



DUKE ENERGY CORPORATION

139 East Fourth Street
P.O. Box 960
Cincinnati, OH 45201-0960
Telephone: (513) 419-1805
Facsimile: (513) 419-1846

Kristen Cocanougher
Sr. Paralegal
E-mail: Kristen.cocanougher@duke-energy.com

VIA HAND DELIVERY

November 19, 2010

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Blvd
Frankfort, KY 40601

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PUBLIC SERVICE
COMMISSION

Re: Case No. 2010-00203

Dear Mr. Derouen:

Enclosed please find an original and twelve copies of Duke Energy Kentucky Inc.'s Public Post Hearing Brief and Petition for Confidential Treatment in the above captioned case. Also enclosed in the white envelope is one copy of the confidential version of Duke Energy Kentucky, Inc.'s Post Hearing Brief being filed under seal.

Please date-stamp the two copies of the letter, Public Brief and the Petition and return to me in the enclosed envelope.

Very truly yours,

Kristen Cocanougher

cc: Parties of Record (via electronic mail)

**BEFORE THE
KENTUCKY PUBLIC SERVICE COMMISSION**

In The Matter of:

Duke Energy Kentucky, Inc.'s Application for Approval)
To Transfer Functional Control of its Transmission Assets)
From the Midwest Independent Transmission System)
Operator to the PJM Interconnection Regional Transmission)
Organization And Request for Expedited Treatment)

Case No. 2010-203

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BRIEF OF DUKE ENERGY KENTUCKY, INC.

TO THE HONORABLE PUBLIC SERVICE COMMISSION:

Please accept for filing in the above-captioned proceeding the Brief of Duke Energy
Kentucky, Inc.

Respectfully submitted,
DUKE ENERGY KENTUCKY, INC.



Rocco O. D'Ascenzo

Senior Counsel

Amy B. Spiller

Associate General Counsel

Duke Energy Kentucky, Inc.

139 East Fourth Street

Rm 25 ATII

Cincinnati, Ohio 45201-0960

Phone: (513) 419-1852

Fax: (513) 419-1846

e-mail: rocco.dascenzo@duke-energy.com

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BRIEF OF DUKE ENERGY KENTUCKY, INC.

I. INTRODUCTION AND BACKGROUND

Duke Energy Kentucky, Inc. (Duke Energy Kentucky or Company) is an electric utility providing safe and reliable generation and distribution service to approximately 135,000 electric customers in the Commonwealth of Kentucky.¹ Duke Energy Kentucky is a transmission dependent electric distribution utility, owning very few facilities above 69 kV as discussed below. Indeed, the Company is otherwise dependent upon the high voltage (100 kV and above) transmission system owned by its parent company, Duke Energy Ohio, Inc., (Duke Energy Ohio) to provide safe and reliable electric service to its Kentucky customers. The only transmission facilities greater than 69 kV owned by Duke Energy Kentucky consist of eighteen 138 kV switches (138 kV Connections) and the high voltage side of eighteen step down transformers associated with those connections. These devices allow for power generated by Duke Energy Kentucky, and subsequently injected into the Duke Energy Ohio Transmission system, to be delivered to load. They are in essence, distribution taps for Duke Energy Kentucky.

Duke Energy Ohio has indicated that it is leaving the Midwest Independent System Operator (Midwest ISO) effective January 1, 2012. Duke Energy Kentucky's three generating stations are connected only to Duke Energy Ohio's transmission. Duke Energy Kentucky is not interconnected to any utility in the Midwest ISO, other than Duke Energy Ohio. Consequently, once Duke Energy Ohio realigns its regional transmission organization (RTO) membership to PJM Interconnections LLC (PJM), Duke Energy Kentucky will not have a direct point of interconnection to the Midwest ISO.

This case is not about whether PJM is a better RTO than Midwest ISO. Duke Energy Kentucky has made no such claim, although the Company's analysis does show a net benefit

with PJM realignment.² This case is about Duke Energy Kentucky needing to follow the bulk transmission system that is instrumental to the Company's ability to provide safe reliable and low-cost electric service. The value and benefits in an RTO are numerous. RTO provide greater reliability and access to more liquid markets for both energy and capacity.³ In this case, PJM has simply become a better fit for Duke Energy Kentucky.

Duke Energy Kentucky's generation (and load) will be in PJM regardless of any action of Duke Energy Kentucky the moment Duke Energy Ohio completes its RTO realignment. Thus, Duke Energy Kentucky must either follow the transmission it depends upon, or somehow virtually preserve its membership in the Midwest ISO through a complex pseudo-tying arrangement in order to continue serving customers.⁴ But as discussed below, Duke Energy Kentucky has determined that RTO realignment is in the best interests of the Company and its customers.

On or about May 20, 2010, Applicant Duke Energy Kentucky filed this case seeking approval to transfer functional control over the 138 kV Connections from the Midwest ISO to PJM. The result of this transaction is that Duke Energy Kentucky is withdrawing its membership from Midwest ISO and is joining PJM.

RTO realignment will keep outage coordination and related functions for these eighteen 138 kV Connections under the functional control of the same RTO as the Duke Energy Ohio transmission system to which they are tied.⁵ Realignment will also avoid the operational complexities associated with pseudo-tying Duke Energy Kentucky's load and generation back to

¹ Duke Energy Kentucky also provides natural gas service to approximately 94,000 customers.

² See Confidential Supplemental Response to Midwest ISO DR-02-07, filed September 25, 2010; and Supplemental/ Clarifying response to Midwest ISO DR-02-07, Confidential Work papers filed October 28, 2010.

³ Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 11:35:00 (media file 1:27:54/02:17:22).

⁴ See Direct Testimony of John D. Swez at 11-12.

⁵ See Direct Testimony of John D. Swez at 10.

the Midwest ISO.⁶ Finally, the opportunities available for off-system sales of capacity and energy in PJM are greater than those currently existing in the Midwest ISO.⁷ Those opportunities translate directly into benefits to customers through a credit on bills through the Company's existing Commission-approved profit sharing mechanism (Rider PSM).⁸

As part of its Application, Duke Energy Kentucky made several commitments with the intent that customers would not have to pay any exit costs associated with withdrawal from the Midwest ISO or for integration into PJM or face the risk of double-paying for transmission expansion projects for overlapping time periods.⁹ Duke Energy Kentucky supported its Application with Direct Testimony of four witnesses, as well as through two additional witnesses identified in responding to multiple rounds of discovery from the Kentucky Public Service Commission (Commission) and from the Midwest ISO. The only intervenors in this proceeding were Midwest ISO and PJM. No intervenor offered direct testimony opposing Duke Energy Kentucky's realignment. Further, there was no evidence whatsoever that disputes Duke Energy Kentucky's realignment request or justification for the realignment. Significantly, the Midwest ISO failed to present any evidence tending to suggest that the Company's customers are harmed or otherwise disadvantaged by the realignment. Indeed, in a similar proceeding before this Commission, Midwest ISO testified before this Commission that it would not be in a position to stop a member from withdrawing.¹⁰ The Commission questioned the Midwest ISO directly about whether the Midwest ISO would protest if Big Rivers sought to withdrawal its membership in the future. The Midwest ISO responded as follows:

⁶ See Direct Testimony of John D. Swez at 11-12.

⁷ Confidential Analysis provided in Response to Midwest ISO DR-02-007, filed September 25, 2010.

⁸ See Direct Testimony of William Don Wathen Jr., at 11.

⁹ *Id* at 7-9. See also Duke Energy Kentucky's Response to Midwest ISO DR-01-003, filed August 2, 2010.

¹⁰ *In Re Application of Big Rivers for Approval to Transfer Functional Control of its Transmission System to Midwest Independent Transmission System Operator, Inc.*, Case No 2010-00043, Hearing September 15, 2010, Video transcript at 5:22:40/5:23:55.

