BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Electric Distribution Rates.	)	Case No. 17-0032-EL-AIR
In the Matter of the Application of Duke Energy Ohio, Inc. for Tariff Approval.	)	Case No. 17-0033-EL-ATA
In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods.	)	Case No. 17-0034-EL-AAM

OBJECTIONS TO THE PUCO STAFF'S REPORT OF INVESTIGATION BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

BRUCE WESTON (0016973)
OHIO CONSUMERS' COUNSEL

William J. Michael (0070921)
Counsel of Record
Christopher Healey (0086027)
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
10 W. Broad Street, Suite 1800
Columbus, Ohio 43215-3485
Telephone [Michael]: 614-466-1291
Telephone [Healey]: 614-466-9571
william.michael@occ.ohio.gov
christopher.healey@occ.ohio.gov

Dane Stinson (0019101)
Bricker & Eckler LLP
100 South Third Street
Columbus, Ohio 43215
Telephone: (614) 227-4854
dstinson@bricker.com

Counsel for the Office of the Ohio
Consumers' Counsel

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OBJECTIONS TO THE PUCO STAFF'S REPORT OF INVESTIGATION
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

I. INTRODUCTION

In this base rate case, Duke Energy Ohio seeks to increase the amount that it charges customers for base electric distribution service.[1] The PUCO Staff issued its report of investigation in this case on September 26, 2017 (with a supplement filed October 12, 2017).[2] The Staff Report's recommendations, if adopted by the PUCO, would go a long way toward reducing the amount that customers pay for electric distribution service. The Staff Report provides many recommendations that benefit consumers, but the Staff Report falls short of fully protecting consumers in a number of ways, as explained in these objections.

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[1] *See generally* Application of Duke Energy Ohio, Inc. (Mar. 2, 2017) (the "Application").

[2] Staff Report (September 26, 2017 and supplemented October 12, 2017), *available at* http://dis.puc.state.oh.us/DocumentRecord.aspx?DocID=f7c741ff-2edb-456f-8511-dbf3eb9ecd37 and http://dis.puc.state.oh.us/DocumentRecord.aspx?DocID=1f899c28-f3fd-4fcd-9eaa-ade1a83eaf3b (together, the "Staff Report").

Notably, the Office of the Ohio Consumers' Counsel ("OCC") supports the following findings, conclusions, and recommendations in the Staff Report:

- The PUCO Staff correctly recommended that PUCO and OCC assessments be removed from the calculation of the Gross Revenue Conversion Factor.[3]

- Duke requested $29.8 million in working capital but did not conduct a lead/lag study or include the cash component. The PUCO Staff correctly recommended that this amount be excluded from rate base.[4]

- The PUCO Staff correctly recommended that the PUCO not approve Duke's proposed Regulatory Mandates Rider.[5]

- The PUCO Staff correctly recommended that the Distribution Capital Investment Rider ("Rider DCI") not include general, common, and intangible plant, or battery storage costs.[6]

- The PUCO Staff correctly recommended that Rider DCI not be expanded to include capital investment in a new billing system.[7]

- The PUCO Staff correctly recommended that the PUCO reject Duke's request to spend $2 million annually to educate consumers on opportunities, energy conservation, and customer choice.[8]

- The PUCO Staff correctly recommended that Duke not be permitted to recover the expenses from its electric security plan case through base rates.[9]

- The PUCO Staff correctly recommended that Duke's rate case expenses be amortized over a five year period instead of three.[10]

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[3] Staff Report at 7.

[4] *Id.* at 11.

[5] *Id.* at 22.

[6] *Id.* at 9.

[7] *Id.* at 16-17.

[8] *Id.* at 16.

[9] *Id.* at 13.

