COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

BACK-UP POWER SUPPLY PLAN OF DUKE ENERGY KENTUCKY, INC.	)	CASE NO. 2007-00044

O R D E R

On January 23, 2007, Duke Energy Kentucky, Inc. ("Duke Kentucky") submitted its application seeking Commission approval of a back-up power supply plan as required pursuant to paragraph 6 of the settlement agreement filed in Case No. 2006-00172.[1] The Commission adopted the settlement agreement in its entirety in the December 21, 2006 Order.

The settlement agreement requires Duke Kentucky to continue its best efforts to procure a back-up power supply. The $49 million revenue increase provided in the settlement agreement includes recovery for all demand charges for back-up power. Effective January 1, 2007, Duke Kentucky was authorized to begin recovery consistent with the Fuel Adjustment Clause ("FAC") regulations.

In Case No. 2003-00252,[2] as part of the acquisition of generating facilities, Duke Kentucky proposed that a back-up power supply plan was necessary in the event Duke

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[1] Case No. 2006-00172, Adjustment of Electric Rates of The Union Light, Heat and Power Company d/b/a Duke Energy Kentucky.

[2] 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).

Kentucky experienced outages with its generating facilities. Originally, the back-up power agreement was to be with Cincinnati Gas and Electric, but that arrangement was not submitted to the Federal Energy Regulatory Commission ("FERC") for its approval. In its periodic updates on the status of its back-up power supply plan, Duke Kentucky has informed the Commission that changes in the arrangement had been necessitated by FERC rulings in other utility cases. Duke Kentucky's most recent action has been to solicit bids for various power arrangements, from which it would select the most cost effective proposal.

Duke Kentucky has evaluated various supply options, and selected a back-up power supply plan for the 2007-2009 period that it contends is consistent with the settlement agreement in Case No. 2006-00172. Duke Kentucky considered supply options from: (1) the Midwest Independent System Operator ("MISO") daily energy markets; (2) a Request For Proposals ("RFP") issued by Duke Kentucky in May 2006; and (3) fixed forward contracts purchased through the Intercontinental Exchange ("ICE").

Duke Kentucky selected a back-up power supply plan consisting of capacity purchases through bilateral contracts and energy purchases through the MISO daily energy markets, with forward contracts purchased through ICE for scheduled outages. Duke Kentucky will purchase capacity during the months when scheduled outages are to occur, enabling it to maintain a 16.2 percent reserve margin. The 16.2 percent reserve margin was used in Duke Kentucky's most recent integrated resource plan.[3]

[3] Case No. 2004-00014, The Integrated Resource Plan of The Union Light, Heat and Power Company, Commission Staff Report dated January 14, 2005.

Duke Kentucky used its Commercial Business Model ("CBM") to analyze the different back-up supply options and to select the optimal back-up power supply plan. The CBM is a proprietary software program that Duke Kentucky uses to project power production requirements and costs under a variety of scenarios. The CBM uses current load forecasts, extensive historical data related to production costs, fuel costs, wholesale power prices, weather conditions and statistical modeling, to predict power needs and costs.

Duke Kentucky states that it selected the back-up power supply plan that best balances cost and risk mitigation. Although the back-up plan chosen by Duke Kentucky was not the least costly of the options, the plan better mitigates the risks presented by any single option.

Duke Kentucky projects that it will incur $15.4 million in costs for capacity and energy purchases for back-up supply during forced outages for the 2007-2009 period, which will be unrecoverable through its FAC filings. For scheduled outages, Duke Kentucky will make fixed forward price purchases when market conditions appear favorable, but the purchases will occur well in advance of the scheduled outages. This should diminish the risk of price spikes during scheduled outages since the price of back-up power would be fixed.

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that Duke Kentucky's back-up power supply plan is reasonable and should be approved. The Commission notes that the proposed back-up power supply plan is only for the 2007-2009 period. If Duke Kentucky determines it needs back-up power supply plans in the future, the Commission should be informed of

this decision and provided adequate time to review and evaluate subsequent back-up power supply plans.

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's back-up power supply plan for the 2007-2009 period is consistent with the settlement agreement in Case No. 2006-00172 and is approved as it is described in its application.

2. Duke Kentucky shall inform the Commission in writing of its intentions concerning future back-up power supply plans 6 months prior to the expiration of Duke Kentucky's 2007-2009 back-up power supply plan approved herein.

3. Duke Kentucky shall submit for review and approval any future back-up power supply plans no later than 60 days prior to the effective date of the new plan.

Done at Frankfort, Kentucky, this 29th day of March, 2007.

By the Commission

ATTEST:

for Beth O'Donnell

Executive Director