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John J. Finnigan, Jr.
Associate General Counsel

VIA OVERNIGHT MAIL

September 25, 2007

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

RECEIVED

SEP 26 2007

PUBLIC SERVICE
COMMISSION

RE: Consideration of the Requirements of the Federal Energy Policy Act of
2005 Regarding Fuel Sources and Fossil Fuel Generation Efficiency,
Administrative Case No. 2007-00300

Dear Ms. O'Donnell:

I am enclosing an original and twelve copies of the Initial Comments of Duke Energy Kentucky, Inc. as permitted by the schedule adopted at the Commission's August 13, 2007 informal conference in the above-referenced case.

Please date stamp and return the two extra copies of the filing in the enclosed envelope.

If you have any questions, please do not hesitate to call me.

Sincerely,

John J. Finnigan, Jr.
Associate General Counsel

JJF/bjl

Enclosures

cc: All parties of record (w/encl.).

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

SEP 26 2007

In the Matter of:

PUBLIC SERVICE
COMMISSION

CONSIDERATION OF THE)
REQUIREMENTS OF THE FEDERAL) ADMINISTRATIVE
ENERGY POLICY ACT OF 2005) CASE NO. 2007-00300
REGARDING FUEL SOURCES AND FOSSIL)
FUEL GENERATION EFFICIENCY)

INITIAL COMMENTS OF DUKE ENERGY KENTUCKY, INC.

Duke Energy Kentucky, Inc. (“DE-Kentucky”) submits these comments as permitted by the schedule adopted at the Commission’s August 13, 2007 informal conference.¹ DE-Kentucky thanks the Commission for the opportunity to comment on the proposed standards.

As required under the Energy Policy Act of 2005 (“EPAAct 2005”), the Commission opened this case on August 2, 2007 to investigate whether to adopt the following standards introduced by Section 1251 of the EPAAct 2005:

FUEL SOURCES – Each electric utility shall develop a plan to minimize dependence on 1 fuel source and to ensure that the electric energy it sells to consumers is generated using a diverse range of fuels and technologies, including renewable technologies.

FOSSIL FUEL GENERATION EFFICIENCY – Each electric utility shall develop and implement a 10-year plan to increase the efficiency of its fossil fuel generation.

¹ *In the Matter of Consideration of the Requirements of the Federal Energy Policy Act of 2005 Regarding Fuel Sources and Fossil Fuel Generation Efficiency*, Administrative Case No. 2007-00300 (Intra-Agency Memorandum of Informal Conference of August 13, 2007) (August 21, 2007).

As an initial matter, DE-Kentucky notes that the selection and efficient operation of generating resources are only two of many factors that utilities must consider in providing electric service. Utilities must select and operate their generating resources in a manner that provides safe, adequate and reliable electric service. Utilities must also consider other matters such as: the cost of various types of generating resources; whether future load requirements call for a baseload or a peaking generating facility – which can dictate different fuel options; environmental constraints; transmission availability; and siting issues.

Kentucky also has two relevant state policies. First, as the Commission noted in its order opening this case, the preamble to the legislation enacting KRS 278.183 states that the General Assembly’s policy is to foster and encourage the use of Kentucky coal by Kentucky electric utilities.² Second, Governor Fletcher’s Executive Order 2005-121, which directed the Commission to report on Kentucky’s future electric needs, stated that Kentucky policies should promote, but not mandate, the use of renewable resources.³

The Commission’s successful regulation of utilities’ selection and operation of generating facilities (including cost, fuel and generating technology diversity, and generator efficiency) has allowed Kentucky electric utilities to offer electric rates that rank among the lowest in the country.⁴ The Commission already has authority to address these matters, and has successfully regulated these matters, such that there is no need to adopt new standards. The Commission’s existing authority arises from the following statutes and rules:

² *Id.* (Order at 5) (August 2, 2005).

³ *In the Matter of An Assessment of Kentucky’s Electric Generation, Transmission and Distribution Needs*, Administrative Case No. 2005-00090 (Order at 90) (September 15, 2005).

⁴ *Id.* at 4.

807 KAR 5:058. Integrated Resource Planning by Electric Utilities

Under the Integrated Resource Planning (“IRP”) regulation, electric distribution utilities with annual revenues exceeding \$10 million, other than distribution cooperatives, must file an IRP every three years. The IRP must discuss the utility’s projected load growth for the next 15-year period; the resources needed to serve the load at the lowest possible cost; and the steps that will be taken to implement the plan. The plan must discuss the utility’s planned resource acquisitions, including improvements in the efficiency of existing generating units and non-utility sources of generation, including renewable resources.

The IRP must also provide the following information relating to the efficiency of new and projected generating resources: capacity; availability; annual heat rate; fuel cost; capital cost; operating and maintenance cost escalation factors; and production costs. The utility must provide the screening criteria for the resource alternatives, such as present value of revenue requirements; capital requirements; environmental impacts; flexibility and fuel diversity.