It would be our request that Big Rivers contemplate the benefits, the categories of which are articulated in our value proposition, and look at a larger picture than just their contingency reserve component as they contemplated their withdrawal. To the degree that we could essentially try to talk them out of it, based on the rest of the benefit picture that only Big Rivers is in a position to judge. And in my testimony I go through some indicative calculations what the categories are and how big the numbers might be. We obviously don't understand the details of Big Rivers actual economic position. We think those benefits are real, we think they should be contemplated. We would expect that this Commission or others would ask similar kinds of questions. *But we would not be in a position to protest, other than to provide what we could provide in terms of facts to the Commission for their considerations.*¹¹

Although it did seek intervention and conducted extensive discovery in this proceeding, the Midwest ISO has remained true to its word, and has not directly protested Duke Energy Kentucky's request to withdrawal. In fact, there is no evidence in the record that Duke Energy Kentucky should not withdraw from the Midwest ISO and realign with PJM. Nor can there be. Duke Energy Kentucky's request is for a proper purpose, is in the public interest and thus should be approved.

II. DISCUSSION

A. Legal Standard for Approval

1. Federal Legal Standard

As noted by this Commission at the outset of the hearing in this matter, Duke Energy Kentucky has received the necessary approval from the Federal Energy Regulatory Commission (FERC) to effect its withdrawal from the Midwest ISO.¹² In approving the withdrawal, the FERC also affirmed the three part test for RTO withdrawal: 1) the withdrawal must satisfy the terms of the applicant's contractual obligations as they relate to RTO withdrawal; 2) the replacement arrangement must comply with FERC Orders No. 888 and 890 and the standard of

¹¹ *Id. Emphasis added.*

¹² See *Duke Energy Ohio, Inc. and Duke Energy Kentucky, Inc.*, 133 FERC ¶ 61,058, Docket Nos. ER10-1562-000, ER10-2254-000, (October 21, 2010).

review under those orders for proposed tariff provisions that differ from the pro forma open access transmission tariff (OATT); and 3) the replacement arrangements must be just, reasonable and non-discriminatory.¹³ In granting Duke Energy Ohio and Duke Energy Kentucky approval to realign with PJM, the FERC has upheld the proposition that membership in an RTO is voluntary, rejecting Midwest ISO's requests to adopt a more restrictive standard on a utility's RTO membership decisions.¹⁴ Specifically, FERC expressly rejected the notion that a withdrawing member must demonstrate that benefits of withdrawal outweigh the costs.¹⁵ Therefore, subject to meeting their commitments at the FERC, Duke Energy Ohio and Duke Energy Kentucky have been cleared to realign their RTO membership.

2. Kentucky's Legal Standard

The standard for approving the application filed in this proceeding is set forth in Kentucky Revised Statutes (KRS) 278.218, which provides in relevant part:

- (1) No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars (\$1,000,000) or more and:
 - (a) The assets are to be transferred by the utility for reasons other than obsolescence; or
 - (b) The assets will continue to be used to provide the same or similar service to the utility or its customers.
- (2) The commission shall grant its approval if the transaction is for a proper purpose and is consistent with the public interest.¹⁶

As explained in the Company's Application,¹⁷ Direct Testimony, and Discovery Responses, as well as through cross examination at the hearing in this matter, Duke Energy Kentucky does have a limited number of transmission facilities through the 138 kV Connections, that are

¹³ *Id.* at paragraphs 19, 48-49.

¹⁴ *Id.* at paragraph 47-48.

¹⁵ *Id.* at Paragraph 49.

¹⁶ KRS 278.218 (2010).

¹⁷ *See* Application at 11.

currently under Midwest ISO functional control. In the aggregate, the value of those assets exceeds the \$1,000,000 threshold contained in Kentucky Revised Statutes (KRS) 278.218. The Commission, by Order dated June 24, 2010, determined that it had jurisdiction over this proposed RTO realignment pursuant to KRS 278.218.¹⁸ Thus the standard for approval is that which is set forth under KRS 278.218(2). In prior similar proceedings involving the transfer of functional control, the Commission has stated that the party seeking approval to transfer control of facilities must demonstrate:

that the proposed transfer will not adversely affect the existing level of utility service or rates or that any potentially adverse effects can be avoided through the Commission's imposition of reasonable conditions on the acquiring party. The acquiring party should demonstrate that the proposed transfer is likely to benefit the public through improved service quality, enhanced service reliability, the availability of additional services, lower rates or a reduction in utility expenses to provide present services. Such benefits, however, need not be immediate or readily quantifiable.¹⁹

The record in this proceeding demonstrates that Duke Energy Kentucky has met the aforementioned standard and that the transaction is for "proper purpose" and in "public interest" under KRS 278.218. Duke Energy Kentucky's application to transfer functional control over its 138 kV Connections to PJM should be approved.

B. Duke Energy Kentucky's RTO Realignment is for a Proper Purpose

1. Realignment with PJM will not require Duke Energy Kentucky to change its operation.

Duke Energy Kentucky's proposed realignment will not affect the Company's service, reliability or operations. Duke Energy Kentucky will operate in PJM in much the same manner as it does today in the Midwest ISO, offering its generation into the market and bidding its

¹⁸ See Order, June 24, 2010.

¹⁹ *In the Matter of Kentucky Power Co. dba American Elec Power.*, Case No. 2002-00475, Order dated July 17, 2003, (quoting *Application for Approval of the Transfer of Control of Kentucky-American Water Co. to RWE*

load.²⁰ PJM operates both a day-ahead market and real-time (balancing) market for energy and Duke Energy Kentucky will have the ability to choose to offer in either the Reliability Pricing Model (RPM) forward capacity auction or the Fixed Resource Requirement (FRR) capacity plan.²¹ PJM also operates an ancillary service market for regulation, synchronized, and supplemental reserves, each of which is cleared separately with different prices for each product.²² Duke Energy Kentucky participates in these ancillary service markets in the Midwest ISO and will do the same in the PJM ancillary service markets.²³ Duke Energy Kentucky will operate its generating resources in a reliable manner and to optimize revenues available in the PJM capacity market, energy market, ancillary services, and black start service for the benefit of customers and shareholders.²⁴

Duke Energy Ohio's realignment to PJM is not dependent upon Duke Energy Kentucky leaving Midwest ISO. Rather, Duke Energy Ohio has its own justification to realign its transmission system based on operational and competitive market initiatives,²⁵ as does Duke Energy Kentucky. Because of its dependence upon the Duke Energy Ohio transmission system, once Duke Energy Ohio realigns its RTO membership, Duke Energy Kentucky will no longer have a direct point of interconnection to the Midwest ISO.²⁶ And Duke Energy Kentucky's generating assets, located within Duke Energy Ohio's transmission service zone, will be in PJM.²⁷ Put another way, Duke Energy Kentucky's generation and its load will be in PJM,

Aktiengesellschaft and Thames Water Aqua Holdings GMBH, Case No. 2002-0001 8, Order dated May 30, 2002, at 7-8).

²⁰ See Direct Testimony of John D. Swez at 7.

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ See Direct Testimony of James B. Gainer at 5-6.

²⁶ *Id.*

²⁷ *Id.* at 4.

irrespective of any action of Duke Energy Kentucky.²⁸ Duke Energy Kentucky's distribution system serving its entire load will be separated from the Midwest ISO by the Duke Energy Ohio transmission system.²⁹ Unless Duke Energy Kentucky realigns with PJM, a RTO seam will be created between Duke Energy Kentucky's generation and its load. As explained by Company Witness John D. Swez, upon Duke Energy Ohio's realignment without Duke Energy Kentucky, Duke Energy Kentucky's generation would be dispatched into PJM and the Company would be subject to associated PJM transmission costs under the FERC OATT in order to serve load in Midwest ISO.³⁰

As explained by Duke Energy Kentucky witness, James B. Gainer, Duke Energy Kentucky is now seeking to realign RTO membership for operational efficiencies.³¹ In order to maintain the current operations with respect to outage planning and load and generation being in same RTO, and to avoid additional operational complexities and likely costs with virtually recreating membership in the Midwest ISO, Duke Energy Kentucky must realign as well.

Realignment to PJM affords many benefits to Duke Energy Kentucky and will have minimal impact in its operations. In fact, realignment to PJM permits Duke Energy Kentucky to maintain an operational status quo. Duke Energy Kentucky expects that its coal-fired and natural gas-fueled generation will be dispatched in a similar pattern as in the Midwest ISO.³² Further, realignment to PJM will allow Duke Energy Kentucky to be in the same RTO as Dayton Power and Light (DP&L), the joint owner of the East Bend Generating Station.³³ This alone provides a new benefit for Duke Energy Kentucky in terms of aligning the asset value-based decisions for

²⁸ See Direct Testimony of John D. Swez at 10.

