

Re Duke Energy Ohio, Inc.
Case Nos. 07-589-GA-AIR, 07-590-GA-ALT, and
07-591-GA-AAM

Ohio Public Utilities Commission
May 28, 2008

ORDER adopting a stipulation that allows a natural gas local distribution company (LDC) to increase its rates by \$18.217 million, or 3.05%, based on an overall rate of return of 8.45%. The order also departs from traditional rate design methods by adopting a levelized residential distribution rate structure that recovers most fixed costs through a flat monthly fee.

Stipulation. The stipulation extends the term of the LDC's accelerated main replacement program (AMRP) and associated rate rider (Rider AMRP) through the year 2019. It provides for the implementation of new Rider AMRP rates, following which the LDC will file a pre-filing notice and application annually to implement subsequent adjustments to Rider AMRP. Residential rate caps established by the stipulation will apply to Rider AMRP. The caps will be cumulative rather than annual caps such that if the rate increase is below the annual cap in a given year, the unused portion may be carried forward for recovery in future years but can never exceed the cumulative cap.

The stipulation revises the gas cost recovery tariff of the LDC to implement a sharing mechanism for net revenues from off-system transactions. The sharing mechanism shall be effective if the LDC does not have an asset management agreement transferring management responsibility for its gas commodity, storage and transportation contracts to a third party, and shall provide for the sharing of net revenues from off-system transactions to be allocated 80% to gas cost recovery and choice customers and 20% to shareholders of the LDC.

Rate Design. Commission concludes that a rate design that separates recovery of the costs of delivering gas from the amount of gas consumed is necessary to align new market realities - declining sales per customer due to volatile and sustained price increases - with important regulatory objectives, such as main-

taining the financial stability of the LDC and encouraging energy efficiency and conservation.

Having determined that a new rate design is necessary, the commission finds that a levelized rate design that recovers most fixed costs up front in a monthly fee is preferable to a decoupling rider, which would maintain a lower customer charge and allow the LDC to offset lower sales through an adjustable rider. In so finding, the commission explains that although both methods would address revenue and earnings stability issues, and would remove disincentives to the promotion of conservation and energy efficiency, a levelized rate design has the added benefit of producing more stable customer bills throughout all seasons. Moreover, the commission finds that a levelized rate design has the advantage of being easier to understand, sends better price signals to customers, and provides a more equitable cost allocation among all customers regardless of usage.

Commission mitigates the effect of the new rate design on residential customers by maintaining a volumetric component to rates, by phasing in the increase over a two-year period, and by not reflecting the full extent of fixed costs in the fixed charge. Moreover, the commission approves a pilot program aimed at helping low-income, low-use customers pay their bills.

In addition to an overall increase in rates of 3.1%, the settlement provides for a reallocation of \$6 million in costs from commercial and industrial customers to the residential class. The reallocation reduces a pre-existing subsidy of residential customers by commercial and industrial customers.

P.U.R. Headnote and Classification

1. PROCEDURE

s16
Oh.P.U.C. 2008
[OHIO] Production of evidence - Motion for protective order - Confidential treatment - Exception to public records law - Trade secret information - Proprietary pricing information.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

***183 2.**
EVIDENCE

s24
Oh.P.U.C. 2008
[OHIO] Deposition transcripts - Filing requirements -
Waiver of requirement that filing occur at least three
days prior to hearing.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

3.
RATES

s373
Oh.P.U.C. 2008
[OHIO] Natural gas local distribution company -
Authorized increase - Revenue distribution - Class
allocations - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

4.
EXPENSES

s92
Oh.P.U.C. 2008
[OHIO] Rate case expense - Amortization of deferred
expense - Natural gas local distribution company -
Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

5.
DEPRECIATION

s55
Oh.P.U.C. 2008

[OHIO] Natural gas local distribution company - New
rates - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

6.
APPORTIONMENT

s58
Oh.P.U.C. 2008
[OHIO] Natural gas - Allocation of common plant to
distribution service - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

7.
EXPENSES

s125
Oh.P.U.C. 2008
[OHIO] Natural gas local distribution company -
Accelerated main replacement program - Recovery
through rate rider - Cumulative residential rate cap -
Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

8.
RATES

s373
Oh.P.U.C. 2008
[OHIO] Natural gas rate design - Accelerated main
replacement program - Rate rider - Annual adjust-
ments - Cumulative residential rate cap - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

9.
RATES

s380
Oh.P.U.C. 2008
[OHIO] Natural gas rate design - Special factors - Accelerated main replacement program rider - Annual adjustments - Deferral of costs in excess of residential rate caps - Local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

10.
AUTOMATIC ADJUSTMENT CLAUSES

s34
Oh.P.U.C. 2008
[OHIO] Cost recovery clause - Accelerated main replacement program rider - Annual adjustments - Deferral of costs in excess of residential rate caps - Natural gas local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

11.
EXPENSES

s19
Oh.P.U.C. 2008
[OHIO] Conservation - Weatherization funding - Base rate recovery - Natural gas local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

12.
EXPENSES

s125
Oh.P.U.C. 2008
[OHIO] Natural gas local distribution company - Weatherization funding - Base rate recovery - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

13.
SERVICE

s199
Oh.P.U.C. 2008
[OHIO] Natural gas - Installation of service line or riser - Ownership of curb-to-meter service - Cost responsibility - Recovery of capitalized costs through accelerated main replacement program rate rider - Local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

14.
SERVICE

s188
Oh.P.U.C. 2008
[OHIO] Burden of costs - Installation of service line or riser - Ownership of curb-to-meter service - Natural gas local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

15.
EXPENSES

s69
Oh.P.U.C. 2008
[OHIO] Repair, replacement, and maintenance - Curb-to-meter service - Capitalization of costs - Recovery through accelerated main replacement program rate rider - Natural gas local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

16.
AUTOMATIC ADJUSTMENT CLAUSES

s23

Oh.P.U.C. 2008

[OHIO] Gas storage carrying costs - Recovery through gas cost recovery rider - *184 Natural gas local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

17.

EXPENSES

s83

Oh.P.U.C. 2008

[OHIO] Service company charges - Allocation method and process - Audit requirement - Natural gas local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

18.

CONSERVATION

s1

Oh.P.U.C. 2008

[OHIO] Natural gas - Demand-side management/energy efficiency programs - Cost benefit tests - Local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

19.

CONSERVATION

s1

Oh.P.U.C. 2008

[OHIO] Natural gas - Incentives for low-income customers - Implementation of pilot program - Local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

20.

GAS

s7

Oh.P.U.C. 2008

[OHIO] Supply procurement - For standard offer service - Consideration of auction process - Establishment of working group collaborative - Local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

21.

REVENUES

s5

Oh.P.U.C. 2008

[OHIO] Natural gas local distribution company - Off-system transactions - Sharing mechanism - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

22.

AUTOMATIC ADJUSTMENT CLAUSES

s30

Oh.P.U.C. 2008

[OHIO] Credits - Sharing of off-system transaction revenues - Natural gas local distribution company - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

23.

PAYMENT

s58

Oh.P.U.C. 2008

[OHIO] Security for payment - Customer deposits - Possible elimination for percentage of income payment plan customers - Natural gas local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

24.

PAYMENT

s17

Oh.P.U.C. 2008

[OHIO] Authorized payment stations - Use of payday lenders - Natural gas local distribution company - Discussion.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

25.

PROCEDURE

s31

Oh.P.U.C. 2008

[OHIO] Disposal of issues - Stipulations - Standard of review.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

26.

RATES

s650

Oh.P.U.C. 2008

[OHIO] Practice and procedure - Disposal of issues - Stipulations - Standard of review.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

27.

RATES

s373

Oh.P.U.C. 2008

[OHIO] Natural gas rate design - Residential distribution service - Fixed cost recovery - Allocation of most fixed costs through monthly flat fee - Modified

straight fixed variable design - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

28.

RATES

s385

Oh.P.U.C. 2008

[OHIO] Natural gas rate design - Residential delivery service - Levelized rate design - Allocation of most fixed costs to monthly flat fee - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

29.

RATES

s378

Oh.P.U.C. 2008

[OHIO] Natural gas rate design - Flat monthly charge for recovery of most fixed costs - Residential delivery service - Levelized rate design - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

30.

