COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF DUKE ENERGY KENTUCKY, INC. FOR (1) A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AUTHORIZING THE ACQUISITION OF THE DAYTON POWER & LIGHT COMPANY'S 31% INTEREST IN THE EAST BEND GENERATING STATION; (2) APPROVAL OF DUKE ENERGY KENTUCKY, INC.'S ASSUMPTION OF CERTAIN LIABILITIES IN CONNECTION WITH THE ACQUISITION; (3) DEFERRAL OF COSTS INCURRED AS PART OF THE ACQUISITION; AND (4) ALL OTHER NECESSARY WAIVERS, APPROVALS, AND RELIEF	)	CASE NO. 2014-00201

ORDER

On June 13, 2014, Duke Energy Kentucky, Inc. ("Duke Kentucky") filed an Application seeking a Certificate of Public Convenience and Necessity ("CPCN"), pursuant to KRS 278.020 and 807 KAR 5:001, Section 15, in connection with the acquisition of the remaining 31 percent interest (approximately 186 megawatts ["MW"] of net installed capacity) in the East Bend Unit 2 Generating Station ("East Bend") from Dayton Power & Light Company ("DP&L") at a purchase price of $12.4 million. Duke Kentucky currently owns the other 69 percent interest (approximately 414 MW of net installed capacity) in East Bend. Duke Kentucky also requests authorization pursuant to KRS 278.300 to assume certain liabilities in connection with the acquisition. Duke Kentucky further seeks authority to accumulate and defer for review and recovery in its next base rate case the additional incremental operation and maintenance ("O&M") costs associated with its proposed purchase of the remaining 31 percent interest in East

Bend; any retirement costs associated with normal retirement of Miami Fort Unit 6 ("MF6") as a result of Mercury and Air Toxics Standards ("MATS"); carrying costs based on Duke Kentucky's cost of debt; and any other incremental costs related to assumed liabilities or otherwise necessary to complete the purchase of East Bend.

Duke Kentucky also requests to include certain capacity revenues associated with the East Bend purchase and net those revenues against any costs Duke Kentucky will incur to satisfy potential deficiencies in its annual capacity plan submitted to its regional transmission organization, PJM Interconnection, LLC ("PJM") as part of the off-system sales profit-sharing mechanism ("Rider PSM"), but that it not be subject to the $1 million sharing threshold set forth in Rider PSM for off-system sales profits. To the extent the PJM capacity revenues exceed the costs to satisfy any capacity plan deficiencies in any given year, customers will receive a direct benefit through a sharing of the net capacity revenues. To the extent the costs of satisfying the capacity plan obligations exceed the PJM capacity revenues, customers could see a charge through Rider PSM. Duke Kentucky proposes to account for the sharing of these net revenues or costs under the same ratio as off-system sales profits in excess of $1 million whereby customers receive 75 percent of the net revenues and Duke Kentucky receives 25 percent. In the event that the cost of any capacity plan exceeds capacity revenues, customers would pay 75 percent of the net cost and Duke Kentucky would pay 25 percent.

The Attorney General, by and through his Office of Rate Intervention ("AG"), requested and was granted intervention in this proceeding. Duke Kentucky was notified, by letter dated June 20, 2014, that its application was deficient. On June 24, 2014, Duke Kentucky cured the deficiencies, and that same day the Commission accepted by letter the application for filing as of that date. On July 16, 2014, the Commission issued an Order continuing the financing request beyond the 60-day period specified in KRS 278.300(2) and establishing a procedural schedule for the processing of this matter. The procedural schedule provided for two rounds of discovery on Duke Kentucky, an opportunity to file intervenor testimony, discovery on intervenor testimony, and an opportunity for Duke Kentucky to file rebuttal testimony.

An Informal Conference was held at the Commission's offices on September 24, 2014, during the course of which a tentative settlement was reached between Duke Kentucky and the AG. On October 9, 2014, Duke Kentucky and the AG filed a Joint Motion to Accept Stipulation and For Leave to Supplement the Record with Testimony in Support of Stipulation ("Stipulation"). Duke Kentucky's supplemental testimony in support of the Stipulation set forth its terms along with an explanation of why the Stipulation should be approved as fair, just, and reasonable. Under the terms of the Stipulation, Duke Kentucky and the AG agreed to waive cross-examination of each other's witnesses at the formal evidentiary hearing, which was held at the Commission's offices on October 30, 2014. Duke Kentucky filed post-hearing responses on November 6, 2014. The matter is now before the Commission for a decision. For the reasons stated below, the Commission will approve the Stipulation.

FACTUAL BACKGROUND

Duke Kentucky is a privately owned utility company that provides electric service to approximately 138,000 customers and gas service to approximately 96,000 customers in all or parts of seven counties in northern Kentucky. Duke Kentucky is a member of PJM, a regional transmission organization that coordinates the movement of wholesale electricity in all or parts of 13 states and the District of Columbia and operates an energy market and a capacity market. Duke Kentucky participates in the PJM capacity market as a Fixed Resource Requirement ("FRR") entity. As an FRR entity, Duke Kentucky is required to submit an FRR capacity plan that identifies specific generating resources that provide Duke Kentucky with capacity to meet its reliability obligations and to satisfy its load and generation needs. The FRR plan is submitted annually for a period of three delivery years into the future. Duke Kentucky currently uses its owned generating resources to satisfy its FRR plan.

Duke Kentucky currently owns and operates approximately 1,069 MW of generating capacity. This includes: (1) the 500-MW Woodsdale Generating Station, which comprises six combustion turbine units located in Butler County, Ohio; (2) MF6, a 163-MW coal-fired, base/intermediate-load plant located in Hamilton County, Ohio; and (3) the 69 percent interest in East Bend, located in Rabbit Hash, Boone County, Kentucky. MF6 was commissioned in 1960 and is designed to burn low- to medium-sulfur eastern bituminous coal. MF6 employs a system that uses "once through" cooling water from the Ohio River and is equipped with high-efficiency electrostatic precipitators and second-generation low-nitrogen oxide ("NO_x") burners. Its estimated useful life is through 2020.

At present, Duke Kentucky jointly owns East Bend with DP&L. As majority owner, Duke Kentucky staffs, controls, maintains, and operates the unit pursuant to the terms of an operating agreement entered into between Duke Kentucky and DP&L. The operating agreement expired on March 24, 2014, and DP&L has indicated that it intends to transfer or sell its ownership interest in East Bend to an affiliate merchant generator or an unaffiliated third party by January 1, 2017, as required pursuant to the Public Utilities Commission of Ohio's corporate restructuring plan for DP&L.

East Bend was commissioned in 1981 and, unlike MF6, is designed to burn low- to high-sulfur eastern bituminous coal. East Bend, a fully scrubbed power plant, is equipped with a mechanical draft cooling tower; a high-efficiency hot-side electrostatic precipitator with dry fly ash collection; a lime-based flue gas desulfurization system ("FGD") to reduce sulfur dioxide ("SO_2") emissions by 97 percent; low-NO_x burners; and a selective catalytic reduction control system, which is designed to reduce NO_x emissions by 85 percent. East Bend has an air permit that limits SO_2 emissions to 1.2 lbs/MMBTU, as compared to the 5.0 lbs/MMBTU SO_2 limit for MF6.

