COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF DUKE ENERGY KENTUCKY, INC. TO BECOME A FULL PARTICIPANT IN THE PJM INTERCONNECTION LLC, BASE RESIDUAL AND INCREMENTAL AUCTION CONSTRUCT FOR THE 2027/2028 DELIVERY YEAR AND FOR NECESSARY ACCOUNTING AND TARIFF CHANGES	))))))	Case No. 2024-00285

ATTORNEY GENERAL'S INITIAL BRIEF

The intervenor, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention ("OAG"), hereby submits his Initial Brief in the above-styled matter.

I. STATEMENT OF THE CASE

On September 6, 2024, Duke Energy Kentucky, Inc. ("DEK," or "the Company") filed its application in the instant docket for the purpose of transitioning its participation in the PJM Interconnection ("PJM") from its current status as a Fixed Resource Requirement ("FRR") participant, to full participation in the PJM Reliability Pricing Model ("RPM") Base Residual Auction ("BRA") and Incremental Auction ("IA") construct beginning with the June 1, 2027 through May 31, 2028 (2027/2028) Delivery Year.[1] In order to effectuate this transition, the Company also seeks approval of amendments to the Company's Profit Sharing Mechanism ("Rider PSM") to account for capacity-related revenues and costs from PJM Billing Line Item ("BLI") and bilateral markets, and to reconcile the net capacity-related

[1] The Company asserts that if a decision is reached by May 2025, it would be eligible to transition to the auction for the 2026/2027 delivery year.

revenues and charges with customers receiving 100 percent of the benefit or costs of capacity outside of the current sharing percentages for other components of Rider PSM.

The OAG filed its motion to intervene in this matter on September 8, 2024, which was granted by Commission order dated September 12, 2024. There were no other intervenors. On September 18, 2024 the Commission entered its procedural order. The OAG filed two rounds of discovery, and Staff filed three. OAG filed its testimony on December 6, 2024, and filed responses to Company data requests on December 20, 2024. On January 10, 2025 DEK filed its rebuttal testimony. On January 13, 2025 both DEK and the OAG filed requests to submit the case for a final decision upon the record. The Commission on February 27, 2025 issued its briefing schedule.

II. BACKGROUND AND SUMMARY OF OAG TESTIMONY

DEK's current status as an FRR participant requires that the Company supply its own resources and reserves to meet its load obligations – it is not allowed to rely upon PJM's RPM capacity auctions to satisfy those obligations. FRR participants thus can meet their obligations either by building new resources, or through bilateral contracts. FRR entities are permitted to sell excess capacity into the RPM auction, however that amount is capped.[2]

RPM participants can meet their load obligations through these same methods, but also have an additional option not available to FRR participants: relying on the RPM capacity market. RPM participants are paid capacity revenues for their resources bid in to the RPM capacity market, with the promise that those resources will produce electricity when called upon by PJM. The RPM operates through capacity auctions, primarily the BRAs, which are

[2] PJM's "Holdback Provision" limits the amount of excess capacity that FRR participants can sell into the auction to the lesser of 450 MW or 3% of DEK's unforced capacity obligation. *See* Direct Testimony of OAG Witness Phil Hayet at 5-6.

held three years in advance of the delivery year.[3] PJM also relies upon the RPM to allow: (a) load-serving entities to secure reliable, cost-effective power supply; and (b) generation owners to sell their existing capacity resources into the market, which sends signals that help generation developers decide when and where to build new capacity resources.[4]

DEK, in the instant docket asserts that although the FRR arrangement has historically benefited its customers, circumstances have changed so significantly that changing to RPM status would provide a net benefit to its customers.[5] OAG witness Phil Hayet conducted his own analysis which contains results identical with those the Company presented, and support the conclusion that customers would be better off as an RPM entity if high market capacity prices were prevalent at a time when DEK had a capacity deficit.[6] Furthermore, Mr. Hayet's analysis also revealed that if the Company could build capacity at a cost below the BRA auction price (the "RPM – build" case as depicted in Table 1 of his testimony), then customers would be better off if the Company moved to RPM status. Mr. Hayet further opined that, "[n]ot only would acquisition of capacity be better for customers from a capacity cost perspective, but depending on the type of capacity, it could also provide an energy hedge as well."[7]

[3] PJM also conducts periodic IAs to allow for adjustments to capacity commitments.
[4] Hayet Direct at 6-7.
[5] *Id*. at 7-8.
[6] *Id.* at 13-14. FRR entities short of capacity are subject to significant PJM penalties, which are magnified at times of high capacity prices. On the other hand, the high capacity prices RPM entities have to pay still come in lower than total costs FRR entities face when they are penalized.
[7] *Id.* at 14-15. Mr. Hayet further noted that although this particular case was predicated upon the cost of new entry (CONE) being below the BRA price, nonetheless ". . . owning capacity would be a hedge to both capacity and energy costs, and it would provide long-term certainty to the costs borne by the Company's customers." *Id.* at 15.

