHASES?**

1 A. First, the Auditor does not believe consumers are paying more for capacity in the
2 market than if purchased from the DENA Assets. Second, the Auditor believes
3 that purchases from affiliates are problematic and reduces competitive bid offers.
4 Third, the Auditor believes the auditing of affiliate transactions is burdensome.
5 Fourth, the Auditor believes that given the condition of the capacity market, DE-
6 Ohio should be able to sell its legacy DENA capacity on the open market.

7 **Q. WHAT IS YOUR RESPONSE TO THESE CRITICISMS?**

8 A. DE-Ohio recognizes the issues of documenting a market price for a transaction,
9 where it owns the capacity purchased. DE-Ohio accepts the burden of
10 demonstrating its purchases at a market price by comparison to other capacity
11 available in the market. DE-Ohio is constantly probing the market and making
12 decisions identifying the best offers for its consumers. If DE-Ohio is permitted to
13 consider DENA Assets for capacity purchases through Rider SRT, DE-Ohio will
14 commit to providing the Commission in future audit proceedings with a written
15 record of the concurrent bids and offers to show that the market price for capacity
16 is equal to or greater than the market price associated with a capacity purchase
17 from the DENA Assets.

18 The Auditor's concern about the reduction of competitive bid offers is
19 simply unwarranted. The vast majority of competitive bidders are not aware of
20 the nuances of DE-Ohio's exclusion of DENA Assets. As far as the outside world
21 is concerned, the DENA Assets are part of DE-Ohio's generating assets. DE-
22 Ohio is currently receiving and accepting competitive bids. There is no reason to
23 believe that DE-Ohio will not continue to do so. Additionally, there is no reason

1 to believe that DE-Ohio's motives are nefarious and that the Company will not
2 continue to act in the best interests of its consumers.

3 The Auditor's concerns about the added "burden" regarding the mechanics
4 of auditing DENA transactions should not be a determining factor. DE-Ohio
5 accepts the burden to prove the prudence of its transactions. The Auditor's
6 reluctance to perform additional work is immaterial. DE-Ohio will provide
7 documentation of the concurrent competitive bids during the audit period along
8 with the purchase price for capacity from the DENA Assets. This should
9 demonstrate the prudence of DE-Ohio's management decisions.

10 Lastly, the Auditor's position with respect to the "size of the market" and
11 ability to sell legacy DENA capacity in the market is dubious. If the Commission
12 does not permit DE-Ohio to purchase capacity from its DENA Assets to satisfy its
13 Rider SRT obligations, DE-Ohio will continue to sell the capacity on the open
14 market. However, the Auditor should recognize that it is not in the best interests
15 of DE-Ohio's consumers to deprive them of a viable economic market option
16 simply because of its status as a legacy DENA Asset. There is limited capacity in
17 the MISO footprint that meets MISO's DNR requirement. Consumers should
18 have access to all of it.

19 **Q. ARE ANY OF THE DENA ASSETS CURRENTLY BEING**
20 **ECONOMICALLY DISPATCHED WITHIN THE MISO FOOTPRINT?**

21 **A.** Yes, the Vermillion generating station is in MISO and is being dispatched.

22 **Q. DO ALL OF THE DENA ASSETS MEET MISO'S DNR**
23 **REQUIREMENTS?**

1 A. Yes. All the DENA Assets meet MISO's DNR Requirements. As I mentioned
2 previously, Vermillion is the only DENA asset actually located in MISO. The
3 other assets are located in the PJM market. However, their location should not
4 exclude them from consideration for Rider SRT capacity purchases. PJM DENA
5 assets could be a more economical solution. I believe that Ohio consumers will
6 benefit from having access to DENA Assets.

IV. CONCLUSION

7 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

8 A. Yes.

**Appalachian Fuel Settlement
Estimated Benefit to Rider FPP Non-Residential Customers**

Line No.	Description	Fuel Type		Total
		Midsulfur contract	Compliance	
1	Date signed	3/1/2002	4/1/2002	
2	Contract No.	HS00467	CS00487	
	Scheduled Shipments (tons):			
3	2002	500,000	216,000	716,000
4	2003	800,000	500,000	1,300,000
5	2004	800,000	500,000	1,300,000
6	2005	800,000	500,000	1,300,000
7	Total Scheduled Shipments	2,900,000	1,716,000	4,616,000
	Actual Shipments (tons):			
8	2002	606,043	200,336	806,379
9	2003	475,575	129,914	605,490
10	Total Actual Shipments	1,081,619	330,250	1,411,869
11	Undelivered Tonnage (line 7 - line 10)	1,818,381	1,385,750	3,204,131
12	2005 Portion of Undelivered Tonnage (line 6 ÷ line 11)			40.57%
13	2005 Load Ratio of Non-Residential Rider FPP Customers (see page 2 of 2)			47.60%
14	Net Settlement Allocable to Non-Residential Rider FPP Customers (line 12 * line 13)			19.31%

Appalachian Fuel Settlement (Worksheet)
Estimated Non-Residential Share of 2005 Rider FPP Load

Month	Total Generation After Losses (kWh)	Sales Subject to FPP (kWh)	Percent of Total
January 2005	2,178,756,465	970,427,454	44.5%
February 2005	1,851,455,693	871,926,259	47.1%
March 2005	1,934,548,445	860,614,768	44.5%
April 2005	1,596,302,838	865,518,017	54.2%
May 2005	1,676,412,336	853,013,838	50.9%
June 2005	2,126,211,045	953,638,907	44.9%
July 2005	2,295,283,749	1,002,821,249	43.7%
August 2005	2,344,070,693	1,037,060,410	44.2%
September 2005	1,928,130,887	1,016,950,570	52.7%
October 2005	1,692,286,128	924,155,524	54.6%
November 2005	1,702,791,217	860,802,285	50.6%
December 2005	2,081,494,729	925,531,826	44.5%
Total	23,407,744,225	11,142,461,107	47.6%

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)	
The Cincinnati Gas & Electric Company to)	Case No. 05-725-EL-UNC
Modify its Quarterly Fuel and Purchase)	
Power Component of its Market Based)	
Standard Service Offer.)	
In the Matter of the Application of)	Case No. 05-724-EL-UNC
The Cincinnati Gas & Electric Company to)	
Adjust and Set its System Reliability Tracker)	
Market Price)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. to Modify its)	Case No. 06-1068-EL-UNC
Quarterly Fuel and Purchase Power)	
Component of its Market Based)	
Standard Service Offer)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc. to Adjust and Set its)	Case No. 06-1069-EL-UNC
System Reliability Tracker)	

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DIRECT TESTIMONY OF

WILLIAM DON WATHEN, JR.

ON BEHALF OF

THE CINCINNATI GAS & ELECTRIC COMPANY

D/B/A DUKE ENERGY OHIO, INC.

Date: September 1, 2006

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ATTACHMENTS:

- WDW-1 Quarterly Rider FPP Submittals for Third & Fourth Quarters of 2005 and First & Second Quarters of 2006
- WDW-2 Estimated Rider SRT for First Quarter of 2007

DIRECT TESTIMONY OF WILLIAM DON WATHEN, JR.

I. INTRODUCTION

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is William Don Wathen, Jr. My business address is 139 East Fourth
3 Street, Cincinnati, Ohio 45202.

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

5 A. I am employed by Duke Energy Shared Services, Inc., (Duke Energy) as Director
6 of Revenue Requirements.

7 Q. PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL
8 QUALIFICATIONS.

9 A. I received Bachelor Degrees in Business and Chemical Engineering in 1985 and
10 1986, respectively, and a Master of Business Administration Degree in 1988, all
11 from the University of Kentucky.

12 After completing graduate studies, I was employed by Kentucky Utilities
13 Company as a planning analyst. Later in 1989, I began employment with the
14 Indiana Utility Regulatory Commission as a senior engineer. From 1992 until
15 mid-1998, I was employed by SVBK Consulting Group where I held several
16 positions as a consultant focusing primarily on utility rate matters. Since 1998, I
17 have been employed by Cinergy Services and have held positions in Budgets and
18 Forecasts, Project Management, and, since 2003, as Director of Revenue
19 Requirements in Rates.

20 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

21 A. Yes. I have previously testified in several cases before this Commission.

William Don Wathen, Jr., Direct

1 Q. PLEASE SUMMARIZE YOUR DUTIES AS DIRECTOR OF REVENUE
2 REQUIREMENTS.

3 A. As Director of Revenue Requirements, I am responsible for the preparation of
4 financial and accounting data used in wholesale and retail rate filings for Duke
5 Energy Ohio (DE-Ohio) and Duke Energy Kentucky (DE-Kentucky), including
6 petitions for changes in fuel and gas cost adjustment factors, and various other
7 recovery mechanisms. My responsibilities include the preparation and filing of
8 the quarterly Fuel and Economy Purchased Power Rider ("Rider FPP") and the
9 quarterly System Reliability Tracker ("Rider SRT") for DE-Ohio, which are the
10 subjects of this testimony.

11 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

12 A. My testimony explains the mechanism for establishing and allocating market
13 prices for DE-Ohio's Rider FPP, which was approved by the Commission in its
14 Order in Case No. 03-93-EL-ATA approving the Company's Market-Based
15 Standard Service Offer ("MBSSO"). I discuss changes that have been made to
16 the Rider FPP filing as a result of the Commission's Order approving a
17 Stipulation that concluded last year's Audit of the Rider FPP. In light of the
18 changes, I also explain the attached schedules and support the reasonableness of
19 DE-Ohio's Rider FPP for quarterly periods from July 2005 through June 2006.

20 In the next section of my testimony, I explain the current mechanism for
21 establishing and allocating market prices for DE-Ohio's Rider SRT which was
22 also approved by the Commission in Case No. 03-93-EL-ATA. I also sponsor
23 Attachment WDW-1 and Attachment WDW-2.