[10] *Id.*

- The PUCO Staff correctly recommended that competitive retail electric service ("CRES") deferral costs approved in PUCO Case No. 15-855-EL-AAM be amortized over a five year period instead of three.[11]

- The PUCO Staff correctly recommended that Ohio Electric Choice Supplier deferral costs approved in PUCO Case No. 11-3549-EL-SSO be amortized over a five year period instead of three.[12]

- The PUCO Staff correctly recommended that customers not be charged $200,000 annually for Duke to perform an audit to determine whether it is billing the correct customer for street lighting.[13]

- The PUCO Staff correctly recommended that deferred costs from PUCO Case No. 14-1160-EL-UNC, which relate to IT costs for advanced meter opt outs, should be amortized over a five year period instead of three.[14]

- The PUCO Staff correctly recommended that Duke's infrastructure modernization rider ("Rider DR-IM") be discontinued when new rates from this case take effect.[15]

- The PUCO Staff correctly recommended that the customer charge remain at $6.00 rather than nearly quadrupling to $22.77.[16]

- The PUCO Staff correctly excluded from this case Duke's improper proposals to include future-looking smart grid spending. Duke's proposed 2017-2018 "business continuity effort" and 2019-2022 "AMI Transition Plan"[17] have nothing to do with the test year, and property that Duke might invest in from 2017-2022 could not have been used and useful as of the June 30, 2016 date certain. The PUCO should not authorize or otherwise entertain any proposals for future spending in this base rate case.

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[11] *Id.* at 16.

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.* at 22.

[16] *Id.* at 33-34.

[17] *See* Direct Testimony of Donald L. Schneider, Jr. on Behalf of Duke Energy Ohio, Inc. at 10, 13 (Mar. 16, 2017) (the "Schneider Testimony").

At the same time, the Staff Report should have gone further and recommended additional reductions for the benefit of consumers, including:

- The Staff Report should have recommended that the continuation of Rider DCI cannot be approved in this rate case because it pertains to costs to be incurred in 2018 and later—well beyond the test year. And Rider DCI pertains to investment that is not used and useful at date certain.

- The Staff Report should not have recommended accelerated amortization of certain accounts related to Duke's current smart grid infrastructure and instead should have recommended excluding these costs altogether from rate base.

- The Staff Report should not have adjusted test year expenses to add $67,787 in net metering expenses.

- The Staff Report made various improper assumptions in calculating a proposed return on equity and rate of return, all of which, if adopted, would unreasonably increase the amount that consumers pay for electric distribution service.

- The Staff Report should have accounted for historical increases in the residential customer base, which would further reduce the amount of the revenues sought from customers.

- The Staff Report should have recommended cancellation of the purchase of accounts receivable program to protect consumers from subsidizing unregulated generation.

To protect consumers and ensure that they pay only rates that are just and reasonable, the PUCO should adopt OCC's recommendations set forth in these objections[18] and in the forthcoming testimony of OCC witnesses.[19] OCC reserves the right to supplement its testimony in this case should any of the Staff Report's findings, conclusions or recommendations noted above (which OCC supports) no longer be supported by the PUCO Staff.

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[18] *See* R.C. 4909.19(C).

[19] The deadline for testimony is November 9, 2017. *See* Entry (Oct. 18, 2017).

II. OBJECTIONS TO THE STAFF REPORT

A. Rate Base

Objection 1: The Staff Report is unreasonable because it recommends that Rider DCI be extended to May 31, 2024, to the detriment of customers who may be required to fund the rider.

Duke's Rider DCI is currently set to expire on May 31, 2018, as authorized in Duke's last electric security plan ("ESP") case.[20] That should mean that Rider DCI would be set back to zero, and the investment included in rate base, to the extent it was used and useful as of date certain.

In this rate case, however, Duke proposes to continue the rider beyond May 31, 2018.[21] The Staff Report recommended that Rider DCI be extended to May 31, 2024.[22] OCC objects to this recommendation by the PUCO Staff.

First, the Staff Report should have recommended that continuation of Rider DCI after May 31, 2018 is not an appropriate issue for this rate case because any associated costs (capital costs and expenses) would not be part of the test year and would not be part of date certain rate base. Thus, these rider costs are not properly raised in this application by Duke to increase rates under R.C. Chapter 4909.[23]

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[20] *In re Application of Duke Energy Ohio, Inc. for Authority to Establish a Standard Serv. Offer Pursuant to R.C. 4928.143 in the Form of an Elec. Sec. Plan*, Case No. 14-841-EL-SSO, Opinion & Order at 71-72 (Apr. 2, 2015).