DE-Kentucky uses sophisticated models for its IRP planning process. These models identify the least cost supply resources that could be used to satisfy future electric demand under a variety of constraints, including cost, reliability concerns, and the recognized need for a diverse mix of fuel and technologies. The Commission and interested stakeholders can offer alternatives to DE-Kentucky’s proposals during the IRP proceedings. Although the Commission does not issue orders formally approving the IRPs, the Commission Staff issues a staff report evaluating the IRPs and making recommendations.

807 KAR 5:001, Section 9. Rules of Procedure; Applications for Certificates of Public Convenience and Necessity

Under the regulation for Certificates of Public Convenience and Necessity (“CPCN”), a utility proposing to construct or acquire a new generating facility must establish that the new generating facility is necessary and in the public interest. The utility must also provide the estimated cost for operating the new generating facility. Typically, utilities submit an IRP analysis showing that a proposed generating facility is the least cost alternative to serve expected load, as DE-Kentucky did when the Commission authorized DE-Kentucky to acquire three generating stations from Duke Energy Ohio, Inc. in Case No. 2003-00252. The Commission has authority to deny a CPCN application if the Commission determines that the proposed generating facility would not provide adequate fuel diversity; would not be as efficient as other generating technologies; or could be avoided by use of renewables.

807 KAR 5:056. Fuel Adjustment Clause

This regulation authorizes the Commission to review utilities’ fuel costs periodically. If the Commission determines that a utility uses fuels that are too costly or is not operating its generating facilities efficiently, resulting in a fuel rate that is unjust and unreasonable, the Commission can approve the appropriate fuel rate.

KRS 278.285. Demand-side Management Plans

The Commission has jurisdiction to approve utilities’ demand-side management plans. Utilities can propose demand-side management programs relying on renewable resources. The Commission can approve such programs if the Commission determines that the programs are reasonable. In evaluating a program’s reasonableness, the Commission must consider whether the program is cost-effective.

KRS 278.466. Net Metering

This statute requires utilities to make net metering available to eligible customers. The law was intended to promote the use of small-scale renewable resources.⁵

KRS 278.260. Complaints

KRS 278.280. Orders by Commission as to Service

The Commission can initiate complaints against a utility if the Commission determines that the utility's service is unreasonable, insufficient or inadequate. The Commission could file a complaint against a utility if the Commission decided that the utility's fuel sources were not diverse enough; if the utility was not operating its generating facilities efficiently; or if the utility did not make adequate use of renewable resources. The Commission can make such orders necessary to correct such conditions.

In addition to the specific statutes and regulations cited above, the Commission's general supervisory powers allow it to investigate matters such as fuel and generating technology diversity, and generator efficiency. Indeed, the Commission has initiated investigations into Kentucky utilities' generating resources during the past several years.⁶ In a 2001 investigation, the Commission ordered Kentucky utilities to begin filing annual reports assessing their supply resources and their needs for future supply resources.⁷

Finally, in addition to the existing policies and authorities outlined above, DE-Kentucky believes that the Fossil Fuel Generation Efficiency section of the EPAct of 2005 may be in direct conflict with other provisions of the government's own regulations.

⁵ *Id.* at 90.

⁶ See, e.g., *In the Matter of An Assessment of Kentucky's Electric Generation, Transmission and Distribution Needs*, Administrative Case No. 2005-00090 (Order) (September 15, 2005); *In the Matter of a Review of the Adequacy of Kentucky's Generation Capacity and Transmission System*, Administrative Case No. 387 (Order) (December 20, 2001).

⁷ *In the Matter of a Review of the Adequacy of Kentucky's Generation Capacity and Transmission System*, Administrative Case No. 387 (Order at 127-128) (December 20, 2001).

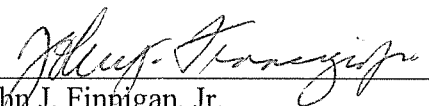
That is, the current broad interpretation by the U.S. Environmental Protection Agency (“EPA”) that any upgrade, modification, or other change in operation of an existing generating unit, without compliance with the New Source Performance Standards (“NSPS”) is in violation of the New Source Review (“NSR”) rules and regulations. To obtain a significant increase in the efficiency of any generating unit would most likely involve a modification and/or upgrade to the existing equipment and may also result in either a change in operation, and/or an increase in the annual emission of one or more of the criteria pollutants. In the case of older generating units, where the greatest improvement in efficiency may be possible, the likelihood of the efficiency improvement offsetting the cost to comply with NSPS is very low.

CONCLUSION

Based on the foregoing, DE-Kentucky respectfully submits that existing statutes and rules grant the Commission adequate authority to regulate the matters addressed by these standards, such that there is no need for the Commission to adopt these duplicative standards.

Respectfully submitted,

DUKE ENERGY KENTUCKY, INC.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Initial Comments of Duke Energy Kentucky, Inc. were served on the following parties by ordinary United States mail, postage prepaid, this 25th day of September, 2007.


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