Although DEK's "heat map" analysis indicates that RPM status likely will bring cost savings to ratepayers in the near term,[8] nonetheless the Commission has always recognized the need to protect ratepayers from over-reliance on market energy prices:[9]

> "Sufficient generation capacity that can be used to serve the entirety of native demand acts as a physical hedge to market energy prices, and without adequate generation capacity, Kentucky Power and its customers are subject to higher prices from market purchases for at least the amount the utility is short of its native demand."[10]

In fact, the Commission's concern regarding over-reliance on market power dates back at least more than a decade to when it first approved DEK's request to join PJM, when it limited DEK's participation to FRR status:[11]

> "Since Duke Kentucky has not demonstrated that its customers will be protected against market-based prices under the RPM option, the Commission will require Duke Kentucky to commit that it will participate in PJM only under an FRR capacity plan until it requests and receives our approval to participate in the RPM market."[12]

In order to satisfy the Commission's well-founded concerns regarding the potential for an over-reliance on market-based capacity and energy under the RPM construct, both of the OAG's witnesses, Messrs. Hayet and Kollen, developed a series of physical and ratemaking

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[8] DEK's analysis indicates that remaining an FRR participant would be economic in only one of the four scenarios analyzed, with three of those scenarios indicating that changing to RPM status would prove more economic. Additionally, even in the one scenario in which retaining FRR status proves more economic, the benefit is relatively small, especially compared to the excess consumer harm that would arise when market prices are high. *See* Hayet Direct at 11:11-15.

[9] *See, e.g., In Re*: Electronic Investigation of the Service, Rates and Facilities of Kentucky Power Company, Case No. 2021-00370, Orders dated June 23, 2023, and Sept. 23, 2023. *See also, In Re:* Electronic Tariff Filing of East Kentucky Power Cooperative, Inc. and its Member Distribution Cooperatives for Approval of Proposed Changes to their Qualified Cogeneration and Small Power Production Facilities Tariffs, Case No. 2021-00198, Order dated Oct. 26, 2021 at 5, FN 10 ("This Commission has no interest in allowing our regulated, vertically-integrated utilities to effectively depend on the market for generation or capacity for any sustained period of time.").

[10] *Id.*, Order dated Sept. 23, 2023 at 3.

[11] *In Re:* 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, Case No. 2010-00203, Order dated Dec. 22, 2010 at 14.

[12] *Id.*

recommendations to provide "guardrails" to avoid these potential harms.[13] Along these same lines, DEK itself has already acknowledged that it does not plan to rely on the RPM capacity auction to satisfy capacity needs ". . . . except for potentially a short time frame under a situation such as additional customer demand entering the Duke Energy Kentucky service territory at a rate faster than a resource can be added."[14] These recommended guardrails are:

1. DEK should be required to replace any retiring dispatchable capacity with owned or purchased pursuant to bilateral agreement, in-zone (preferably located in Kentucky), dispatchable capacity prior to the retirement of the capacity.

2. Purchases through the BRA auction should be limited so that DEK does not overly rely on the auction to satisfy capacity requirements. DEK should be limited to purchase no more than nine percent of its annual capacity requirement through the BRA auction, and it should be required to bring its long-term capacity imbalance back into balance within a period of six years.

3. As an alternative to the two conditions above, the Commission could consider approving DEK's request to become an RPM entity, but also open a new docket to establish minimum capacity obligations for Kentucky based RPM entities and set a goal for the new obligations to be in effect within one year of issuing its order in this docket.

4. The Commission should limit the capacity and time period for recovery of net BRA and IA capacity purchase expense in PSM rates consistent with the underlying physical conditions addressed by Witness Kollen.

5. The Commission should ensure there is no double recovery of capacity costs, once through base rates and then another recovery in whole or part through PSM rates.

6. The Commission should maintain the 10% Company and 90% customers sharing allocation for all revenue and expense BLIs included in PSM rates, including the new BLIs. The present sharing allocation provides an appropriate disincentive to the Company purchase capacity in the BRAs and IAs and an appropriate incentive to the Company to sell capacity in the BRAs and IAs.