²⁹ *Id.* at 11.

³⁰ *Id.*

³¹ See Direct Testimony of James B. Gainer at 2.

³² See Direct Testimony of John D. Swez at 10.

³³ *Id.* at 9.

outage planning, capital deployment and maintenance of the unit with its joint owner that has not previously existed in the Midwest ISO. PJM offers opportunities for off-system sales for capacity, energy, and ancillary services.³⁴ PJM has a more robust capacity market, with transparent prices three years into the future.³⁵

2. Realignment avoids complexities and costs of pseudo-tying its generation and load back to Midwest ISO.

Staying in the Midwest ISO creates inefficiencies and complexities for Duke Energy Kentucky. As soon as Duke Energy Kentucky learned Duke Energy Ohio was going to realign its RTO membership to PJM, Duke Energy Kentucky started to examine the consequences and its options.³⁶ Realigning its RTO membership to PJM became the best solution. Staying in Midwest ISO would not maintain the status quo. In fact, it results in Duke Energy Kentucky being in a worse position in terms of ongoing operation and risk of an inability to control costs. If Duke Energy Kentucky were to remain in the Midwest ISO, its load and generating facilities would need to be pseudo-tied from PJM into the Midwest ISO at a cost to Duke Energy Kentucky customers.³⁷ Pseudo-tying involves virtually mimicking Duke Energy Kentucky's operation in the Midwest ISO, even though its generation and load would be physically located in PJM.³⁸ While this type of arrangement has been employed in the past for single generating units that purchase firm-point to point transmission for deliverability, the Company is not aware of any instance where a utility's entire generation and its full requirements load is pseudo-tied to a different RTO than the bulk transmission to which it is connected. Such a complex and dubious method of operation would not only create numerous inefficiencies, but could prove to

³⁴ See Direct Testimony of John D. Swez at 8.

³⁵ See Direct Testimony of Kenneth J. Jennings at 6.

³⁶ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 16:48:00-16:48 (media file 08:11/01:02:34).

³⁷ See Direct Testimony of John D. Swez at 11.

be very costly. Such ongoing operational costs would ultimately be reflected in electric rates. Realigning to PJM avoids those risks and costs.

As Duke Energy Kentucky Witness Swez explained on cross examination to stay in Midwest ISO, Duke Energy Kentucky would have to create a virtual Midwest ISO presence to mimic its operation as if it were in Midwest ISO. Duke Energy Kentucky's entire load would need to be pseudo-tied from PJM to the Midwest ISO and, the Company's generation would also have to be pseudo-tied from PJM to the Midwest ISO.³⁹ This inherently creates complexities in ongoing operations because even though the Company would continue to participate in the Midwest ISO market, it would also at the same time respond to PJM as the reliability coordinator. Such a complex operational arrangement would require Duke Energy Kentucky to balance potential conflicting dispatch signals from two separate RTOs for the same generation units.⁴⁰ Further, this type of operation creates the potential for price discrepancies from what it is paid for the power it generates in one RTO and the price the load pays for the power it consumes in the other.⁴¹ As Mr. Swez further explained on cross examination, pseudo-tying would likely require additional equipment by way of revenue quality metering in order to stay in Midwest ISO.⁴² Complexities with not realigning to PJM are also created due to additional scheduling functions related to the North American Electric Reliability Corporation (NERC) requirements where utility output changes by more than twenty-five percent an hour, such that the Company would have to tag its load and each of its eight generators every hour of every day.⁴³ The Company would also incur costs associated with the effects of congestion and losses in both PJM

³⁸ *Id.*

³⁹ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 16:46:16 – 16:47:12 (media file 06:54/ 01:02:34); *See also* Direct Testimony of John D. Swez at 11-12.

⁴⁰ *Id.* at 12.

⁴¹ *Id.*

⁴² Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 17:00:00 – 17:12:32 (media file 30:28/ 01:02:34).

and Midwest ISO by pseudo-tying both the generation and load back to Midwest ISO.⁴⁴ In order to monitor and manage these additional complexities, it would be necessary to allocate additional labor resources.⁴⁵ All of these complexities directly translate into additional costs of daily operation for Duke Energy Kentucky, and ultimately its customers, just to stay in the Midwest ISO.

Staying in Midwest ISO, while technically feasible, becomes very complicated.⁴⁶ Admittedly, Duke Energy Kentucky did not perform a formal analysis to attempt to quantify the financial impact to the Company's daily operations just to stay in the Midwest ISO.⁴⁷ Such an analysis was not necessary to conclude remaining in Midwest ISO was a bad idea for Duke Energy Kentucky, because it would require significant operational changes and risks.⁴⁸ First, it is difficult for the Company to fully comprehend how it could even operate in such a complex situation. Second, as explained below, the energy and capacity markets in PJM provide significant benefits which are projected to exceed the costs of withdrawing from Midwest ISO. Third, based upon the expertise of the Company's personnel, it was determined that the better course of action for ongoing operations was simply avoiding the operational risks, uncertainty with congestion impacts, and potential ongoing costs. PJM membership avoids all of the potential issues associated with pseudo-tying the Company's entire electric generation and

⁴³ *Id.*

⁴⁴ *Id.* at 17:12:00 (media file 31:45 / 01:02:34).

⁴⁵ See Direct Testimony of John D. Swez at 11.

⁴⁶ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 17:10:00 – 17:12:32 (media file 30:28 / 01:02:34).

⁴⁷ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 16:46:00 – 16:48:40 (media file 08:11 / 01:02:34).

⁴⁸ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 17:10:00 – 17:12:32 (media file 30:28 / 01:02:34).

distribution operations back to the Midwest ISO.⁴⁹ Realigning to PJM is proper and in the best interests of the Company and its customers.

3. Realignment to PJM provides new opportunities for Duke Energy Kentucky to maximize the value of its generation assets.

Duke Energy Kentucky has attempted to sell its capacity reserves in the Midwest ISO's monthly capacity auction. To date, the opportunities have been limited. Since June 2009, Duke Energy Kentucky's total sales in the Midwest ISO monthly capacity auction have totaled just over \$13,300.⁵⁰

On cross examination of Company witness Swez, the Midwest ISO attempted to make an issue of whether the transmission capacity somehow changes once the Company realigns with PJM and whether Duke Energy Kentucky could sell its generating capacity into PJM without becoming a member.⁵¹ Midwest ISO misses the point. As explained in discovery, there are two issues with respect to firm transmission for external generators to deliver in PJM.⁵² There must be "firm transmission service to the PJM interface and into PJM."⁵³ Duke Energy Kentucky is currently unable to sell its excess generation into PJM, because there is no available transmission capacity (ATC) for Duke Energy Kentucky as an external generator to deliver inside PJM to PJM load.⁵⁴ Curiously, the Midwest ISO did not pose this question to Company witness G. Robert Burner who provided answers to the Commission Staff's discovery questions regarding ATC, and who appeared at the hearing.⁵⁵ As Mr. Burner explained through written discovery, although PJM accommodates external generators like Duke Energy Kentucky, the external

⁴⁹ See Direct Testimony of John D. Swez at 12.

⁵⁰ See Response to Midwest ISO DR-02-001(c)(2) filed August 25, 2010; and accompanying attachment showing capacity sales since June 2009.

⁵¹ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 16:54 1:49 – 16:54:00(media file 13:25/ 01:02:34).

⁵² See Response to Midwest ISO DR-01-17, filed August 2, 2010.