Duke Kentucky currently operates a permitted landfill at East Bend which is used for the disposal of coal combustion residuals resulting from the FGD process and other coal-combustion residual materials. Approximately 80 percent of the ash produced at East Bend is dry fly ash. That material is mixed with scrubber slurry and slime and is ultimately transformed into a solid concrete-like matter. The dry fly ash mixture is placed in an onsite landfill. The remaining 20 percent is bottom ash and is treated in an onsite ash pond. The existing East Bend landfill is projected to reach its capacity in approximately seven years, but will need additional landfill space before the current landfill is full due to the manner in which the material being landfilled must be handled.

EAST BEND PURCHASE

Duke Kentucky states that it would most likely need to retire MF6 by June 1, 2015 due to the potential costs associated with bringing the unit into MATS compliance.

The likely impact and cost of other emerging environmental regulations such as the Transport Rule, Rule 316(b) of the Clean Water Act, the Coal Combustion residuals rule, the Cross State Air Pollution Rule, National Ambient Air Quality Standards, and proposed greenhouse gas regulation, also will contribute to the retirement decision, given the age of the unit and its size.

In evaluating the future viability of MF6, Duke Kentucky issued requests for proposals ("RFPs") in the second quarter of 2013 for both short-term and long-term capacity. Duke Kentucky retained an independent consultant, Burns & McDonnell, to conduct the RFPs. The Short-Term RFP was issued in April 2013 for resource needs up to 200 MWs of PJM Unforced Capacity through a purchase power agreement for PJM delivery years 2014/2015, 2015/2016, and/or 2016/2017. Duke Kentucky received 13 proposals from eight different counterparties. The Short-Term RFP did not result in an executed capacity purchase, but did identify assets uncommitted to PJM for the 2015/2016 delivery year.

The Long-Term RFP was issued in June 2013 and sought a long-term solution for up to 200 MWs of capacity. Duke Kentucky sought multiple capacity alternatives, including purchase power agreements, tolling agreements, asset purchases, and new self-build generation to potentially replace MF6. Duke Kentucky received approximately 30 proposals from ten counterparties. The proposals, which included asset acquisitions and financial transactions such as purchase power agreements and tolling agreements, consisted primarily of coal- or natural-gas fueled units. After evaluating the responses, Duke Kentucky identified seven responses that were lower in cost than the MF6 retrofit option. The seven responses included five asset-acquisition proposals, a long-term purchase power proposal, and a tolling proposal. Duke Kentucky's Integrated Resource Plan ("IRP") team, in consultation with Burns & McDonnell, conducted an economic analysis to determine the lowest-cost solution.

The top seven proposals were modeled using Duke Kentucky's IRP software tool, PROSYM,[1] to determine the total production costs of the bids, which were then combined with the fixed costs of each alternative to develop a total energy-adjusted cost. Duke Kentucky identified three primary scenarios under which the seven most competitive alternatives were analyzed to determine the lowest present-value solution. The base case reflects the estimated cost for the continued operation of MF6, assuming that MF6 could become MATS compliant through equipment upgrades, additional operating expense, and fuel, as well as factoring in the replacement of the unit by 2020 with a new natural gas combined-cycle unit. The first alternative case assumes carbon pricing and locational marginal prices ("LMP") that reflected possible differing values of additional megawatts of energy at the specific generating station locations being considered. The second alternative case assumes no carbon pricing and no LMP differential. Although not every scenario resulted in the East Bend acquisition being the lowest-cost option, Duke Kentucky's analysis ultimately determined that the acquisition of the remaining 31 percent of East Bend is the most reasonable lowest-cost and best option for Duke Kentucky's ratepayers. Duke Kentucky noted that the East Bend purchase resulted in approximately $50 million less in upfront capital costs when compared to the next-lowest-cost option in the long-term RFP; the East Bend purchase

[1] PROSYM is a commercial software package that is designed for performing planning and operational studies with the capability of processing detailed hour-by-hour investigation of the operations of electric utilities in a chronological fashion. Duke Kentucky notes that the planning runs performed by PROSYM closely reflects actual utility operations.

is also the lowest present-value cost option; and the purchase matches well with the incremental capacity requirement of Duke Kentucky.

Pursuant to the terms and provisions of the Purchase and Sale Agreement Between Duke Kentucky and DP&L ("Purchase Agreement"), Duke Kentucky will become the sole owner of East Bend and will acquire all of DP&L's rights, title, and interest in all the assets primarily related to East Bend as set forth in the Purchase Agreement. Duke Kentucky will also assume all of DP&L's liabilities, including any and all environmental liabilities, to the extent arising from, or related to the purchased assets or the operation or retirement of East Bend.

The Purchase Agreement also allows Duke Kentucky to make a financial adjustment for the unreimbursed spring 2014 outage costs associated with DP&L's share in East Bend against the purchase price paid to DP&L. This represents the portion of the outage costs for which DP&L has not reimbursed Duke Kentucky for DP&L's proportional share, or 31 percent. As of May 31, 2014, the cumulative amount of outstanding outage costs was $5,826,929.55. Pursuant to the Purchase Agreement, this amount is capped at $9.5 million.

Duke Kentucky will also receive the PJM revenues associated with DP&L's share of East Bend capacity that DP&L has committed in PJM's base residual auction ("BRA") through May 31, 2018. DP&L, a PJM member, participates in PJM's capacity market auction construct in which it satisfies its load and generation needs by purchasing all capacity through the BRA to meet its reliability obligations. PJM conducts its base residual auctions in May of each year for a delivery year three years in the future. A PJM delivery year runs from June through the following May. Thus, if the East Bend acquisition is approved and closes before the end of the PJM 2014/2015 delivery year, Duke Kentucky will receive the pro-rata portion of the monthly PJM capacity revenues attributed to the 31 percent interest in East Bend for the 2014/2015 delivery year, estimated to be approximately $20,000 per day through May 31, 2015. Duke Kentucky will receive all of the capacity revenues for the 2015/2016, 2016/2017, and 2017/2018 delivery years.

If the transaction is approved, Duke Kentucky will make its decision to retire MF6 before June 1, 2015. If retired, the MF6 capacity cannot continue to be used as part of Duke Kentucky's FRR plan.[2] Because the MF6 capacity has already been committed by Duke Kentucky through PJM delivery year 2017/2018, upon retirement of MF6, Duke Kentucky must procure unit-specific resources to satisfy its obligations or face penalties by PJM. Duke Kentucky has made arrangements that will satisfy its fixed resource requirements obligation for PJM delivery years 2015/2016 and 2016/2017, but Duke Kentucky has not yet satisfied its capacity obligation for delivery year 2017/2018. Beginning with the PJM 2018/2019 delivery year, Duke Kentucky can use the capacity associated with the East Bend purchase to remedy any deficiencies resulting from the retirement of MF6.