[13] *See* Hayet Direct at 20-24, and Kollen Direct at 9-11.
[14] DEK response to AG-DR-2-9 (b).

7. The Commission should ensure there are no ratemaking incentives to purchase capacity in the BRAs and IAs instead of acquiring new owned capacity and/or new or additional bilateral capacity purchases to replace retired owned capacity or terminated or reduced capacity purchases. This can be achieved through a combination of all three of the preceding conditions.

8. The Commission should exclude the compliance and other penalty expense BLIs from the PSM and thereby preclude the Company from recovering these avoidable expenses through PSM rates.

III. ARGUMENT

With regard to the OAG's Recommendation One, which proposes the Company be required to replace any retiring dispatchable capacity with dispatchable owned or purchased (via bilateral agreements) capacity in-zone and preferably in Kentucky prior to the retirement of the capacity, Company Witness Swez generally agrees that it makes sense to have replacement resources in place prior to retirement of existing resources.[15] Mr. Swez also states that KRS 278.264 already defines actions for retirement of generating resources.[16] Thus the Company believes that any additional requirements are duplicative.[17] The OAG agrees with Mr. Swez on this point.

Mr. Swez also states that the only difference between OAG's Recommendation One and KRS 278.264 relates to OAG's proposal that replacement capacity be located within the DEOK zone and preferably be in the state of Kentucky.[18] While Mr. Swez states that locating resources outside of the DEOK zone may "represent additional risks,"[19] he states that the Company would still prefer to seek new resources wherever it might be most economic, and

[15] Swez Rebuttal, at 9:21.
[16] *Id*. at 10:3.
[17] *Id*. at 10:9.
[18] *Id*. at 10:15.
[19] *Id*. at 10:19.

then justify its decision within the Commission's Certificate of Public Convenience ("CPCN") process. The OAG agrees with the Company that there can be additional risks to locating resources in different capacity zones, which can lead to cost impacts in both the capacity and energy markets. The OAG also believes that exposing ratepayers to market vulnerabilities for capacity needs is, in the long term, a disastrous practice. The OAG also recognizes that there would be an opportunity to address location-based capacity acquisition issues when the Company seeks approval for resources in CPCN proceedings. OAG's Recommendation One remains its primary recommendation, but Recommendation Three would also provide a reasonable resolution, and would allow for further consideration of this issue.

In rebuttal, Company witness Swez disagrees with OAG's Recommendation Two, which proposes that purchases through the BRA auction be limited to no more than nine percent of the Company's annual capacity requirements so that the Company does not overly rely on the BRA auction to satisfy capacity needs. But Mr. Swez agrees "that owned resources are the best hedge against potentially volatile capacity market prices"[20] and states the "Company does not anticipate that it would solely rely on the RPM auction net capacity purchases to address the Company's long term capacity needs."[21]

In the end, the Company's position is that it will likely acquire owned resources or enter into bilateral purchases; however, it would still like the flexibility to acquire resources through the BRA auction when economic. This is not an unreasonable position; however, OAG is concerned that while DEK may want this flexibility, not establishing a rule to prevent over-dependence on the capacity auction could lead to situations where the Company may

[20] *Id*. at 13:15.
[21] *Id*. at 13:19.

not have sufficient capacity when the capacity market tightens, and capacity prices increase dramatically. Relying on short term energy needs as a FRR entity is one thing, but relying on capacity as an RPM participant is quite another. OAG strongly recommends that the Commission implement a requirement limiting the amount of capacity that could be acquired through the BRA auction, as set forth in OAG Recommendation Two.[22]

In rebuttal testimony, Company witness Lisa Steinkuhl argues the Commission need not worry at this time about double recovery of non-fuel operating expenses when generating units are retired and those expenses no longer are incurred, but still recovered through base revenues, even as the Company incurs incremental purchased capacity expenses for the replacement capacity and recovers the expenses through the PSM.[23] The OAG disagrees. The Commission should ensure now that there is no double recovery in such a circumstance, as a condition of approving the request to transition to RPM status, and not leave this to future proceedings. If there is recovery of incremental purchased capacity expenses through the PSM, then there should be an offsetting reduction in the PSM for the expenses no longer incurred, but still recovered through base revenues.

Witness Steinkuhl also argues the Company is entitled to recovery of its remaining net book value whether through base rates or a rider for this purpose.[24] The OAG notes that Witness Kollen's proposed condition in this proceeding relates solely to non-fuel operating expenses and not to the recovery or form of the recovery of the remaining net book value. Witness Steinkuhl's argument addresses an entitlement to recovery that is not at issue in this case.

