

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF DUKE ENERGY KENTUCKY,)	
INC. FOR AUTHORIZATION TO ENTER INTO A)	CASE NO.
TRANSACTION AND AGREEMENT WITH AN)	2014-00287
AFFILIATE OR IN THE ALTERNATIVE, APPROVAL)	
OF DEVIATIONS FROM THE REQUIREMENTS OF)	
KRS 278.2207 AND KRS 278.2213(6))	

ORDER

On August 12, 2014, Duke Energy Kentucky, Inc. (“Duke Kentucky”) submitted an application seeking authorization to enter into a transaction and agreement which amends its current operating agreement with its affiliate, Duke Energy Miami Fort, LLC (“Duke Energy Miami Fort”), pursuant to KRS 278.2207 or, in the alternative, for a deviation from the requirements of KRS 278.2207 and KRS 278.2213(6).¹

The transaction and proposed amended operating agreement relate to the operation of the Miami Fort Unit 6 generator (“MF6”) owned by Duke Kentucky and currently operated by Duke Energy Miami Fort in conjunction with Miami Fort Units 7 and 8 (respectively “MF7” and “MF8”), which are currently majority owned by Duke Energy Commercial Asset Management, a subsidiary of Duke Energy Corporation.

The Commission issued one request for information in this matter. No persons have requested intervention or a hearing, and this matter now stands ripe for adjudication.

¹ Duke Kentucky filed a motion to amend its Application on September 29, 2014, by substituting a new Exhibit 2 for the one filed with its Application.

DISCUSSION

Duke Kentucky is a utility engaged in providing electric and natural gas service to approximately 137,000 and 96,000 customers, respectively, in seven counties in northern Kentucky.² The Commission authorized Duke Kentucky's acquisition of MF6 by Order on December 5, 2003.³ Thereafter, on January 25, 2006, Duke Kentucky entered into an agreement with Duke Energy Miami Fort for the latter to assume operation and maintenance responsibility over MF6. The agreement required Duke Kentucky to fully reimburse Duke Energy Miami Fort for its expenses and costs incurred in operating MF6.

Duke Kentucky states that when it acquired MF6 in 2003, it expected to operate the unit for 17 years, until approximately 2020. However, as a result of federal environmental regulations, particularly the Mercury and Air Toxics Standards ("MATS") rule, MF6 will likely be retired early. Duke Kentucky expects to retire the unit by June 1, 2015. In anticipation of the early retirement, Duke Kentucky applied for and recently received approval to acquire Dayton Power and Light Company's 31 percent interest (186 megawatts) in the East Bend Unit 2 Generation Station in which it already owned a 69 percent interest.⁴

² *Annual Reports of Duke Energy Kentucky, Inc. to the Kentucky Public Service Commission for the Year Ending December 31, 2013*, Ref Pg. 0.

³ Case No. 2003-00252, *Application of the Union Light, Heat and Power Company for a Certificate of Public Convenience and Necessity to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchase Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6)* (Ky. PSC Dec. 5, 2003).

⁴ Case No. 2014-00201, *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* (Ky. PSC Dec. 4, 2014).

The proposed amended operating agreement with Duke Energy Miami Fort was drafted in contemplation of a future sale of MF7 and MF8 to Dynegy, Inc. (“Dynegy”), an unaffiliated third party.⁵ On August 21, 2014, Dynegy Resource I. LLC (“Dynegy Resource”), a subsidiary of Dynegy, and Duke Energy Corporation entered into an agreement for the sale of Duke Energy Commercial Asset Management to Dynegy Resource.⁶ As a result of the sale, Dynegy will acquire MF7 and MF8, as well as Duke Energy Miami Fort.⁷ As part of the sale and acquisition, the operating agreement by which Duke Energy Miami Fort operates MF7 and MF8 will be assumed by Dynegy Resource. Duke states that because Dynegy Resource will be acquiring Duke Energy Miami Fort, it will not be necessary for the MF6 amended operation agreement to be assigned or assumed.⁸ As a result of Dynegy Resource’s acquisition of Duke Energy Miami Fort, Dynegy will be obligated to continue operating MF6 pursuant to the amended operating agreement, upon Commission’s approval of the agreement. Should the sale be closed prior to the Commission’s adjudication of the application, MF6 will be operated consistent with prior practice and operations.