As part of the transaction, Duke Kentucky will receive DP&L's 31 percent interest in approximately 940 acres surrounding the East Bend site. This land is currently jointly owned by DP&L and Duke Energy Ohio. Duke Kentucky states that it is in the process of acquiring Duke Energy Ohio's ownership interest in this land through a separate

[2] Duke Kentucky's most recent FRR plan is for the 2017/2018 delivery year and consists of unit-specific capacity associated primarily with Duke Kentucky's ownership share of East Bend, MF6, and the Woodsdale station, as well as some limited MWs of qualifying demand response.

transfer transaction. Eventually, this land will be solely owned by Duke Kentucky and will be used to expand the current East Bend landfill.

STIPULATION TERMS

The Stipulation enumerates the benefits to Duke Kentucky's ratepayers, including the favorable $12.4 million cost; the operational flexibility of replacing MF6; provision of additional reserves as well as a hedge against real-time energy price exposure; additional capacity revenues due to the fact that DP&L participates in PJM's base residual auction and has committed its interest in East Bend to PJM's BRA through May 31, 2018; operational efficiency achieved by Duke Kentucky's being the sole owner of East Bend; environmental benefits of replacing MF6 with East Bend; avoidance of uncertainty and litigation related to the expired operating agreement with DP&L; expected lower fuel costs of East Bend compared to a MATS compliant MF6; and the location of a greater percentage of Duke Kentucky's generation in Kentucky.

In recognition of these benefits, Duke Kentucky and the AG agree that Duke Kentucky's application should be approved as filed, including: (1) granting of the requested CPCN and associated filing deviations set forth in the application; (2) approving the acquisition of the 31 percent interest in East Bend from DP&L for $12.4 million, as adjusted pursuant to the Purchase Agreement; (3) using the $12.4 million purchase price to establish the net book value of the 31 percent interest in East Bend for ratemaking purposes; (4) approving Duke Kentucky's assumption of liabilities as requested in the application; (5) all costs of operation of East Bend will be considered in the course of future rate proceedings; (6) approving as filed, Duke Kentucky's requests for accounting treatment, including deferrals, as follows: incremental O&M costs above amounts currently reflected in base rates, MF6 retirement costs, carrying costs on the unrecovered balance of regulatory assets based on Duke Kentucky's cost of debt, and any other incremental costs related to the assumed liabilities or otherwise necessary to effectuate the purchase; (7) consideration of cost recovery for the previously listed accounting treatments in a future rate proceeding; (8) accounting and ratemaking treatment related to the sharing of capacity revenues and netting capacity revenues against costs to acquire additional capacity; (9) modification of Rider PSM to include the sharing of net revenues and costs as proposed; (10) consideration of the retirement of MF6 as a normal retirement for ratemaking purposes; and (11) the journal entries relating to the East Bend transaction.

As part of the Stipulation, Duke Kentucky further agrees that it will not file a notice of intent to file an application for a base electric rate increase prior to December 1, 2015, and will not file an application that would increase its electric base rates prior to January 1, 2016. Duke Kentucky retains the right to seek approvals of certain emergency cost recovery, surcharge mechanism adjustments, or gas-rate-related requests as necessary.

Duke Kentucky and the AG agree that the Stipulation terms are fair, just and reasonable.

FINDINGS

No utility may construct or acquire any facility to be used in providing utility service to the public until it has obtained a CPCN from this Commission.[3] To obtain a

[3] KRS 278.020(1).

CPCN, the utility must demonstrate a need for such facilities and an absence of wasteful duplication.[4]

"Need" requires:

> [A] showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.
>
> [T]he inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service.[5]

"Wasteful duplication" is defined as "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[6] To demonstrate that a proposed facility does not result in wasteful duplication, we have held that the applicant must demonstrate that a thorough review of all reasonable alternatives has been performed.[7] Selection of a proposal that ultimately costs more than an alternative does not necessarily result in

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[4] *Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 252 S.W.2d 885 (Ky. 1952).

[5] *Id.* at 890.

[6] *Id.*

[7] Case No. 2005-00142, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Construction of Transmission Facilities in Jefferson, Bullitt, Meade, and Hardin Counties, Kentucky (Ky. PSC Sept. 8, 2005).

wasteful duplication.[8] All relevant factors must be balanced.[9] The statutory touchstone for ratemaking in Kentucky is the requirement that rates set by the Commission must be fair, just and reasonable.[10]

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that the proposed East Bend acquisition is reasonable and should be approved. We note that Duke Kentucky will need to replace the capacity and energy that will be lost due to the high likelihood of MF6's being retired by June 1, 2015, as a result of new and emerging environmental regulations. The retirement of MF6 would also require Duke Kentucky, as a self-supply FRR entity in PJM's capacity market construct, to identify unit-specific generating or demand-response resources in its FRR Plan that will provide the amount of capacity necessary to fulfill its expected reliability requirements for capacity for each delivery year. Accordingly, we find that Duke Kentucky has sufficiently demonstrated a need for the East Bend purchase.

The Commission also finds that the record, including Duke Kentucky's economic analysis, is sufficient to demonstrate that the proposed East Bend acquisition represents the most reasonable least-cost resource to meet Duke Kentucky's capacity and energy needs upon retirement of MF6. The Commission further finds that the proposed purchase is reasonable, will not result in wasteful duplication of utility facilities, and is feasible in terms of its impact on rates.

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[8] *See Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 390 S.W.2d 168, 175 (Ky. 1965). *See also* Case No. 2005-00089, Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for the Construction of a 138 kV Electric Transmission Line in Rowan County, Kentucky, (Ky. PSC Aug. 19, 2005), Final Order.

[9] Case No. 2005-00089, East Kentucky Power Cooperative, Inc. (Ky. PSC Aug. 19, 2005), Final Order, p. 6.

[10] KRS 278.190(3).

Thus, our finding of need and the absence of wasteful duplication arises from the expected retirement of MF6 on or before June 1, 2015. Accordingly, MF6 may only be operated after June 1, 2015 following the filing of a new case whereby Duke Kentucky seeks such authorization and the Commission grants it.

The Commission lastly finds that the terms and provisions of the Stipulation are reasonable and should be approved. The benefits identified in the Stipulation are sufficiently supported by the evidentiary record and the base rate stay-out provision agreed to by Duke Kentucky is a benefit to ratepayers that otherwise could not have been achieved in the absence of the Stipulation.

During the hearing in this matter, Duke Kentucky was questioned about the proposed changes to the Rider PSM tariff attached to the Stipulation. Duke Kentucky agreed that the proposed changes to the Rider PSM tariff should include language that the net capacity revenue or costs will be shared 75/25 with ratepayers receiving or paying 75 percent and shareholders receiving or paying 25 percent.[11]

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's request to acquire the remaining 31 percent interest in East Bend and to assume the liabilities associated with the East Bend acquisition is approved subject to the provisions of the Stipulation set forth in the Appendix.

2. The Stipulation, including the Rider PSM tariff proposed to implement the terms of the Stipulation, is approved.

3. Within seven days after the closing of the East Bend transaction, Duke Kentucky shall file written notification to the Commission detailing the status of the transaction.

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[11] October 30, 2014 Hearing Video at 13:36:16.

4. Within 20 days of the closing of the East Bend transaction, Duke Kentucky shall file with this Commission, using the Commission's electronic Tariff Filing System, revised Rider PSM tariff sheets setting out the revisions approved herein and reflecting that they were approved pursuant to this Order.