1 Q. PLEASE DESCRIBE THE ATTACHMENTS TO YOUR TESTIMONY.

2 A. For ease of reference, I have included as Attachment WDW-1 complete copies of
3 the filings made by DE-Ohio to support the Rider FPP prices that were in effect
4 for the quarterly periods July 2005 through June 2006. These filings have been
5 made in the docket for Case No. 05-725-EL-UNC. Also, included as Attachment
6 WDW-2, is an estimate of the 2007 Rider SRT calculations.

7 II. OVERVIEW OF RIDER FPP CALCULATION

8 Q. PLEASE PROVIDE AN OVERVIEW OF THE CURRENT MECHANISM
9 FOR RIDER FPP.

10 A. Similar to the manner in which fuel and purchased power costs were recovered
11 prior to deregulation, Rider FPP is designed to recover the Company's actual
12 costs of fuel, purchased power, and certain environmental costs.

13 Rider FPP currently has four basic components: (1) fuel and economy
14 purchased power costs ("FC"); (2) SO₂ emission allowance costs ("EA"); (3) a
15 reconciliation adjustment ("RA"); and (4) a system loss adjustment ("SLA"). For
16 the quarterly filings made from July 2005 through March 2006, costs associated
17 with environmental reagents were also included in Rider FPP; however, pursuant
18 to the Stipulation and Order in Case No. 05-806-EL-UNC, environmental reagent
19 costs are now excluded from the Rider FPP calculation, but are recoverable in the
20 Annually Adjusted Component ("Rider AAC"). Revenues related to
21 environmental reagents collected since January 1, 2005, have been refunded to
22 consumers in subsequent quarterly filings of Rider FPP.

1 Beginning with the first quarterly filing for 2006, two other changes were
2 made to Rider FPP. First, the rate freeze ended for residential consumers;
3 therefore, Rider FPP is applied to all non-switched consumers beginning January
4 1, 2006. The second change in the calculation was to recognize the impact of
5 differences in system losses related to voltage differences among consumers.
6 This voltage differential calculation was part of the Stipulation approved by the
7 Commission in Case No. 03-93-EL-ATA. In general, a consumer taking service
8 at a lower voltage requires more kWh to be generated than a consumer taking
9 service at higher voltage.

10 **Q. PLEASE DESCRIBE THE FC COMPONENT OF RIDER FPP.**

11 A. The FC or Fuel and Economy Purchased Power Cost component is the
12 mechanism used to charge the costs of fuel and purchased power. The total
13 estimated includable fuel and purchased power costs for the upcoming quarter are
14 divided by the total projected includable energy, which results in a price on a
15 ¢/kWh basis. This price is compared to the fuel price currently embedded in the
16 unbundled generation component of the Company's MBSSO market price, which
17 is 1.2327 ¢/kWh. The difference between the current average price for fuel and
18 purchased power costs and the 1.2327 ¢/kWh is the FC component to be included
19 in the Rider FPP price.

20 **Q. HAVE THERE BEEN ANY SIGNIFICANT CHANGES TO THE**
21 **CALCULATION OF THE FC COMPONENT?**

1 A. We made one significant change that is already being reflected in the Rider FPP
2 and we are proposing to make another change beginning with the quarterly filing
3 for the first quarter of 2007.

4 **Q. DESCRIBE THE CHANGE THAT HAS ALREADY BEEN MADE TO**
5 **THE RIDER FPP?**

6 A. Beginning with the filing for the period April 1, 2006, through June 30, 2006, we
7 are including certain payments from the Midwest Independent System Operator,
8 Inc., ("MISO") as a credit against fuel costs. On our MISO bill, this credit is
9 called the revenue sufficiency guarantee ("RSG") make-whole payment.

10 **Q. WHAT IS THE NATURE OF THIS PAYMENT?**

11 A. *Based on pure economic dispatch principles, the Company often will not commit*
12 *a peaking unit to serve load since the cost of producing the energy is higher than*
13 *the price that can be obtained in the market. However, for reliability purposes or*
14 *for congestion relief, MISO may ask that we commit an uneconomic unit,*
15 *typically a peaker, to serve load. For this commitment, MISO ensures that we are*
16 *made "whole" for any costs incurred which are not recovered by the sale of the*
17 *resulting generation into the market. For example, MISO may instruct us to have*
18 *a unit available in the day-ahead market that costs us \$100 per MWh and cost*
19 *\$100,000 to start up the unit. The market price for that power may only be \$50*
20 *per MWh. On a pure economic basis, we would not dispatch the unit to incur a*
21 *loss. However, in the interest of reliability or congestion relief, MISO may ask*
22 *that we run this unit. To the extent we incur a loss due to above-market hourly*
23 *cost of running the unit or because the market prices did not produce enough*

1 revenue to cover the start-up costs, MISO provides us with the RSG make-whole
2 payment.

3 **Q. WHY NOT JUST CONTINUE TO PASS THIS CREDIT THROUGH THE**
4 **COMPANY'S RIDER TCR?**

5 A. The nexus between the RSG make-whole payments and fuel costs is such that it
6 makes more sense to include this credit in Rider FPP instead of the Transmission
7 Cost Recovery Rider ("Rider TCR"). The nexus I am referring to is that the fuel
8 costs associated with running the unit "out of merit" would flow through the
9 Rider FPP; therefore, we believe it is more logical to include the associated credit
10 for that "out of merit" dispatch in the same rider that the cost is flowing through.

11 **Q. WHAT ADDITIONAL CHANGE TO RIDER FPP ARE YOU**
12 **PROPOSING?**

13 A. Similar to the change we made for the RSG make-whole payment, there are two
14 other MISO charges that we believe are more appropriately included in Rider FPP
15 that have previously been recovered in Rider TCR. Specifically, we propose to
16 begin recovering charges for congestion and incremental losses in Rider FPP and
17 remove this item from Rider TCR.

18 **Q. WHAT IS THE RATIONALE FOR THIS PROPOSED CHANGE IN**
19 **RECOVERY FOR CONGESTION AND INCREMENTAL LOSSES?**

20 A. In Case No. 05-727-EL-UNC, I sponsored testimony describing the Rider TCR
21 and proposing a methodology for recovery of transmission-related costs,
22 including costs for MISO Day 2. I addressed this issue in my testimony in that
23 case explaining that congestion and losses are "arguably also appropriate for

1 recovery through the Rider FPP.” (Direct Testimony of William D. Wathen, Jr.,
2 filed June 3, 2005, in Case No. 05-727-EL-UNC, pg. 12.) Congestion is simply
3 another name for fuel cost. It is distinguished from what is typically considered
4 generation fuel cost only in that it is derived from running a unit “out of merit” to
5 relieve congestion.

6 Consider how these costs would have been handled in the past. A
7 transmission coordinator would have issued an order to redispatch our generation
8 for “transmission loading relief” if there was a congestion problem on the
9 transmission system. Substituting a higher cost resource for a lower cost resource
10 would have simply flowed through to consumers in the form of higher fuel cost.
11 This incremental cost would not have been identified as congestion cost, *per se*,
12 although that is precisely what it is. In the MISO Day 2 market congestion cost is
13 an explicit charge in that MISO includes congestion as a component of its
14 locational marginal price (“LMP”) as a direct incentive to mitigate congestion
15 across the system. Essentially, by establishing LMPs at different pricing nodes
16 that reflect congestion at that node, MISO allows pricing signals in the market to
17 manage congestion.

18 Similarly, the economic value of losses is exclusively a function of the
19 amount of extra generation required to compensate for the physical loss of power
20 from the generator to the load. Losses charged from MISO are incremental to the
21 Company.

22 **Q. WHEN DO YOU PROPOSE TO MAKE THIS CHANGE IN THE**
23 **TREATMENT OF CONGESTION AND LOSSES?**

1 A. We will begin to incorporate this change in the first quarter filing for 2007.
2 Ultimately, there is no difference to the Company or to the consumer in terms of
3 value since the consumer either pays both the TCR and FPP or, for a switching
4 customer, pays neither. We are making this change in part because, after much
5 consideration, it provides the proper symmetry in terms of the nature of costs and
6 method of recovery.

7 Q. WOULD YOU SUMMARIZE THE FC COMPONENT OF THE RIDER
8 FPP PRICES FOR THE LAST FOUR QUARTERLY FILINGS?

9 A. For the last four quarterly filings, the FC component of Rider FPP has been:

<i>Period</i>	<i>Fuel Component (¢/kWh)</i>
Q3 2005	0.6071
Q4 2005	0.5829
Q1 2006	0.9089
Q2 2006	1.1861

10 Q. WHAT ARE YOUR SOURCES FOR TOTAL INCLUDABLE ESTIMATED
11 FUEL AND PURCHASED POWER COSTS AND TOTAL PROJECTED
12 INCLUDABLE ENERGY?

13 A. DE-Ohio's witness Charles R. Whitlock is responsible for providing me with the
14 projections of includable fuel and purchased power costs and includable energy
15 prior to each quarter's submittal.

16 Q. DESCRIBE THE EA COMPONENT OF RIDER FPP.

17 A. The EA component recovers the allocable costs of SO₂ emission allowances.
18 Although the Company receives a number of zero-cost SO₂ emission allowance
19 credits from the Environmental Protection Agency ("EPA") each year in the form

1 of tons, it is not enough to cover our total SO₂ emissions. Consequently, it is
2 necessary to buy additional credits on the open market. The cost of these credits
3 goes into the calculation of the weighted-average inventory cost of all tons,
4 including the zero-cost EAs. Each month, the number of tons of emissions
5 allocable to the Rider FPP load is relieved from inventory at the weighted-average
6 inventory cost.