⁵³ *Id.*

⁵⁴ See Response to Staff DR-02-007, filed August 25, 2010.

generator must demonstrate deliverability into PJM.⁵⁶ Presently there is no ATC to allow Duke Energy Kentucky to deliver within into PJM to PJM load.⁵⁷ Again, Duke Energy Ohio's transmission is the only bulk transmission to which Duke Energy Kentucky is connected. To date, that transmission has been under Midwest ISO operational control and not under PJM control and, therefore, it is not considered firm ATC for deliverability within PJM. Accordingly, as the Company's discovery responses confirm - and the Midwest ISO did not dispute - Duke Energy Kentucky is unable to sell capacity into PJM.⁵⁸ Once Duke Energy Ohio realigns, that transmission automatically becomes PJM transmission and Duke Energy Kentucky will be able to deliver to the PJM interface. That alone does not address the issue of firm ATC within PJM to the PJM load. ATC is no longer an issue once Duke Energy Kentucky realigns with Duke Energy Ohio because Duke Energy Kentucky's load and generation will be in PJM (*i.e.* not pseudo-tied back to Midwest ISO).⁵⁹

Realignment provides additional benefits as well. As Mr. Burner further explained, once Duke Energy Kentucky realigns its RTO membership, PJM's transparent forward capacity prices become a reliable benchmark for the Company's resource planning.⁶⁰ If Duke Energy Kentucky is required to remain in the Midwest ISO, Duke Energy Kentucky will continue to be considered an external resource because the Company's load and generation would be forced back into Midwest ISO through the pseudo-tie. The availability of ATC inside PJM for delivery to PJM load is still an issue irrespective of Duke Energy Ohio's realignment. And therefore, whether Duke Energy Kentucky could still sell capacity into PJM once Duke Energy Ohio realigns,

⁵⁵ See Response to Staff DR-02-007, filed August 25, 2010.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

becomes irrelevant. Even assuming the firm transmission issue within PJM could be solved, due to the additional operational complexities, risks and costs with pseudo-tying the load and generation back into Midwest ISO the value of access to PJM markets will be greatly reduced if not eliminated unless Duke Energy Kentucky realigns as well.⁶¹

As such, realigning with PJM provides many benefits to Duke Energy Kentucky and thus is for a proper purpose. Realigning to PJM allows Duke Energy Kentucky to participate in PJM's robust capacity market, providing greater opportunities for resource planning, off-system sales, and allows Duke Energy Kentucky to avoid all of the operational complexities, costs, and risks associated with pseudo-tying the Company's entire generation and load through PJM back to the Midwest ISO. The Commission should approve the Company's request to transfer operational control of its 138 kV Connections from Midwest ISO to PJM.

C. Duke Energy Kentucky's Realignment to PJM is in the Public Interest.

1. Realignment to PJM will not impact the Commission's jurisdiction and regulatory oversight over the Company's rates.

Duke Energy Kentucky's request to realign its RTO membership will not affect the Commission's regulatory authority over the Company. The Commission will retain all of its existing authority over Duke Energy Kentucky's rates and Integrated Resource Planning (IRP). And the Company will continue to have all of its obligations to provide safe, reliable and reasonably priced electric service to its customers.

It is important to note that Duke Energy Kentucky is not requesting to increase its rates as part of this proceeding. Nor is the Company requesting this Commission to pre-determine that a particular amount of future RTO-related costs (Midwest ISO or PJM) are fair, just and

⁶¹ *Infra discussion at Section B(1)-(2).*

reasonable to recover. Duke Energy Kentucky is simply seeking to realign its RTO membership so that it can continue to operate in the same manner as it does today.⁶²

Duke Energy Kentucky Witness William Don Wathen Jr. explains in his direct testimony the level of RTO-related costs currently included in Duke Energy Kentucky's rates.⁶³ Those rates were determined in the Company's last electric rate case filed in 2006, using a forecasted test year of twelve months ending December 31, 2007.⁶⁴ Mr. Wathen also explains that since that last rate case, Midwest ISO administrative-related costs through 2009 have increased by 20% above those budgeted for 2007.⁶⁵ That 20% increase in costs does not include costs from Midwest ISO Transmission Expansion Plan (MTEP) allocations which were neither included as part of the 2007 test year, nor included as part as the increase in Midwest ISO administrative cost calculation.⁶⁶

Duke Energy Kentucky can only adjust its current base rates through an application filed under KRS 278.180.⁶⁷ Duke Energy Kentucky does not have a rate case pending before this Commission. Accordingly, all future rate issues will be addressed when the Company files its next electric rate case, likely sometime in the next two or three years.⁶⁸ And the Commission will continue to have jurisdiction over determining whether any of Duke Energy Kentucky's future rate adjustments, including but not limited to RTO costs, results in fair, just and reasonable rates. RTO realignment does not change the authority of the Commission. Duke

⁶² See Application filed May 20, 2010.

⁶³ See Direct Testimony of William Don Wathen Jr., at 3.

⁶⁴ *Id.*

⁶⁵ See Direct Testimony of William Don Wathen Jr., at 5; "Since the time electric rates were set in the last electric rate case, Duke Energy Kentucky's charges from the Midwest ISO have increased from about \$1.5 million to more than \$1.8 million." See also Response to Midwest ISO DR-01-015, filed August 2, 2010.

⁶⁶ *Id.*

⁶⁷ See Direct Testimony of William Don Wathen Jr., at 5.

⁶⁸ Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 10:32:50 – 10:33:02 (media file 25:35/ 02:17:22).

Energy Kentucky will continue to have the burden of proof that any future proposal to change its rates meets the appropriate standard of being fair, just and reasonable.

It is premature to determine possible rate impacts and eligibility for recovery at this time. Duke Energy Kentucky has not performed a cost of service study to determine rate impacts of the RTO realignment, if any. This is because Duke Energy Kentucky is not asking for any rate recovery approval at this time. Indeed, many of those future costs are not yet known and it is premature to make any decision as to recovery of future operating costs. Duke Energy Kentucky is not yet a member of PJM and the negotiations with Midwest ISO regarding actual exit costs, including ongoing commitments for transmission expansion, have not yet occurred. The FERC only recently approved the withdrawal from Midwest ISO, and the exit negotiations have not yet begun. The Company can only estimate those costs at present based upon other similar withdrawals. Concern over future rate recovery is premature and outside the scope of this proceeding. But the Company acknowledges that in any future rate case, it must support any such adjustment that it may request. The Commission and any stakeholder may review the Company's application and its justification for any changes in rates at that time.

Whenever Duke Energy Kentucky or the Commission determines that a change in base rates is appropriate, Duke Energy Kentucky will then determine the appropriate level and method of recovery of all of its operating costs, including RTO expenses (*e.g.* membership fees, administrative costs, transmission expansion costs, *etc.*) in accordance with Kentucky's rules and regulations for filing of a base electric rate case.⁶⁹ The determination of how much and which variety of transmission costs will be included in the Company's rates will be determined in a manner consistent with Kentucky law. A test year would be determined and the Company would explain the amount included in the test year and the recovery method will be proposed at that

time. Consistent with the Company's commitments made at the outset of this proceeding, Duke Energy Kentucky will not seek to include a penny of the Midwest ISO exit fee or the PJM integration costs. The Commission and intervenors will have all discovery rights to seek details of any costs included in Duke Energy Kentucky's test year. The Company will also not seek to recover transmission expansion costs for overlapping periods due to the differences in allocation methodologies between PJM and the Midwest ISO.

Similarly, the Commission will retain its jurisdiction over Duke Energy Kentucky's Demand Side Management (DSM) offerings, including demand response, as part of its energy efficiency portfolio under KRS 278.285. Duke Energy Kentucky currently offers its own robust portfolio of energy efficiency and demand response programs that are reported on annually to this Commission.⁷⁰ These programs will continue to be available to its customers even after realignment to PJM.⁷¹ Duke Energy Kentucky witness Jennings mentions in his testimony that PJM offers some benefits to retail customers, including the availability of demand response.⁷² On cross examination, Mr. Jennings further discussed the demand response opportunity available to participating jurisdictions through the PJM process.⁷³ Where permitted, market participants can offer their demand response to PJM as if they are a generator and receive compensation to offset capacity costs through curtailment.⁷⁴ Participants must, however, follow PJM's processes.⁷⁵ The PJM process requires registration with the utility which then must evaluate whether the relevant electric retail regulatory authority (RERRA) permits the retail customer to

⁶⁹ See Direct Testimony of William Don Wathen Jr., at 10.

⁷⁰ See e.g. *In re: Annual Cost Recovery Filing For Demand Side Management by Duke Energy Kentucky*, Case No. 2009-444, (Order March 22,2010).

⁷¹ *Id.* Duke Energy Kentucky's current portfolio of programs was approved through December 31, 2012.

