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" or "Company") 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") but was not consumed for electric generation and subsequently sold at a loss. This situation was repeated in February 2014, subsequent to the Company's letter. The Company is seeking approval to include the difference between the purchase price of unburned gas procured for Woodsdale in the day-ahead energy market ("day-ahead market") and the sale price of that same gas in the real-time energy market ("real-time market") (positive or negative) as part of the net costs of off-system sales shared through its Rider Profit Sharing Mechanism ("Rider PSM").

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. In his response, the AG expressed the position that this matter should be addressed through a formal proceeding. On March 14, 2014, the Commission issued an Order establishing this case to investigate and address Duke Kentucky's proposed accounting treatment. By Order dated April 1, 2014, a procedural schedule was established for this case which included: (1) the opportunity for interested parties to request intervention; (2) two rounds of discovery on Duke Kentucky by Staff and intervenors; (3) an opportunity for intervenors to file testimony; (4) one round of discovery on intervenors; (5) an opportunity for Duke Kentucky to file rebuttal testimony; (6) a formal hearing; and (7) the filing of post-hearing briefs.

A public hearing was held on October 1, 2014. The AG, the only intervenor in this matter, issued data requests to the Company and conducted cross-examination during the hearing. However, the AG did not file testimony and declined to submit a post-hearing brief. Duke Kentucky responded to Staff's Post-Hearing Data Request ("Staff's Post-Hearing Request") on October 15, 2014, and submitted a brief ("Duke Kentucky's Brief") on October 30, 2014. This matter now stands submitted for decision.

BACKGROUND

Woodsdale is a six-unit combustion turbine generating station located in Trenton, Butler County, Ohio which has a collective net winter capability of 564 MW and a net summer capability of 492 MW (including inlet cooling).[1] Woodsdale is designed for peaking service and has dual fuel capability (natural gas and propane) and black start capability.[2]

Duke Kentucky operates in the PJM Interconnection, LLC ("PJM") under a fixed resource requirement construct. Operationally, PJM commits and dispatches the Duke

[1] Duke Kentucky's Brief, p. 2.

[2] *Id.*

Kentucky units in two separate and distinct market operations, the day-ahead and real-time markets. In the day-ahead market, PJM commits units and makes awards based on load demand, generation availability, offer pricing, and system transmission topology forecasts. These awards are financially binding obligations on both PJM and Duke Kentucky's part, but in real time, if conditions change from those forecasted, PJM has the flexibility to reduce generation awards. PJM also has the ability to commit generating units in the real-time market that did not receive a day-ahead award. When the Woodsdale units clear the PJM day-ahead market, Duke Kentucky typically procures natural gas in the day-ahead gas market, which is injected into the Texas Eastern Transmission Company ("TETCO") pipeline, without any assurance that the units will run in real time and be able to burn the gas nominated.[3] When the units do not run in real time, Duke Kentucky incurs a long position on its natural gas inventory on the TETCO pipeline.

During the extremely cold weather experienced in January and part of February 2014, the Woodsdale units frequently cleared the day-ahead market but the generation awards were reduced by PJM in the real-time market due to lower actual demand, additional generation imports, cancellation of planned outages, and changes in congestion.[4] As a result, nominated gas went unburned, creating an excessive positive imbalance position on the TETCO pipeline for Duke Kentucky.

Duke Kentucky has an operating balancing agreement ("OBA") with TETCO which governs the parties' contractual obligations on the pipeline. During the extreme

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[3] Duke Kentucky's Brief, pp. 4-5.

[4] Duke Kentucky's Response to Staff's First Request for Information (Staff's First Request"), Item 8.

cold weather experienced in January and February of 2014, TETCO limited daily actual burn volumes to the volume specifically nominated and delivered for that day. These limitations, called Imbalance Postings, can significantly limit Duke Kentucky's ability to ensure that the Woodsdale units are available to its customers for dispatch in the PJM energy market. During the extended periods of pipeline operational limitations in January and February 2014, Duke Kentucky lost the ability to reduce its excess long position in its gas inventory. Pursuant to the OBA, TETCO could have required Duke Kentucky to remedy the long position by either requiring the Company to sell the gas or by confiscating its delivery.[5] When these operational restrictions were in place, burning the gas would not reduce Duke Kentucky's long position since it was required to continue procuring additional gas that at least matched the anticipated expected burn at the station. Therefore, the position would never be reduced by burning the gas, and, consequently, selling the natural gas was the only viable option to ensure unit availability.[6]

On January 28, 2014, TETCO notified Duke Kentucky that the positive imbalance could not be increased, and would need to be addressed immediately upon removal of the restrictions and be reduced in an efficient manner. As a result, rather than have the gas confiscated by TETCO, Duke Kentucky sold portions of the gas on various dates in January and February 2014. The net loss from these sales was $534,000.

Duke Kentucky requests approval to net any gain or loss from the sale of natural gas that is not consumed for generation against any off-system sales that flow through its quarterly Rider PSM. The Company believes that this is a logical treatment because

[5] Duke Kentucky's February 3, 2014 letter to the Commission, pp. 1 and 3.