[21] *See* Application ¶ 8 ("As part of this Application ... Duke Energy Ohio is seeking to extend its Rider DCI ..."); Direct Testimony of Cicely M. Hart on Behalf of Duke Energy Ohio, Inc. at 10 (Mar. 16, 2017) ("the Commission should approve Rider DCI to extend beyond its current term of three years").

[22] Staff Report at 9 (recommending that Rider DCI continue through May 31, 2024 as long as Duke files a rate case by May 31, 2023 and if Duke does not, then Rider DCI be set at $0 on June 1, 2023).

[23] *See* R.C. 4909.15(C)(1) ("the revenues and expenses of the utility shall be determined during a test period").

Second, the Staff Report should have recommended that approval or continuation of Rider DCI rider cannot occur in a rate case because the Revised Code only authorizes single-issue ratemaking in an ESP case.[24]

Third, the Staff Report should not have recommended continuation of Rider DCI without evaluating the cost effectiveness and benefits associated with the 19 programs that were authorized when the PUCO approved Rider DCI. These factors should be considered before making a recommendation that customers should continue, over the next six years, to fund these programs through Rider DCI.

Fourth, the Staff Report, before recommending continuation of Rider DCI, should have considered the impact (if any) that Rider DCI is having on Duke's distribution reliability performance and the projected impact of any new programs.

Fifth, the Staff Report proposes annual caps on the amount that customers can be charged under Rider DCI.[25] While OCC supports limits to rider charges in general, we object to the PUCO Staff's recommendation for a number of reasons. The Staff Report should have considered the impact that its proposed caps will have on customers' bills and the overall affordability of Duke's retail electric service. And if Rider DCI is going to continue through the PUCO Staff's proposed end date of May 31, 2024, which OCC does not recommend and objects to, the revenue caps found in the Staff Report are not just or reasonable because they are not linked to any quantifiable benefits for consumers and are arbitrary and unreasonably high.

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[24] *See* R.C. 4928.143(B)(2)(h).

[25] Staff Report at 9.

Objection 2: The Staff Report unreasonably recommends accelerated amortization of certain accounts related to Duke's current smart grid infrastructure.

The Staff Report recommends that Account 370.2 Echelon AMI Meters, Account 397.0, and Account 197.0 Communication Equipment-Nodes replaced be "treated as dying assets and the unrecovered investment be amortized over a 10-year period."[26] OCC objects to this recommendation as unreasonable because Duke's decision to install this technology was not prudent in the first place, so the associated costs and value should be excluded from rate base (not amortized under a shorter period of time) so that customers do not have increased rates to cover these investments and expenses.

B. Operating Income

Objection 3: The Staff Report should have increased the residential customer charge revenue to account for growth in the customer base, thereby decreasing the amount of revenue increase that customers are left to pay.

OCC objects to the Staff Report's calculation of adjusted residential customer charge revenue because the calculation failed to recognize the growth being experienced in the residential service rate class. Duke has understated the projected revenue in the test year. The Staff Report should have annualized residential customer bills using the last month of the test year. Duke has experienced a consistent growth pattern of approximately 5,000 additional residential customers per year since 2014.

[26] *Id.* at 11.

Objection 4: The Staff Report erred by increasing test year operating expenses by $67,787 for generation related net metering costs.

OCC objects to the Staff's recommendation that net metering costs related to generation for all customers except residential be added to test year operating expenses and allocated to residential based on the cost of service.[27]

C. Rate of Return

Objection 5: The Staff Report used an unduly high 4.45% risk-free return in the CAPM analysis.

The Staff Report inappropriately increased the cost of common equity by using a risk-free return of 4.45% in its CAPM analysis.[28] This risk-free return is based on the forecasted yield on 30-year treasury bonds of the Congressional Budget Office (4.1%) and the Bureau of Labor Statistics (4.8%). The risk-free return is inflated and unreasonable. The use of forecasted yields of treasury bonds is unreliable and not supported by financial theory or evidence. The exclusive use of the yield of the 30-year treasury bonds is also unreasonable. The method used in the Staff Report is a significant departure from the methodology that has been consistently used by the PUCO Staff in many rate cases over an extended period of time. For example, in the last Duke electric distribution rate case, the PUCO Staff used the actual yields of the 10-year and 30-year treasury bonds in estimating the risk-free return. The resulting risk-free return in the last rate case was 2.255%. The use of an inflated and unreasonable risk-free return of 4.45% will unnecessarily and unreasonably increase the cost of electric services to Duke's residential customers.

