COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF DUKE ENERGY KENTUCKY, INC.'S ACCOUNTING SALE OF NATURAL GAS NOT USED IN ITS COMBUSTION TURBINES	))))	CASE NO. 2014-00078

ORDER

On February 3, 2014, the Commission received a letter from Duke Energy Kentucky, Inc. ("Duke Kentucky") setting forth a proposed accounting treatment for natural gas which was purchased in January 2014 for use in its combustion turbines at the Woodsdale Station ("Woodsdale")[1] but which was unused and subsequently sold.[2] Duke Kentucky states that it was required to make these natural gas purchases when its Woodsdale units cleared in the PJM Interconnection, Inc. Day Ahead market, but was unable to burn the gas because the Woodsdale units were not called upon to operate in the Real Time market.

Duke Kentucky states that during the extreme cold weather experienced in January 2014, the owner of the natural gas pipeline used to serve Woodsdale, Texas Eastern Transmission Corporation ("TETCO"), limited daily actual burn volumes to the volume specifically nominated and delivered for that day. In order to keep the Woodsdale units available to make sales in the energy market, Duke Kentucky states, it had to procure gas in the day-ahead market (which was injected into the pipeline)

[1] Duke Kentucky owns six combustion turbine generators at its Woodsdale Station located in Butler County, Ohio.

[2] A copy of the letter is attached as Appendix A to this Order.

without any assurance that the Woodsdale units would run and be able to burn the gas nominated. As a consequence, a situation developed in which Duke Kentucky's nominations of gas exceeded its gas supply, resulting in a positive imbalance position on the pipeline.

On January 28, 2014, TETCO notified Duke Kentucky that the positive imbalance could not be increased and would need to be addressed. As a result, Duke Kentucky sold 100,000 Dth of natural gas. Duke Kentucky states that it proposes to account for the sale of the natural gas by first determining the difference between the purchase price of unburned gas procured for the Woodsdale units in the Day Ahead market and the sale price of that same gas in the Real Time market. Then, this price differential is to be included as part of the net costs of off-system sales shared through its Rider Profit Sharing Mechanism ("Rider PSM"). According to Duke Kentucky, this accounting treatment is consistent with the Commission's current regulations and the intent and operation of Rider PSM. Duke Kentucky contends that a formal application to utilize this accounting treatment is not required, but should the Commission determine otherwise, Duke Kentucky states that it will file a formal application upon notification by the Commission of the need to do so.

On February 17, 2014, the Commission received a letter from the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, ("AG") acknowledging and responding to Duke Kentucky's February 3, 2014 letter.[3] In his response, the AG expressed the position that this matter should be addressed through a formal proceeding.

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[3] A copy of the letter is attached as Appendix B to this Order.

Based on a review of Duke Kentucky's letter, the AG's response, and being otherwise sufficiently advised, the Commission finds that this case should be opened to investigate Duke Kentucky's proposed accounting treatment for the cost of gas purchased for Woodsdale, but not burned.

IT IS THEREFORE ORDERED that:

1. This case is established to investigate and address Duke Kentucky's proposed accounting treatment for the cost of gas purchased for Woodsdale, but not burned.

2. Duke Kentucky's February 3, 2014 letter and the AG's February 17, 2014 response shall be included in the record of this case.

3. Within 20 days of the date of this Order, Duke Kentucky shall file prepared direct testimony in support of its proposed accounting treatment for the cost of gas purchased for Woodsdale but not burned, as described in its February 3, 2014 letter.

4. The Attorney General is made a party to this proceeding.

By the Commission

ENTERED
MAR 14 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Aaron D. Greenwell for
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2014-00078 DATED MAR 14 2014

DUKE ENERGY.

COPY

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Rocco O. D'Ascenzo
Associate General Counsel

January 31, 2014

Mr. Jeff Derouen
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602-0615

Dear Mr. Derouen,

As the Kentucky Public Service Commission (Commission) and the Commission staff (Staff) are aware, during January 2014, much of the Eastern half of the United States has experienced a prolonged period of extreme cold. One of the many challenges faced by utilities, including Duke Energy Kentucky (DEK), during this period, has been the persistent operational limitations placed on natural gas pipelines. For much of the month of January, Texas Eastern Transmission Corporation (TETCO), the owner of the natural gas pipeline used to serve Woodsdale station, has placed restrictions limiting daily actual burn volumes to the volume specifically nominated and delivered for that day. These limitations, called Imbalance Postings, can significantly limit Duke Energy Kentucky's ability to ensure that the units are available to our customers for dispatch into the PJM energy market.