7 **Q. IS THERE ANYTHING ELSE NOTEWORTHY ABOUT THE EA**
8 **CALCULATION?**

9 **A.** In the Stipulation that was approved by the Commission in Case No. 05-806-EL-
10 UNC, the Company agreed to two changes in the way it calculates its EA
11 component. First, it agreed to allocate zero-cost EAs between two inventories,
12 one for native and one for non-native sales, based on projected emissions
13 allocable to each group. The Company further agreed to allocate an additional
14 16,421 tons of zero-cost EAs to each year's native-load inventory through 2008;
15 thus, reducing the average cost of EAs allocable to the Rider FPP load in each
16 year through 2008. The combination of these agreements fixed the number of
17 zero-cost allowances allocable to Rider FPP load for 2005 through 2008 are as
18 follows:

<i>Year</i>	<i>Tons</i>
2005	61,121
2006	89,894
2007	86,265
2008	79,009

1 Also, it should be noted that, for the duration of the RSP, emission
2 allowances for NO_x are excluded from the Rider FPP altogether. This is a
3 specific provision of the Stipulation approved by the Commission in Case No. 05-
4 806-EL-UNC settling last year's Audit.

5 **Q. WOULD YOU SUMMARIZE THE EA COMPONENT OF THE RIDER**
6 **FPP PRICES FOR THE LAST FOUR QUARTERLY FILINGS?**

7 **A. For the last four quarterly filings, the EA component of Rider FPP has been:**

<i>Period</i>	<i>EA Component (¢/kWh)</i>
Q3 2005	0.2403
Q4 2005	0.1977
Q1 2006	0.2257
Q2 2006	0.0990

8 As a reminder, part of the calculation of the MBSSO includes a deduction
9 of 0.0126 ¢/kWh attributable to EA costs from the last Electric Fuel Component
10 ("EFC") filing made by the Company in Case No. 98-103-EL-EFC. Therefore,
11 the EA component of the Rider FPP formula market price is "net of" the legacy
12 EA component included in the MBSSO market price.

13 **Q. DESCRIBE THE RA COMPONENT OF THE RIDER FPP.**

14 **A. The actual fuel and economy purchased power costs, the EA costs, and/or the**
15 **actual energy sales will vary from the projection. Differences between actual and**
16 **projected data for any of these items will normally result in a situation where the**
17 **Company bills either more or less to its consumers than it needs to cover the**
18 **actual costs attributable to them. The RA component of Rider FPP is the**
19 **methodology used to reconcile the difference between the actual costs incurred**

1 for the various components of Rider FPP (FC, EA, RA, and SLA) for the quarter
2 and the Rider FPP revenue that was billed to consumers for these same
3 components based on projections. The RA is also the mechanism the Company
4 has used to implement changes that resulted from the Audit.

5 The RA component of Rider FPP gives DE-Ohio a mechanism to ensure
6 that consumers taking service under Rider FPP are only charged the actual cost of
7 fuel and purchased power, and EAs, attributable to them. With the RA, it was
8 also possible to refund to the consumers the revenue billed for environmental
9 reagent costs which we agreed to eliminate as a result of the Stipulation reached
10 in last year's Audit.

11 **Q. HOW IS THE RA COMPONENT CALCULATED?**

12 A. The actual cost of fuel and economy purchased power, and EAs, attributable to
13 the Rider FPP component of the MBSSO market price is compared to the total
14 revenue billed for the same period under (i) the Rider FPP and (ii) the components
15 of the FC, EA, and SLA embedded in the MBSSO market price. The difference
16 between the actual costs for these items and the revenue billed during the period is
17 divided by the projected Rider FPP kWh sales for the upcoming quarter to
18 determine the RA component.

19 Since Rider FPP was not applicable to residential consumers in 2005, any
20 over- or under-recovery of costs for that period are exclusively related to non-
21 residential consumers.

22 Another change in Rider FPP that was introduced in the first quarter of
23 2006 was to recognize voltage differences between consumers. This mismatch in

1 the applicability of the Rider FPP among consumers requires that we calculate
2 three different reconciliation adjustments: one for non-residential consumers at
3 distribution voltage, one for non-residential consumers at transmission voltage,
4 and one for residential consumers.

5 For the first two quarterly filings of 2006, the RA adjustment for non-
6 residential consumers was the same regardless of voltage and, for residential
7 consumers, the RA was \$0 since we did not have complete actual data for the first
8 two quarterly filings in 2006 to reconcile.

9 **Q. IS THERE ANYTHING ELSE NOTEWORTHY ABOUT THE RA**
10 **COMPONENT?**

11 A. Yes. Every filing will contain revisions to previous reconciliation adjustments. A
12 number of factors contribute to this need for revisions. First, the calculation of
13 the Rider FPP has changed since it was first implemented in January 2005. Costs
14 we originally included, such as environmental reagents, are now excluded. To
15 reflect this change, we had to go back and revise the RA component for all
16 quarters that had previously included environmental reagents costs.

17 Another factor driving the need for revisions owes to the manner in which
18 the Company is billed from the MISO.

19 **Q. WHY DOES THE WAY MISO BILLS DE-OHIO RESULT IN REVISIONS**
20 **TO PRIOR RECONCILIATION ADJUSTMENTS?**

21 A. The timing for incorporating the reconciliation adjustment is to reflect any needed
22 changes in the first quarterly Rider FPP filing for which actual data is available.
23 Unfortunately, the MISO bills that would be included in that actual data are

1 subject to restatements. The Company commonly receives multiple restated bills
2 from MISO for the same period. In some cases, MISO can restate a charge as
3 much as one year after the fact. Consequently, costs that had been included in the
4 RA component calculation for one period may change again if the MISO provides
5 an updated bill after the quarterly Rider FPP was filed based on the then available
6 actual data for the same period.

7 **Q. DESCRIBE THE SLA COMPONENT OF RIDER FPP.**

8 A. The system loss adjustment, or SLA, is a required adjustment due to the manner
9 in which the FC is calculated. Specifically, because the energy sales used in the
10 calculation of the FC are the kilowatt-hours generated at the busbar, there must be
11 an accommodation for the fact that the sales actually metered and billed to
12 consumers will be different than the kilowatt-hour sales generated by DE-Ohio or
13 purchased for delivery into the DE-Ohio load zone due to physical losses over the
14 transmission and distribution lines.

15 The Company's MBSSO market price formula includes an amount to
16 recover a portion of these losses. Since the value of the losses is related to the
17 magnitude of the fuel cost recovery, the FC portion of the current Rider FPP, any
18 change in the FC means that the price for loss recovery must change as well. The
19 SLA provides a mechanism for ensuring that the appropriate charges for losses
20 are consistent with the then current FC portion. The SLA component is nothing
21 more than a way to translate the FC price at the busbar to an amount "at-the-
22 meter." price.

23 **Q. HOW IS THE SLA COMPONENT CALCULATED?**

1 A. The component for recovery for losses included in the Company's MBSSO
2 market price is 0.0999 ¢/kWh. For consumers taking service at transmission level
3 voltage, it is 0.0882 ¢/kWh. These figures are based on the legacy EFC price,
4 1.5353 ¢/kWh, and loss factors at the time of the Company's last traditional base
5 rate case, Case No. 92-1464-EL-AIR. The distribution and transmission loss
6 factor are 6.504% and 3.134%, respectively. To transform the "busbar" price to
7 the "at-the-meter" price, it is simply a matter of dividing the FC component by (1
8 – loss rate). The difference between the two prices is the total price that needs to
9 be recovered to compensate for losses. From this amount, we deduct the amount
10 already included in the MBSSO market price in order to determine the SLA
11 component.

12 Q. **WHY ARE THERE TWO SLA COMPONENTS OF RIDER FPP SHOWN**
13 **IN THE QUARTERLY FILINGS?**

14 A. As part of the RSP settlement, the Company agreed to calculate different Rider
15 FPP market prices in a manner that recognizes the difference in losses that
16 consumers experience if they take power at higher voltage. In order to implement
17 this provision, the Company established a process in Rider FPP to calculate the
18 SLA for consumers above and below transmission level voltage. The impact of
19 this change is essentially to give Rider FPP consumers taking service at
20 transmission level voltage a discount of around 3.6% of the FC price (equivalent
21 to the distribution losses).

22 Q. **WHAT WERE THE SLA COMPONENTS INCLUDED IN THE LAST**
23 **FOUR QUARTERLY RIDER FPP SUBMITTALS?**

1 A. For the last four quarterly filings, the SLA component of the Rider FPP has been:

<i>Period</i>	<i>Distribution Level (¢/kWh)</i>	<i>Transmission Level (¢/kWh)</i>
Q3 2005	0.0198	0.0198
Q4 2005	0.0182	0.0182
Q1 2006	0.0461	0.0236
Q2 2006	0.0672	0.0344

2 Q. ARE THE SCHEDULES SHOWN IN ATTACHMENT WDW-1 THE FPP
3 FILINGS THAT DE-OHIO MADE WITH THE COMMISSION FOR THE
4 PERIOD JULY 1, 2005, THROUGH JUNE 30, 2006?

5 A. Yes. These are the filings we made that were applicable for that period.

6 **III. OVERVIEW OF SRT CALCULATION**

7 Q. PLEASE PROVIDE AN OVERVIEW OF THE CURRENT MECHANISM
8 FOR THE RIDER SRT MARKET PRICE, COST ALLOCATION, AND
9 RATE & PRICE DESIGN.

10 A. For 2006, DE-Ohio's Rider SRT price was based on (1) estimates of the total
11 dollars it expected to spend on capacity products available in the power markets
12 in 2006 with the objective of maintaining at least a 15% reserve margin and (2)
13 the amount of over-recovered 2005 Rider SRT costs to be refunded to non-
14 residential consumers. Mr. Whitlock describes the capacity products DE-Ohio
15 has purchased in 2006 to meet its reliability requirements.