[6] This situation was discussed with Staff during a January 24, 2014 conference call.

the corresponding energy payments received for the day-ahead award of the Woodsdale units are allocated to off-system (i.e., non-native) sales and already flow to customers through Rider PSM.[7] Further, the Company maintains that the procurement of the gas is necessary to receive the day-ahead award, and that its customers are directly benefiting from its ability to participate in the PJM day-ahead market and its receipt of payments for such awards. Duke Kentucky also believes its proposed accounting treatment is consistent with the Commission's current regulations and with Rider PSM. Duke Kentucky states that its customers also receive benefits from PJM as a result of payments, such as lost opportunity payments for all six Woodsdale units and black start capacity payments for two of the Woodsdale units.[8] The Company maintains that its actions have brought substantial value to its Kentucky customers due to its operations at Woodsdale. In the first quarter of 2014, exclusive of the subject net loss on the sale of natural gas and including lost opportunity payments accounted for through the Fuel Adjustment Clause, the total benefit provided to Kentucky customers by the operations at Woodsdale was $3,606,136.[9] Finally, the Company states that its purchase of gas in the day-ahead market was prudent under the extenuating circumstances, as waiting to procure gas in the intra-day gas market would expose Duke Kentucky's customers to excessive and unacceptable risk due to unpredictable prices and uncertain availability.[10]

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[7] Duke Kentucky's February 3, 2014 letter to the Commission, p. 3.

[8] Duke Kentucky's response to Staff's First Request, Item 3, and to Staff's Second Request for Information ("Staff's Second Request"), Item 3.

[9] Duke Kentucky's response to Staff's Post-Hearing Request, Item 7.

[10] Duke Kentucky's Brief, p. 8.

DISCUSSION

Duke Kentucky originally designed the Rider PSM to share with its customers the net profit associated with off-system sales of power from its generation fleet, as well as 100 percent of its net profit from sales of emission allowances. In Case No. 2008-00489,[11] the Commission approved Duke Kentucky's request to modify the Rider PSM to include, as an eligible profit, net revenues related to its provision of ancillary services in the Midwest Independent System Operator (now Midcontinent Independent System Operator) Ancillary Service Market. As approved in Case No. 2010-00203,[12] the Rider PSM currently requires that Duke Kentucky's customers receive 100 percent of the first $1 million of off-system sales net margins and 75 percent of net margins above $1 million, as well as 100 percent of the net profit from sales of emission allowances. Further, in the event of a net loss on the Rider PSM in any year, the net loss is not passed on to the Company's customers.[13]

Under the Rider PSM, the Company computes the net profits it realizes from off-system energy sales, ancillary services, and emission allowance sales.[14] "In order to determine net margins, costs attributed to generating off-system sales revenues, such as hedging losses, variable operations and maintenance costs, and consumed-fuel

[11] Case No. 2008-00489, *Application of Duke Energy Kentucky, Inc. to Modify Rider PSM Off-System Sales Profit Sharing Mechanism to Account for Off-System Sales Due to the Initiation of the Midwest Independent System Operator Ancillary Service Market* (Ky. PSC Jan. 30, 2009).

[12] Case No. 2010-00203, *Application of Duke Energy Kentucky, Inc. 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* (Ky. PSC Dec. 22, 2010).

[13] Duke Kentucky's response to Staff's Second Request, Item 7, and Duke Kentucky's Brief, pp. 13-14.

[14] Duke Kentucky's Brief, p. 14.

expenses, are netted against revenues related to off-system sales, such as off-system energy sales, ancillary service revenues, and PJM Balancing & Day-Ahead Operating Reserve Credits (to the extent such credits are allocated to non-native load)."[15]

FINDINGS AND SUMMARY OF DECISION

The Commission is cognizant of the risks and benefits of Duke Kentucky's operations in PJM. The Company has shown that its operations at Woodsdale in extremely cold conditions during the first quarter of 2014 provided a substantial benefit to its customers and contributed to the reliability of operations in the PJM footprint. The Commission is of the opinion that to deny recovery of the loss on the sale of the unburned gas would be inconsistent with the intent of the Rider PSM. Furthermore, the Commission commends Duke Kentucky for mitigating its losses on the unburned gas by arranging to sell the natural gas to a third party instead of having it confiscated by TETCO. In light of the extenuating circumstance that existed in the first quarter of 2014 due to the extreme cold, the Commission finds that Duke Kentucky's actions were reasonable. The Commission finds that Duke Kentucky's proposed accounting treatment for the gain or loss from the sale of the natural gas not consumed for generation purposes during January and February 2014 should be approved.

Duke Kentucky amended its request that the proposed accounting treatment be approved not only for its loss in the first quarter of 2014 as described herein, but also be approved to apply to similar losses or gains under similar circumstances in the future, should they occur. The Commission finds that its decision in this case is limited to the

[15] *Id.*

loss for which this investigation was opened. Duke Kentucky's request to apply the proposed accounting treatment for that loss to future like-kind losses or gains is overly broad and, therefore, we will not approve Duke Kentucky's amended request. Such gains or losses should be investigated on a case-by-case basis. If such losses or gains arise in the future, Duke Kentucky shall notify the Commission so those matters may be addressed in a formal proceeding.

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's proposed accounting treatment for the sale of natural gas not consumed for generation and sold at a loss of $534,000 during the first quarter of 2014 is approved.

2. Duke Kentucky shall include the loss of $534,000 on the sale of gas during the first quarter of 2014 in Rider PSM for the period beginning March 1, 2015.

By the Commission

ENTERED
NOV 25 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

Case No. 2014-00078

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