Operationally, PJM commits and dispatches the DEK units in its footprint in two separate and distinct market operations. In the Day Ahead market, PJM commits units and makes generation awards based on load demand, generation availability, offer pricing, and system transmission topology forecasts. These awards are financially binding on both PJM and DEK's part; but in Real Time, if conditions change from forecasted, PJM has the physical flexibility to de-commit or reduce generation awards. The significance of this market construct is that during periods of natural gas scarcity, DEK must secure physical gas both to make the unit available in the market, as well as to satisfy any Day Ahead generation awards, but does not have the discretion to burn nominated and delivered gas volumes.

During much of January, even though the Woodsdale units have cleared the day-ahead market and received Day Ahead awards, PJM has frequently de-committed the units in the real-time market. As a result, nominated gas has gone unburned, creating a long position on the pipeline. During extended periods of pipeline operational limitations DEK loses the ability to reduce this long position. Excessive long positions can cause other operational problems for the pipeline. The pipeline can choose to remedy these long positions by either requiring customers to sell natural gas or simply confiscating deliveries. DEK must maintain the ability to either deliver additional volumes or burn long pipeline positions in order to meet PJM must offer market rule obligations and ensure the generating units availability as Duke Energy Kentucky customer resources.

For background, Woodsdale Station is comprised of 6 simple cycle combustion turbines rated at 94 MW each (Winter) that consume natural gas on the Texas Eastern Transmission Company (TETCO) pipeline. Prior to 11:00 each day, Duke Energy Kentucky submits generating unit offers to PJM for the next operating day based on the current natural gas price, generating unit heat rate (conversion efficiency) and other operational factors. At 17:00 of the same day, PJM notifies Duke Energy Kentucky if a unit has received an energy award for the following operating day. PJM may also commit the units in the Real Time. Since the Woodsdale Combustion Turbines are considered peaking units and have relatively low capacity factors, if the units do receive a day-ahead award, under normal operation, natural gas can be purchased either at the time the offer is made, at 17:00 once the day-ahead award is received, procured in the intra-day gas market the next day, or purchased in a following day-ahead gas market. PJM also has the ability to commit the generating units in the real-time market without a day-ahead award. In addition, PJM may also choose to not actually turn the units on-line even though the units received a day-ahead award. All of these situations are possible and typically the gas position is managed thru the various options available. For example, if Real Time conditions do not support PJM dispatching the generating units after receiving a day-ahead award, under normal conditions either the natural gas was never purchased for the unit's day-ahead award or if gas was purchased, it is left "on the pipe" simply to be consumed at another time in the future. The option to procure gas in the intra-day market, after waiting to see if PJM actually turns on the generating units, is also a cost effective way to manage the gas position on the pipeline.

During January 2014, due to scarcity of natural gas supply and diminished liquidity, waiting to procure gas in the intra-day market was not a viable option. Offering the units to PJM in the Day Ahead market without confidence as to the ability to secure gas below the offered price exposes DEK customers to excessive risk. Thus, in order to guarantee that the units actually had natural gas available to meet their day-ahead obligation, Duke Energy Kentucky procured the necessary or expected volume of gas in the day-ahead gas market to meet that PJM obligation. Recently, due to weather, this gas procurement has been during times where TETCO has been issuing its Imbalance Posting requiring customers to not burn more gas than was nominated for that gas day. Thus, if the Woodsdale units received a day-ahead award, the expected natural gas burn was procured and nominated in the day-ahead market. TETCO, due to the Imbalance Posting, does not permit its customers to carry over or bank the gas procured and nominated from one day to the next for a future burn. This has resulted in an anomaly in the real-time PJM energy market, where despite receiving the day-ahead award, PJM hasn't actually dispatched the Woodsdale units for every day-ahead award. In fact, if the units were turned on, they frequently ran at an output level lower than the day-ahead award and, a substantial long natural gas position has developed on the pipeline.

Because of the nuances in the rules between the PJM energy and the natural gas markets, and the inability to "carry forward" gas balances, Duke Energy Kentucky finds itself in a position where to keep the Woodsdale generating station units available in the energy market to meet the "must-offer" obligation, the Company must continue to procure gas in the day ahead gas market and inject it into the pipeline without having any assurance that it will be able to burn the gas and be called upon in the real-time energy market.