RATES

s373

Oh.P.U.C. 2008

[OHIO] Natural gas rate design - Reallocation of revenue requirement - Shift from commercial and industrial to residential customers - Reduction to pre-existing subsidy - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

***185 31.**
CONSERVATION

s1
Oh.P.U.C. 2008
[OHIO] Natural gas - Weatherization and other conservation programs - Funding commitment - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

32.
CONSERVATION

s1
Oh.P.U.C. 2008
[OHIO] Natural gas - Encouraging energy efficiency - Decoupling of fixed cost recovery from consumption - Levelized rate design - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

33.
GAS

s7
Oh.P.U.C. 2008
[OHIO] Conservation programs - Encouraging energy efficiency - Decoupling of fixed cost recovery from consumption - Levelized rate design - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

34.
REVENUES

s5
Oh.P.U.C. 2008
[OHIO] Natural gas local distribution company - Decoupling of revenues from sales - Preference for levelized rate design over decoupling rider.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

35.
RATES

s380
Oh.P.U.C. 2008
[OHIO.] Natural gas rate design - Special factors - Decoupling revenues from consumption - Preference for levelized rate design over decoupling rider - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

36.
RATES

s373
Oh.P.U.C. 2008
[OHIO] Natural gas rate design - Residential distribution service - Fixed cost recovery - Allocation of most fixed costs through monthly flat fee - Adoption of modified straight fixed variable design - Mitigation of effect on customers - Phase-in of increase - Assistance to low-income customers - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

37.
RATES

s385
Oh.P.U.C. 2008
[OHIO] Natural gas rate design - Residential delivery service - Levelized rate design - Allocation of most fixed costs to monthly flat fee - Mitigation of effect on customers - Phase-in of increase - Assistance to low-income customers - Local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

38.

RATES

s125

Oh.P.U.C. 2008

[OHIO] Reasonableness - Affordability - Assistance to low-income customers - Natural gas local distribution company.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

39.

VALUATION

s281

Oh.P.U.C. 2008

[OHIO] Natural gas local distribution company - Rate base - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

40.

REVENUES

s5

Oh.P.U.C. 2008

[OHIO] Natural gas local distribution company - Operating revenue - Net operating income - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

41.

RATES

s373

Oh.P.U.C. 2008

[OHIO] Natural gas local distribution company - Authorized increase - Stipulation.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

42.

RETURN

s92

Oh.P.U.C. 2008

[OHIO] Natural gas local distribution company - Overall rate of return - Stipulation - Reasonableness.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

43.

RATES

s373

Oh.P.U.C. 2008

[OHIO] Natural gas rate design - Adoption of straight fixed variable method - Residential distribution service - Statement in concurring option.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

44.

RATES

s373

Oh.P.U.C. 2008

[OHIO] Natural gas rate design - Residential distribution service - Transition to fixed-charge rate design - Partial dissent.

Re Duke Energy Ohio, Inc.

P.U.R. Headnote and Classification

*186 45.

CONSERVATION

s1

Oh.P.U.C. 2008

[OHIO] Natural gas - Encouraging energy efficiency - Need for cost-effecting expansion of programs - Local distribution company - Statement in partial dissent.

Re Duke Energy Ohio, Inc.

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Before Schriber, chairman (concurring with separate opinion), and Centolella (concurring in part and dissenting in part with separate opinion), Fergus, Lemmie, and Roberto, commissioners.

BY THE COMMISSION:

****1 OPINION AND ORDER**

The Commission, considering the applications, testimony, the applicable law, proposed Stipulation, and other evidence of record, and being otherwise fully advised, hereby issues its opinion and order.

OPINION:

I. PROCEDURAL BACKGROUND

Duke Energy Ohio, Inc. (Duke, company) is a public utility, engaged in the distribution and sale of natural gas to approximately 424,000 customers in Adams, Brown, Butler, Clermont, Clinton, Hamilton, Highland, Montgomery, and Warren counties, Ohio. As a public utility and a natural gas company within the definition of Sections 4905.02 and 4905.03 (A)(6), Revised Code, Duke is subject to the jurisdiction of this Commission in accordance with Sections 4905.04, 4905.05 and 4905.06, Revised Code.

On June 18, 2007, Duke filed notice of its intent to file an application to increase its rates. The Commission issued an entry on July 11, 2007, establishing a test period of January 1, 2007 through December 31, 2007 for the proposed rate increase and a date certain of March 31, 2007, as well as granting certain waivers requested by Duke.

Duke filed the application in Case No. 07-589-GA-AIR, seeking to increase its gas rates on July 18, 2007. Duke also filed separate applications for approval of an alternative rate *187 plan (Case No. 07-590-GA-ALT) and for approval to change accounting methods (Case No. 07-591-GA-AAM). As originally filed, Duke's rate increase application sought approval for a 5.71 percent annual rate increase, an additional \$34 million, over current total adjusted operating revenues. As part of the alternative rate plan application, Duke proposes to: (a) extend the term of the Accelerated Main Replacement Program (AMRP) and the associated rider (Rider AMRP) through the year 2019, (b) establish a process to recover its future investment in Duke's Utility of the Future initiative through a new rider (Rider AU), and (c) create a new sales decoupling rider (Rider SD) to remove any disincentive for energy conservation initiatives. In the accounting application, Duke seeks approval to defer certain costs to be recovered later as a part of the AMRP expenditures and to capitalize the cost incurred for certain property relocations and replacements.

By entry issued September 5, 2007, the Commission found that Duke's application in Case No. 07-589-GA-AIR complied with the requirements of Section 4909.18, Revised Code, and Rule 4901:1-19-05, Ohio Administrative Code (O.A.C.) and accepted the application for filing as of July 18, 2007. The entry also granted Duke's waiver requests as to certain standard filing requirements and directed Duke to publish notice of the application in newspapers of general circulation in the company's service territory. Duke filed proof of such publication on February 25, 2007. To provide interested parties with an opportunity to make inquiries about the Duke applications, a technical conference was hosted by the Commission's staff on August 20, 2007.

****2** Motions to intervene in these cases were granted to the Ohio Energy Group (OEG), the Kroger Company (Kroger), Interstate Gas Supply, Inc. (Interstate), the city of Cincinnati, the office of the Ohio Consumers' Counsel (OCC), People Working Cooperatively, Inc. (PWC), Integrys Energy Services, Inc. (Integrys), Direct Energy Services, LLC (Direct), Stand Energy Corporation (Stand), and the Ohio Partners for Affordable Energy (OPAE).

Investigations of Duke's applications were conducted and reports filed by the Commission staff and Blue Ridge Consulting Services, Inc. (Blue Ridge), an independent auditing firm. Both the report filed by staff (Staff Report, Staff Ex. 1) and financial audit report filed by Blue Ridge (financial audit report, Staff Ex. 4) were filed on December 20, 2007. Objections to the Staff Report and/or financial audit report were filed by PWC, OEG, Duke, OPAE, OCC, and, jointly, by Integrys and Direct. Motions to strike certain objections were filed by Duke and OCC. Memoranda contra the motions to strike objections were filed by Duke, Interstate, OPAE, and, jointly, by Integrys and Direct.

On January 25, 2008, a prehearing conference was held, as required by Section 4909.19, Revised Code. In accordance with Section 4903.083, Revised Code, local public hearings were held on February 25, 2008, in Cincinnati, Ohio, and on March 11, 2008, in Mason, Ohio.

A total of 27 witnesses testified at the two local hearings in Cincinnati, while four people took the

stand at the Mason hearing. Two witnesses testified in favor of the rate increase, particularly as to the accelerated main replacement (AMRP) and riser replacement programs. Another witness testified that, although he was not opposed to the rate increase if Duke required additional money to maintain the gas lines, he was opposed to the extent that the increase is incorporated into the monthly customer charge as opposed to the volumetric charge. The witness claimed that applying the increase in such a manner discourages energy efficiency and adversely affects residential customers with small homes (Cincinnati Public Hearing I, p. 20-21). The remaining witnesses at the local public hearings were opposed to the increase, asserting that their utility bills are already expensive, particularly for individuals on fixed incomes and for low income individuals and families; while others argued that increasing the customer charge, as proposed, would discourage conservation.

The evidentiary hearing was called on February 26, 2008, and continued, to allow the parties additional time to negotiate a settlement of the issues in these proceedings. On February 28, 2008, the parties filed a Joint Stipulation ***188** and Recommendation (Stipulation, Joint Ex. 1) resolving all the issues except the adoption of a new residential rate design. The evidentiary hearing was reconvened on March 5 and March 6, 2008. Duke and staff filed the testimony of Paul G. Smith (Duke Ex. 29) and of J. Edward Hess (Staff Ex. 2), in support of the Stipulation. With respect to the unresolved issue of residential rate design, Duke presented witnesses James A. Riddle (Duke Exs. 10 and 25), Paul G. Smith (Duke Exs. 11 and 19), Donald L. Stork (Duke Exs. 13, 20, and 22), and James E. Ziokowski (Duke Ex. 16); OCC called Wilson Gonzalez (OCC Exs. 5 and 18) and Anthony J. Yankel (OCC Ex. 6 and 17); and Staff presented the testimony of Stephen E. Puican (Staff Ex. 3).

****3** Initial briefs, in support of their respective positions, were filed by Duke, OPAE, OCC, and staff on March 17, 2008. Reply briefs were filed on March 24, 2008.