⁷² Direct Testimony of Kenneth J. Jennings at 6.

⁷³ Hearing November 3, 2010, Cross Examination of Kenneth J. Jennings., Video transcript at 16:07:40 – 16:09:33 (media file 2:36:23/ 02:50:17).

⁷⁴ *Id.*

⁷⁵ *Id.* at 16:10:00.

participate in demand response.⁷⁶ Based upon this evaluation, and if the jurisdiction does not permit retail participation, then PJM must reject the retail participant's request.⁷⁷

As Mr. Jennings stated on cross-examination, Duke Energy Kentucky does not intend to participate in PJM's demand response programs at this time, and its Commission-approved tariffs do not currently allow such participation.⁷⁸ Further, to the Company's knowledge, there has been no direct customer interest in PJM's direct demand response offerings. If at some time in the future, the Company decides to participate in PJM's demand response programs, it will first seek Commission approval. Therefore, the Commission will retain its existing authority over Duke Energy Kentucky's energy efficiency and demand response service offerings to customers.

2. Realignment to PJM will not impact the Commission's jurisdiction and regulatory oversight over the Company's Integrated Resource Planning

The Commission will also retain all of its current authority over the Company's IRP. Duke Energy Kentucky will continue to file its IRP every three years as required under 807 KAR 5:058 and provide annual updates to Administrative Case No. 387. Duke Energy Kentucky last filed its IRP in 2008, in Case Number 2008-00248. The Company will thus file its next IRP on or before July 1, 2011. The realignment to PJM will not materially affect how Duke Energy Kentucky plans to meet its load obligations going forward as Duke Energy Kentucky has sufficient capacity to meet its load serving obligation.

As was discussed in the Company's 2008 IRP, the Company assumed a long-term reliability criterion as 15% reserve margin.⁷⁹ Prior to 2003, Duke Energy Kentucky had used a

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *In re. Duke Energy Kentucky's 2008 Integrated Resource Plan*, filed July 1, 2008, at 1-7.

17% planning reserve margin.⁸⁰ As discussed in the Duke Energy Kentucky 2008 IRP, in June 2008, Duke Energy Kentucky's reserve requirements were impacted by Reliability*First*, which adopted a Resource Planning Reserve Requirement Standard that the Loss of Load Expectation (LOLE) due to resource inadequacy cannot exceed one occurrence in ten years (0.1 occurrences per year).⁸¹ Duke Energy Kentucky was a member of the Midwest Planning Reserve Sharing Group (PRSG) for the Planning Year June 2008-May 2009.⁸² On February 5, 2008, the PRSG issued its preliminary report showing the required reserve margins for the Planning Year, with a minimum of 14.3% for the zone where Duke Energy Kentucky is located. This was the first year that the Midwest PRSG (with the Midwest ISO as the Group Administrator) performed this type of study, so there were many refinements to assumptions and methodologies that were anticipated to be incorporated in future studies. For that reason, the IRP was performed with a 15% reserve margin as the minimum target.⁸³ The 2008 IRP demonstrated that under a 15% reserve, Duke Energy Kentucky had sufficient capacity to meet its load obligations through 2019.⁸⁴

As part of its most recent update filing to Administrative Case No.387, Duke Energy Kentucky explained that since the filing of the 2008 IRP, the reserve margin target evolved due to changes the Midwest ISO has made to its tariff to include a long-term resource adequacy requirement similar to the Reliability*First* requirement.⁸⁵ The Planning Reserve Margin (PRM) that is assigned to each load serving entity (LSE) is on a UCAP (*i.e.*, unforced capacity) basis, such that the PRM on an ICAP (*i.e.*, installed capacity) basis is translated to PRM_{UCAP} by

⁸⁰ *Id.* at 2-5.

⁸¹ *Id.* at 1-8.

⁸² *Id.*

⁸³ *Id.* at 1-9.

⁸⁴ *Id.* at 1-34.

⁸⁵ See Administrative Case No. 387, update filing March 27, 2010.

multiplying it by 1 minus the Midwest ISO system average equivalent forced outage rate excluding events outside of management control (XEFOR_d).⁸⁶ For the 2010-2011 Planning Year, Duke Energy Kentucky was required to meet a PRM_{UCAP} of 4.5%, which is the equivalent of a PRM of 11.94% on an ICAP basis (the historical method used by Duke Energy Kentucky).

PJM has an equivalent concept to the Midwest ISO PRM_{UCAP}, called the Installed Reserve Margin (IRM) and Forecast Pool Requirement (FPR). The IRM corresponds to the reliability requirement of one event in 10 years of load expectation as set by *ReliabilityFirst*.⁸⁷ The cleared reserve margin in PJM is determined by the intersection of the capacity-offer curve with an administratively determined demand curve.⁸⁸ The comparison between the two is that the Midwest ISO PRM of 11.94% on a *non-coincident* peak basis is roughly equivalent to a PJM IRM of 15.5% on a *coincident* peak basis.⁸⁹ The difference between the two calculations is due primarily to load diversity of 3% to 4% in both Midwest ISO and PJM. For Duke Energy Kentucky, this is a distinction without a difference. As was explained, Duke Energy Kentucky's 2008 IRP assumed a 15% reserve margin on an installed capacity basis and had sufficient capacity available to meet this requirement through 2019.⁹⁰ Even under a 15.5% IRM on a coincident peak basis, the Company continues to have adequate reserves to meet its obligation with Megawatts to spare and sell into PJM. The Company's financial analysis supporting its decision to realign to PJM took the 15.5% reserve margin on a coincident into consideration and the realignment still produced benefits for Duke Energy Kentucky and its customers.⁹¹

3. Duke Energy Kentucky's commitments hold its customers harmless from costs of exiting Midwest ISO.

⁸⁶ *Id.*

⁸⁷ *Id.* at 5.

⁸⁸ See Direct Testimony of Kenneth J. Jennings at 3.

⁸⁹ The 15.5% is roughly equivalent to a 10.66% IRM after including load diversity within PJM.

⁹⁰ *In re. Duke Energy Kentucky's 2008 Integrated Resource Plan, Filed July 1, 2008*, at 1-7.

⁹¹ See Company Response to Midwest ISO DR-02-007, filed September 28, 2010.

As explained in the Direct Testimony of James, B. Gainer, Duke Energy Kentucky and Duke Energy Ohio will incur costs as a consequence of withdrawing from Midwest ISO and realigning with PJM.⁹² The PJM integration costs will total \$3 million.⁹³ The original estimate of the Midwest ISO exit costs was approximately \$72 million. This estimation included the following:

- approximately \$18.5 million for the exit fee required under the Midwest ISO membership agreement;⁹⁴
- an estimation of the MTEP obligation for existing projects approved prior to the companies exiting Midwest ISO totaling \$45 million; and⁹⁵
- approximately \$8.5 million for “other costs” including hold harmless obligations, legal fees and information technology (IT) upgrades.⁹⁶

Of the PJM integration costs and Midwest ISO exit fee, Duke Energy Kentucky will be allocated a portion, based upon a percentage of the Company’s load (approximately 15-17%),⁹⁷ of the total. Duke Energy Kentucky’s Midwest ISO exit costs were initially estimated at approximately \$11-13 million, including MTEP, exit fees, and other costs.⁹⁸ As clarified at the hearing, Duke Energy Kentucky will not be allocated any of the approximate \$8.5 million for hold harmless, IT

⁹² See Direct Testimony of James B. Gainer at 7.

⁹³ See Direct Testimony of James B. Gainer, Attachment JBG-1, at Article 4.1.2.1-4.1.4.1. See also Post Hearing Data Request MISO-DR-01-005, filed November 10, 2010.

⁹⁴ *Id.* at 9.

⁹⁵ See Post Hearing Data Response MISO-DR-01-03, filed November 10, 2010.

⁹⁶ *Id.*

⁹⁷ Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 10:25:22 – 10:27:00 (media file 18:45/02:17:22). See also Post Hearing Data Request MISO-DR-01-002 filed November 10, 2010. “The 15% to 17% range represents the different results using the 1 CP method versus the 12 CP method.”