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[27] *Id.* at 17.

[28] *Id.* at 11.

Objection 6: The Staff Report used an unduly high 7% risk premium in its cost of common equity calculation.

The Staff Report inappropriately increased the cost of common equity by using a risk premium of 7%. The PUCO Staff indicated that this risk premium was a derived spread of arithmetic mean total returns between large company stocks (12.1%) and long-term government bonds (5.1%) in 2014. This estimated risk premium is inflated and unreasonable. The most recent data (end of 2016) compiled by financial publications would indicate a lower risk premium of approximately 6%. Further, the mean total returns of 5.1% for long-term government bonds used in the Staff Report cannot be verified at this time. The use of an inflated and unreasonable risk premium of 7% will unnecessarily and unreasonably increase the cost of electric services to Duke's residential customers.

Objection 7: The Staff Report inappropriately applied unequal weights to the CAPM and DCF model.

The Staff Report inappropriately increased the cost of equity by applying different and unequal weights to its estimates under the two models: 25% to the capital asset pricing model ("CAPM") and 75% to the discounted cash flow ("DCF") model.[29] These weights are contrary to the weighting that has been used consistently over an extended period of time in many previous Ohio natural gas and electric rate cases. The PUCO Staff's explanation for the change in the weights assigned to the results of the CAPM and DCF for estimating Duke's cost of common equity is not supported by financial theory, evidence, or sound regulatory principles. This assignment of unequal weights to the results of the CAPM and the DCF models is arbitrary. It will unnecessarily and

[29] *Id.* at 18-19.

unreasonably increase the cost of electric services to Duke's residential customers. The CAPM and DCF model should be weighted equally (50% each).

Objection 8: The Staff Report made improper adjustments for equity issuance and other costs.

The Staff Report inappropriately increased the cost of common equity by allowing an adjustment for equity issuance and other costs.[30] The addition of an equity issuance and other costs to its estimate of cost of common equity is not supported by sound regulatory principles. Further, there is no proof that Duke is likely to incur these costs—and certainly not to the same magnitude. Even if an adjustment for equity issuance and other costs is allowed, the Staff Report inappropriately increased the cost of common equity by using a generic issuance cost factor of 3.5%. The Staff Report does not explain why this generic issuance cost factor is reasonable or why it should be applied in this proceeding. This addition of an arbitrary and unproven equity issuance and other costs will unnecessarily and unreasonably increase the cost of electric services to Duke's residential customers.

Objection 9: The Staff Report's recommended rate of return and return on equity are unreasonable because they far exceed the rate of return and return on equity authorized for electric distribution utilities nationwide that are similar to Duke.

The Staff Report inappropriately increased the cost of electric services to Duke's residential customers by recommending a rate of return of 7.20% to 7.74% and a return on equity (or cost of common equity) of 9.22% to 10.24%.[31] These overstated and

[30] *Id.*

[31] *Id.*

unreasonable recommendations are based on the unreasonable methodology and data used by the PUCO Staff in its rate of return analysis, as described above.

The Staff Report's recommended rate of return and return on equity are also unreasonable because they far exceed the rate of return and return on equity authorized for electric distribution utilities nationwide in recent years. A rate of return or return on equity above the market rate for electric distribution utilities could be justified only if Duke has significantly higher business and financial risks than the average electric distribution utilities—which Duke does not.

D. Management and Operations Review

Objection 10: The Staff Report appropriately recommended that the Purchase of Accounts Receivable program should include a discount rate, but it should have gone further and recommended discontinuation of the program altogether.

OCC supports the PUCO Staff's recommendation that if there is a Purchase of Accounts Receivable program, it should have a discount rate.[32] If there were no discount rate, then customers would be subsidizing the credit and business risks of unregulated CRES suppliers.