A. Duke's Motion for Protective Order

[1] On February 21, 2008, Duke filed a motion for protective order for information attached to the direct testimony of Matthew G. Smith (Duke Ex. 27) and marked as Attachment MGS-I. Duke contends that

Attachment MGS-1 contains proprietary pricing information from vendors for equipment necessary for Duke's Utility of the Future program. The company states that the information for which Duke seeks confidential treatment is not known outside of Duke and its vendors. Furthermore, Duke states that, within the company, such information is only disseminated to employees who have a legitimate business need to know and act upon such information. Accordingly, Duke considers the information to be proprietary, confidential, and trade secret, as defined in Section 1333.61, Revised Code, and requests that the information be treated as confidential in accordance with the provisions of Sections 1333.61 and 4901.16, Revised Code. No party opposed Duke's request for protective treatment of Attachment MGS-1.

The Commission recognizes that Ohio's public records law is intended to be liberally construed to ensure that governmental records are open and made available to the public, subject to only a few very limited and narrow exceptions. *State ex rel. Williams v. Cleveland* (1992), 64 Ohio St.3d 544, 549. However, one of the exceptions is for trade secrets. Section 1333.61(D), Revised Code, defines trade secret as: [I]nformation, including the whole or any portion or phase of any scientific or technical information, design, process, procedure, formula, pattern, compilation, program, device, method, technique, or improvement, or any business information or plans, financial information, or listing of names, addresses, or telephone numbers, that satisfies both of the following:

(1) It derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.

(2) It is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The Commission finds that Attachment MGS-1 is financial information that derives independent economic value from not being generally known to or readily ascertainable by proper means by others who can obtain economic value from its use and that it is subject to reasonable efforts to maintain its secrecy. Therefore, we find that it contains trade secret information, as defined under Section 1333.61 (D), Re-

vised Code, and, therefore, that it should be granted protective treatment. In accordance with Rule 4901-1-24, O.A.C., Duke's request for a protective order is granted and the information filed under seal, as Attachment MGS-1, shall be afforded protective treatment for 18 months from the date this order is issued. Any request to extend protective treatment shall be made in accordance with Rule 4901-1-24(F), O.A.C.

***189 B. Duke's Motion for Waiver and Leave to File Depositions**

****4 [2]** On February 25, 2008, Duke filed a motion for waiver of a Commission filing requirement and leave to file depositions *instanter*. Duke states that depositions were conducted on February 21, 2008. On Friday, February 22, 2008, Duke filed notice that it would be filing the deposition transcripts of five witnesses and commenced electronic transmission of the depositions. However, Duke states that it subsequently learned that only one of the five depositions was received by the Commission's Docketing Division before the end of the business day on February 22, 2008. Accordingly, the remaining four depositions were electronically transmitted on Monday, February 25, 2008. Duke requests that the Commission waive the requirement of Rule 4901-1-21(N), O.A.C., that depositions be filed with the Commission at least three days prior to the commencement of the hearing. In this instance, the Commission finds Duke's request to waive the requirement that deposition transcripts be filed at least three days prior to the commencement of the hearing to be reasonable. Accordingly, the request for waiver should be granted.

II. SUMMARY OF THE EVIDENCE

A. Summary of the Proposed Stipulation

[3-26] The only issue not resolved by the Stipulation is the proposed residential rate design which was litigated and is expressly reserved for our determination. A new design is recommended by the Commission's staff and Duke, but opposed by OCC and OPAE. The city of Cincinnati, PWC, and the commercial and industrial intervenors take no position with respect to this issue (Jt. Ex. 1 at 5). Pursuant to the Stipulation, the parties agree, among other things, that:

(1) Duke will receive a revenue increase of

\$18,217,566, which represents a percentage increase of 3.05 percent and is based on a 8.15 percent rate of return. Duke will not be required to file the 60-day update filing of actual financial data for the test year (Jt. Ex. 1, at 5 and Stipulation Ex. 1).

(2) Duke's revenue distribution, billing determinants, and rates to be adopted are shown on Exhibit 2 of the Stipulation, and assume the adoption of the new residential rate design. The rates also reflect the shift of \$6,000,000 to the residential class, phased-in over two years, based upon the agreed revenue requirement and Duke's updated cost of service study (*Id.* at 5; Stipulation Ex.2).^{FN1}

(3) Duke will amortize deferred rate case expenses requested for recovery in its filing in these cases as recommended in the Staff Report (*Id.* at 6).

(4) Duke will implement new depreciation rates that reflect the mid-point between Duke's proposed depreciation rates and the rates proposed in the Staff Report, as shown on Stipulation Exhibit 5 (*Id.*).

(5) The allocation of common plant related to the provision of gas distribution service will be based on an updated allocation factor of 18.29 percent that excludes the generation plant assets contributed to Duke by Duke Energy North America, LLC (*Id.*).

****5** (6) Duke will file actual data to support a Rider AMRP adjustment for the last nine months of 2007. The Rider AMRP revenue requirement will be modified to include deferred curb-to-meter expense and riser expense, net of maintenance savings, for calendar year 2007. Such net deferred expense shall be capitalized with carrying charges at an annual rate of 5.87 percent, representing the company's long-term debt rate, and recovered through Rider AMRP, beginning in this filing. Duke may elect to recover this expense in any annual Rider AMRP filings, provided that the recovery does not exceed the Rider AMRP cumulative residential rate caps. If this deferred expense causes Duke to exceed the Rider AMRP cumulative rate cap in any year, Duke may recover that portion of the deferred expense that exceeds the rate cap in a subsequent year as long as the recovery does not exceed the cumulative rate cap. The new Rider AMRP residential rates are limited ***190** on a cumulative basis as shown on Stipulation Exhibit 4, at 3, and recoverable pursuant to the Rider AMRP revenue allocation de-

scribed in paragraph 9 of the Stipulation. Duke may implement these rates, effective with the beginning of the first billing cycle following issuance of the Commission's order, adjusted as necessary to permit the company full recovery of the revenue increase through May 1, 2009, subject to refund, upon Commission approval (*Id.* at 6-7).

(7) Following the implementation of new Rider AMRP rates, Duke will file a pre-filing notice and application annually to implement subsequent adjustments to Rider AMRP, beginning in November 2008.^{FN2} The annual filing will support the adjustment to Duke's revenue requirement for any increase to Rider AMRP. Duke shall continue to make its Rider AMRP annual filing until the effective date of the Commission's order in Duke's next base rate case (*Id.* at 8-9).

(8) Duke's revenue requirement calculation and Rider AMRP application filed with the Commission shall include the post-March 31, 2007 (date certain) original cost and accumulated reserve for depreciation of property associated with the AMRP program that is used and useful on December 31 of the prior year in the rendition of service as such property is associated with the AMRP and riser replacement programs, including capital expenditures for new plant (including but not limited to new mains, services and risers), adjustments for the retirement of existing assets, calculated Post-In-Service Carrying Charges ('PISCC') on net plant additions and related deferred taxes until included in rates for collection in Rider AMRP, a proper annual depreciation expense, and any sums of money or property that Duke may receive to defray the cost of property associated with the AMRP capital expenditures. The return assigned to the recovery of all such net capital expenditures shall be at a pre-tax weighted average cost of capital of 11.7 percent (*Id.* at 9-11).^{FN3}

(9) Duke will substantially complete the AMRP by the end of 2019 and will complete the riser replacement program by the end of 2012. Duke will file an application with the Commission for approval to extend the AMRP program if not substantially completed by the end of 2019 (*Id.* at 12).

****6** (10) Duke shall maintain its alternative regulation commitments until the effective date of the Commission's order in the company's next base rate case, ex-

cept that the incremental \$1,000,000 in funding for weatherization shall be funded through base rates.

^{FN4}If, for any reason, Duke does not expend the \$3,000,000 gas weatherization funding amount in any year, the amount not expended will be carried over to the following year and added to the annual \$3,000,000 funding to be available for distribution to weatherization projects during that year. If a weatherization service provider does not meet its contract requirements, including its failure to meet deadlines, following consultation with the Duke Energy Community Partnership (Collaborative), Duke will reprogram the remaining funding to a different project and/or assign it to another weatherization service provider so that the funding dollars can be spent expeditiously and productively (*Id.* at 12-14).^{FN5}

(11) The residential rate caps on Stipulation Exhibit 4 apply to Rider AMRP. Duke may establish deferrals for the expenses of the riser replacement program if these expenses cause Duke to exceed the cumulative rate cap, including a carrying cost of 5.87 percent. The rate caps shall be cumulative rather than annual caps such that if the rate increase is below the annual cap in a given year, the unused portion of the cap may be carried forward to future years but can never exceed the cumulative cap. If the deferred curb-to-meter expense or the deferred riser replacement program expense causes Duke to exceed the cumulative rate cap in any year, then Duke may recover that portion of the deferred expense that exceeds the cumulative rate cap in a subsequent year as long as the recovery does not exceed the cumulative rate cap (*Id.* at 17).