5. Any documents filed pursuant to ordering paragraph 3 of this Order shall reference the number of this case and shall be retained in the utility's general correspondence file.

Nothing contained herein shall be construed as a finding of value for any purpose or as a warranty on the part of the Commonwealth of Kentucky or any agency thereof as to the securities authorized herein.

By the Commission

ENTERED
DEC 04 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

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Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2014-00201 DATED DEC 0 4 2014

STIPULATION, SETTLEMENT AGREEMENT AND RECOMMENDATION

This Stipulation, Settlement Agreement and Recommendation ("Stipulation") is entered into and effective this 7th day of October, 2014 by and among Duke Energy Kentucky, Inc. ("Duke Energy Kentucky" or "Company") and the Office of the Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention ("AG") in the proceeding involving the above parties, which is the subject of this Stipulation, as set forth below. (Duke Energy Kentucky and the AG are referred to collectively herein as the "Parties".)

WITNESSETH:

WHEREAS, Duke Energy Kentucky filed on June 13, 2014, with the Kentucky Public Service Commission ("Commission") its Application in *In the Matter of the Application of Duke Energy Kentucky, Inc. For (1) A Certificate of Public Convenience and Necessity Authorizing the Acquisition of the Dayton Power & Light Company's 31% Interest in the East Bend Generating Station; (2) Approval of Duke Energy Kentucky Inc.'s Assumption of Certain Liabilities in Connection with the Acquisition; (3) Deferral of Costs Incurred as Part of the Acquisition; and (4) All Other Necessary Waivers, Approvals and Relief*, and the Commission established Case No. 2014-00201; and

WHEREAS, the Application requests Commission approval for Duke Energy Kentucky to acquire the thirty-one percent (31%) ownership interest currently held by the Dayton Power & Light Company ("DP&L") in the East Bend Generating Station located in Rabbit Hash, Kentucky ("East Bend"); and

WHEREAS, Duke Energy Kentucky's acquisition proposal regarding East Bend Generating Station was the result of an evaluation of competitively bid and conforming proposals to a request for proposals ("RFP") issued by Duke Energy Kentucky, against which the East Bend acquisition was the lowest cost option; and

EXHIBIT
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WHEREAS, the AG was granted intervention by the Commission in this proceeding; and

WHEREAS, in this proceeding, the Commission Staff and AG have tendered numerous data requests which the Company has answered to the satisfaction of the AG; and

WHEREAS, the Parties understand and agree that the acquisition of DP&L's interest in East Bend will result in substantial tangible and intangible benefits to the ratepayers of Duke Energy Kentucky, including, but not necessarily limited to:

- The very favorable cost of $12.4 million to acquire 186 MW of net installed capacity, which equals an upfront investment that is significantly below the next best option bid in response to the Company's independently administered RFP; and

- The operational flexibility to replace approximately 163 MW of net installed capacity at the Miami Fort Unit 6 ("MF6") that may be economically retired by June 1, 2015, due to the MATS rule; and

- The provision of additional reserves to meet the load obligations for Duke Energy Kentucky, as well as, enhancing the ratepayers' hedge against real time energy price exposure; and

- The benefit to ratepayers realized through additional capacity revenues derived from the approximately 186 MWs of net installed capacity attributed to the East Bend acquisition, already committed to PJM's base residual auction through May 31, 2018, because the Company has already fulfilled its capacity position through May 31, 2015 with MF6. Estimated to be approximately $20,000 per day through the end of the 2014/2015 delivery year (or May 31, 2015), these proceeds would flow through the proposed Rider Profit Sharing Mechanism ("Rider PSM") tariff; and

- The ability to achieve operational efficiency with Duke Energy Kentucky as the sole owner of the East Bend station and no longer subject to a joint operation obligation; and

- The environmental benefits associated with having the ability to retain a comparable number of MWs of capacity through a scrubbed coal-fired base-load generator once the unscrubbed MF6 is retired, which is nearing the end of its useful life, while still reducing Duke Energy Kentucky's overall environmental footprint; and

- The avoidance of uncertainty and litigation over the terms and effect of the expired Operating Agreement previously entered into with DP&L; and

- The expected realization of lower fuel costs based upon historical fuel expenses for East Bend and MF6 coupled with the ability to avoid the increased cost of compliance and dispatch of MF6 should the Company continue to operate MF6 and bring the station into MATS compliance; and

- The Company's commitment to the Commonwealth by locating a greater percentage of its generation resources in Kentucky, thereby maintaining a skilled work force and a market for coal produced in Kentucky; and

WHEREAS, the Parties recognize and note that the proposed transaction has already received the approval of the Federal Energy Regulatory Commission and the Public Utilities Commission of Ohio, being the only other two regulatory agencies whose approval is necessary; and

WHEREAS, an informal conference was attended in person by representatives of the Parties and Commission Staff on September 24, 2014, at the offices of the Commission. At the informal conference, a number of procedural and substantive issues were discussed, including terms and conditions related to the issues pending before the Commission in this proceeding that might be considered by both Parties to constitute reasonable means of addressing their requests and issues; and

WHEREAS, the Parties desire to recommend to the Commission that it enter its Order setting the terms and conditions that the Parties believe are reasonable as stated herein; and

WHEREAS, it is understood by all Parties that this Stipulation is an agreement among the Parties concerning all matters at issue in these proceedings pursuant to 807 KAR 5:001, Section 9(6); and

WHEREAS, the Parties have spent many hours to reach the terms and conditions that form the basis of this Stipulation; and

WHEREAS, the Parties, who represent diverse interests and divergent viewpoints, agree that this Stipulation, viewed in its entirety, is a fair, just and reasonable resolution of all the issues in this proceeding; and

WHEREAS, the Parties recognize that this Stipulation constitutes only an agreement among, and a recommendation by, themselves, and that all issues in this proceeding remain open for consideration by the Commission at the formal hearing in this proceeding; and

NOW, THEREFORE, in consideration of the premises, recitations and conditions set forth herein, the Parties hereby stipulate, agree, and recommend as follows:

1. Duke Energy Kentucky's Application should be approved as filed:

   a. Duke Energy Kentucky's request for a Certificate of Public Convenience and Necessity ("CPCN") should be approved and the filing deviations requested in its Application should be granted;

b. Duke Energy Kentucky should be allowed to acquire the 31% interest in East Bend from DP&L for a purchase price of $12.4 million, as adjusted in accordance with the terms of the Purchase and Sale Agreement;

c. The purchase price of $12.4 million should be used for establishing the net book value of the 31% interest in East Bend for rate making purposes;

d. Duke Energy Kentucky's assumption of liabilities should be approved as requested in the Application;

e. Duke Energy Kentucky will become responsible for all costs of operation of the entire East Bend generating station upon closing and such costs of full operation and environmental compliance, including those associated with any liabilities assumed, shall be considered in the ordinary course of utility rate making in future rate proceedings;

f. Duke Energy Kentucky's requests for accounting treatment, including deferrals, should be approved as filed:

i) Incremental operations and maintenance ("O&M") expenses above amounts currently reflected in base rates associated with the 31% interest in East Bend;

ii) Any and all retirement costs associated with MF6 identified in the Application;

iii) Carrying costs on the unrecovered balance of regulatory assets based upon cost of debt; and

iv) Any other incremental costs related to the assumed liabilities or otherwise necessary to effectuate the purchase;

g. Cost recovery for the foregoing accounting treatments shall be considered in the course of a future rate proceeding;

h. Duke Energy Kentucky's requests for accounting and ratemaking treatment related to sharing of capacity revenues and netting such revenues against costs to acquire additional capacity should be approved as requested;

i. The Company's request for modification of its Rider PSM tariff should be approved as requested, including the sharing of net revenues. A copy of the revised Rider PSM is attached hereto and incorporated herein as Exhibit 1; and

j. The retirement of MF6 shall be considered as a normal retirement for rate making purposes;

k. The journal entries relating to the East Bend Transaction, as requested in the Application, should be approved. A copy of the accounting entries to be made were set forth in Exhibit WAG-2 to the Application and are attached hereto and incorporated herein as Exhibit 2;

