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

PUBLIC VERSION

DIRECT TESTIMONY OF

LISA STEINKUHL

ON BEHALF OF

DUKE ENERGY KENTUCKY, INC

April 2, 2014

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I. INTRODUCTION AND PURPOSE

Q. STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Lisa Steinkuhl, and my business address is 139 E. Fourth Street, Cincinnati, Ohio 45201.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed as Rates & Regulatory Strategy Manager by Duke Energy Business Services, LLC, a service company subsidiary of Duke Energy Corporation and a non-utility affiliate of Duke Energy Kentucky, Inc. (Duke Energy Kentucky, or Company).

Q. PLEASE DESCRIBE BRIEFLY YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUNDS.

A. I received a Bachelor Degree in Mathematics from Western Kentucky University in Bowling Green, Kentucky. After completing my Bachelor Degree, I received a Post Baccalaureate Certificate in Professional Accountancy from the University of Southern Indiana in Evansville, Indiana. I became a Certified Public Accountant (CPA) in the State of Ohio in 1993. After receiving my Post Baccalaureate Certificate in 1988, I was employed by small public accounting firms. I was hired by Cinergy Services, Inc., the predecessor to Duke Energy Business Services, LLC, in 1996 as a tax accountant. I held various positions with Cinergy Services, Inc. including responsibilities in Regulated Business Financial Operations, Commercial Business Asset Management, and Budgets and Forecasts. I joined

the Rates Department in April 2006 as a Lead Rates Analyst and have held my current position as Rates & Regulatory Strategy Manager since January 2014.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL AFFILIATIONS.

A. I am a member of the American Institute of Certified Public Accountants and the Ohio Society of Certified Public Accountants.

Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THE PUBLIC SERVICE COMMISSION?

A. Yes.

Q. PLEASE SUMMARIZE YOUR DUTIES AS RATES & REGULATORY STRATEGY MANAGER.

A. As Rates & Regulatory Strategy Manager, I am responsible for the preparation of financial and accounting data used in applications for changes in fuel and gas cost adjustment factors and various other rates and recovery mechanisms for Duke Energy Kentucky and Duke Energy Ohio, Inc.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to respond to the Commission's March 14, 2014, Order and address the components of Duke Energy Kentucky's proposed accounting treatment for the cost of gas purchased for Woodsdale Generating Station (Woodsdale), but not burned, and consequently sold.

II. DISCUSSION

Q. PLEASE GENERALLY EXPLAIN THE CIRCUMSTANCES WHICH CAUSED WOODSDALE TO HAVE TO SELL THE UNBURNED GAS.

A. As more fully explained by Duke Energy Kentucky witness Mr. Swez, during January 2014 through March 2014, Duke Energy Kentucky procured natural gas fuel for Woodsdale as it does regularly when the unit is offered into the PJM Interconnection LLC (PJM) energy market and receives an award. Due to the tight gas markets and the operational restrictions in place on Texas Eastern Transmission Corporation (TETCO), the Company procured the gas for Woodsdale at either the time the day-ahead energy market offer was made or when the day-ahead energy market award from PJM was received to ensure Woodsdale had fuel available to support the day-ahead award of the units. On some of these days, Woodsdale cleared the PJM day-ahead energy market and received a day-ahead energy award; however, in PJM, this does not necessarily mean that the unit will actually run. The station will only be dispatched and the gas will only be burned if Woodsdale is then called upon by PJM in its real-time energy market. During the time at issue, PJM chose not to run Woodsdale in the real-time market or ran it at a lower output than was cleared in the day-ahead energy market, causing less gas to be burned than was procured on the day-ahead basis. Therefore, a long natural gas imbalance position was created.

Due to a number of factors beyond Duke Energy Kentucky's control, including, but not limited to, limited gas availability for delivered interruptible supply, operational restrictions imposed by TETCO on natural gas pipeline capacity, and the discrepancy in unit dispatch between the PJM day-ahead energy market awards and the PJM real-time energy market dispatch, all caused by the prolonged period of extreme cold, Duke Energy Kentucky was forced to sell the

unburned gas. If the Company did not sell the gas that created the imbalance position, TETCO would confiscate the gas without reimbursement to the Company.

Q. PLEASE EXPLAIN DUKE ENERGY KENTUCKY'S PROPOSED ACCOUNTING TREATMENT FOR THE COST OF GAS PURCHASED AT WOODSDALE AND CONSEQUENTLY SOLD.