16 Using the projected cost of capacity purchases, DE-Ohio allocated the
17 costs between residential and non-residential consumer classes subject to Rider
18 SRT. The total cost allocated to non-residential consumer classes was reduced by
19 the amount of over-recovered Rider SRT costs for 2005. The allocated cost of the

1 "reliability" purchases, net of the 2005 over-recovery for non-residential
2 consumers, was divided by the projected number of kWhs, and in some cases
3 kWhs, for all of 2006 in each of those classes. The result is a price, in ¢/kWh or
4 ¢/kW, which is applied to each DE-Ohio consumer class subject to the Rider SRT
5 in 2006.

6 **Q. HOW OFTEN ARE RIDER SRT FILINGS MADE?**

7 A. Beginning in 2006, the Company, with Commission approval in Case No. 05-724-
8 EL-UNC, began making quarterly filings for Rider SRT. The benefit of using
9 quarterly filings has been evident this year. Consider that the initial Rider SRT
10 price was based on a much higher estimate of capacity purchase costs than has
11 been experienced. By filing quarterly, instead of annually, consumers and the
12 Company are less likely to be in a position of being excessively and persistently
13 over- or under-recovered for Rider SRT. Although purchases under Rider SRT
14 have been much lower in 2006 than initially estimated at the end of 2005, we will
15 be in a position by the end of the year of being only minimally over- or under-
16 recovered. If we were still under the annual filing, we would have been
17 significantly over-recovered and it would take a much longer period of time to
18 remedy the situation. Quarterly filings help mitigate this problem.

19 **Q. HOW ARE RIDER SRT COSTS ALLOCATED BETWEEN**
20 **RESIDENTIAL AND NON-RESIDENTIAL CONSUMER CLASSES?**

21 A. In the Stipulation approved by the Commission in Case No. 05-724-EL-UNC, it
22 was agreed that 42.382% of the 2006 Rider SRT costs are allocated to residential
23 consumers. The remaining costs are allocated among the various non-residential

1 consumers based on their load ratio share using the average of 12 coincident
2 monthly peaks.

3 **Q. ARE ALL CONSUMERS CHARGED THE RIDER SRT?**

4 A. Pursuant to the Stipulation Agreement reached in the 2005 SRT proceeding, Case
5 No. 05-724-EL-UNC, the Rider SRT price is applicable to all consumers except
6 those non-residential consumers who "have or will sign a contract with [DE-
7 Ohio] or provide a CRES contract to [DE-Ohio], or provide a release in the form
8 approved by the Commission in Case No. 03-93-EL-ATA, indicating that the
9 customer will remain off of MBSSO service through December 31, 2008." The
10 Rider SRT is therefore bypassable to these non-residential customers subject to
11 meeting these conditions.

12 **Q. DOES DE-OHIO PROFIT FROM RELIABILITY PURCHASES MADE**
13 **UNDER THE RIDER SRT?**

14 A. No. Because Rider SRT has a true-up mechanism, it only collects from its
15 consumers the actual cost of making reliability purchases used to serve its system
16 load, net of the proceeds of the resale of any unused Rider SRT reliability
17 purchases.

18 **Q. IS THE COST OF ENERGY PURCHASED THROUGH THESE**
19 **RELIABILITY PURCHASES RECOVERED THROUGH THE RIDER**
20 **SRT?**

21 A. No. To the extent energy is a separately identifiable component of the purchase,
22 the cost of energy purchased is recovered through DE-Ohio's Fuel and Rider FPP.

1 **Q. PLEASE EXPLAIN THE CURRENT PROCESS FOR TRUING UP COSTS**
2 **WITH REVENUE.**

3 A. Rider SRT is trued-up quarterly based on actual results and revised estimates of
4 planned reliability purchases for the balance of the calendar year. At the time of
5 the initial filing for 2006 Rider SRT prices, we had only estimates of the expected
6 purchases required for 2006 reliability requirements. With each quarterly update,
7 our estimate improved either because we have a better estimate of the projected
8 costs of the required system reliability purchases for the remainder of the year or
9 we have incurred actual costs for reliability purchases.

10 The Company compares the updated projected cost, net of any remaining
11 true-up amounts due to non-residential consumers from 2005 for the remainder of
12 the year, with the actual revenue collected up to that date. The amount of dollars
13 left to be collected (*i.e.*, the total estimated amount for the year minus the amount
14 collected up to that date) will be collected over the remainder of the year using
15 similar allocations and billing determinants.

16 **Q. EXPLAIN WHY YOU "NET" REMAINING TRUE-UPS DUE TO NON-**
17 **RESIDENTIAL CONSUMERS FROM 2005?**

18 A. The Rider SRT produced a significant over-recovery for 2005. Following the
19 methodology used for all of the SRT prices, we allocate the over-recovery (or
20 under-recovery if that occurs) over the remainder of the year. Since only non-
21 residential consumers were eligible for the Rider SRT in 2005, any over- or
22 under-recovery for that year is exclusively attributable to this group of consumers.
23 In each quarterly update to the Rider SRT in 2006, we applied the remaining

1 balance of over-recovery from 2005 to the non-residential share of 2006 Rider
2 SRT costs. By netting the over-recovery from last year, we will have returned all
3 of the over-recovery from 2005 to non-residential consumers by the end of 2006.

4 **Q HOW, AND WHEN, WILL THE FINAL ANNUAL TRUE-UP BE MADE?**

5 A. As we did for true-ups related to the 2005 Rider SRT, after year end, actual costs
6 and collections for Rider SRT for that year will be known. The actual costs are
7 allocated to the consumer classes and subtracted from actual collections for each
8 class. The over- or under-collection will be included in the Rider SRT filing for
9 the second quarter of the following calendar year. This will allow DE-Ohio to
10 recover any under-collection or consumers to receive any over-collection during
11 the remaining months of the next year.

12 **IV. ESTIMATED RIDER 2007 SRT**

13 **Q. PLEASE EXPLAIN THE ATTACHED SCHEDULES RELATED TO**
14 **RECOVERY OF COSTS FOR THE YEAR 2007.**

15 A. The first page of Attachment WDW-2 summarizes the current factors used to
16 allocate the costs of system reliability purchases among the consumer classes and,
17 using projected billing determinant data, calculates the prices for the 2007 Rider
18 SRT. It is similar to the summary schedule filed in the initial case setting the
19 Rider SRT price for 2006 in Case No. 05-724-EL-UNC.

20 Some non-residential classes have prices that are either blocked (*i.e.*,
21 prices are different at different levels of usage) or separated into demand and
22 energy prices. In order to implement Rider SRT prices fairly and consistently
23 across classes and among consumers in a given class, the next three pages are

1 used to allocate the Rider SRT revenue requirement in a manner which follows
2 the way each consumer class is billed. Essentially, the revenue requirement is
3 allocated to each block on the basis of the MBSSO revenue generated from each
4 block. In my opinion, this is a reasonable approach.

5 The cost data associated with the Rider SRT capacity purchases comes
6 from schedules which will be discussed by DE-Ohio's witness Charles R.
7 Whitlock.

8 **Q. ARE THE PRICES SHOWN IN ATTACHMENT WDW-2 THE PRICES**
9 **THAT DE-OHIO PROPOSES BE SET FOR 2007?**

10 **A.** No. Attachments WDW-2 sets forth the Company's best estimate of the Rider
11 SRT prices for 2007 at this time. DE-Ohio will update these schedules and set its
12 estimate for the 2007 Rider SRT rate. Although the Company has already made
13 some purchases for 2007, more purchases are required for the Company to meet
14 its reliability requirement as discussed by Mr. Whitlock. Consequently, the
15 Company believes that it is still too early to set these prices for 2007. DE-Ohio
16 will update and set its estimate for 2007 when it makes its quarterly Rider SRT
17 Application for 2007, no later than December 1, 2006.

18 **V. CONCLUSION**

19 **Q. DO YOU HAVE ANY FINAL COMMENTS REGARDING THE RIDER**
20 **FPP BEING ADDRESSED IN THIS FILING?**

21 **A.** I believe that DE-Ohio is calculating and applying the Rider FPP appropriately.
22 We use reasonable methods for developing the Rider FPP prices and have

1 mechanisms in place to ensure that consumers paying the Rider FPP are charged
2 only for the Company's actual costs.

3 Q. WERE ATTACHMENTS WDW-1 AND WDW-2 PREPARED BY YOU OR
4 UNDER YOUR SUPERVISION?

5 A. Yes.

6 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

7 A. Yes.

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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application)
of Duke Energy Ohio, Inc,)
to Adjust and Set the Annually)
Adjusted Component of its Market)
Based Standard Service Offer)

Case No. 06-1085-EL-UNC

DIRECT TESTIMONY OF

WILLIAM DON WATHEN, JR.

ON BEHALF OF

DUKE ENERGY OHIO, INC.

SEPTEMBER 1, 2006

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Overview of AAC	2
Calculation of 2007 Rider AAC	4
Conclusion	13

ATTACHMENTS:

- WDW-1 Attachment JPS-4 from the direct testimony of John P. Steffen in Case No. 03-93-EL-ATA
- WDW-2 Summary of Rider AAC Revenue Requirement
- WDW-3 Revised Rider AAC Tariff
- WDW-4 Calculation of Updated Rider AAC Rates

I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is William Don Wathen, Jr. My business address is 139 East Fourth
3 Street, Cincinnati, Ohio 45202.