***191** (12) The parties agree that Duke shall take over ownership of the curb-to-meter service, including the riser, whenever a new service line or riser is installed or whenever an existing curb-to-meter service or riser is replaced. Duke shall file its tariffs in these cases such that Duke will be responsible for the cost of initial installation, repair, replacement and maintenance of all curb-to-meter services, including risers, except that consumers shall pay the initial installation costs related to the portion of service lines in excess of 250 feet. In 2008, Duke will begin capitalizing rather than expensing the costs currently described as 'Customer Owned Service Line Expense.' For this purpose, Duke will submit proposed tariff changes to Staff for review and approval, with a copy to parties, prior to filing the revised sheets with the Commission. Such capitalized costs shall be recoverable through

Rider AMRP (*Id.* at 12-14).^{FN6}

(13) Duke will file, within 60 days of the Commission's final order in this proceeding, a deployment plan for the company's Utility of the Future Program for 2008-2009 (*Id.* at 15-16).

(14) Duke's base rates do not include any amount for gas storage carrying costs. On a going forward basis, Duke will recover its actual gas storage carrying costs through its gas cost recovery rider (Rider GCR), without reduction to rate base, as shown on Stipulation Exhibit 1. Carrying charges associated with the actual monthly balances of Current Gas in Storage shall be accrued at a 10 percent annual rate as shown on Stipulation Exhibit 3. Further, the parties agree that the Commission should: (a) approve the methodology for the calculation of the storage carrying costs for inclusion in the GCR rate, as demonstrated in Stipulation Exhibit 3; (b) find that such an adjustment to Duke's rates is not an increase in base rates; and (c) approve recovery of such costs in Duke's next GCR filing following the Commission's order in this proceeding (*Id.* at 16-17).

****7** (15) Duke shall conduct an internal audit of its method and process for allocating service company charges to Duke by no later than 2009, and shall provide the audit report to Staff and the OCC (*Id.* at 18).

(16) Duke shall continue to use the 'Participants Test' as one of the methods for evaluating its Demand Side Management/Energy Efficiency programs as appropriate; however, Duke shall continue to use other cost/benefit tests as the Collaborative deems appropriate (*Id.* at 19).

(17) Duke will implement a pilot program available to the first 5,000 eligible customers. The intent of the pilot program will be to provide incentives for low-income customers to conserve and to avoid penalizing low-income customers who wish to stay off of programs such as the Percentage of Income Payment Plan (PIPP). Eligible customers shall be non-PIPP low usage customers verified at or below 175 percent of the poverty level. Duke will design a tariff that adjusts the fixed monthly charge for eligible customers as shown on Stipulation Exhibit 2. These rates may be adjusted if the Commission does not approve the fixed customer charge as shown in Stipulation Exhibit 2. Duke will develop the details for

this program in consultation with Staff and the parties. Duke shall evaluate the program after the first winter heating season to determine, following consultation with staff and the parties, whether the program should be continued to all eligible low-income customers, including considerations of program demand and cost (*Id.* at 20).

(18) Duke will convene a working group or collaborative process, open to interested stakeholders, within 60 days after approval of the Stipulation, to explore implementing an auction to supply the standard service offer. Duke will report to the Commission within one year after approval of this Stipulation, the findings of the working group or collaborative including the facts and arguments which support and or oppose implementation of an auction process. The working group or collaborative process shall also review whether the present allocation of 80 percent of the net revenues from Duke's asset management*192 agreement should continue to flow to GCR customers only, or should be changed to flow to GCR customers and choice customers (*Id.* at 21-22).

(19) Duke shall revise its GCR tariff to implement a sharing mechanism for sharing of net revenues from off-system transactions. ^{FN7}Such sharing mechanism shall be effective if Duke does not have an asset management agreement transferring management responsibility for its gas commodity, storage and transportation contracts to a third party, and shall provide for sharing of the net revenues from off-system transactions to be allocated 80 percent to GCR and choice customers and 20 percent to Duke shareholders. The revenue sharing percentage proposed by implementation of the sharing mechanism in this Stipulation is expressly limited to gas-related sales transactions, and shall not have precedential value in establishing the sharing percentages for similar electric sales transactions by Duke. This sharing mechanism, but not the 80 percent/20 percent revenue allocation, shall be subject to review in future GCR cases (*Id.* at 21-22). ^{FN8}

**8 (20) Duke shall meet with Staff and other interested parties to discuss eliminating customer deposits for PIPP customers and shall eliminate such deposits if Staff agrees (*Id.* at 18).

(21) Duke shall review and fully consider the merits of adopting any new payment plans submitted by any

party and, if Duke elects not to implement such new payment plan, Duke shall respond to the stakeholder in writing to state the reason for its decision (*Id.* at 18).

(22) Duke shall review its use of payday lenders as authorized payment stations and will use its best efforts to eliminate the use of payday lenders as authorized payment stations if other suitable locations for the payment stations are available in the same geographic area. Duke shall provide a list of all payday lenders utilized as authorized payment stations to Staff and other interested parties annually. The annual payday lenders list is to be provided initially on May 1, 2008, and on May 1, each year thereafter (*Id.* at 18-19).

(23) Duke shall communicate with its customers to educate them about the difference between authorized and non-authorized payment stations. Duke shall work with members of the Collaborative to develop the educational materials and communication strategy (*Id.* at 19).

B. Summary of the Residential Rate Design Issue

[27-29] This case marks a sea change in the recommendation of the Commission's Staff with respect to the method of determining a gas utility's residential distribution rate design. Traditionally, natural gas distribution rates in Ohio have been set by allocating a relatively small proportion of the fixed costs to the 'customer' charge, with the remaining fixed costs recovered through a volumetric component. However, volatile and sustained increases in the price of natural gas, along with heightened interest in energy conservation, have called into question long-held ratemaking practices for gas companies. In this proceeding, Staff and Duke advocate the adoption of a modified Straight Fixed Variable (SFV) residential rate design that allocates most fixed costs of delivering gas to a monthly flat fee with the remaining fixed costs recovered through a variable or volumetric component. Under this proposed new 'levelized' rate design, Duke's current \$6.00 residential customer charge would be eliminated. Instead, residential customers would pay a flat monthly fee of around \$20 to \$25, but with a corresponding lower usage component to recover the remaining fixed distribution costs (Staff Ex. 1, at 30-33, 46-48; Stipulation Ex. 2; Duke Ex. 29 at 6; Tr. I at 87-88, 147-148, 159).

In its initial filings, Duke's proposed residential rate design included a \$15.00 customer charge with a sales decoupling rider to address an alleged revenue erosion problem caused by declining average use per customer. The Staff Report noted this historical trend, but rejected a sales decoupling rider mechanism in favor of a phased-in SFV rate design. Staff's position was subsequently joined by Duke and the new *193 design was used for calculations in the Stipulation exhibits, but adoption of the proposed rate design was expressly reserved for consideration by the Commission (Staff Ex. 1, at 30-33, 46-49; Jt. Ex. 1, at 1, 5, 19-20).

****9** The levelized rate design is opposed by OCC and OPAE, both of whom advocate keeping the current low residential customer charge and high volumetric rates. In the alternative, they argue that, if a decoupling mechanism is to be adopted, the appropriate design is a decoupling rider rather than the flat rates recommended by Duke and Staff. The other parties to these proceedings either have no interest in residential rate design or chose not to take a position on this issue.

OCC and OPAE first cite the projected overall growth in Duke's residential gas revenues for 2008-2012 in contending that Duke has no revenue erosion problem because any revenue loss from declining sales on a per-customer basis will be more than offset by future increases in Duke's residential customer base (OCC Br. at 53; OCC Ex. 6, at 5-6; OCC Ex. 12). OCC and OPAE then argue that, in the event the Commission determines there is a revenue erosion problem, the Commission should adopt a sales decoupling rider to unlink revenue recovery from sales, similar to that stipulated to by Vectren Energy Delivery of Ohio ("Vectren"). See, *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Approval, Pursuant to Section 4929.11, Revised Code, of a Tariff to Recover Conservation Expenses and Decoupling Revenues Pursuant to Automatic Adjustment Mechanisms and for Such Accounting Authority as May be Required to Defer Such Expenses and Revenues for Future Recovery through Such Adjustment Mechanisms*, Case No. 05-1444-GA-UNC, Supplemental Opinion and Order (June 27, 2007).