A. To account for this sale of gas, Duke Energy Kentucky intends to include the cost of any unburned gas procured for Woodsdale and net it against the sale proceeds of that same gas (positive or negative) as part of the net costs of off-system (non-native) sales shared through the Company's Profit Sharing Mechanism (Rider PSM). These costs and/or credits will be netted against any off-system sales that flow through the quarterly PSM.

Q. PLEASE BRIEFLY DESCRIBE RIDER PSM.

A. Rider PSM is the mechanism under which Duke Energy Kentucky shares the costs and benefits associated with net off-system (non-native) sales of its generation assets in PJM. Under the Rider PSM's current terms, Duke Energy Kentucky's customers receive a credit on their bills for the first $1 million of any net profits from off-system sales. After that first $1 million the net profits are shared between customers and the Company under a 75/25 split, respectively.

Q. WHY NOT INCLUDE THE NATURAL GAS PROCURED FOR WOODSDALE TO MEET THE DAY-AHEAD AWARD AS PART OF THE COST OF FUEL RECOVERED UNDER THE FUEL ADJUSTMENT CLAUSE?

A. Simply put, under the Fuel Adjustment Clause (FAC) regulation, the cost of fuel burned for native load is recoverable through the FAC. In this situation, the gas was procured to meet the PJM day-ahead market award, but would not actually be burned until the plant was dispatched in the real-time energy market. Under normal circumstances, the gas would eventually get burned when Woodsdale was dispatched in the real-time energy market. At that time, the gas would then flow through the FAC, if allocated to native, or Rider PSM, if allocated non-native. It was this anomalous situation explained by Mr. Swez, where, because of extreme cold weather resulting in commodity scarcity, the natural gas pipelines were not permitting the Company to carry forward a long position of gas for a future burn and began threatening to confiscate the supply. This situation required Duke Energy Kentucky to proactively address the situation and mitigate the potential loss through a sale of the gas.

Passing the cost of unburned gas volumes and crediting the sale proceeds through the FAC is an acceptable method of accounting treatment for Duke Energy Kentucky. However, given the existing regulation, this particular accounting treatment is not possible absent a Commission waiver.

Q. PLEASE GENERALLY EXPLAIN THE PJM TRANSACTIONS THAT OCCUR WHEN A UNIT RECIEVES A DAY-AHEAD AWARD, BUT THEN IS NOT DISPATCHED IN THE REAL-TIME MARKET.

A. It is my understanding that the Company receives a payment from PJM based on the hourly day-ahead generation award. This payment is based on the awarded Megawatt-hours (MWH) at the generation LMP for that hour. When PJM decides

not to run that unit for that hour in the real-time market, the Company has to buy back that amount of generation at the hourly real-time LMP. The Company may also receive a lost opportunity payment which is a component of the PJM Balancing Operating Reserve. Lost opportunity payments may be paid to generators that PJM reduced or suspended in the real-time market for reliability purposes.

Q. PLEASE DISCUSS HOW THOSE PJM TRANSACTIONS, THE COST OF FUEL, AND PURCHASED POWER WILL BE ALLOCATED IN THE COMPANY'S GENENERATION COST ALLOCATION MODEL AND INCLUDED IN REGULATORY FILINGS OF THE COMPANY.

A. The after-the-fact generation cost model is used to economically dispatch on an hourly basis the demand (load) with available supply resources (*i.e.* generation or purchases) which are economically stacked. The production costs are generally prioritized based on production costs, lowest cost to highest cost. Consequently, the model economically allocates the production costs for servicing native load such that native load is allocated the lowest cost supply resource.

The model performs two stacking processes, a day-ahead stacking and then a real-time stacking. The model will stack the hourly day-ahead energy market generation awards from PJM against the day-ahead load cleared by PJM, providing Duke Energy Kentucky native customers first call on the lowest cost generation in the day-ahead market. Generation that clears day-ahead in excess of day-ahead load is committed to day-ahead non-native sales. In the real-time stacking process, if a unit was committed in the day-ahead allocation process as