⁹⁸ Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 11:15:12 – 11:12:18 (media file 1:05:10/02:17:22).

upgrades, and legal fees.⁹⁹ Also, the Company has refined its calculation of the MTEP obligation upon withdrawal to approximately \$36 million due to a change in Midwest ISO's allocation methodology.¹⁰⁰ These adjustments reduce Duke Energy Kentucky's Midwest ISO exit cost obligation to approximately \$8.2 million to \$9.3 million.¹⁰¹ Duke Energy Kentucky's allocation of the PJM integration fee will be approximately \$450,000-\$510,000.¹⁰²

As part of its Application, Duke Energy Kentucky has made three significant commitments regarding cost impacts of the RTO realignment to customers. First, Duke Energy Kentucky is committing not to seek recovery of the exit fee in base rates or through any rate adjustment mechanism.¹⁰³ The exit fee imposed upon a withdrawing member of the Midwest ISO is a contractual commitment endorsed by FERC.¹⁰⁴ Moreover, this very Commission has previously permitted a utility withdrawing from the Midwest ISO to recover the exit fee in base rates, amortized over a period of years.¹⁰⁵ Nonetheless, to ensure that the RTO realignment is in the public interest and as part of the Company's ongoing commitment to continue to offer fair, just and reasonable rates, Duke Energy Kentucky commits to absorb this exit fee and not pass it through to its customers. Duke Energy Kentucky will not seek a deferral of the exit fee and will not include the exit fee as part of the test year expense in its next electric rate case.¹⁰⁶ Second, Duke Energy Kentucky is committing to hold its customers harmless from the costs of

⁹⁹Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 11:15:42 (media file 01:07:49 /02:17:22). *See also* Post Hearing Data Request Response MISO-DR-01-003, filed November 10, 2010.

¹⁰⁰\$36 million MTEP + \$18.5 million exit fee= \$54.5

¹⁰¹ Calculated as 15-17% of \$3 million.

¹⁰² *See* Direct Testimony of William Don Wathen Jr., at 7.

¹⁰³ *See* Docket Nos. ER10-1562-000, ER10-2254-000 Order Addressing RTO Realignment Request, (October 21, 2010) at Paragraph 74

¹⁰⁴ *In the Matter of Investigation Into Membership of Louisville Gas & Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission System Operator, Inc.*, Case No. 2003-266, (Order at 40) (May 31, 2006); "LG&E and KU are authorized to establish for accounting purposes both a regulatory asset for the MISO exit fee, subject to adjustment for future MISO credits, if any, and a regulatory liability upon exiting MISO for the revenues collected which are associated with the MISO Schedule 10 charges included in existing rates."

¹⁰⁵ *See* Direct Testimony of William Don Wathen Jr., at 7.

integration into PJM.¹⁰⁷ Again, Duke Energy Kentucky will not include those costs as part of the test year expense in its next electric rate case.

Third, Duke Energy Kentucky is committing that it will not seek to double recover in its base rates both MTEP and PJM's similar regional transmission expansion planning process (RTEP) costs that may be assessed for overlapping periods.¹⁰⁸ As explained by Company witnesses Wathen and Gainer, both the Midwest ISO and PJM have processes for transmission expansion projects, the costs of which are allocated among their respective members.¹⁰⁹ MTEP and RTEP are assessed pursuant to FERC-approved tariffs. Duke Energy Kentucky will be allocated a share of PJM's existing RTEP upon the Company's becoming a member.¹¹⁰ Duke Energy Kentucky will also be financially obligated for its share of Midwest ISO's MTEP approved when the Company was a member and prior to its withdrawal.¹¹¹ Because of this difference in allocation methodologies between the two RTOs, Duke Energy Kentucky will be responsible for paying for both RTEP and MTEP for an overlapping period of time. However, Duke Energy Kentucky's customers will not. As part of the Company's next electric case, Duke Energy Kentucky will ensure that its test year will not include both RTEP and MTEP for any overlapping period of time.¹¹² And this Commission has complete authority to ensure that the Company is living up to its commitment.

Duke Energy Kentucky does not know what the exact MTEP obligation will be, in terms of either the value or the duration of the ongoing obligation. Those obligations will be

¹⁰⁶ See Response to Midwest ISO DR-01-003, filed August 2, 2010.

¹⁰⁷ See Direct Testimony of William Don Wathen Jr., at 9.

¹⁰⁸ See e.g. Direct Testimony of James B. Gainer at 7 and 12; Direct Testimony of William Don Wathen Jr., at 8.

¹⁰⁹ See Direct Testimony of William Don Wathen Jr., at 9.

¹¹⁰ *Id.*

¹¹¹ *Id.* at 10.

¹¹² See Direct Testimony of James B. Gainer at 7.

determined through negotiations with the Midwest ISO.¹¹³ As explained by Duke Energy Kentucky witness Wathen on cross examination, the Company does not know whether its Midwest ISO MTEP obligation will be spread out over “two years,” “five years” or “ten years.”¹¹⁴ However, Duke Energy Kentucky will not seek to recover 100% of that MTEP obligation as a test year expense. Rather, as Mr. Wathen explained, the Company would include an annual amount of the transmission expansion costs.¹¹⁵ Duke Energy Kentucky “is not trying to mix what will be the upfront payment for a thirty year obligation even though it may be on a present value basis, and comparing that to the annual costs that the Company will incur in PJM for its expansion projects.”¹¹⁶

Similarly, Duke Energy Kentucky does not currently know what its assessment of RTEP will be upon joining PJM. The determination on which costs will be included in the Company’s future rates will be determined when the Company files its next rate case. Duke Energy Kentucky does not anticipate its RTO realignment to be a driver for its next electric rate case. As Mr. Wathen explained in his direct testimony, the timing of its next rate case will determine the category of transmission expansion costs that would be included.¹¹⁷

For instance, if Duke Energy Kentucky were to file an electric rate case this year using a historic test year ending prior to January 1, 2012, (the anticipated consummation of the RTO realignment), then the Company could only base its rates upon MTEP expenses during the test year, because it would not incur any RTEP expenses. Similarly, if the Company does not file an electric rate case until sometime after the consummation of the RTO realignment, and uses a forecasted test year, then it may be appropriate for only RTEP costs to be included in base rates. If the Company files a rate case with a test year that covers both a period prior to

¹¹³ Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 11:20:42 (media file 1:13:36/02:17:22).

¹¹⁴ *Id.*

¹¹⁵ Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 11:21:20 – 11:21:38 (media file 1:14:00 to 1:14:29/02:17:22)

¹¹⁶ *See* Direct Testimony of William Don Wathen Jr., at 10.

¹¹⁷ *Id.*

and after the RTO realignment, it may be appropriate for some level (but not all) of both RTEP and MTEP. That is why the Company believes the decision should only be determined at the time of the next electric base rate case.¹¹⁸

As evidenced by Mr. Wathen's explanation, the timing of the next rate case is yet to be decided. Duke Energy Kentucky thus needs some measure of flexibility in determining the appropriate level of RTO transmission costs that should be included as part of the Company's test year operating budget. In any event, Duke Energy Kentucky's customers will not be asked to pay for both sets of costs for the same period. And the Commission will be the ultimate authority on whether Duke Energy Kentucky's proposal for recovery of transmission expansion costs is fair, just and reasonable. The fact the Duke Energy Kentucky is committing that its customers will not be asked to pay for duplicative transmission costs for overlapping periods of time as a result of the RTO realignment confirms that the Company's request is in the public interest.

4. Realignment to PJM will not cause Duke Energy Kentucky's customers to pay more for electricity

Duke Energy Kentucky's customers will not pay more for electricity simply because Duke Energy Kentucky withdraws from Midwest ISO and joins PJM. The realignment to PJM will not affect Duke Energy Kentucky's Fuel Adjustment Clause (FAC).¹¹⁹ The use of a 1 Coincident Peak (CP) versus a 12 CP will not impact the FAC.¹²⁰ Similarly, as explained by Duke Energy Kentucky witness Swez, the PJM energy market will not impact the Company's costs of dispatch.¹²¹ The cost to customers will still be based principally upon Duke Energy

¹¹⁸ Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 11:03:09 (media file 56:00/ 02:17/22); noting the company will get bills from PJM instead of Midwest ISO. *See also* Id. At 11:21:50-11:22:39 (media file 01:15:07/02:17:22).