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

5 A. I am employed by Duke Energy Corporation ("Duke Energy") as Director of
6 Revenue Requirements.

7 **Q. PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL**
8 **QUALIFICATIONS.**

9 A. I received Bachelor Degrees in Business and Chemical Engineering in 1985 and
10 1986, respectively, and a Master of Business Administration Degree in 1988, all
11 from the University of Kentucky. After completing graduate studies, I was
12 employed by Kentucky Utilities Company as a planning analyst. In 1989, I began
13 employment with the Indiana Utility Regulatory Commission as a senior
14 engineer. From 1992 until mid-1998, I was employed by SVBK Consulting
15 Group where I held several positions as a consultant focusing primarily on utility
16 rate matters. Since 1998, I have been employed by Cinergy Services and have
17 held positions in Budgets and Forecasts, Project Management, and, since 2003, as
18 Director of Revenue Requirements in Rates.

19 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

20 A. Yes. I have previously testified in several cases before this Commission.

21 **Q. PLEASE SUMMARIZE YOUR DUTIES AS DIRECTOR OF REVENUE**
22 **REQUIREMENTS.**

1 A. As Director of Revenue Requirements, I am responsible for the preparation of
2 financial and accounting data used in the wholesale and retail rate filings for Duke
3 Energy Ohio and Duke Energy Kentucky, petitions for changes in fuel and gas
4 cost adjustment factors, and various other rate recovery mechanisms in Ohio and
5 Kentucky.

6 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

7 A. First, I will explain the origin of the Annually Adjusted Component ("Rider
8 AAC") of the Company's Market Based Standard Service Offer ("MBSSO").
9 Next, I will describe how Rider AAC was calculated and applied in the first two
10 years of the Rate Stabilization Plan. Then, I will discuss the components that are
11 included in the calculation of the proposed Rider AAC for 2007. Finally, I will
12 step through the process of developing the revised Rider AAC rates.

13 **II. OVERVIEW OF THE AAC**

14 Q. **WHAT IS THE ORIGIN OF THE ANNUALLY ADJUSTED**
15 **COMPONENT?**

16 A. As a result of Company's approved MBSSO, in Case No. 03-93-EL-ATA, Duke
17 Energy Ohio was authorized to establish a charge that recovers certain costs
18 associated with environmental compliance, changes in taxes, and costs for
19 homeland security.

20 Q. **WHEN DID DUKE ENERGY OHIO IMPLEMENT RIDER AAC?**

21 A. Rider AAC became effective for non-residential customers beginning in 2005 and
22 for residential customers beginning in 2006.

23 Q. **HOW WERE THE RIDER AAC RATES INITIALLY SET?**

1 A. Per the Commission's Entry on Rehearing in Case No. 03-93-EL-ATA Rider
2 AAC for non-residential consumers was set at an agreed upon market price of 4%
3 of "little g" for 2005 and 8% of "little g" for 2006. For residential consumers,
4 Rider AAC was not applicable in 2005, since these consumers continued to be in
5 the Market Development Period. After the market development period effective
6 January 1, 2006, residential consumers' Rider AAC rate was set at the market
7 price of 6% of "little g."

8 Q. WHAT IS "LITTLE G"?

9 A. Since Case No. 99-1658-EL-ETP, the term "little g" has represented the result of
10 removing the "regulatory transition charge" ("RTC") from the Company's
11 unbundled generation rate (the unbundled generation rate is sometimes referred to
12 as "Big G"). Currently, little g is simply a component of the MBSSO; however,
13 the market prices for little g applicable to each rate class have not changed since
14 the end of the Market Development Period. The concept of little g was carried
15 forward in the MBSSO as a means to simplify the calculation of certain charges
16 approved by the Commission for Duke Energy Ohio.

17 Q. CAN THE RIDER AAC RATES BE REVISED FOR 2007 AND 2008?

18 A. Yes. However, as prescribed in the Entry on Rehearing in Case No. 03-93-EL-
19 ATA, any change in Rider AAC must be approved by the Commission.

20 Q. IS THE COMPANY REQUESTING AN INCREASE IN RIDER AAC FOR
21 2007?

1 A. Yes. The costs eligible for recovery in Rider AAC have increased to the point
2 that the current Rider AAC market price is insufficient to fully recover these
3 costs.

4 **III. CALCULATION OF 2007 RIDER AAC**

5 **Q. PLEASE PROVIDE A GENERAL OVERVIEW FOR THE**
6 **CALCULATION OF RIDER AAC FOR 2007.**

7 A. There are essentially three components of Rider AAC. The first component is
8 environmental costs. This includes the incremental costs associated with earning
9 a return on and a return of environmental compliance equipment capital
10 investment, operation and maintenance expenses, and environmental reagent
11 costs. The second component of Rider AAC includes changes in tax rates due to
12 changes in tax laws. Finally, Rider AAC includes incremental costs for
13 Homeland Security, including a return on and a return of capital, and expenses.

14 **Q. EXPLAIN HOW "INCREMENTAL ENVIRONMENTAL COSTS" ARE**
15 **DETERMINED.**

16 A. I have included, as Attachment WDW-1, a copy of Attachment JPS-4 from the
17 direct testimony of John P. Steffen in Case No. 03-93-EL-ATA. This schedule
18 was included as page 4 of Stipulation Exhibit 1 in the Stipulation and
19 Recommendation filed by the Company in that case on May 19, 2004. Although
20 the Stipulation and Recommendation was not approved as filed, the Commission
21 adopted substantial portions of it in its Energy on Rehearing in Case No. 03-93-
22 EL-ATA, including the environmental compliance component of Rider AAC.
23 The Rider AAC revenue requirement for environmental would be calculated in a

1 manner similar to the methodology outlined in Attachment WDW-1. In this case,
2 environmental compliance costs incremental to the year 2000 are determined by
3 (1) determining the incremental environmental compliance net plant, including
4 construction work in progress ("CWIP") at May 31, 2006, and multiplying by the
5 pre-tax rate of return approved in the Company's most recent electric distribution
6 rate case, Case No. 05-059-EL-AJR, (2) calculating the incremental annualized
7 depreciation expense, and (3) calculating the incremental operation and
8 maintenance ("O&M") expenses for environmental equipment including reagent
9 costs.

10 Depreciation expense is annualized on the Plant In-Service at May 31,
11 2006. O&M expenses are based on the twelve-month period ending May 31,
12 2006. Environmental reagent costs are projected for 2007.

13 **Q. ATTACHMENT WDW-1 SUGGESTS THAT THE PERIOD FOR**
14 **DETERMINING THE RIDER AAC REVENUE REQUIREMENT WOULD**
15 **BE THE TWELVE MONTHS ENDING JUNE 30. WHY DID YOU USE**
16 **MAY 31 INSTEAD?**

17 **A.** In its Entry on Rehearing in Case No. 03-93-EL-ATA, the Commission required
18 the Company to make this filing by September 1 in order to give the Commission
19 sufficient time to review and make a determination on this filing, such that the
20 new rates can be placed in effect for 2007. Using May 31 as the end date of the
21 period for actual data in Rider AAC allowed the Company sufficient time to
22 collect the necessary information, analyze it, and prepare this filing by September
23 1.

1 **Q. WHY ARE ENVIRONMENTAL REAGENT COSTS BASED ON**
2 **PROJECTED RATHER THAN HISTORICAL DATA?**

3 A. The nature of environmental reagent costs is such that the Company believes it is
4 more appropriate to include these costs in its fuel and purchased power tracker
5 ("Rider FPP"). However, as a result of the 2005 Rider FPP Audit and, per the
6 Stipulation and Order in Case No. 05-806-EL-UNC, the Company nevertheless
7 agreed to stop including the environmental reagent costs in the Rider FPP
8 calculation and, instead, include these costs in Rider AAC. The Order in that case
9 specifically requires the Company to include "projected year 2007 environmental
10 reagent costs in the Application that [Duke Energy Ohio] may file to set the 2007
11 Rider AAC rate." Projected environmental reagent costs will be trued-up for
12 actual costs as discussed later in my testimony.

13 The use of the historical year for O&M costs, other than the environmental
14 reagent cost, is also consistent with the methodology proposed in the Stipulation
15 and approved in the Entry on Rehearing in Case No. 03-93-EL-ATA.
16 Annualization of depreciation expense is a typical component of the
17 Commission's traditional revenue requirement calculation.

18 **Q. ARE EMISSION ALLOWANCE COSTS INCLUDED IN RIDER AAC?**

19 A. No. Costs for SO₂ emission allowances are included in Rider FPP and costs for
20 NO_x emission allowances are currently not recoverable.

21 **Q. DESCRIBE THE TAX COMPONENT OF RIDER AAC.**

22 A. The intent of including "changes in taxes" as part of Rider AAC was to ensure
23 that neither the Company nor consumers are harmed by changes in tax laws since

1 the year 2000. In the instant case, there are two tax law changes that impact the
2 Rider AAC calculation. First, is the recently passed change in federal tax law
3 allowing a deduction for certain domestic production activities. The new section
4 added to the Internal Revenue Code ("IRC"), Section 199, allows a permanent tax
5 deduction for "Qualified Domestic Production." The generation of electricity is
6 specifically identified as an eligible activity qualifying for this deduction.
7 Consequently, Rider AAC reflects the estimated net benefit to Duke Energy
8 Ohio's consumers of the impact of this tax law change.

9 Second, the State of Ohio also implemented certain legislative tax law
10 changes. The Ohio Franchise Tax is being phased-out over a five year period. At
11 the same time, the Commercial Activity Tax is being phased-in. The impact of
12 these changes on the Company's retail generation operations for the twelve
13 months ended May 31, 2006, is included in the Rider AAC calculation. These tax
14 items decrease the amount requested by the Company in this proceeding.