2. Duke Energy Kentucky agrees to refrain from filing any notice of intent to file an application for an increase in its base electric rates prior to December 1, 2015 and, therefore, will not file any application that would increase its existing electric base rates prior to January 1, 2016. Notwithstanding the foregoing, Duke Energy Kentucky shall retain the right to seek approval from the Commission of: (a) the deferral of extraordinary and uncontrollable costs (e.g., ice, wind storm, etc.); (b) emergency rate relief under KRS 278.190(2) to avoid a material impairment or damage to its credit or operations; (c) adjustments to the operation of any of Duke Energy Kentucky's cost recovery surcharge mechanisms (e.g., Fuel Adjustment Clause, Demand Side Management, etc.), including any base rate roll-ins, which are part of the noma l operations of such mechanisms; (d) the establishment or implementation of an environmental surcharge

mechanism pursuant to KRS 278.183; or (e) any rate-related request with respect to its natural gas distribution business.

3. Except as specifically stated otherwise in this Stipulation, the Parties agree that making this Stipulation shall not be deemed in any respect to constitute an admission by any Party hereto that any computation, formula, allegation, assertion, or contention made by any other Party in these proceedings is true or valid.

4. The Parties agree that the foregoing terms and conditions represent a fair, just, and reasonable resolution of the issues addressed herein.

5. The Parties agree that the foregoing terms will result in the lowest cost option of the competitively bid proposals as analyzed and assessed by Duke Energy Kentucky.

6. The Parties agree that, following the execution of this Stipulation, the Parties shall cause the Stipulation to be filed with the Commission, and Duke Energy Kentucky shall further file supplemental testimony in support of said Stipulation.

7. Each Party waives all rights of cross-examination of the other Parties' witnesses, unless the Commission disapproves this Stipulation. The AG stipulates that, after the date of this Stipulation, it will not otherwise contest Duke Energy Kentucky's Application in this proceeding, as modified by this Stipulation, during the hearing in this proceeding, and that it will refrain from cross-examination of all witnesses during the hearing, except insofar as such cross-examination supports the Stipulation or Duke Energy Kentucky's Application subject to the terms and conditions of this Stipulation.

8. The Parties agree to act in good faith and to use their best efforts to recommend to the Commission that this Stipulation be accepted and fully incorporated into any Order approving Duke Energy Kentucky's Application in this proceeding.

9. If the Commission issues an Order adopting all of the terms and conditions recommended herein, the Parties agree that neither of them shall file either a request for rehearing with the Commission or an appeal to the Franklin Circuit Court with respect to such Order.

10. The Parties agree that if the Commission does not implement all of the terms recommended herein in its final Order in this proceeding, or if the Commission in its final Order in this proceeding adds or imposes additional conditions or burdens upon any or all of the Parties that are unacceptable to any or all of the Parties for any reason, then, upon written notice by any Party: (a) this Stipulation shall be void and withdrawn by the Parties from further consideration by the Commission and none of the Parties shall be bound by any of the provisions herein, provided that no Party is precluded from advocating any position contained in this Stipulation; and (b) neither the terms of this Stipulation nor any matters raised during the settlement negotiations shall be binding on any of the Parties to this Stipulation or be construed against any of the Parties.

11. The Parties agree that this Stipulation shall in no way be deemed to divest the Commission of jurisdiction under Chapter 278 of the Kentucky Revised Statutes.

12. The Parties agree that this Stipulation shall inure to the benefit of, and be binding upon, the Parties, their successors and assigns.

13. The Parties agree that this Stipulation constitutes the complete agreement and understanding among the Parties, and any and all oral statements, representations, or agreements made prior hereto or contemporaneously herewith, shall be null and void, and shall be deemed to have been merged into this Stipulation.

14. The Parties agree that, for the purpose of this Stipulation only, the terms are based upon the independent analysis of the Parties to reflect a fair, just, and reasonable resolution of the issues herein and are the product of compromise and negotiation.

15. The Parties agree that neither the Stipulation nor any of the terms shall be admissible in any court or commission except insofar as such court or commission is addressing litigation arising out of the implementation of the terms herein. This Stipulation shall not have any precedential value in this or any other jurisdiction.

16. The signatories hereto warrant that they have informed, advised, and consulted with the Parties they represent in this proceeding in regard to the contents and significance of this Stipulation, and based upon the foregoing are authorized to execute this Stipulation on behalf of the Parties they represent.

17. The Parties agree that this Stipulation is a product of negotiation among all Parties, and that no provision of this Stipulation shall be strictly construed in favor of, or against, any Party.

18. The Parties agree that this Stipulation may be executed in multiple counterparts.

IN WITNESS WHEREOF, the Parties, by and through their duly authorized counsel, have hereunto affixed their signatures.

Duke Energy Kentucky, Inc.

HAVE SEEN AND AGREED:

Rocco D'Ascenzo, Counsel
Amy B. Spiller, Counsel
Mark David Goss, Counsel
David S. Samford, Counsel

Office of the Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention

HAVE SEEN AND AGREED:

Jennifer Black Hans

Jennifer Black Hans, Assistant Attorney General
Lawrence W. Cook, Assistant Attorney General
Gregory T. Dutton, Assistant Attorney General

Case No. 2014-00201

Stipulation, Settlement Agreement and Recommendation

Exhibit 1
(Revised Rider PSM)

RIDER PSM
OFF-SYSTEM POWER SALES AND EMISSION ALLOWANCE SALES
PROFIT SHARING MECHANISM

APPLICABILITY

Applicable to all retail sales in the Company's electric service area, excluding interdepartmental sales, beginning with the billing month. (T)

Deleted: June 2014

PROFIT SHARING RIDER FACTORS

The Applicable energy charges for electric service shall be increased or decreased to the nearest $0.000001 per kWh to reflect the sharing of profits on off-system power sales and ancillary services, the net profits on sales of emission allowances, and net margins on capacity transactions related to the acquisition of 100% of East Bend Unit 2.

The Company will compute its profits on off-system power sales and ancillary services, profits on emission allowance sales, and net margins on capacity transactions related to the acquisition of 100% of East Bend Unit 2 in the following manner:

Rider PSM Factor = ((P + A) + E + C + R)/S

where:

P = Eligible profits from off-system power sales for applicable month subject to sharing provisions established by the Commission in its Order in Case No. 2003-00252, dated December 5, 2003.