The Staff Report, however, is unreasonable in two regards. First, the Staff Report should have recommended instead that the Purchase of Accounts Receivable ("POR") program be discontinued altogether. Second, and in the alternative, if there is to be a POR program, then the Staff Report should have identified the criteria that are to be considered when the discount rate is calculated to protect customers from future supplier financial risks, as required by Ohio law.[33]

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[32] *Id.* at 53.

[33] *See* R.C. 4928.08(B) (requiring electric suppliers to provide "a financial guarantee sufficient to protect customers and electric distribution utilities from default").

E. Smart Grid[34]

Objection 11: The Staff Report failed to address whether Duke's current smart grid infrastructure delivers all of the capabilities and functionality that Duke promised it would in past cases and in its application to the U.S. Department of Energy for federal funding.

Under the approved settlement in PUCO Case No. 10-2326-GE-RDR (the "Mid-Deployment Review Settlement"),[35] Duke was to develop a portfolio of time-differentiated offerings, including "non-pilot rates that provide standard service offer customers pricing structures that incentivize them to shift energy usage to reduce their electric bills."[36] The Staff Report should have concluded that Duke failed to satisfy this requirement.

Under the Mid-Deployment Review Settlement, Duke was required to "provide CRES providers the necessary billing system functionality to offer CRES customers time differentiated rates consistent with its existing supplier tariff beginning January 1, 2013."[37] The Staff Report should have concluded that Duke does not appear to have satisfied this requirement.

Under the Mid-Deployment Review Settlement, Duke was required to determine the effectiveness of Validation Estimate and Edit (VEE) routines in the Meter Data Management System.[38] The Staff Report should have addressed whether Duke in fact

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[34] These smart grid objections may also relate to the Staff Report's conclusions regarding rate base, operating income, rate of return, rates and tariffs, service monitoring and enforcement, management and operations review, and other issues. For ease of reference and organization, smart-grid-related objections are generally included in this section.

[35] *In re Application of Duke Energy Ohio, Inc. to Adjust & Set its Gas & Elec. Recovery Rate for 2010 SmartGrid Costs Under Rider AU & Rider DR-IM & Mid-Deployment Review of AMI/SmartGrid Program*, Case No. 10-2326-GE-RDR, Stipulation & Recommendation (Feb. 24, 2012); Opinion & Order (June 13, 2012) (approving the Mid-Deployment Review Settlement).

[36] Mid-Deployment Review Settlement § III.a.

[37] *Id.* § III.c.

[38] *Id.* § VI.b.

analyzed the effectiveness of VEE routines, and if so, whether such analysis should have informed Duke's decision to continue installing a node-based distribution system.

Objection 12: The Staff Report failed to address whether Duke's current smart grid infrastructure is capable of providing customers with safe, reliable, and reasonably priced electric service as required by R.C. 4928.02(A).

The Staff Report should have evaluated Duke's current smart grid system to determine whether it is capable of providing customers with safe, reliable, and reasonably priced electric service as required by R.C. 4928.02(A). This is the core purpose of the utility's distribution system.

Objection 13: The Staff Report failed to address the prudence of Duke's spending on smart grid infrastructure.

The Mid-Deployment Review Settlement provides that the revenue requirement in this base rate case "will reflect the level of the benefits attributable to SmartGrid which have actually been achieved by the Company and all prudently incurred current costs associated with the program."[39] OCC objects to the Staff Report because it does not evaluate whether the costs associated with Duke's smart grid program to date have been prudent, as required by the Mid-Deployment Review Settlement. The Staff Report should have concluded that many of the costs that Duke has incurred to install the node-based distribution system were imprudent and should be disallowed.

Objection 14: The Staff Report failed to address whether the revenue requirement in this case reflects the savings that have been achieved for customers from Duke's smart grid investments.

The Mid-Deployment Review Settlement provides that the revenue requirement in this base rate case "will reflect the level of the benefits attributable to SmartGrid which

[39] *Id.* at 7 (emphasis added).

have actually been achieved by the Company and all prudently incurred current costs associated with the program."[40] OCC objects to the Staff Report because it does not evaluate whether the revenue requirement in this base rate case reflects the level of the benefits specifically attributable to SmartGrid that Duke has actually achieved.