Staff maintains that the evidence of record clearly indicates that Duke's revenue erosion problem is real and that the levelized rate design is the better way to balance the utility's desire for recovery of its authorized return with promotion of energy efficiency as a

customer and societal benefit through control of energy bills. Staff notes that nearly six million dollars of the total \$34.1 million revenue deficiency identified by Duke in this case is attributable to declining customer usage and cites the decline in per-customer, residential natural gas consumption, which has been accelerating since the marked price increases in the winter of 2000/2001. Staff asserts that, as long as the bulk of a utility's distribution costs are recovered through the volumetric component of base rates, this decline in per-customer usage threatens the utility's recovery of its fixed costs of providing service. Staff contends that the levelized rate design best addresses this issue while simultaneously removing the disincentives to utility-sponsored energy efficiency programs that exist with the traditional rate design (Duke Ex. 11, at 3-6, 11; Staff Ex. 3, at 3-5; Tr. I at 214-216; Staff Br. at 6-7).

Staff points out that the proposed new levelized rate design is a form of decoupling that breaks strict linkage between utility earnings and customer consumption by recognizing that virtually all the costs of gas distribution service are fixed, and the cost to serve a residential customer is largely the same, regardless of the specific customer's usage. Duke and Staff contend that it is neither fair nor accurate to characterize this fixed component as a customer charge because, under Duke's current rate design, the customer charge is set at an artificially low level that only minimally compensates the company for its fixed costs of providing gas service (Duke Ex. 29, at 6; Tr. I at 159; Staff Br. at 6-8;).

****10** Staff and Duke argue that, since the costs of providing gas distribution service are almost exclusively fixed, the proposed rate design will more closely match costs and revenues, thereby giving customers more accurate and timely pricing signals. They also contend that spreading the recovery of fixed costs more evenly over the entire year will help to reduce winter heating bills. Staff and Duke allege that customer incentives to conserve energy will remain strong because 75 to 80 percent of each customer's total bill is the cost of the gas itself (Staff Ex. 3, at 3-5; Tr. I at 159, 214-216; Tr. II at 91-93).

***194** Finally, Staff and Duke suggest that a strict matching of fixed rates with fixed costs would result in a \$30.00 fixed residential distribution charge. However, because the proposed rate design is a sig-

nificant departure from current rates, the Stipulation proposes to phase-in the new design over two years, using a lower fixed charge of \$20.25 in year one, and \$25.33 in year two. In addition, the remaining variable base rate component contains two usage tiers in an effort to minimize impacts on low-use residential customers, since average and larger usage residential customers will either benefit or be unaffected by the levelized rate design proposal (Jt. Ex. 1, at Ex. 2; Tr. I at 55, 87-88, 147-148).

OCC and OPAE counter that the stipulated rate design proposal amounts to a huge jump in the fixed monthly customer charge and violates a 30-year rate-making principle of gradualism. Moreover, they allege, it would violate the state policy to promote energy efficiency under Section 4929.02, Revised Code, because the proposed rate design sends an anti-conservation price signal to consumers, penalizes customers who have invested in energy efficiency by extending the payback period, and takes away the consumers' ability to control their energy bills. In addition, they assert that the levelized rate design is regressive towards low-use customers, and transfers wealth from low-income customers to high-use customers who are predominantly high-income customers (OCC Br. at 17-35, 46-55, 75-76).

Staff and Duke contend that under the proposed new rate design, high-use customers will benefit relative to low-use customers, and cite an analysis of PIPP customers to support the proposition that most low-income customers will actually benefit from this change. According to Duke witness Paul G. Smith, the PIPP customer data indicated that the average PIPP customer consumes approximately 1,000 ccf per year, or approximately 25 percent more than the average non-PIPP customer and, therefore, levelized rates will actually reduce the annual cost for the average PIPP customer, and the cost of the PIPP program (Duke Ex. 29; at 11-12). Duke and Staff argue that if PIPP customer usage is representative of all of Duke's low-income customers, then most of Duke's low-income ratepayers will actually benefit from this policy change. In addition, they note any adverse impact of the levelized rate design will be mitigated by the new low-income/low-use pilot program included in the Stipulation. This program provides a credit to offset the higher fixed monthly charge for the first 5,000 non-PIPP, low-use customers verified at or below 175 percent of the federal poverty level. (Duke

Br. at 17-35, 46-55, 75-76).

****11** OCC and OPAE insist that the levelized rates will harm low-income customers and that the PIPP customer data is not indicative of other Duke low-income customers, but offered no data to support this contention (OCC Br. at 46-53; OPAE Br. at 4, 8).

III. DISCUSSION AND CONCLUSION

A. Consideration of the Stipulation

Rule 4901-1-30, O.A.C., authorizes parties to Commission proceedings to enter into a stipulation. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. *See Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, at 125 (1992), *citing Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155 (1978). This concept is particularly valid where the stipulation is unopposed by any party and resolves all or most of the issues presented in the proceeding in which it is offered.

In considering the reasonableness of a stipulation, the Commission has used the following criteria:

- (a) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
- (b) Does the settlement, as a package, benefit ratepayers and the public interest?
- (c) Does the settlement package violate any important regulatory principle or practice?

***195** The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St.3d 559 (1994) (*citing Consumers' Counsel, supra*, at 126). The court stated in that case that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

The Commission finds that the Stipulation filed in these cases appears to be the product of serious bargaining among capable, knowledgeable parties. The signatory parties represent a wide diversity of interests including the utility, residential consumers,

low-income residential consumers, commercial and industrial consumers, and Staff. Further, we note that the signatory parties routinely participate in complex Commission proceedings and that counsel for the signatory parties have extensive experience practicing before the Commission in utility matters.

The Stipulation also meets the second criterion. As a package, the Stipulation advances the public interest by resolving all issues raised, except as to residential revenue design, thereby avoiding extensive litigation. While the Stipulation includes a general rate increase of approximately three percent across all customer classes, that increase will allow the company an opportunity to recover its expenses. As for the new AMRP, which now includes riser replacement and company ownership of certain customer service lines, the Stipulation continues the mechanism established for the parties and the Commission to evaluate the reasonableness of the expenses incurred on a consistent, regular basis during the program until another base rate application is filed by Duke. We conclude that the continuance of the main replacement program, the initiation of the riser replacement program and Duke's ownership of customer service lines advances the public interest and safety. As with the previous program, the new AMRP and riser replacement program does not sanction cost recovery of any or all yet-to-be-incurred costs and does institute caps on future recovery. The Stipulation also continues the process under which each year's AMRP and riser replacement expenses can be evaluated for the next AMRP rider, while also addressing questions related to over-recovery and treatment of cost savings. We note that the accounting provisions adopted to facilitate the new AMRP program and the riser replacement program cease at the completion of each program. The Commission further notes that the Stipulation provides for the continuation of the weatherization program and a pilot program for low income customers.

****12** Regarding company ownership of certain customer service lines, Duke should, upon the request of the customer, work with the customer as to location, relocation, and, manner of installation of the service line, to the extent feasible under the gas pipeline safety regulations, Duke's tariff, and Duke's procedures.

Finally, the Stipulation meets the third criterion because it does not violate any important regulatory principle or practice. Indeed, the Stipulation provides

a resolution for Duke to economically continue the AMRP and to initiate the riser replacement program facilitating gas system safety and reliability improvements.

On March 14, 2008, Duke moved for waiver of the requirement to file an update of the partially forecasted income statement and any variances for the test year, pursuant to Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C. Duke notes that, as part of the Stipulation, the parties negotiated a revenue increase and further agreed to recommend that Duke be allowed to forgo the requirement of filing actual financial data for the test year (Jt Ex. 1, at 5, footnote 5).

The Commission finds that the Stipulation filed in these matters is in the public interest and represents a reasonable disposition of all but one of the issues raised in these proceedings. We will, therefore, adopt the Stipulation in its entirety and grant Duke's motion for a waiver of the requirement to file an updated income statement in accordance with Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C.

***196 B. Consideration of the Residential Rate Design**

[30-38] The Commission first notes that there is no disagreement in this case that Duke's residential rates need to go up in order to cover Duke's prudently incurred costs to provide service. There is also no dispute in this case as to the amount of the increase in revenues needed to allow Duke to earn a fair rate of return on its investment. In addition to an overall increase in revenue of 3.1 percent, the settlement before us provides for the assignment of \$6 million in costs from commercial and industrial customers to the residential class. This reallocation reduces a pre-existing subsidy of residential customers by commercial and industrial customers. Thus, the parties have already agreed that residential customers, as a class, will pay an increase of 11.9 percent during the first year and 14.1 percent in the second year for the distribution portion of each residential customer's bill.