A = All net profits related to its provision of ancillary services in markets administered by PJM per the Commission's Order in Case No. 2008-00489, dated January 30, 2009.

The first $1 million in annual profits from off-system sales and ancillary services will be allocated to ratepayers, with any profits in excess of $1 million split 75:25, with ratepayers receiving 75 percent and shareholders receiving 25 percent per the Commission Order in Case No. 2010-00203 dated December 22, 2010. After December 31st of each year, the sharing mechanism will be reset for off-system power sales. Each month the sharing mechanism will be reset for the ancillary service profits.

E = All net profits on sales of emission allowances are credited to customers per the Commission's Order in Case No. 2006-00172, dated December 21, 2006.

C = Capacity revenue received from the Dayton Power & Light Company related to its participation in PJM's Base Residual Auction through May 31, 2018, less the cost incurred by Duke Energy Kentucky to procure sufficient capacity to meet its obligations as a Fixed Resource Requirement entity

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KY.P.S.C. Electric No. 2
____ Revised Sheet No 82
Cancels and Supersedes
____ Revised Sheet No 82
Page 2 of 3

Duke Energy Kentucky, Inc.
4580 Olympic Blvd
Erlanger, KY 41018

under the Reliability Assurance Agreement with PJM per the Commission's Order in Case No. 2014-00201, dated ______, 2014.

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R = Reconciliation of prior period Rider PSM actual revenue to amount calculated for the period.

S = Current month sales in kWh used in the current month Rider FAC calculation.

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Issued by authority of an Order of the Kentucky Public Service Commission dated ______, 201_, in Case No. 20______.

Issued:
Effective:
Issued by: James P. Henning, President /s/ James P. Henning

Duke Energy Kentucky, Inc. 4580 Olympic Blvd Erlanger, KY 41018	KY.P.S.C. Electric No. 2 Revised Sheet No 82 Cancels and Supersedes Revised Sheet No 82 Page 3 of 3

Rate Group	Rate ($/ kWh)	
Rate RS, Residential Service	0.00	(R)
Rate DS, Service at Secondary Distribution Voltage	0.00	(R)
Rate DP, Service at Primary Distribution Voltage	0.00	(R)
Rate DT, Time-of-Day Rate for Service at Distribution Voltage	0.00	(R)
Rate EH, Optional Rate for Electric Space Heating	0.00	(R)
Rate GS-FL, General Service Rate for Small Fixed Loads	0.00	(R)
Rate SP, Seasonal Sports Service	0.00	(R)
Rate SL, Street Lighting Service	0.00	(R)
Rate TL, Traffic Lighting Service	0.00	(R)
Rate UOLS, Unmetered Outdoor Lighting	0.00	(R)
Rate OL, Outdoor Lighting Service	0.00	(R)
Rate NSU, Street Lighting Service for Non-Standard Units	0.00	(R)
Rate NSP, Private Outdoor Lighting Service for Non-Standard Units	0.00	(R)
Rate SC, Street Lighting Service – Customer Owned	0.00	(R)
Rate SE, Street Lighting Service – Overhead Equivalent	0.00	(R)
Rate TT, Time-of-Day Rate for Service at Transmission Voltage	0.00	(R)
Other	0.00	(R)

Rider PSM credits, reductions to bills, are shown as positive numbers without parentheses. Rider PSM charges, increases to bills, are shown in parentheses.

SERVICE REGULATIONS

The supplying of, and billing for, service and all conditions applying thereto are subject to the jurisdiction of the Kentucky Public Service Commission, and to the Company's Service Regulations currently in effect, as filed with the Kentucky Public Service Commission as provided by law.

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Issued by authority of an Order of the Kentucky Public Service Commission dated, , 201 , in Case No. 20 .

Issued:
Effective:
Issued by: James P. Henning, President /s/ James P. Henning

Case No. 2014-00201

Stipulation, Settlement Agreement and Recommendation

Exhibit 2
(Exhibit WAG-2 to the Application)

Purchase of 31% of East Bend Assets by Duke Energy Kentucky
(Dollars in Thousands)

Duke Energy Kentucky's acquisition of the thirty-one percent (31%) interest in East Bend Unit 2 will be accounted for in accordance with the requirements of Electric Plant Instruction No. 5, as depicted below.

1. Entry to record the acquisition of 31% East Bend from DP&L

Account	Account Description	Debit	Credit
102	Electric Plant Purchased or Sold	12,400	
154	Plant materials and operating supplies	2,966	
151	Fuel Stock	4,228	
228	Accumulated Provision for pensions and benefits	2,785	
236	Taxes accrued		182
165	Prepayments		4,592
131	Cash		17,605
		22,379	22,379

Amounts are based on Schedule 3.2(a) in the purchase agreement as of March 31, 2014. Actual journal amounts will be based on balances as of the acquisition date.

2. Proposed Entry to clear account 102 (to be booked 6 months from the acquisition date)

Account	Account Description	Debit	Credit
101-106	Electric plant in service	208,483	
107	Construction Work In Progress-Electric	8,222	
105	Electric plant held for future use	588	
108	Accumulated provision for depreciation of electric utility plant		140,053
102	Electric Plant Purchased or Sold		12,400
114	Electric plant acquisition adjustments		64,840
		217,293	217,293

Amounts are based on the DP&L balance sheet as of March 31, 2014. Actual journal amounts will be based on balances as of the acquisition date.
The entries reflect the original cost with an adjustment to disregard the impairment loss of $76.0 million Dayton Power and Light recorded in 2012.

($-millions)		
Net book value as of March 31, 2014	$	2.5
Impairment recognized by DPL in 2012		76.0
Less: Impairment related to Asset Retirement Obligation asset		(0.4)
Depreciation on assets for the three months ending March 31, 2014		(0.9)
Adjusted net book value	$	77.2
Purchase Price		12.4
Negative Acquisition Adjustment	$	64.8

3. Proposed Entry to clear account 114 electric plant acquisition adjustment to account 108 Accumulated Depreciation of electric utility plant

Account	Account Description	Debit	Credit
114	Electric plant acquisition adjustments	64,840	
108	Accumulated provision for depreciation of electric utility plant		64,840

To clear negative acquisition adjustment in account 114-Electric plant acquisition adjustments to account 108 accumulated depreciation of electric utility plant.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter of:

The Application of Duke Energy Kentucky, Inc. For (1) A Certificate of Public Convenience And Necessity Authorizing the Acquisition of the Dayton Power & Light Company's 31% Interest in The East Bend Generating Station; (2) Approval of Duke Energy Kentucky, Inc.'s Assumption of Certain Liabilities in Connection with the Acquisition; (3) Deferral of Costs Incurred as Part Of the Acquisition; and (4) All Other Necessary Waivers, Approvals, and Relief	))))))	Case No. 2014-00201

SUPPLEMENTAL TESTIMONY OF

WILLIAM DON WATHEN, JR.,

ON BEHALF OF

DUKE ENERGY KENTUCKY, INC.