Objection 15: The Staff Report failed to address whether Duke's current smart grid infrastructure is used and useful for consumers, as required by R.C. 4909.15(A)(1).

By law, a utility can only include in its rate base property that is "used and useful ... in rendering the public utility service for which rates are to be fixed and determined."[41] The Staff Report correctly concludes that a certain "Columbia Substation" is not used and useful and should be removed from rate base,[42] but the Staff Report does not address whether Duke's current smart grid infrastructure (or any other property) is used and useful.

As described by Duke, its current node system consists of Echelon electric meters, Badger gas communication modules, and Ambient/Ericsson communication nodes, plus a meter data management system that Duke calls the "Energy Data Management System" or "EDMS."[43] The Staff Report improperly failed to address whether any of these components, or whether the system as a whole, is "used and useful" for consumers.

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[40] *Id.*

[41] R.C. 4909.15(A)(1).

[42] Staff Report at 8.

[43] Schneider Testimony at 3, 7.

Objection 16: The Staff Report should have verified that expenses included in the test year are not also being collected from customers through Rider DR-IM.

The test year in this case is from April 1, 2016 through March 31, 2017.[44] During the entire test year, therefore, Duke was charging customers for smart-grid-related costs through Rider DR-IM. The Staff Report should have evaluated the test year smart grid costs to ensure that customers are not being double-charged for the same costs in both base rates and Rider DR-IM. Customers should not pay for the same costs twice.

III. CONCLUSION

To protect consumers from paying rates that are unjust or unreasonable, the PUCO should adopt OCC's recommendations set forth in these objections, which will be further developed through OCC testimony.

Respectfully submitted,

BRUCE WESTON (0016973)
OHIO CONSUMERS' COUNSEL

/s/ William J. Michael
William J. Michael (0070921)
Counsel of Record
Christopher Healey (0086027)
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
10 W. Broad Street, Suite 1800
Columbus, Ohio 43215-3485
Telephone [Michael]: 614-466-1291
Telephone [Healey]: 614-466-9571
william.michael@occ.ohio.gov
christopher.healey@occ.ohio.gov
(Both will accept service via email)

[44] *See* Staff Report at 6.

Dane Stinson (0019101)
Bricker & Eckler LLP
100 South Third Street
Columbus, Ohio 43215
Telephone: (614) 227-4854
dstinson@bricker.com

Counsel for the Office of the Ohio Consumers' Counsel

CERTIFICATE OF SERVICE

I hereby certify that a copy of these Objections was served on the persons stated below via electronic transmission, this 26th day of October 2017.

/s/ William J. Michael
William J. Michael
Assistant Consumers' Counsel

SERVICE LIST

Steven.beeler@ohioattorneygeneral.gov
Robert.eubanks@ohioattorneygeneral.gov
cmooney@ohiopartners.org
mfleisher@elpc.org
fdarr@mwncmh.com
mpritchard@mwncmh.com
paul@carpenterlipps.com
mleppla@theOEC.org
tdougherty@theOEC.org
rick.sites@ohiohospitals.org
dborchers@bricker.com
dparram@bricker.com
whitt@whitt-sturtevant.com
campbell@whitt-sturtevant.com
glover@whitt-sturtevant.com
mjsettineri@vorys.com

Amy.spiller@duke-energy.com
Jeanne.kingery@duke-energy.com
Elizabeth.watts@duke-energy.com
Rocco.dascenzo@duke-energy.com
mkurtz@BKLlawfirm.com
kboehm@BKLlawfirm.com
jkylercohn@BKLlawfirm.com
joliker@igsenergy.com
eakhbari@bricker.com
mdortch@kravitzllc.com
Bojko@carpenterlipps.com
Perko@carpenterlipps.com
mnugent@igsenergy.com
swilliams@nrdc.org
daltman@environlaw.com
jnewman@environlaw.com
jweber@environlaw.com

Attorney Examiner:

Nicholas.walstra@puc.state.oh.us

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Summary: Objection Objections to the PUCO Staff's Report of Investigation by the Office of the Ohio Consumers' Counsel electronically filed by Ms. Deb J. Bingham on behalf of Michael, William J. Mr.