15 **Q. DESCRIBE THE HOMELAND SECURITY COST COMPONENT OF**
16 **RIDER AAC.**

17 **A.** Much has been made of increasing Homeland Security in the last five years.
18 Protecting the infrastructure in the United States has been deemed of great
19 importance as evidenced by the President's policy on protecting the nation's
20 "critical infrastructure." The Entry on Rehearing in Case No. 03-93-EL-ATA
21 specifically allows the Company to include the incremental costs associated with
22 Homeland Security in Rider AAC. In the current case, we have included costs
23 based on the twelve-month period ending May 31, 2006. Since there were no

1 "Homeland Security" costs in the year 2000, all of the costs and revenues
2 calculated for this component are incremental.

3 **Q. HOW HAVE YOU CALCULATED THE RIDER AAC MARKET PRICE?**

4 A. Attachment WDW-2 provides all the schedules I have used to calculate the Rider
5 AAC market price. In summary, the schedules in Attachment WDW-2 are:

<i>Schedule 1</i>	<i>Summary of Rider AAC Market Price</i>
<i>Schedule 2</i>	<i>Revenue Requirement on Environmental Compliance</i>
<i>Schedule 3</i>	<i>Revenue Requirement on Homeland Security</i>
<i>Schedule 4</i>	<i>Tax Changes</i>

6 **Q. HOW WAS THE BASE YEAR ENVIRONMENTAL COMPLIANCE**
7 **MARKET PRICE DETERMINED?**

8 A. The base year is the calendar year 2000 with December 31, 2000, the "date
9 certain" for plant. The information for the base year market price was captured
10 during the litigation of Case No. 03-93-EL-ATA and was audited by the
11 Commission's Staff at that time. The environmental compliance original cost and
12 reserve for depreciation is from the Company's fixed asset records. The
13 annualized depreciation was calculated on this plant balance. The O&M expenses
14 and environmental reagent costs are the actual expenses per the books and records
15 of the Company.

16 **Q. HOW WAS THE CURRENT YEAR ENVIRONMENTAL NET PLANT,**
17 **SHOWN ON ATTACHMENT WDW-2, SCHEDULE 2, DETERMINED?**

18 A. The current year net environmental plant was calculated as of May 31, 2006, from
19 the Company's fixed asset records. The CWIP balance as of that date was
20 determined from the Company's construction tracking system.

1 Q. HOW WERE THE CURRENT YEAR ENVIRONMENTAL O&M
2 EXPENSES DETERMINED?

3 A. These expenses are also from the Company's accounting records and are the
4 actual expenses for the twelve months ended May 31, 2006.

5 Q. HOW WERE THE PROJECTED YEAR 2007 ENVIRONMENTAL
6 REAGENT EXPENSES DETERMINED?

7 A. These expenses are the current budget estimates for the year 2007, as determined
8 by the business managers at each of the Company operated generating stations. In
9 addition, the Company's share of projected environmental reagent costs at jointly
10 owned units operated by its partners was obtained from those companies.

11 Q. HOW DID YOU INCORPORATE THE TAX LAW CHANGES INTO THE
12 RIDER AAC MARKET PRICE CALCULATION, AS SHOWN ON
13 ATTACHMENT WDW-2, SCHEDULE 4?

14 A. The first tax law change included in the calculation is the Qualified Domestic
15 Production deduction (IRC Section 199 deduction). This impact is based on the
16 Company's IRC Section 199 deduction for the tax year 2005. The effective Ohio
17 Franchise Tax rate for the year 2006 was calculated recognizing that the tax is
18 deductible in its own calculation. Then the effective federal income tax rate was
19 determined after the reduction for the effective state tax rate. The combined
20 effective federal and state tax rate was multiplied by the IRC Section 199
21 deduction amount to arrive at the tax benefit for the period.

22 The other relevant tax law change involves Ohio legislation which
23 provides for the phase-out of the Ohio Franchise Tax over five years while

1 phasing-in the Commercial Activity Tax. The Company's retail generation
2 revenue and pre-tax income were used to determine the total tax under the prior
3 law and with the law in effect for the year 2006. The decrease in the total tax is
4 included in the Rider AAC calculation.

5 **Q. HOW WERE HOMELAND SECURITY COSTS INCLUDED?**

6 A. Three types of projects were required for the Company to comply with Homeland
7 Security regulation - physical security, cyber security, and Information
8 Technology security. The Company incurred capital costs and O&M costs in
9 each area to meet its compliance requirement. The pre-tax return from Case No.
10 05-059-EL-AIR was used to determine the return on the Net Plant as of May 31,
11 2006. To this return, annualized depreciation and property taxes were added, as
12 well as the actual O&M for the twelve months ended May 31, 2006, to calculate
13 the revenue requirement. As I mentioned earlier, all Homeland Security costs are
14 incremental to the year 2000.

15 **Q. WHAT IS THE COMBINED MARKET PRICE FOR RIDER AAC?**

16 A. As shown on Schedule 1 of Attachment WDW-2, the total of the Rider AAC
17 market price, including all of the components detailed above, is \$73,818,962.

18 **Q. IS THERE A TRUE-UP PROVISION FOR RIDER AAC?**

19 A. To the extent that actual 2007 costs for environmental reagents are higher or
20 lower than projected, there will be a true-up provision in subsequent filings for
21 this component of Rider AAC. The true-up will occur as a separate filing to
22 adjust the 2008 Rider AAC rate as soon as actual data for 2007 is available. This
23 true-up provision for environmental reagents is a specific provision of the Order

1 in Case No. 05-806-EL-UNC allowing projected environmental reagent costs in
2 Rider AAC. Because all other components of Rider AAC are based on actual
3 data, there will be no true-up of other Rider AAC components.

4 **Q. BASED ON THIS RIDER AAC MARKET PRICE, IS THERE**
5 **JUSTIFICATION TO CHANGE THE RIDER AAC MARKET PRICE?**

6 A. Yes. The calculated market price is greater than the Rider AAC market price in
7 effect. When measured as a percent of little g, the newly computed Rider AAC
8 market price would be a greater percent of little g than the market price currently
9 in effect for all rate classes.

10 **Q. HOW DID YOU DETERMINE THE PERCENT OF LITTLE G FROM**
11 **THE MARKET PRICE CALCULATED ABOVE?**

12 A. The first step was to express the calculated 2007 market price for Rider AAC as a
13 percent of little g revenue. To do this, I divided the total Rider AAC market price
14 shown on Schedule 1 of Attachment WDW-2 by total little g revenue, on a non-
15 switched basis (*i.e.*, as if no one switched), for the twelve month period ended
16 May 31, 2006. The resulting percentage is measured against the current Rider
17 AAC market price, also expressed as a percent of little g, specifically, 8% for
18 non-residential consumers and 6% for residential consumers. Since the resulting
19 percentage is greater than the current percentage for both residential and non-
20 residential consumers, an increase to the Rider AAC rate from current levels is
21 warranted. The new rate for all consumers is thus proposed to be 9.1% of little g.

22 **Q. YOU MENTIONED THAT, IN CALCULATING THE NEW RIDER AAC**
23 **MARKAET PRICE, YOU DIVIDE CURRENT AAC REVENUE**

1 **REQUIREMENTS BY LITTLE G REVENUE ON A "NON-SWITCHED"**
2 **BASIS. EXPLAIN WHAT YOU MEAN BY THAT.**

3 A. Since switching customers can bypass Rider AAC, subject to the limits
4 established in Case No. 03-93-EL-ATA (*i.e.*, the first 25% of residential load and
5 the first 50% of non-residential load), we must allocate the Rider AAC revenue
6 requirement to all customers as if no one switched. If the market price was
7 divided by the little g revenue from only those who did not switch, these non-
8 switched consumers would be essentially "picking up the tab" for the switching
9 customers. In other words, if the total Rider AAC market price was divided by
10 only the little g revenue from non-switched consumers, the resulting Rider AAC
11 rate would be increasingly higher as the number of switching customers increases.
12 Therefore, we must impute little g revenue from switching customers who avoid
13 Rider AAC and add this number to the "per books" little g revenue for non-
14 switched consumers.

15 **Q. DID YOU MAKE ANY ATTEMPT TO ALLOCATE THE RIDER AAC**
16 **REVENUE REQUIREMENT AMONG CONSUMER CLASSES?**

17 A. No. In setting the existing Rider AAC market price on the basis of a percent of
18 little g, the Commission did not distinguish among the various non-residential
19 consumer classes. Although the residential consumers were billed at a lower
20 2006 market price than non-residential consumers, this was done to mitigate the
21 first year impact on residential consumers in lieu of moving them to the full 2006
22 market price being paid by non-residential consumers. Since the new market
23 price is above the existing 8% of little g for non-residential consumers, there is no

1 reason to allow the different market price for residential and non-residential
2 consumers to persist. Therefore, Duke Energy Ohio proposes that the new Rider
3 AAC market price calculated in Attachment WDW-2, Schedule 1, be applied to
4 all consumers at an equivalent percent of little g.

5 In Attachment WDW-3, I provide an updated version of the Rider AAC
6 schedule. In Attachment WDW-4, I illustrate how the new market prices were
7 calculated essentially using the ratio of the new market price (9.1% of little g) and
8 old market price (6% or 8% of little g) to scale up the existing Rider AAC rates to
9 the proposed market price.

10 **Q. CAN CONSUMERS CONTINUE TO AVOID PAYING RIDER AAC?**

11 **A.** Yes. There is no change in this aspect of Rider AAC. The first 50% of non-
12 residential consumer load and the first 25% of residential consumer load can
13 continue to avoid Rider AAC by switching to an alternative supplier.

14 **IV. CONCLUSION**

15 **Q. DO YOU HAVE ANY FINAL COMMENTS REGARDING RIDER AAC**
16 **BEING ADDRESSED IN THIS FILING?**

17 **A.** I believe that the calculation of the Rider AAC rate is calculated fairly and
18 appropriately. The methodology follows the guidelines established in the Entry
19 on Rehearing in Case No. 03-93-EL-AIR and other relevant orders.