October 7, 2014

EXHIBIT

B

TABLE OF CONTENTS

PAGE

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

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

A. I am employed by Duke Energy Busienss Services, LLC, as Director of Rates & Regulatory Strategy – Ohio and Kentucky.

Q. HAVE YOU PREVIOUSLY OFFERED TESTIMONY IN THIS PROCEEDING?

A. Yes. My Direct Testimony is attached as Exhibit D to the Application filed in this matter on or about June 13, 2014.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A. The purpose of my supplemental testimony is twofold. First, I will generally describe this proceeding and the Stipulation, Settlement Agreement and Recommendation entered into on or about October 7, 2014 (the Stipulation), by and among Duke Energy Kentucky, Inc. (Duke Energy Kentucky or Company), and the Office of the Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (the AG) (Duke Energy Kentucky and the AG may be referred to collectively herein as the Parties). Second, I will explain why the Stipulation represents a fair, just and reasonable resolution of all the issues in this proceeding. The Stipulation is attached as Exhibit A to the Joint Motion to which this supplemental testimony is attached; I have personally reviewed the Stipulation and affirm that it accurately reflects the agreement that the Company and the AG have reached.

II. OVERVIEW OF THE PROCEEDING

Q. PLEASE GENERALLY DESCRIBE THE RELIEF SOUGHT BY DUKE ENERGY KENTUCKY IN THIS PROCEEDING.

A. Duke Energy Kentucky's Application in this proceeding requests the Kentucky Public Service Commission (Commission) to issue a Certificate of Public Convenience and Necessity (CPCN) for the acquisition of the 31% interest in the East Bend Unit 2 Generating Station (East Bend) currently owned by The Dayton Power & Light Company (DP&L). The Application also requests that the Commission approve Duke Energy Kentucky's assumption of certain liabilities and costs in connection with the East Bend purchase to be considered in future rate proceedings, deferral of costs incurred as part of the acquisition, a sharing of the anticipated capacity revenues, net of costs to acquire capacity to comply with PJM Interconnection, LLC (PJM), requirements for fixed resource requirement entities, and all necessary waivers, approvals, adjustments and relief necessary to effectuate the transaction.

Q. WAS DUKE ENERGY KENTUCKY'S PROPOSED ACQUISITION OF THE 31% INTEREST IN EAST BEND CURRENTLY OWNED BY DP&L SELECTED AS RESULT OF A REQUEST FOR PROPOSALS PROCESS?

A. Yes. Duke Energy Kentucky's acquisition proposal regarding East Bend was the result of an evaluation of competitively bid and conforming proposals to a request for proposals (RFP) issued by Duke Energy Kentucky. From the proposals evaluated, the East Bend acquisition was the lowest cost option for ratepayers.

Q. HAS DUKE ENERGY KENTUCKY'S PROPOSED ACQUISITION OF THE 31% INTEREST IN EAST BEND CURRENTLY OWNED BY DP&L BEEN APPROVED BY ANY OTHER REGULATORY AGENCIES?

A. Yes. The only other regulatory agencies (besides the Commission) whose approval is necessary, namely the Federal Energy Regulatory Commission (FERC) and the Public Utilities Commission of Ohio (PUCO), approved of Duke Energy Kentucky's proposed transaction on July 16, 2014,[1] and September 17, 2014,[2] respectively.

Q. HAS THE AG INTERVENED IN THIS PROCEEDING?

A. Yes. On July 9, 2014, the AG moved the Commission to grant him full intervenor status in this action pursuant to KRS 367.150(8) and 807 KAR 5:001 Section 4(11). The Commission granted the AG's motion and made him a full party to this proceeding by Order entered July 25, 2014.

Q. HAS THE AG PROPOUNDED ANY REQUESTS FOR INFORMATION UPON DUKE ENERGY KENTUCKY IN THIS PROCEEDING?

A. Yes. The AG has propounded upon Duke Energy Kentucky two sets of data requests in this proceeding, dated July 28, 2014, and August 20, 2014, respectively. Additionally, Commission Staff propounded upon the Company

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[1] *See* Docket No. EC14-103-000, *Duke Energy Kentucky, Inc.*, 148 FERC ¶ 62,049 (Order entered July 16, 2014).

[2] *See* Case No. 14-1084-EL-UNC, *In the Matter of the Application of The Dayton Power and Light Company for Authority to Sell its Interest in East Bend Unit 2* (Finding and Order entered September 17, 2014).

two sets of data requests in this proceeding, dated July 25, 2014, and August 19, 2014, respectively. As stated in the Stipulation, the AG is satisfied with the responses provided by Duke Energy Kentucky to all data requests.

Q. HAS DUKE ENERGY KENTUCKY PARTICIPATED IN AN INFORMAL CONFERENCE AS PART OF THIS PROCEEDING?

A. Yes. On September 24, 2014, an informal conference was attended in person by representatives of the Parties and Commission Staff at the offices of the Commission. At the informal conference, a number of procedural and substantive issues were discussed, including terms and conditions related to the issues pending before the Commission in this proceeding that might be considered by both Parties to constitute reasonable means of addressing their requests and issues.

III. OVERVIEW OF THE STIPULATION

Q. PLEASE BRIEFLY DESCRIBE HOW THE STIPULATION CAME ABOUT.

A. The Stipulation is the product of much negotiation and compromise by the Company and the AG. Duke Energy Kentucky is appreciative of the AG's willingness to view this case on its own facts and to fashion an agreement accordingly. Duke Energy Kentucky is also appreciative of the Commission Staff accommodating the Parties by hosting an informal conference and providing helpful comment and insight into various issues in this proceeding.

Q. AS PART OF THE STIPULATION, DOES THE AG AGREE THAT DUKE ENERGY KENTUCKY'S APPLICATION SHOULD BE APPROVED AS FILED?

A. Yes. Specifically, the Parties agree and recommend to the Commission that:

a. Duke Energy Kentucky's request for a CPCN should be approved and the filing deviations requested in its Application should be granted;

b. Duke Energy Kentucky should be allowed to acquire the 31% interest in East Bend from DP&L for a purchase price of $12.4 million, as adjusted in accordance with the terms of the Purchase and Sale Agreement;

c. The purchase price of $12.4 million should be used for establishing the net book value as of the date of closing of the 31% interest in East Bend for rate making purposes;

d. Duke Energy Kentucky's assumption of liabilities should be approved as requested in the Application;

e. Duke Energy Kentucky will become responsible for all costs of operation of the entire East Bend generating station upon closing and such costs of full operation and environmental compliance, including those associated with any liabilities assumed, shall be considered in the ordinary course of utility rate making in future rate proceedings;

f. Duke Energy Kentucky's requests for accounting treatment, including deferrals, should be approved as filed:

i) Incremental operations and maintenance (O&M) expenses above amounts currently reflected in base rates associated with the 31% interest in East Bend;

ii) Any and all retirement costs associated with the Miami Fort Unit 6 (MF6) identified in the Application;

iii) Carrying costs on the unrecovered balance of regulatory assets based upon the Company's cost of debt; and

iv) Any other incremental costs related to the assumed liabilities or otherwise necessary to effectuate the purchase;

g. Cost recovery for the foregoing accounting treatments shall be considered in the course of a future rate proceeding;

h. Duke Energy Kentucky's requests for accounting and ratemaking treatment related to sharing of capacity revenues and netting such revenues against costs to acquire additional capacity should be approved as requested;

i. The Company's request for modification of its Rider Profit Sharing Mechanism (PSM) tariff should be approved as requested, including the sharing of net revenues;

j. The retirement of MF6 shall be considered as a normal retirement for rate making purposes; and

k. The journal entries relating to the East Bend Transaction, as requested in the Application, should be approved.