The only issue left to the Commission is the design of the rates Duke should bill residential customers to collect the revenues agreed to in the settlement. We agree with Staff that the time has come to re-think traditional natural gas rate design. Conditions in the natural gas industry have changed markedly in the past several years. The natural gas market is now charac-

terized by volatile and sustained price increases, causing customers to increase their efforts to conserve gas. The evidence of record clearly documents the declining sales-per-customer trend over the decades. In fact, more than 15 percent of Duke's revenue deficiency in this rate case is attributable to declining customer usage, a trend which is not just continuing, but is also accelerating (Duke Ex. 11, at 3-6, 11; Staff Ex. 3, at 3-5; Tr. I at 214-216; Staff Br. at 7). Under traditional rate design, the ability of a company to recover its fixed costs of providing service hinges in large part on its actual sales, even though the company's costs remain fairly constant regardless of how much gas is sold. Thus, a negative trend in sales has a corresponding negative effect on the utility's ongoing financial stability, its ability to attract new capital to invest in its network, and its incentive to encourage energy efficiency and conservation.

****13** The Commission, therefore, concludes that a rate design which separates or 'decouples' a gas company's recovery of its cost of delivering the gas from the amount of gas customers actually consume is necessary to align the new market realities with important regulatory objectives. We believe it is in the interest of all customers that Duke has adequate and stable revenues to pay for the costs of its operations and capital and to ensure the continued provision of safe and reliable service. We further believe that there is a societal benefit to removing from rate design the current built-in incentive to increase gas sales. A rate design that prevents a company from embracing energy conservation efforts is not in the public interest. Duke's commitment to provide \$3 million for weatherization projects under the Stipulation is critical to our decision in this case (Jt. Ex. 1, at 12-14). Indeed, the Commission notes that a commitment to conservation initiatives will be an important factor in any future decision to adopt a decoupling mechanism. The Commission encourages Duke to review and further enhance its weatherization and conservation program offerings. As one part of this review, Duke should adopt the objective to make cost-effective weatherization and conservation programs available to all low-income consumers and to ramp up such programs as rapidly as reasonably practicable.

Having determined that a new decoupling rate design is appropriate, we must decide the better choice of two methods: a levelized rate design, which recovers most fixed costs up front in a flat monthly fee, or a de-

coupling rider, which maintains a lower customer charge and allows the company to offset lower sales through an adjustable rider.

On balance, the Commission finds the levelized rate design advocated by Duke and Staff to be preferable to a decoupling rider. Both methods would address revenue and earnings stability issues in that the fixed costs of delivering gas to the home will be recovered regardless of consumption. Each would also remove any disincentive by the company to promote conservation and energy efficiency. The levelized rate ***197** design, however, has the added benefit of producing more stable customer bills throughout all seasons because fixed costs will be recovered evenly throughout the year. In contrast, with a decoupling rider, as favored by OCC, customers would still pay a higher portion of their fixed costs during the heating season when their bills are already the highest, and the rates would be less predictable since they could be adjusted each year to make up for lower-than-expected sales.

A levelized rate design also has the advantage of being easier for customers to understand. Customers will transparently see most of the costs that do not vary with usage recovered through a flat monthly fee. Customers are accustomed to fixed monthly bills for numerous other services, such as telephone, water, trash, internet, and cable services. A decoupling rider, on the other hand, is much more complicated and harder to explain to customers. It is difficult for customers to understand why they have to pay more through a decoupling rider if they worked hard to reduce their usage; the appearance is that the company is penalizing them for their conservation efforts.

****14** The Commission also believes that a levelized rate design sends better price signals to consumers. The rate for delivering the gas to the home is only about 20 to 25 percent of the total bill. The largest portion of the bill, the other 75 to 80 percent, is for the gas that the customer uses. This commodity portion, the cost of the actual gas used, is the biggest driver of the amount of a customer's bill. Therefore, gas usage will still have the biggest influence on the price signals received by the customer when making gas consumption decisions, and customers will still receive the benefits of any conservation efforts in which they engage. While we acknowledge that there will be a modest increase in the payback period for custom-

er-initiated energy conservation measures with a levelized rate design, this result is counterbalanced by the fact that the difference in the payback period is a direct result of inequities within the existing rate design that cause higher use customers to pay more of their fair share of the fixed costs than low-use customers.

The levelized rate design also promotes the regulatory objective of providing a more equitable cost allocation among customers regardless of usage. It fairly apportions the fixed costs of service, which do not change with usage, among all customers, so that everyone pays his or her fair share. Customers who use more energy for reasons beyond their control, such as abnormal weather, large number of persons sharing a household, or older housing stock, will no longer have to pay their own fair share plus someone else's fair share of the costs.

We recognize that, with this change to rate design, as with any change, there will be some customers who will be better off and some customers who will be worse off, as compared with the existing rate design. The levelized rate design will impact low usage customers more, since they have not been paying the entirety of their fixed costs under the existing rate design. Higher use customers who have been overpaying their fixed costs will actually experience a rate reduction. Average users will see only the impact of the increase agreed to by the parties; they will see no additional impact as a result of the Commission choosing the levelized rate design.

The Commission is sensitive to the impact of any rate increase on customers, especially during these tough economic times. We believe that the new levelized rate design best corrects the traditional design inequities while mitigating the impact of the new rates on residential customers by maintaining a volumetric component to the rates, by phasing in the increase over a two-year period, and by not reflecting the full extent of Duke's fixed costs in the proposed fixed charge. Still, we are concerned with the impact on low-income, low-use customers. Thus, crucial to our decision to adopt Duke and Staff's proposed rate design is the Pilot Low Income Program aimed at helping low-income, low-use customers pay their bills. This new program will provide a four-dollar, monthly discount to cushion much of the impact on qualifying customers. To ensure that this discount is available to

as many customers as possible, we direct that Duke expand this pilot program to include up to 10,000 customers, instead of the *198 5,000 customers specified in the Stipulation. Pursuant to the terms of the stipulation, Duke, in consultation with staff and the parties, shall establish eligibility qualifications for this program by first determining and setting the maximum low usage volume projected to result in the inclusion of 10,000 low-income customers who have previously been defined by the stipulation to be those at or below 175 percent of the poverty level. The Commission expects that Duke will promote this program such that to the fullest extent practicable the program is fully enrolled with 10,000 customers. Following the end of the pilot program, the Commission will evaluate the program for its effectiveness in addressing our concerns relative to the impact on low-use, low-income customers.

****15** We are also concerned about the immediate impact of implementing the levelized rate design during the summer months when overall consumption is lowest. For the average customer, the new rate design will result in lower bills in the winter, but higher bills in the summer. Our concern is that the fixed charge increase may not be anticipated by customers who have budgeted for the traditional lower fixed charge during the low usage summer months. To mitigate this impact, we are directing that, from the initial bills resulting from this order through bills covering the period ending September 30, 2008, the fixed charge be set at \$15.00, consistent with Duke's original proposal. The corresponding volumetric rate for those months should also be adjusted to compensate for any revenue shortfall that this adjustment in the fixed charge will cause. Thereafter, rates will be as proposed in the Stipulation. We believe this additional phase-in of the new residential rate structure will give customers a further opportunity to adapt to this change, including the benefits of the budget billing option.

C. Rate Determinants:

1. Rate Base

[39] The value of Duke's property used and useful in the rendition of natural gas services as of the December 31, 2007, is not less than \$649,964,874, as stipulated by the parties (Jt. Ex. 1, at Schedule A-1).

The Commission finds the rate base of \$649,964,874, as provided in the Stipulation, to be reasonable and proper based on the evidence presented in these matters. Accordingly, the Commission adopts the valuation of \$649,964,874 as the rate base for purposes of this proceeding.

2. *Operating Income:*

[40] In accordance with the proposed Stipulation, the parties agree that Duke's operating revenue is \$597,573,805 and that the net operating income is \$43,274,872 for the 12 months ended December 31, 2007 (Jt. Ex. 1, at Schedule A-1). The Commission finds the operating revenue and net operating income, as provided in the Stipulation, to be reasonable and proper based on the evidence presented in these matters. The Commission will, therefore, adopt these figures for purposes of these proceedings.

3. *Rate of Return and Authorized Increase:*

[41, 42] As stipulated by the signatory parties, under its present rates, Duke's net operating income is \$43,274,872. Applying this amount to the rate base of \$649,964,874 results in a rate of return of 6.66 percent. Such a rate of return is insufficient to provide Duke with reasonable compensation for the gas service it renders to customers. Accordingly, the signatory parties have agreed that Duke should be authorized to increase its revenues by \$18,217,566, an increase of approximately 3.05 percent above current annual revenues. This would result in an overall rate of return of 8.45 percent, which the Commission finds to be reasonable.

4. *Rates and Tariffs:*

Duke is directed to file a proposed customer notice. Duke is further authorized to cancel and withdraw its present tariffs governing service to customers affected by these applications*199 and to file tariffs consistent in all respects with the discussion and findings set forth herein for the Commission's consideration. The approved tariffs will be effective for all services rendered after the effective date of the tariffs.