¹¹⁹ *Id.*

¹²⁰ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 17:046:55- 17:09:52 (media file 26:44 through 29:43/01:02:34).

¹²¹ *Id.*

Kentucky fuel cost.¹²² Similarly, Duke Energy Kentucky's customers will not be adversely impacted because of Duke Energy Kentucky's participation in either the RPM capacity market or the FRR alternative in PJM.¹²³ The Company confirmed that Duke Energy Kentucky's customers will pay for energy in the same way that they currently do, and that the price of the fuel for its generating stations will not be impacted by realigning to PJM.¹²⁴ There may be slight differences in the dispatching of the Company's low-cost generating units in PJM than in Midwest ISO, but the cost impact to customers, positive or negative, would not be significant.¹²⁵

Finally, Duke Energy Kentucky's customers will be essentially held harmless for the differences in capacity prices between the PJM three-year forward looking capacity market and Midwest ISO's month-ahead capacity auction.¹²⁶ Duke Energy Kentucky is long in generation capacity and will be a net seller in PJM. Therefore, any capacity charges incurred in the RPM will be offset by revenues paid to Duke Energy Kentucky for the capacity resources that clear in the RPM auction.¹²⁷

5. Duke Energy Kentucky's realignment to PJM provides many benefits to the Company and its Customers.

Duke Energy Kentucky performed a financial analysis that compared the energy and capacity markets of Midwest ISO and PJM to determine if the RTO realignment was in the best interests of Duke Energy Kentucky and its customers.¹²⁸ This analysis was supported by Duke Energy Kentucky witnesses Burner and Swez in discovery,¹²⁹ through direct testimony¹³⁰ and

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ See Response to Midwest ISO DR-02-008, filed August 25, 2010.

¹²⁶ See Response to Midwest ISO DR-02-008, filed August 25, 2010.

¹²⁷ See Confidential Response to Midwest ISO DR-02-007, filed September 28, 2010 and work papers filed in Supplemental/ Clarifying Response to Midwest ISO DR-02-007, filed October 28, 2010.

¹²⁸ *Id.*

¹²⁹ See Direct Testimony of John D. Swez at 10.

under cross examination at the hearing.¹³¹ The results of this financial analysis show that realigning to PJM provides direct and tangible benefits to the Company and to its customers through increased opportunities for off-system sales for energy and capacity.¹³² This analysis took the form of an overall financial impact study of energy and capacity, taking into consideration the costs of realignment, capacity reserve requirements in both Midwest ISO and PJM, and excesses available to sell into the comparative markets.¹³³ The net result is a direct benefit through the additional value of Duke Energy Kentucky's generation assets in PJM that will be shared with its customers through a credit back in rates.¹³⁴

Mr. Swez explained the energy analysis he performed comparing actual historical prices for the Company's East Bend Generating station that happens to be in both Midwest ISO and PJM.¹³⁵ The East Bend Generating Station is jointly owned by Duke Energy Kentucky and DP&L.¹³⁶ Duke Energy Kentucky share of the unit is dispatched and directly connected into Midwest ISO while DP&L's share is pseudo-tied into PJM.¹³⁷ Therefore, there are pricing points for both RTOs for this station.¹³⁸ Mr. Swez's analysis shows what Duke Energy Kentucky's generation would look like in PJM, using the East Bend data and the forward markets in Midwest ISO for the CINERGYHUB and the forward Market in PJM at the AEP- Dayton hub,

¹³⁰ Hearing November 3, 2010, Confidential Cross Examination of John D. Swez, Video transcript (confidential portion under seal) beginning at 17:44:21 (media file 1:31/ 1:47); Hearing November 3, 2010, Confidential Cross Examination of G. Robert Burner, Video transcript (confidential) beginning at 18:00:00 (media file 17:10/41:47).

¹³¹ See Confidential Response to Midwest ISO DR-02-007, filed September 28, 2010 and work papers filed in Supplemental/ Clarifying Response to Midwest ISO DR-02-007, filed October 28, 2010.

¹³² *Id.*

¹³³ See Direct Testimony of William Don Wathen Jr., at 5-6.

¹³⁴ Hearing November 3, 2010, Cross Examination of John D. Swez, Video transcript at 17:04:15 – 17:06:40 (media file 23:11 through 26:24/01:02:34).

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.*

“ADHUB,” on an hour by hour basis, on peak and off peak, over ten years.¹³⁹ This analysis shows a benefit to the Company and to its customers of just over [REDACTED] a net present value basis.¹⁴⁰ This additional value is due primarily to the increased opportunities for off-system energy sales during off-peak periods that do not currently exist in the Midwest ISO.¹⁴¹

Similarly, Duke Energy Kentucky witness Burner supported the Company’s capacity analysis in discovery and under cross examination at the hearing.¹⁴² His analysis shows that there is an increase opportunity for additional capacity sales in PJM over the next ten years even taking into consideration the costs that will be incurred upon exiting the Midwest ISO.¹⁴³

Mr. Burner’s analysis shows that even taking into consideration the estimated

[REDACTED]

Any benefits of the RTO realignment will be shared with customers either through the Rider PSM or through base rates when Duke Energy Kentucky files its next electric rate case.¹⁴⁴ Mr. Wathen explained the Company’s Rider PSM in his direct testimony.¹⁴⁵ The Commission approved Rider PSM as part of Duke Energy Kentucky’s last electric rate case.¹⁴⁶ Rider PSM

¹³⁹See Confidential Supplemental Response to Midwest ISO DR-02-07, filed September 25, 2010; and Supplemental/ Clarifying response to Midwest ISO DR-02-07, Confidential Work papers filed October 28, 2010.

¹⁴⁰See Direct Testimony of John D. Swez at 10.

¹⁴¹See Confidential Supplemental Response to Midwest ISO DR-02-07, filed September 25, 2010; and Supplemental/ Clarifying response to Midwest ISO DR-02-07, Confidential Work papers filed October 28, 2010.

¹⁴²See Confidential Supplemental Response to Midwest ISO DR-02-07, filed September 25, 2010; and Supplemental/ Clarifying response to Midwest ISO DR-02-07.

¹⁴³Hearing November 3, 2010, Cross Examination of William Don Wathen Jr., Video transcript at 10:31:26 (media file 24:55/ 02:17:22).

¹⁴⁴See Direct Testimony of William Don Wathen Jr., at 5-6

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

allows customers and shareholders to share in the profits from off-system sales.¹⁴⁷ If the Company sells more energy or capacity in a given hour than it purchased for its native load requirement, the surplus is considered an off-system sale.¹⁴⁸ In 2008, the Company voluntarily sought Commission approval to expand Rider PSM to include the margins from the sale of ancillary services.¹⁴⁹ Under the Rider PSM, all of this profit for the year is shared between customers and shareholders such that customers get 100% of the profits from off-system sales up to the first \$1 million.¹⁵⁰ To the extent profits for the year exceed \$1 million, shareholders and customers evenly split the profit after the first \$1 million. Customers receive a direct credit on their bill, thereby lowering their overall monthly total electric bill.¹⁵¹

As previously discussed, Duke Energy Kentucky will not seek to recover the exit fee, integration costs, or double recover overlapping transmission expansion costs from its customers. Nor will Duke Energy Kentucky use those costs to offset any of the excess profits credited to customers under Rider PSM. Realignment to PJM will provide Duke Energy Kentucky's customers with an immediate benefit through lower overall electric costs due the company's ability to maximize the value of its generation portfolio in the robust PJM market.

III. CONCLUSION

Duke Energy Kentucky's request to transfer the functional control over its limited transmission facilities should be approved. The evidence of record demonstrates that the transfer to PJM is both for a proper purpose and in the public interest. Realignment from the Midwest

¹⁴⁷ *Id.*

¹⁴⁸ Beginning 1/6/2009, the Midwest ISO implemented its "Day 3" market. The implementation of this Day 3 market allows Midwest ISO members to buy and sell certain ancillary services (*i.e.*, regulation, spinning reserve, and supplemental reserve).

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

ISO to PJM is for a proper purpose because it allows Duke Energy Kentucky to participate in a more robust capacity market that is a useful and reliable tool for resource planning. Realignment also allows Duke Energy Kentucky to maintain its current operational structure with respect to RTO participation without having to pseudo tie both generation and load back to Midwest ISO thereby avoiding the additional costs and operational risks with having to stay behind in the Midwest ISO.