Q. AS PART OF THE STIPULATION, DOES DUKE ENERGY KENTUCKY AGREE NOT TO SEEK TO INCREASE ITS BASE ELECTRIC RATES FOR A SPECIFIED PERIOD?

A. Yes. As part of the Stipulation, Duke Energy Kentucky agrees to refrain from filing any notice of intent to file an application for an increase in its base electric rates prior to December 1, 2015, and, therefore, will not file any application that would increase its existing electric base rates prior to January 1, 2016. Notwithstanding the foregoing, Duke Energy Kentucky retains the right to seek approval from the Commission of: (a) the deferral of extraordinary and uncontrollable costs (*e.g.*, ice, wind storm, etc.); (b) emergency rate relief under KRS 278.190(2) to avoid a material impairment or damage to its credit or operations; (c) adjustments to the operation of any of Duke Energy Kentucky's cost recovery surcharge mechanisms (*e.g.*, Fuel Adjustment Clause, Demand Side Management, etc.), including any base rate roll-ins, which are part of the nomal operations of such mechanisms; (d) the establishment or implementation of an environmental surcharge mechanism pursuant to KRS 278.183; or (e) any rate-related request with respect to its natural gas distribution business.

Q. WHY DOES DUKE ENERGY KENTUCKY BELIEVE IT IS APPROPRIATE TO AGREE NOT TO SEEK TO INCREASE ITS BASE ELECTRIC RATES PRIOR TO 2016?

A. Duke Energy Kentucky has aggressively managed its costs since its last electric rate case and will continue to do so, thereby allowing it to delay seeking an increase in electric base rates for the time set forth in the Stipulation. Moreover, because the terms of the Stipulation explicitly permit Duke Energy Kentucky to seek rate relief in certain contexts (as discussed above), and permits the Company to defer certain incremental costs, not already reflected in the Company's base rates, of Operating the East Bend station, the Company believes that the Stipulation is consistent with the ratemaking principal of gradualism. In sum, the Company is confident that the Stipulation is particularly beneficial to the customers it serves, both in the near and extended term.

Q. DOES THE STIPULATION CONTAIN OTHER TERMS AND CONDITIONS COMMON TO DOCUMENTS OF THIS KIND?

A. Yes. Although I have already discussed the main, substantive portions of the Stipulation, the Parties also agree in the Stipulation to various terms and conditions commonly found in documents of this nature (*e.g.*, the AG waives all rights of cross-examination of the Company's witnesses unless the Commission disapproves the Stipulation; the Parties agree that the Stipulation shall in no way be deemed to divest the Commission of jurisdiction under Chapter 278 of the Kentucky Revised Statutes; the Parties agree that the Stipulation may be executed in multiple counterparts; etc.).

Q. WHY HAVE DUKE ENERGY KENTUCKY AND THE AG ENTERED INTO THE STIPULATION?

A. There are a number of reasons why Duke Energy Kentucky and the AG have entered into the Stipulation. In general terms, the Parties, who represent diverse interests and divergent viewpoints, agree that the Stipulation, viewed in its entirety, is a fair, just and reasonable resolution of all the issues in this proceeding, and further agree that the terms of the Stipulation will result in the lowest cost option of the competiviely bid proposals as analyzed and assessed by Duke Energy Kentucky. Additionally, both Duke Energy Kentucky and the AG understand and agree that the acquisition by the Company of DP&L's interest in East Bend will result in substantial tangible and intangible benefits to the ratepayers of Duke Energy Kentucky, including, but not necessarily limited to:

- The very favorable cost of $12.4 million to acquire 186 MW of net installed capacity, which equals an upfront investment that is significantly below the next best option bid in response to the Company's independently administered RFP; and
- The operational flexibility to replace approximately 163 MW of net installed capacity at MF6 that may be economically retired by June 1, 2015, due to the MATS rule; and
- The provision of additional reserves to meet the load obligations for Duke Energy Kentucky, as well as, enhancing the ratepayers' hedge against real time energy price exposure; and
- The benefit to ratepayers realized through additional capacity revenues derived from the approximately 186 MWs of net installed capacity attributed to the East Bend acquisition, already committed to PJM's base residual auction through May 31, 2018, because the Company has already fulfilled its capacity position through May 31, 2015, with MF6. Estimated to be approximately $20,000 per day through the end of the 2014/2015 delivery year (or May 31, 2015), these proceeds would flow through the

proposed Rider PSM tariff; and

- The ability to achieve operational efficiency with Duke Energy Kentucky as the sole owner of the East Bend station and no longer subject to a joint operation obligation; and
- The environmental benefits associated with having the ability to retain a comparable number of MWs of capacity through a scrubbed coal-fired base-load generator once the unscrubbed MF6 is retired, which is nearing the end of its useful life, while still reducing Duke Energy Kentucky's overall environmental footprint; and
- The avoidance of uncertainty and litigation over the terms and effect of the expired Operating Agreement previously entered into with DP&L; and
- The expected realization of lower fuel costs based upon historical fuel expenses for East Bend and MF6 coupled with the ability to avoid the increased cost of compliance and dispatch of MF6 should the Company continue to operate MF6 and bring the station into MATS compliance; and
- The Company's commitment to the Commonwealth by locating a greater percentage of its generation resources in Kentucky, thereby maintaining a skilled work force and a market for coal produced in Kentucky.

IV. SUMMARY

Q. PLEASE SUMMARIZE YOUR SUPPLEMENTAL TESTIMONY.

A. Duke Energy Kentucky and the AG entered into the Stipulation on or about October 7, 2014. As part of the Stipulation, the Parties agree and recommend to the Commission that the Company's Application in this proceeding should be approved as filed; additionally, Duke Energy Kentucky agrees that it will not file any application that would increase its existing electric base rates prior to January 1, 2016. The Stipulation represents a fair, just and reasonable resolution of all the issues in this proceeding, and the Parties recommend to the Commission that the Stipulation be accepted and fully incorporated into any Order approving Duke Energy Kentucky's Application in this proceeding.

Q. **DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?**

A. Yes.

VERIFICATION

STATE OF OHIO	)	
	)	**SS:**
COUNTY OF HAMILTON	)	

The undersigned, William Don Wathen Jr., Director of Rates & Regulatory Strategy-OH/KY, being duly sworn, deposes and says that he has personal knowledge of the matters set forth in the foregoing Stipulation contained therein are true and correct to the best of his knowledge, information and belief.

William Don Wathen Jr., Affiant

Subscribed and sworn to before me by William Don Wathen Jr. on this 7th day of October, 2014.

ADELE M. FRISCH
Notary Public, State of Ohio
My Commission Expires 01-05-2019

Adele M. Frisch
NOTARY PUBLIC

My Commission Expires: 1/5/2019

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