FINDINGS OF FACT:

**16 (1) On June 18, 2007, Duke filed notice of its

intent to file an application to increase its rates. In that notice, the company also requested a test year beginning January 1, 2007, and ending December 31, 2007, with a date certain of March 31, 2007.

(2) By entry issued July 11, 2007, the Commission approved Duke's request to establish the test period of January 1, 2007, through December 31, 2007, for the rate increase proposal and a date certain of March 31, 2007.

(3) Duke filed its rate increase application on July 18, 2007. On July 18, 2007, Duke also separately filed requests for approval of an alternative rate plan, docketed at Case No. 07-590-GA-ALT, and for approval of changes in accounting methods, docketed at Case No. 07-591-GA-AAM.

(4) By entry dated September 5, 2007, the Commission found that Duke's rate increase and alternative rate plan applications complied with the requirements of Section 4909.18, Revised Code, and Rule 4901:1-19-05, O.A.C.

(5) The Commission accepted Duke's rate increase application for filing as of July 18, 2007.

(6) OEG, Kroger, Interstate, the city of Cincinnati, OCC, PWC, Integrys, Direct, Stand and OP&E each requested, and was granted, intervention in these proceedings.

(7) Objections to the staff report were filed by Duke, PWC, OEG, OP&E, OCC, and, jointly, by Integrys and Direct.

(8) Duke published notice of its applications and the hearings and filed the required proofs of publication on February 11, February 25, and March 12, 2008.

(9) The staff of the Commission and the financial auditor filed their respective reports of investigation on December 20, 2007.

(10) On January 25, 2008 a prehearing conference was held, as required by Section 4909.19, Revised Code.

(11) Two local public hearings were held in Cincinnati, Ohio, on February 25, 2008, and another local public hearing was held in Mason, Ohio, on March 11,

2008, in accordance with Section 4903.083, Revised Code. At the Cincinnati hearings a total of 27 witnesses gave testimony and four witnesses gave testimony at the Mason hearing.

(12) On February 28, 2008, a Stipulation was filed by all the parties to this proceeding resolving all the issues presented in these matters, except rate design.

(13) The evidentiary hearing commenced as scheduled on February 26, 2008, was continued until February 28, 2008, and reconvened on March 5, 2008. At the evidentiary hearing, Duke and staff each presented one witness in support of the Stipulation. In regard to the one litigated issue, rate design, Duke presented four witnesses, OCC presented two witnesses and staff presented one witness.

(14) The Stipulation is the product of serious bargaining between knowledgeable parties, benefits ratepayers, advances the public interest, and does not violate any important regulatory principles or practices.

(15) The value of all of the company's jurisdictional property used and useful for the rendition of natural gas service to customers affected by this application, determined in accordance with Section 4909.15, Revised Code, is not less than \$649,964,874.

****17** (16) Under its existing rates, Duke's net operating revenue is \$43,274,872, under its existing rates. This net annual revenue of \$43,274,872, when applied to a rate base of \$649,964,874, results in a rate of return of 6.66 percent.

(17) A rate of return of 6.66 percent is insufficient to provide Duke reasonable compensation for the service it provides.

(18) A rate of return of 8.45 percent is fair and reasonable, under the circumstances presented in these cases, and is sufficient to provide the company just compensation and return on the value of its property used and useful in furnishing natural gas service to its customers.

***200** (19) A rate of return of 8.45 percent applied to the rate base of \$649,964,874 will result in allowable net operating income of \$54,922,032.

(20) The allowable gross annual revenue to which the company is entitled for purposes of this proceeding is \$615,791,371.

CONCLUSIONS OF LAW:

(1) Duke's application for a rate increase was filed pursuant to, and this Commission has jurisdiction of the application pursuant to, the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code. The application complies with the requirements of these statutes.

(2) Staff and Blue Ridge conducted investigations of the application, filed their respective reports, and served copies of the Staff Report on interested persons in accordance with the requirements of Section 4909.19, Revised Code.

(3) The hearings, and notice thereof, complied with the requirements of Sections 4909.19 and 4903.083, Revised Code.

(4) The Stipulation is the product of serious bargaining between knowledgeable parties, benefits ratepayers, advances the public interest, and does not violate any important regulatory principles or practices. The Stipulation submitted by the parties is reasonable and shall be adopted in its entirety.

(5) Duke's existing rates and charges for gas service are insufficient to provide Duke with adequate net annual compensation and return on its property used and useful in the provision of natural gas service.

(6) A rate of return of 8.45 percent is fair and reasonable under the circumstances of this case and is sufficient to provide Duke just compensation and return on its property used and useful in the provision of gas service to its customers.

(7) Duke should be authorized to cancel and withdraw its present tariffs governing service to customers affected by these applications and to file tariffs consistent in all respects with the discussion and findings set forth herein.

(8) The levelized rate design, as modified herein, is a reasonable resolution to address Duke's declining

sales volumes per customer, allow Duke the opportunity to collect the revenue requirement established in this rate case proceeding and encourage Duke's participation in customer energy conservation programs.

ORDER:

It is, therefore,

ORDERED, That Duke's request for a protective order in regards to Attachment MGS-1 is granted for 18 months from the date this order is issued. It is, further,

****18** ORDERED, That Duke's request for leave to file depositions less than three days prior to the commencement of the evidentiary hearing is granted. It is, further,

ORDERED, That the Stipulation filed on February 28, 2008 is approved in its entirety. It is, further,

ORDERED, That Duke's request for a waiver of the requirement to file an updated income statement, pursuant to Rule 4901-7-01, Appendix A, Chapter II(A)(5)(d), O.A.C., is granted. It is, further,

ORDERED, That Duke implement the levelized rate design for its residential customers as discussed in this order. It is, further,

ORDERED, That Duke's applications to increase its rates and charges for gas service, to implement an alternative rate plan and to modify accounting methods are granted to the extent provided in this opinion and order. It is, further,

ORDERED, That Duke is authorized to cancel and withdraw its present tariffs governing gas service to customers affected by these applications and to file new tariffs consistent with the discussion and findings as set forth in this order. Upon receipt of four complete copies of tariffs conforming to this opinion and order, the Commission will review and consider approval of the proposed tariffs by entry. It is, further,

ORDERED, That a copy of this order be served upon all interested persons of record.

Entered in the Journal MAY 28 2008

***201 CONCURRING OPINION OF CHAIRMAN
ALAN R. SCHRIBER**

[43] The straight fixed variable (SFV) option proposed by the PUCO Staff and adopted here today appropriately speaks to two significant issues. One is the potential impact on low income customers and the other is the desired effect that the Order shall have upon conservation.

The latter consideration is paramount. As we acknowledge that there are serious energy issues, we strive to promote and adopt advanced and renewable energy sources. While these are necessary and important pursuits, I believe that conservation is the most important measure of all. Nothing is less costly or more effective than simply reducing consumption. As time goes by, I trust that we will expend many resources adopting conservation measures on 'both sides of the meter.'

What we are attempting to do today is to provide appropriate incentives, through a rational pricing scheme, to encourage a reduction in the consumption of natural gas. By 'rational', I mean a balanced approach that penalizes neither those whom have already squeezed the last cubic foot of natural gas from their budget, nor those whom might be inclined to 'over-conserve.'

The proposed SFV option achieves the optimum balance because it segregates fixed costs from those costs that are within the control of the consumer. In contrast, the current pricing scheme assigns all costs-fixed and variable - to the level of usage. The inherent danger with the current system is that consumers might be led to believe that the more they cut back, the more they save. This is true to a point. The point happens to be that of diminishing returns; over conservation takes place when the fixed costs of providing the service are no longer covered with revenue. This inevitably leads to a rate case and higher rates. In other words, if usage-sensitive rates are assigned to fixed costs, find if usage falls below a certain point, then fixed costs do not get covered. It is then time for a rate case: what has the consumer saved?

****19** If the solution is appropriate price signals, then prices must be associated with the volume of gas alone. In contrast, under the current pricing scheme,

the gas company has no incentive to encourage conservation because those same usage sensitive rates might flow through to fixed costs as consumption grows, much to the utility's advantage. Under the SFV, the fixed costs are covered and the company makes no money on the gas commodity. Therefore, the company might actually promote conservation more aggressively.

One alternative to the old conventional method is a decoupling rider mechanism. In this case, Homeowner A who has already squeezed the last cubic foot of un-needed gas from his home via conservation oriented expenditures is discriminated against. This results from the make-whole provision that accrues to the utility when Homeowner B begins to pare down consumption. In other words, as B's meter begins to spin slower, so too do the company's revenues. Homeowner A will be compelled to make up some share of the shortfall, notwithstanding the fact that Homeowner A can cut back consumption no further.

Finally, those who argue that inadequate price signals are the biggest issue need only look at the impact of budget billing. What signal is being sent when the bill each month is the same regardless of consumption? Yet, is anyone recommending the elimination of budget billing?