On Friday, January 24, Duke Energy Kentucky and Staff Personnel held a conference call informing Staff of the gas procurement and developing inventory situation. A listing of individuals that participated on the phone call is listed below. At the time of the conference call, Duke Energy Kentucky personnel indicated their concern that the TETCO pipeline would require Duke Energy Kentucky to address this long position, leaving Duke Energy Kentucky with only two options: 1) burn the natural gas at the units; or 2) sell the gas in the market to reduce the length. While the restrictions on the pipeline are present, the option of burning the gas does not reduce the natural gas position since additional gas must continue to be procured that at least matches the anticipated expected burn at the station. Thus, the position would never be reduced by this option, consequently, selling the natural gas is the only current viable option to ensure unit availability.

On Tuesday, January 28, Duke Energy Kentucky received official notification from TETCO pipeline that the positive imbalance could not be increased and would need to be addressed immediately upon removal of the restrictions, and reduced in an efficient manner. A copy of this notification is attached.

As described above, in order to ensure that the Woodsdale units remain available in PJM, Duke Energy Kentucky must sell any of the excess daily gas before the end of each gas day. If the gas is not sold, TETCO has the right to cut the gas down to the amount of dekatherm burned for the day, essentially confiscating the gas that has been purchased. So far, Duke Energy Kentucky has been forced to sell 100,000 dth.

To account for this sale of gas, Duke Energy Kentucky intends to include any difference between the purchase price of any unburned gas procured for Woodsdale in the day-ahead market and sale price of that same gas in the real-time market (positive or negative) as part of the net costs of off system sales shared through the Company's Rider PSM (Profit Sharing Mechanism). These costs and/or credits will be netted against any off-system sales that flow through the quarterly PSM. The Company believes this is a logical treatment because the corresponding energy payments received for the day-ahead award of the Woodsdale Units that are allocated (stacked) to off-system sales (*i.e.* non-native) as part of normal PACE modeling already flow through the PSM. This procurement of the gas is necessary for Duke Energy Kentucky to receive the day-ahead award. Customers are directly benefitting from the Company's ability to participate in the PJM Day Ahead energy market and receive payments for that award. If and when Woodsdale is called upon by PJM in the real-time energy market, then the gas will be burned and will flow through the Company's Fuel Adjustment Clause consistent with the Commission's regulation.

Duke Energy Kentucky believes that this proposed accounting treatment is consistent with the current regulations of the Kentucky Public Service Commission and the intent and operation of its Rider PSM and that a formal application is not required. If however, the Commission believes that Duke Energy Kentucky is required to file a separate application to receive

Commission approval for this accounting treatment, the Company will do so upon notification by the Commission.

Conference call participants:

Aaron Greenwell (KYPSC)	Jim Eckstein (Duke)
Daryl Newby (KYPSC)	James Manning (Duke)
Chris Whelan (KYPSC)	Lisa Steinkuhl (Duke)
John Verderame (Duke)	Rocco D'Ascenzo (Duke)
John Swez (Duke)	Scott Burnside (Duke)

Thank you for understanding in this matter.

Respectfully Submitted

Duke Energy Kentucky, Inc.,

Rocco O. D'Ascenzo (92796)
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#567291

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2014-00078 DATED MAR 1 4 2014

RECEIVED

FEB 18 2014

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
OFFICE OF THE ATTORNEY GENERAL

JACK CONWAY
ATTORNEY GENERAL

1024 CAPITAL CENTER DRIVE
SUITE 200
FRANKFORT, KENTUCKY 40601

February 17, 2014

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602-0615

RE: Letter from Duke Energy Dated Jan. 31, 2014 Addressed to Mr. Derouen Regarding Fuel Supply for Duke's Woodsdale Station Combustion Turbine Units

Dear Mr. Derouen:

The Office of the Attorney General is in receipt of a copy of the above-referenced letter from Duke Energy addressed to you, regarding the gas fuel supply for the company's Woodsdale Station combustion turbine units and specific accounting treatment related to gas procurement. A copy of this letter is attached hereto for your reference.

The Attorney General believes this matter should be addressed through a formal filing, such as in a fuel adjustment filing. The Attorney General may have some questions he wishes to pose to Duke in this regard which he believes should be addressed in a formal record.

Finally, and simply for purposes for the record, it should be noted that Duke's letter mistakenly indicates that "Jennifer Hans" works with the Kentucky PSC, while in fact she is Executive Director of the Office of Rate Intervention here at the Office of the Attorney General.

Thank you for your attention to this matter.

Yours Truly,

Dennis G. Howard, II
Assistant Executive Director
Office of Rate Intervention

Cc: Richard Raff, General Counsel KY PSC
Rocco D'Ascenzo, Duke Energy Senior Counsel

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