The transfer is in the public interest because Duke Energy Kentucky is committing that its customers will not be asked to pay for the FERC-endorsed and approved PJM integration costs, Midwest ISO exit fees, or to pay for overlapping periods of transmission expansion costs due to the different allocation between PJM's RTEP and Midwest ISO's MTEP. The Commission's jurisdiction over Duke Energy Kentucky's electric rates and resource planning will not be impacted by the realignment. The PJM markets provide greater opportunities for off-system sales in both capacity and energy that translate to direct benefits to Duke Energy Kentucky's customers through credits back on their total electric bill. Accordingly, Duke Energy Kentucky respectfully requests that the Commission approve this application so that Duke Energy Kentucky may begin the process to realign with PJM.

Respectfully submitted,
DUKE ENERGY KENTUCKY, INC.



Rocco O. D'Ascenzo
Senior Counsel
Amy B. Spiller
Associate General Counsel
Duke Energy Kentucky, Inc.
139 East Fourth Street
Rm 25 ATII

Cincinnati, Ohio 45201-0960
Phone: (513) 419-1852
Fax: (513) 419-1846
e-mail: rocco.dascenzo@duke-energy.com

CERTIFICATE OF SERVICE

I certify that a copy of the attached Brief has been served via UPS overnight mail to the following parties on this day of November, 2010:

✓
19th



Rocco O. D'Ascenzo

Hon. Dennis Howard Office of the Attorney General Utility Intervention and Rate Division 1024 Capital Center Drive Frankfort, Kentucky 40601	Katherine K Yunker John B. Park Yunker & Park, PLC P.O. Box 21784 Lexington, KY 40522-1784
Keith Beall Esquire P.O. Box 4202 Carmel, Indiana 46082-4202	Honorable Jason R Bentley Attorney at Law McBrayer, McGinnis, Leslie & Kirkland PLLC 305 Ann Street Suite 308 Frankfort, KY 40601

**BEFORE THE
KENTUCKY PUBLIC SERVICE COMMISSION**

In The Matter of:

Duke Energy Kentucky, Inc.'s Application for Approval)
To Transfer Functional Control of its Transmission Assets)
From the Midwest Independent Transmission System)
Operator to the PJM Interconnection Regional Transmission)
Organization And Request for Expedited Treatment)

Case No. 2010-203

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COMMISSION

**PETITION OF DUKE ENERGY KENTUCKY, INC.
FOR CONFIDENTIAL TREATMENT OF INFORMATION CONTAINED IN
ITS POST HEARING BRIEF**

Duke Energy Kentucky, Inc. (Duke Energy Kentucky or Company), pursuant to 807 KAR 5:001, Section 7, respectfully requests the Commission to classify and protect certain information provided by Duke Energy Kentucky in its Post Hearing Brief.

The information for which Duke Energy Kentucky now seeks confidential treatment (Confidential Information) pertains to the Company's proprietary analysis of its generation portfolio including capacity and energy valuation in PJM Interconnection LLC (PJM), as well as assumptions of forward markets for both capacity and energy.

In support of this Petition, Duke Energy Kentucky states:

1. The Kentucky Open Records Act exempts from disclosure certain Commercial information. KRS 61.878(1)(c). Significantly, this rule applies to those records that are generally recognized as confidential or proprietary. And provided the records at issue satisfy this general characterization, they are subject to protection where the disclosure of such information would otherwise result in an unfair advantage to competitors of the

party seeking non-disclosure. Public disclosure of the information identified herein would, in fact, prompt such a result for the reasons set forth below.

2. The information for which Duke Energy Kentucky seeks protection concerns its review and assessment of financial projections and forecasts related to future capacity and energy markets. Furthermore, the Confidential Information at issue herein also relates to Duke Energy Kentucky's analysis of its generation portfolio, including future capacity positions. This information was, and remains, integral to Duke Energy Kentucky's effective execution of business decisions. And such information is generally regarded as confidential or proprietary. Indeed, as the Kentucky Supreme Court has found, "information concerning the inner workings of a corporation is 'generally accepted as confidential or proprietary.'" *Hoy v. Kentucky Industrial Revitalization Authority*, Ky., 904 S.W.2d 766, 768.

3. Disclosure of the Confidential Information, which includes individual factors underlying Duke Energy Kentucky's analysis of its generation portfolio and forecasts related to future capacity value in PJM, would damage Duke Energy Kentucky's position and business interests. This information reveals the Company's proprietary analysis of its generation portfolio, including load and capacity positions for many years in to the future which were used to value its generation portfolio, as well as assumptions for market prices for capacity for many years into the future. If the Commission grants public access to the Confidential Information contained in Duke Energy Kentucky's Post Hearing Brief, being filed contemporaneously herewith, potential parties to future bilateral capacity agreements could gain insight into Duke Energy Kentucky's valuation of its own capacity position as well as its view of the PJM Interconnection and Midwest

ISO markets, thereby putting the Company at a disadvantage in negotiations. Moreover, release of the Company's analysis and assumptions could give potential competitors for similar products insight into Duke Energy Kentucky's own valuation thereby creating the potential to manipulate market pricing or undermine Duke Energy Kentucky's ability to secure reasonable cost products in the market.

4. The information for which Duke Energy Kentucky is seeking confidential treatment is not known outside of Duke Energy Kentucky.

5. On September 28, 2010, Duke Energy Kentucky filed a Petition for Confidential Protection of the information contained in Duke Energy Kentucky's Supplemental Response to MISO's Data Request No. 7(c). This is the same information contained in Duke Energy Kentucky's Post Hearing Brief and for which Duke Energy Kentucky is now seeking confidential treatment of. Significantly, on November 10, 2010, the Commission ordered this information as confidential.

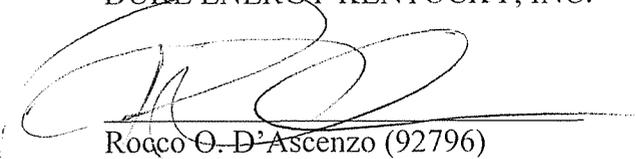
6. Duke Energy Kentucky and Midwest ISO executed a Confidentiality Agreement on September 17, 2010 to govern the disclosure and use of confidential information in this case.

7. In accordance with the provisions of 807 KAR 5:001 Section 7, the Company is filing with the Commission one copy of the Confidential Material highlighted and ten (10) copies without the confidential information.

WHEREFORE, Duke Energy Kentucky, Inc. respectfully requests that the Commission classify and protect as confidential the specific information described herein.

Respectfully submitted,

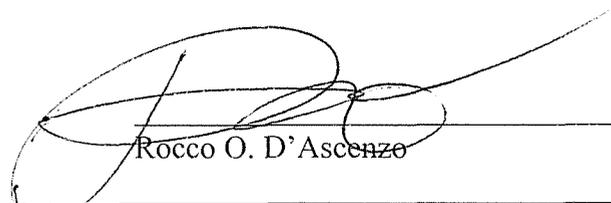
DUKE ENERGY KENTUCKY, INC.



Rocco O. D'Ascenzo (92796)
Senior Counsel
Amy B. Spiller (85309)
Associate General Counsel
Duke Energy Business Services, LLC
139 East Fourth Street, Rm 25 AT II
Cincinnati, Ohio 45201-0960
Phone: (513) 419-1852
Fax: (513) 419-1846
e-mail: rocco.d'ascenzo@duke-energy.com

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing has been served via hand delivery to the following party on this 19th day of November 2010:



Rocco O. D'Ascenzo

Hon. Dennis Howard Office of the Attorney General Utility Intervention and Rate Division 1024 Capital Center Drive Frankfort, Kentucky 40601	Katherine K Yunker John B. Park Yunker & Park, PLC P.O. Box 21784 Lexington, KY 40522-1784
Keith Beall Esquire P.O. Box 4202 Carmel, Indiana 46082-4202	Honorable Jason R Bentley Attorney at Law McBrayer, McGinnis, Leslie & Kirkland PLLC 305 Ann Street Suite 308 Frankfort, KY 40601