The other issue in play is that of the income effect of the SFV methodology. One can conclude that consumers of greater amounts of gas will see their bills fall while those at the low end will see theirs rise. This does not mean that the burden will fall disproportionately on low-income consumers. There is record testimony that suggests that low-income consumers, *i.e.*, PIPP customers consume more on average per year than others. Clearly, PIPP customers are protected. Furthermore, while one can play freely with percentages, the nominal dollar increases due to the rate restructuring is quite small. As a precaution, however, the Commission is modifying the stipulation to provide a four dollar credit to ten thousand non-PIPP customers*202 as opposed to five thousand provided for in the stipulation.

All told, it is important that we arrive at a decision as expeditiously as possible. I believe that over the years the lesson to be learned is that we can never know with one hundred percent certainty all of the facts and all of the possible outcomes. This is precisely why the law

has provided this Commission with the ability to react to adverse outcomes should they arise. This is the ultimate consumer protection.

Alan R. Schriber, Chairman

OPINION OF COMMISSIONER PAUL A. CENTOLLELLA CONCURRING IN PART AND DISSENTING IN PART

[44, 45] The majority concludes that the current residential rate design has a negative impact on the ability of Duke Energy Ohio (hereafter 'Duke', 'the Company', or 'the utility') to maintain financial stability, attract new capital, and on its incentive to encourage energy efficiency and conservation. And, the majority determines that it is necessary to decouple the utility's recovery of fixed costs from its volumetric sales. I concur with the majority in these conclusions and on issues other than residential rate design. I dissent from the majority regarding how to transition toward a residential rate design which decouples the recovery of fixed costs from volumetric rates.

****20** Having determined that a new decoupling rate design is appropriate, the Commission must decide two questions. First, we must decide the better choice between two decoupling methods: a straight fixed variable (SFV) rate design, which recovers fixed costs in a flat monthly customer charge, or a decoupling adjustment, which allows the company to recover the same fixed cost revenue requirement with a lower customer charge by adjusting subsequent year rates to true up revenues received from volumetric charges. Second, in the event the Commission finds the SFV rate design preferable, the Commission should consider how to transition to a rate design which, is significantly different from the rate structures that have formed the basis of consumer expectations.

Over the long-term, moving in the direction of a SFV rate design is preferable to keeping a modest customer charge and relying entirely on a decoupling adjustment. Both methods will address revenue and earnings stability issues in that the fixed costs of delivering gas to the home will be recovered irrespective of consumption. When fully implemented, each will remove any disincentive by the Company to promote conservation and energy efficiency. And, both methods can be implemented in a straight forward manner and, if appropriately designed, easily explained to consumers

as a deliberate or more gradual transition toward recovering fixed costs through a customer charge. However, as the ultimate objective, significant movement toward a fixed variable rate design is consistent with developing a more efficient rate structure. Efficient rate design seeks to align price elastic rate elements more closely to marginal costs, while recovering a larger portion of any residual revenue requirements through comparatively price inelastic charges. Experience shows that there is a significant price response to increases in volumetric charges, as evidenced by the recent steep reductions in average per customer consumption as gas costs increased. Given that customer charges are paid to provide access to gas service, it is reasonable to expect comparatively less price response with respect to increases in the customer charge. Over the long-term, this supports significant movement toward a SFV rate design in which a larger portion of the company's fixed cost revenue requirements is recovered through the customer charge.

Additionally, the SFV rate design will reduce the month-to-month variation in customer bills as fixed costs will be recovered evenly throughout the year, making it easier for customers to deal with high winter heating bills. While decoupling adjustments are not difficult to implement, a SFV rate design, when fully implemented, will remove the need for any additional administrative proceedings to review decoupling adjustments.

***203** Consumers have made investment decisions based on expectations regarding natural gas pricing and fairness compels us to move at a measured pace when making fundamental changes in rate design. For this reason, the Commission should carefully consider the appropriate transition path.

****21** On the question of how to transition to a fixed charge rate design, Duke and the Staff have proposed a modified SFV rate design in which the customer charge would be set at \$20.25 per bill in year one and \$25.33 per bill in year two. Fully implementing a SFV rate design would require a customer charge in excess of \$30 per residential consumer bill. Duke and the Staff also proposed and the Commission has expanded a 'Pilot Low Income Program' that would provide some low income consumers a discount to cushion the impact of the change in rate design.

In my view, the pace of the transition in this case is more rapid than should be selected given the consumer expectations created by long-standing rate design practices and the recovery of fixed costs should be fully decoupled from sales volumes during the transition.

The pace of the transition proposed in the stipulation could send the wrong message to consumers with respect to energy conservation. Consumers who have made efficiency investments and reduced their consumption could see a significant increase in the regulated portion of their bills, while their neighbors who have implemented no energy efficiency measures and are high use customers will see the regulated portion of their gas bills decline by similar amounts. Given rising gas commodity costs, increasing dependence on foreign sources of gas supply, and the likely adoption of limits on greenhouse gas emissions from the burning of fossil fuels, encouraging the adoption of cost effective energy efficiency measures should be among our highest priorities. A more gradual transition to a SFV rate design would minimize near term bill increases for low use consumers recognizing the investments that many of these consumers have made to reduce their gas usage, allow consumers to capture a greater portion of the expected benefits of such investments, and avoid the appearance that the Commission is rewarding high use by lowering the gas bills of high use customers.

Second, during the period covered by this Order, the modified SFV approach will not fully decouple recovery of the Company's fixed costs from sales volumes. A modest three percent reduction in sales during the first year would represent a loss to Duke of the opportunity to recover more than a million dollars of its fixed costs.

To address these concerns, I would reach the following result.

First, the recommendation of the Staff and Company should be modified to reduce the year one customer charge for all residential consumers to \$16.25 per residential bill and establish the base level of the year two customer charge for all residential consumers at \$21.33.

Second, consistent with the majority opinion, the Company should review and further enhance its

weatherization and conservation program offerings. As one part of this review, Duke should adopt the objective of making cost-effective weatherization and conservation programs available to all low income consumers and to ramp up programs to facilitate implementation of all such measures as rapidly as reasonably practicable. Low income consumers often face difficult choices between paying their energy bills and meeting other essential needs, yet may be among the last to be able to take advantage of cost-effective energy efficiency investments. Consumers who struggle to make ends meet often find it difficult to pay for the initial cost of efficiency measures. And, many low income consumers live in rental housing with landlords who have little incentive to install efficiency measures that would reduce their tenants' utility bills.

****22** Third, in conjunction with filing a proposal for approval of significantly expanded energy efficiency programs and recovery of the costs of such programs, I would invite the Company to propose an interim decoupling adjustment. This adjustment should be structured to adjust the second and subsequent year base customer charge of \$21.33 for the difference, on a per customer bill basis, between the portion of the ***204** Company's fixed cost residential revenue requirement that is allocated to volumetric rates and the revenues recovered for such fixed costs through volumetric rates at weather normalized sales levels.

To meet the energy challenges of the 21st Century, Ohio will need to greatly improve the efficiency with which we use all forms of energy including natural gas. Efficient price signals will be an important, but not sufficient, element in this transformation. Our increasing knowledge of behavioral economics and experience with utility energy efficiency programs has shown that utility efficiency programs can produce significant net economic benefits. The Commission needs to encourage the cost-effective expansion of such programs. And, we should not wait through the completion of a multi-year transition to a SFV rate design before doing so in full measure.

Paul A. Centolella, Commissioner

FOOTNOTES

FN1 OCC and OP&E object to the characterization of this cost reallocation as a 'subsi-

dy/excess' used in the Stipulation (*Id.* at 5, footnote 6).

FN2 Although the Stipulation directs Duke to make its annual filings in Case No. 07-589-GA-AIR, each annual review should be filed in a new case to accommodate the operational efficiencies of the Commission's Docketing Information System. These annual review cases will be linked to the instant proceedings, and Duke should serve all parties to these proceedings with each pre-filing notice and annual AMRP application.

FN3 This rate of return is based on a 10.4 percent return on equity.

FN4 OCC agrees with Duke's incremental \$1 million weatherization funding; however, OCC does not agree that this out-of-test period expenditure should be collected through base rates, and asserts that this amount should instead be collected through a rider.

FN5 The members of the Collaborative include Duke personnel and representatives of the OCC, Staff, the Hamilton County Cincinnati Community Action Agency, City of Cincinnati, and PWC.

FN6 Neither Direct, Interstate, nor Integry's endorse this provision of the stipulation.

FN7 Off-system transactions are defined to include but are not limited to Off-System Sales Transactions, Capacity Release Transactions, Park Transactions, Loan Transactions, Exchange Transactions, and any other similar, but yet unnamed transactions.

FN8 This paragraph does not change the allocation contained in the current sharing mechanism for revenues received under Duke's asset management agreement.

END OF DOCUMENT