Accordingly, Duke Kentucky requests approval of the proposed amended operating agreement which, *inter alia*, permits its assignment to an unaffiliated entity, such as Dynegy. The amended operating agreement also includes revised terms relating to insurance, confidentiality, force majeure, termination, procurement, standards of performance, budgeting, records management, records retention, cost and expense

⁵ Duke Kentucky Motion to Amend Application at 2.

⁶ Duke Kentucky Response to Commission Staff’s First Request for Information, Item 2.

⁷ *Id.*

⁸ *Id.*

reimbursement, indemnification, liabilities, dispute resolution, and warranties, and also provides for the payment of a fee for services rendered in operating MF6 in the amount of \$250,000 per operating year and \$100,000 per year while retirement services are rendered. The proposed amended operating agreement also provides for the automatic escalation of the fee according to an escalation factor, which is based on the Consumer Price Index. Duke Kentucky notes that it is unlikely that an unaffiliated third party would continue to operate MF6 without any remuneration beyond its costs, and therefore the fee, which was negotiated with Duke Energy Miami Fort, is necessary to permit an acceptable profit and incentive to provide the service.

Duke Kentucky states that the proposed amended operating agreement was negotiated at arm's length with Duke Energy Miami Fort. However, the amended operating agreement requests a deviation pursuant to KRS 278.2219 in the event the amended operating agreement is deemed to not be the result of an arm's-length transaction or priced at its fully distributed costs pursuant to KRS 278.2213(6) and KRS 278.2207(1)(b), respectively. Although the amended operating agreement was not competitively bid, Duke Kentucky asserts that such a bidding process would not have been beneficial, given the likely sale of MF7 and MF8. It states that a competitive bidding process would also have been unduly complicated and costly.

On October 3, 2014, the Commission granted Duke Kentucky's request to amend Exhibit 2 to its Application. The amendment included identifying Dynegy as the third-party purchaser of MF 7 and MF 8, and also contained minor amendments to the agreement that were requested by Dynegy.

FINDINGS

Based upon a review of the record and being otherwise sufficiently advised, the Commission finds that Duke Kentucky's proposed affiliate transaction agreement complies with the KRS 278.2207(1) and should be approved.

KRS 278.2207(1) provides:

The terms for transactions between a utility and its affiliates shall be in accordance with the following:

- (a) Services and products provided to an affiliate by the utility pursuant to a tariff shall be at the tariffed rate, with nontariffed items priced at the utility's fully distributed cost but in no event less than market, or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.
- (b) Services and products provided to the utility by an affiliate shall be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.

KRS 278.2207(2) further permits a utility to request a deviation from the requirements set forth in KRS 278.2207(1). Here, the Commission finds that the terms of the affiliate transaction agreement, as amended, are reasonable and that no deviation is needed. Duke Kentucky has demonstrated that the continued operation of MF6 in concert with MF7 and MF8 by Duke Energy Miami Fort promotes efficiencies through economy of scale. In compliance with KRS 278.2207(1), the costs paid by Duke Kentucky to Duke Energy Miami Fort will be the latter's fully distributed cost and

will not be greater than market value, and will continue to be operational for a limited period of time.⁹

Furthermore, the projected eventual operation by Dynegy Resource upon its acquisition of Duke Energy Miami Fort will continue to be reasonable based upon the same rationale of economy of scale. Dynegy Resource, as an unaffiliated third-party company, is entitled to an additional fee as compensation for its operating services, and the agreed-upon fee is a reasonable necessity in retaining Dynegy Resource, subsequent to its acquisition of Duke Energy Miami Fort, to continue operating and maintaining MF6. The Commission finds that the agreed-upon negotiated fee is reasonable and satisfies the pricing requirements set forth in KRS 278.2207(1). Accordingly, the Commission finds that the amended operating agreement should be approved.

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's request to enter into a transaction and amended operation agreement for MF6 with its affiliate Duke Energy Miami Fort is granted.
2. Duke Kentucky's alternative request for a deviation from KRS 278.2207 and KRS 278.2213(6) is denied as moot.

⁹ According to the Commission's Final Order in Case No. 2014-00201, *Duke Energy Kentucky* (Ky. PSC Dec. 4, 2014), MF6 may not be operated beyond June 1, 2015 without additional approval by the Commission.

By the Commission

ENTERED
JAN 12 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST



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