20 **Q. WERE ATTACHMENTS WDW-1, WDW-2, WDW-3 AND WDW-4**
21 **PREPARED BY YOU OR UNDER YOUR SUPERVISION?**

22 **A.** Yes.

23 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

WILLIAM DON WATHEN, JR., DIRECT

1 A. Yes.

2

WILLIAM DON WATHEN, JR., DIRECT

THE CINCINNATI GAS & ELECTRIC COMPANY
POLR Charge Calculation
Calculation of Revenue Requirement on Environmental Compliance Cost Increase
In Excess of Year 2000

**Amount to Be
Recovered**

<u>Return on Environmental Plant</u>	<u>As of 12/31/2000</u>	<u>Activity</u>	<u>As of 6/30/2004</u>	
Original Cost	\$ 459,948,529		\$ 459,948,529	
2001 Additions (East Bend)		\$ 48,726	48,726	
2002 Additions (MF 8)		31,861,127	31,861,127	
2003 Additions (MF 7)		35,672,604	35,672,604	
2004 Additions (thru June) (EB, Stuart, Zimmer)		87,478,558	87,478,558	
	<u>\$ 459,948,529</u>	<u>\$ 155,081,015</u>	<u>\$ 615,009,544</u>	
Reserve for Depreciation				
2001 Additions	\$ (190,580,960)	\$ (32,135,633)	\$ (222,716,593)	
2002 Additions		(4,415)	(4,415)	
2003 Additions		(1,841,573)	(1,841,573)	
2004 Additions (thru June)		(1,030,938)	(1,030,938)	
	<u>\$ (190,580,960)</u>	<u>\$ (35,012,559)</u>	<u>\$ (225,583,519)</u>	
Net Book Value	\$ 269,367,569	\$ 120,048,458	\$ 389,416,025	
Construction Work in Progress at 12/31/2003				
2004 Additions (thru June)		140,737,941	140,737,941	
		35,184,187	35,184,187	
	<u>\$ 269,367,569</u>	<u>\$ 295,970,584</u>	<u>\$ 565,338,153</u>	
Pre-tax Return at 14.22%	\$ 38,304,068		\$ 80,391,085	
<u>Environmental O&M Expenses</u>				
Operation & Maintenance				
Year 2000	4,898,585		1,305,839	
July through December, 2003			1,088,058	
January through June, 2004				
Annualized Depreciation	9,198,971		12,300,191	
Kentucky Property Tax (East Bend Additions)			63,620	
	<u>\$ 52,401,624</u>		<u>\$ 95,149,793</u>	
Total Revenue Requirement			<u>\$ 42,748,169</u>	

DUKE ENERGY OHIO
Summary of Rider AAC Revenue Requirement
For Recovery in 2007

Revenue Requirement From:	<u>Amount</u>
Environmental Compliance	\$79,001,379
Homeland Security	132,732
Tax Changes	<u>(5,315,149)</u>
Total Revenue Requirement	<u><u>\$73,818,962</u></u>

Duke Energy Ohio
139 East Fourth Street
Cincinnati, Ohio 45202

P.U.C.O. Electric No. 19
Sheet No. 51.3
Cancels and Superseded
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RIDER AAC

ANNUALLY ADJUSTED COMPONENT RIDER

APPLICABILITY

Applicable to all jurisdictional retail customers in the Company's electric service area.

CHARGE

The Annually Adjusted Component Rider Charges detailed below are applicable after the end of the Market Development Period, except that they will not apply to those customers that receive a shopping credit or are eligible to avoid the Annually Adjusted Component charge as described below in the AVOIDANCE OF CHARGE section. All applicable kW and kWh are subject to the Annually Adjusted Component Rider Charge. See Section VI, Item 7 of the Electric Service Regulations for the definition of the term "Market Development Period."

The following rates are effective for non-residential customers (including residential service of a commercial or public character) from January 1, 2007 through December 31, 2007.

<u>Tariff Sheet</u>	<u>AAC Charge</u> (per kWh/kW)
Rate DS, Service at Secondary Distribution Voltage	
First 1000 kW	\$0.696800
Additional kW	\$0.551200
Billing Demand Times 300	\$0.001781
Additional kWh	\$0.001480
Rate GS-FL, Optional Unmetered For Small Fixed Loads	
kWh Greater Than or Equal to 540 Hours	\$0.005918
kWh Less Than 540 Hours	\$0.006803
Rate CUR, Common Use Residential Service	
Summer, First 1000 kWh	\$0.004020
Summer, Additional kWh	\$0.005094
Winter, First 1000 kWh	\$0.004020
Winter, Additional kWh	\$0.001517
Rate EH, Optional Rate For Electric Space Heating	
All kWh	\$0.002429
Rate DM, Secondary Distribution Service, Small	
Summer, First 2800 kWh	\$0.005329
Summer, Next 3200 kWh	\$0.001360
Summer, Additional kWh	\$0.000594
Winter, First 2800 kWh	\$0.004229
Winter, Next 3200 kWh	\$0.001363
Winter, Additional kWh	\$0.000563

Filed pursuant to an Order dated March 29, 2006 in Case No. 06-407-GE-ATA before the Public Utilities Commission of Ohio.

Issued: December 31, 2006

Effective: January 1, 2007

Issued by Sandra P. Meyer, President

Duke Energy Ohio
139 East Fourth Street
Cincinnati, Ohio 45202

P.U.C.O. Electric No. 19
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CHARGES (Contd.)

Tariff Sheet

AAC Charge
(per kWh/kW)

Rate DP, Service at Primary Distribution Voltage	
First 1000 kW	\$0.629300
Additional kW	\$0.496400
Billing Demand Times 300	\$0.002007
Additional kWh	\$0.001610
Rate TS, Service at Transmission Voltage	
First 50,000 Kva	\$0.762800
Additional kVA	\$0.549900
Billing Demand Times 300	\$0.001310
Additional kWh	\$0.001490
Rate SL, Street Lighting Service	
All kWh	\$0.002621
Rate TL, Traffic Lighting Service	
All kWh	\$0.001534
Rate OL, Outdoor Lighting Service	
All kWh	\$0.002621
Rate NSU, Street Lighting Service for Non-Standard Units	
All kWh	\$0.002621
Rate NSP, Private Outdoor Lighting for Non-Standard Units	
All kWh	\$0.002621
Rate SC, Street Lighting Service - Customer Owned	
All kWh	\$0.002621
Energy only - all kWh	\$0.001043
Rate SE, Street Lighting Service - Overhead Equivalent	
All kWh	\$0.002621
Rate UOLS, Unmetered Outdoor Lighting Electric Service	
All kWh	\$0.001079

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CHARGES (Contd.)

The following rates apply to residential customers from January 1, 2007 through December 31, 2007.

<u>Tariff Sheet</u>	<u>AAC Charge</u> (per kWh/kW)
Rate RS, Residential Service	
Summer, First 1000 kWh	\$0.004021
Summer, Additional kWh	\$0.005095
Winter, First 1000 kWh	\$0.004021
Winter, Additional kWh	\$0.001517
Rate ORH, Optional Residential Service With Electric Space Heating	
Summer, First 1000 kWh	\$0.003590
Summer, Additional kWh	\$0.004301
Winter, First 1000 kWh	\$0.003589
Winter, Additional kWh	\$0.001858
Winter, kWh greater than 150 times demand	\$0.001162
Rate TD, Optional Time-of-Day Rate	
Summer, On-Peak kWh	\$0.008198
Summer, Off-Peak kWh	\$0.001197
Winter, On-Peak kWh	\$0.006444
Winter, Off-Peak kWh	\$0.001198

AVOIDANCE OF ANNUALLY ADJUSTED COMPONENT RIDER CHARGE

The first 25% of eligible residential load and the first 50% of eligible non-residential load, by customer rate class, to switch to a certified supplier shall not pay the AAC. All remaining 75% of residential load or 50% of non-residential load, by customer rate class, shall pay the AAC. The Company shall calculate the switched load by customer class in the same manner as it calculates switched load pursuant to its transition plan stipulation approved by the Commission in Case No 99-1658-EL-ETP.

The Company shall establish and maintain a queue of switched load, effective January 1, 2005, such that as the load of one customer returns to the Company's market-based standard service offer (MBSSO) market price, the applicable load of the next customer in the queue shall move into the percent of switched load permitted to avoid the AAC in the applicable customer class, in order, until the applicable switched percentage of load has been achieved.

Filed pursuant to an Order dated March 29, 2006 in Case No. 06-407-GE-ATA before the Public Utilities Commission of Ohio.

Issued: December 31, 2006

Issued by Sandra P. Meyer, President

Effective: January 1, 2007

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AVOIDANCE OF ANNUALLY ADJUSTED COMPONENT RIDER CHARGE (Contd.)

To qualify to bypass the AAC, a non-residential customer must enter into a contract with a creditworthy CRES provider to provide firm generation service through December 31, 2008, or a non-residential customer may sign a contract with the Company assuring that it will purchase competitive retail electric generation service from a competitive retail electric service provider through December 31, 2008. Such contract or agreement must satisfy the full capacity, energy, and transmission requirements associated with the customer. The applicable non-residential customer must provide a minimum of 60-days notice to the Company of the effective date of the contract, and may provide notice to the Company beginning November 23, 2004. All loads of customers seeking to avoid the AAC must be in the applicable percentage of switched load of the applicable customer class necessary to avoid the AAC at the time that contract notice is given to the Company. All customers, including those already switched, may give such notice and shall be placed in the queue for avoidance of the AAC at the time notice is given. To calculate the applicable percentage of switched load by customer class the Company shall count all switched customers receiving shopping credits and customers having given the required notice and with the required contract. Switched non-residential customers who return to the Company's generation service will be charged the highest hourly generation cost that the Company incurs for that hour. None of the restrictions or requirements set forth above shall apply to residential customers prior to January 1, 2006. At the end of their market development period at January 1, 2006, residential customers may bypass the RSC if they are in the first 25% of residential load as determined by order and receipt by the Company of a proper Direct Access Service Request as of January 1, 2006. Residential customers returning to the Company due to the default of their contracting competitive retail electric service provider or upon expiration of their contract shall be served at the Company's then existing MBSSO market price calculated as if the consumer had never purchased competitive retail electric service from a certified supplier.