non-native for an hour it remains a non-native unit in the real time. Then, utilizing the actual real-time generation and load, everything is restacked, and Duke Energy Kentucky native customers are assigned the lowest cost generation that did not clear for non-native in the day-ahead market, but was dispatched in the real-time energy market. If Duke Energy Kentucky's real-time native load is greater than the available real-time generation not committed in the day-ahead energy market to non-native, Duke Energy Kentucky will purchase energy in the real-time market from PJM to make-up the difference. If Duke Energy Kentucky's real-time native load is less than the available real-time generation not committed in the day-ahead market to non-native, then any excess generation is considered as a real-time non-native energy market sale. All costs and revenues associated with generators that clear day-ahead for non-native energy market sales or in real-time for non-native energy market sales are assigned to a non-native cost allocation. Duke Energy Kentucky native customers will only pay for fuel charges associated with the units that are assigned to them.

The PJM Balancing & Day Ahead Operating Reserve Credit is allocated on a daily basis on how the hourly fuel was allocated for that day. This is on a daily basis because PJM does not provide hourly data for balancing & day-ahead operating reserve credit.

Q. WHAT IS THE IMPACT OF THE PROCUREMENT AND SUBSEQUENT SALE OF THE GAS THAT THE COMPANY IS INTENDING TO FLOW THROUGH RIDER PSM FOR THE MONTH OF JANUARY 2014 AND FEBRUARY 2014?

A. An estimate of the loss on the sale of gas for the months of January and February 2014 is included in the tables below. The final loss amounts will be included in the Rider PSM tariff filing which will be filed with the Commission on May 2, 2014.

January

Dekatherms	Purchase Price	Sale Price	Gain (Loss) on Sale
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
100,000			[redacted]

February

Dekatherms	Purchase Price	Sale Price	Gain (Loss) on Sale
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]			[redacted]

Q. WILL THERE BE ANY ADDITIONAL SALES OF UNBURNED GAS RELATED TO THE LONG NATURAL GAS IMBALANCE POSITION CREATED IN JANUARY THROUGH MARCH OF 2014, AND IF SO, HOW WILL THEY BE HANDLED?

A. Based on the testimony of Duke Energy Kentucky witness Mr. Swez, there is a likelihood of additional sales in the short-term to relieve the current long natural gas imbalance position. The Company intends to use the same accounting treatment as discussed above for any additional sale of gas due to the circumstances discussed in the testimony filed in this case.

Q. PLEASE COMMENT GENERALLY ON THE REASONABLENESS OF DUKE ENERGY KENTUCKY'S PROPOSED ACCOUNTING TREATMENT FOR THE COST OF GAS PURCHASED AT WOODSDALE, BUT NOT BURNED.

A. The Company believes the proposed accounting treatment for sale of the unburned gas is a logical treatment because of the nexus between the loss incurred on the sale of the unburned gas and the corresponding energy payments received for the day-ahead award, energy buy-back in the real-time, and the lost opportunity credit received for the Woodsdale Units allocated (stacked) to off-system sales (*i.e.* non-native) as part of normal modeling process flows through Rider PSM. Simply put, to the extent the day-ahead award and real-time energy dispatch is allocated to non-native in the stacking/modeling process I described above, then those payments will flow through Rider PSM. The cost of fuel procured to secure the day-ahead energy market award should be netted against the payments received on the award. The situation here is that the fuel procured to secure the day-ahead energy market award is not coupled with a real-time dispatch and not included in the fuel consumed amount allocated between native and non-native customer loads. Therefore, it should be treated as 100% non-native and included as a cost netted under Rider PSM along with the proceeds received from selling that gas.

If and when Woodsdale is called upon by PJM in the real-time energy market, the gas will be burned and will flow through either the Company's FAC or Rider PSM based on the allocation of the costs between native and non-native as part of the normal modeling process.

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.

Q. HOW DOES THE COMPANY PLAN TO HANDLE ANY FUTURE SALE OF UNBURNED GAS THAT OCCURS DUE TO THE SAME OPERATIONAL CIRCUMSTANCES IN THIS CASE?

A. The Company intends to use the same accounting treatment as discussed above for any future sale of gas, including, but not limited to, limited gas availability for delivered interruptible supply, operational restrictions imposed by interstate pipeline companies on natural gas pipeline capacity, and the discrepancy in unit dispatch between the PJM day-ahead energy market awards and the PJM real-time energy market dispatch.

III. CONCLUSION

Q. DOES THIS CONCLUDE YOUR PREPARED TESTIMONY?

A. Yes, it does.