Filed pursuant to an Order dated March 29, 2006 in Case No. 06-407-GE-ATA before the Public Utilities Commission of Ohio.

Issued: December 31, 2006

Issued by Sandra P. Meyer, President

Effective: January 1, 2007

DUKE ENERGY OHIO
Calculation of Rider AAC Percentage
and Revised Rider AAC Tariff
Year 2007

AAC Recovery % Calculation

Revised AAC Revenue Requirement	\$ 73,818,962
Little g Revenue - 12 Months Ended May 31, 2006	\$ 812,324,838
Revised Rider AAC %	<u>9.1%</u>

<u>Tariff Sheet</u>	<u>Current AAC Charge (per kWh/kW)</u>	<u>New % / Old % Ratio (1)</u>	<u>Proposed AAC Charge (per kWh/kW)</u>
Rate RS, Residential Service			
Summer, First 1000 kWh	\$ 0.002651	1.5167	\$ 0.004021
Summer, Additional kWh	\$ 0.003359	1.5167	\$ 0.005095
Winter, First 1000 kWh	\$ 0.002651	1.5167	\$ 0.004021
Winter, Additional kWh	\$ 0.001000	1.5167	\$ 0.001517
Rate ORH, Optional Residential Service With Electric Space Heating			
Summer, First 1000 kWh	\$ 0.002367	1.5167	\$ 0.003590
Summer, Additional kWh	\$ 0.002836	1.5167	\$ 0.004301
Winter, First 1000 kWh	\$ 0.002366	1.5167	\$ 0.003589
Winter, Additional kWh	\$ 0.001225	1.5167	\$ 0.001858
Winter, kWh greater than 150 times demand	\$ 0.000766	1.5167	\$ 0.001162
Rate TD, Optional Time-of-Day Rate			
Summer, On-Peak kWh	\$ 0.005405	1.5167	\$ 0.008198
Summer, Off-Peak kWh	\$ 0.000789	1.5167	\$ 0.001197
Winter, On-Peak kWh	\$ 0.004249	1.5167	\$ 0.006444
Winter, Off-Peak kWh	\$ 0.000790	1.5167	\$ 0.001198
Rate DS, Service at Secondary Distribution Voltage			
First 1000 kW	\$ 0.612600	1.1375	\$ 0.696800
Additional kW	\$ 0.484600	1.1375	\$ 0.551200
Billing Demand Times 300	\$ 0.001566	1.1375	\$ 0.001781
Additional kWh	\$ 0.001301	1.1375	\$ 0.001480
Rate GS-FL, Optional nmetered For Small Fixed Loads			
kWh Greater Than or Equal to 540 Hours	\$ 0.005203	1.1375	\$ 0.005918
kWh Less Than 540 Hours	\$ 0.005981	1.1375	\$ 0.006803
Rate CUR, Common Use Residential Service			
Summer, First 1000 kWh	\$ 0.003534	1.1375	\$ 0.004020
Summer, Additional kWh	\$ 0.004478	1.1375	\$ 0.005094
Winter, First 1000 kWh	\$ 0.003534	1.1375	\$ 0.004020
Winter, Additional kWh	\$ 0.001334	1.1375	\$ 0.001517
Rate EH, Optional Rate For Electric Space Heating			
All kWh	\$ 0.002135	1.1375	\$ 0.002429

DUKE ENERGY OHIO
Calculation of Rider AAC Percentage
and Revised Rider AAC Tariff
Year 2007

<u>Tariff Sheet</u>	<u>Current AAC Charge (per kWh/kW)</u>	<u>New % / Old % Ratio (1)</u>	<u>Proposed AAC Charge (per kWh/kW)</u>
Rate DM, Secondary Distribution Service, Small			
Summer, First 2800 kWh	\$ 0.004685	1.1375	\$ 0.005329
Summer, Next 3200 kWh	\$ 0.001196	1.1375	\$ 0.001360
Summer, Additional kWh	\$ 0.000522	1.1375	\$ 0.000594
Winter, First 2800 kWh	\$ 0.003718	1.1375	\$ 0.004229
Winter, Next 3200 kWh	\$ 0.001198	1.1375	\$ 0.001363
Winter, Additional kWh	\$ 0.000495	1.1375	\$ 0.000563
Rate DP, Service at Primary Distribution Voltage			
First 1000 kW	\$ 0.553200	1.1375	\$ 0.629300
Additional kW	\$ 0.436400	1.1375	\$ 0.496400
Billing Demand Times 300	\$ 0.001764	1.1375	\$ 0.002007
Additional kWh	\$ 0.001415	1.1375	\$ 0.001610
Rate TS, Service at Transmission Voltage			
First 50,000 Kva	\$ 0.870600	1.1375	\$ 0.762800
Additional Kva	\$ 0.483400	1.1375	\$ 0.549900
Billing Demand Times 300	\$ 0.001152	1.1375	\$ 0.001310
Additional kWh	\$ 0.001310	1.1375	\$ 0.001490
Rate SL, Street Lighting Service			
All kWh	\$ 0.002304	1.1375	\$ 0.002621
Rate TL, Traffic Lighting Service			
All kWh	\$ 0.001349	1.1375	\$ 0.001534
Rate OL, Outdoor Lighting Service			
All kWh	\$ 0.002304	1.1375	\$ 0.002621
Rate NSU, Street Lighting Service for Non-Standard Units			
All kWh	\$ 0.002304	1.1375	\$ 0.002621
Rate NSP, Private Outdoor Lighting for Non-Standard Units			
All kWh	\$ 0.002304	1.1375	\$ 0.002621
Rate SC, Street Lighting Service - Customer Owned			
All kWh	\$ 0.002304	1.1375	\$ 0.002621
Energy Only - All kWh	\$ 0.000917	1.1375	\$ 0.001043
Rate SE, Street Lighting Service - Overhead Equivalent			
All kWh	\$ 0.002304	1.1375	\$ 0.002621
Rate UOLS, Unmetered Outdoor Lighting Electric Service			
All kWh	\$ 0.000949	1.1375	\$ 0.001079

(1) Residential = 9.1% / 6%; Non-residential = 9.1% / 8%

DUKE ENERGY OHIO
Summary of Rider AAC Revenue Requirement
For Recovery in 2007

Revenue Requirement From:	<u>Amount</u>
Environmental Compliance	\$79,001,379
Homeland Security	132,732
Tax Changes	<u>(5,315,149)</u>
 Total Revenue Requirement	 <u><u>\$73,818,962</u></u>

DUKE ENERGY OHIO
Revenue Requirement on Environmental Compliance
Increase from Year 2000

<u>Return on Environmental Plant</u>	<u>Period Ending</u>	
	<u>12/31/2000</u>	<u>5/31/2006</u>
Original Cost	\$405,942,184	\$682,657,284
Reserve for Depreciation	<u>(165,336,370)</u>	<u>(221,251,787)</u>
Net Book Value	240,605,814	461,405,497
Construction Work in Progress	<u> </u>	<u>244,413,759</u>
Total Environmental Plant	<u>\$240,605,814</u>	<u>\$705,819,256</u>
Pre-tax Return at 11.69% ^(a)	\$28,126,820	\$82,510,271
<u>Environmental O&M Expenses</u>		
Operation & Maintenance	4,453,158	4,798,597
Environmental Reagents ^(b)	4,598,944	18,854,155
Annualized Depreciation	<u>7,749,260</u>	<u>17,766,538</u>
Total Revenue Requirement	<u>\$44,928,182</u>	<u>\$123,929,561</u>
Increase		<u>\$79,001,379</u>

Note: ^(a) From Case No. 05-0059-EL-AIR.

^(b) Environmental Reagent costs are based on budgeted amounts for 2007 and are subject to true-up per Order in Case No. 05-806-EL-UNC.

DUKE ENERGY OHIO
Revenue Requirement on Homeland Security
Twelve Months Ended May 31, 2006

	Information Technology	Cyber Security	Physical Security	Total
<u>Return on Capital Expenditures</u>				
Original Cost	\$84,370	\$226,365	\$28,531	\$339,266
Reserve for Depreciation	22,499	56,591	2	79,092
Net Plant	<u>\$61,871</u>	<u>\$169,774</u>	<u>\$28,529</u>	<u>\$260,174</u>
Pre-tax Return at 11.69%	\$7,233	\$19,847	\$3,335	\$30,414
<u>Operation & Maintenance Expenses</u>				
Operation & Maintenance				38,436
Annualized Depreciation	16,874	45,273	548	62,695
Annualized Property Taxes	<u>295</u>	<u>792</u>	<u>100</u>	<u>1,187</u>
Amount to Be Recovered	<u>\$24,402</u>	<u>\$65,912</u>	<u>\$3,983</u>	<u>\$132,732</u>

Note: All Homeland Security Costs are incremental to the year 2000.

DUKE ENERGY OHIO
Tax Changes
Twelve Months Ended May 31, 2006

<u>Tax Legislation Change</u>	Revenue Requirement Impact
Section 199 - Production Activity Deduction	(\$2,253,369)
Commercial Activity Tax vs. Ohio Franchise Tax	<u>(3,061,780)</u>
Total Impact of Tax Changes	<u><u>(\$5,315,149)</u></u>