[22] Alternatively, the Commission could open a new docket to allow for further consideration of OAG's Recommendations One and Two, and to address any further issues.
[23] Steinkuhl Rebuttal at 3-5.
[24] *Id*. at 4.

In rebuttal, Witnesses Steinkuhl and Swez both reiterate their arguments in direct testimony to modify the authorized sharing of capacity revenues and costs related to meeting PJM's FERC-approved reliability requirements for recoveries through the PSM, from the currently-authorized 90% customers/10% Company ratio to the proposed 100% customers/0% Company.[25] Witnesses Steinkuhl and Swez both argue that customers pay for these generating resources through base rates and should pay for incremental PJM capacity purchases in lieu of owned resources in base rates.[26] The OAG disagrees for the reasons cited in OAG Witness Kollen's testimony. The OAG also notes that neither of these rebuttal arguments are relevant to the PSM sharing mechanism because the capacity purchases and the expense recoverable through the PSM are incremental to the owned resource capacity resources and the costs recoverable through base rates, as explained in Mr. Kollen's testimony. Further, as Witnesses Kollen and Hayet note, capacity purchases in the BRA and/or IA should be temporary and limited in size, and should not be incentivized in lieu of owned generation or bilateral purchase agreements.

In addition, Witness Swez provides an example in which the Company is capacity short and required to purchase incremental capacity to serve its load.[27] Under this scenario, the Company is presently authorized to recover 90% of the cost of this incremental capacity through the PSM. Mr. Swez argues against maintaining the present sharing, stating the Company is being denied the ability to recover its costs of serving customers, contrary to the fundamental concepts of utility rate making. Yet, the present sharing was proposed by the

[25] Steihkuhl Rebuttal at 5-6 and Swez Rebuttal at 20-25.
[26] *Id.*
[27] Swez Rebuttal at 21-23.

Company itself in Case 2017-00321,[28] which belies this argument. In addition, the Company itself in this proceeding proposes all non-capacity related expenses continue to be shared 90% to customers/10% to the Company, which also belies the Company's argument. Further, if the Company sells excess capacity, then it shares in 10% of those capacity revenues, so there is a symmetrical and equitable opportunity for the Company to share in incremental capacity purchase expenses and incremental capacity sales revenues.

Company Witness Swez also takes issue with Witness Kollen's recommendation to exclude the BLIs that represent penalties for costs imposed on the Company due to compliance and performance failures.[29] Including these penalty BLIs in the PSM, as the Company proposes, essentially presumes the expenses are reasonable, unless the expenses are challenged by OAG and/or other parties. This proposal imposes the burden of demonstrating the unreasonableness or imprudence of expenses onto the OAG and other parties. On the other hand, if the penalty BLIs are excluded, then the Company can seek to have any penalty expenses included for recovery in the PSM, but will retain the burden to specifically request recovery of the expenses and to justify the expenses as reasonable and prudent, which is where the burden should remain.

Witness Swez's rebuttal argues that the OAG seeks to enjoy the benefits of RPM status, but not pay for the costs.[30] That argument is incorrect on its face. The OAG agrees that both the benefits and expenses of RPM status should be included, but recommends the Commission exclude the BLIs and expenses due to compliance or performance failures unless

[28] *In Re*: Electronic Application Of Duke Energy Kentucky, Inc. For: 1) An Adjustment Of The Electric Rates; 2) Approval Of An Environmental Compliance Plan And Surcharge Mechanism; 3) Approval Of New Tariffs; 4) Approval Of Accounting Practices To Establish Regulatory Assets And Liabilities; And 5) All Other Required Approvals And Relief.
[29] Swez Rebuttal at 25-29.
[30] *Id.* at 27-28.

the Company satisfactorily justifies its compliance and performance failures and the related expenses as prudent and reasonable, and therefore recoverable through the PSM.

Finally, the Commission should carefully note that DEK's application comes at a time when PJM is facing an unprecedented capacity crisis and record high capacity prices. On December 9, 2024, PJM's Board of Governors announced ". . . [T]he PJM system could see a capacity shortage as soon as the 2026/27 Delivery Year."[31] The North American Electric Reliability Corporation's 2024 Long-Term Reliability Assessment confirms this coming shortfall.[32] In response to the impending crisis the market prices from PJM's last BRA increased by almost 1,000%. This rapidly approaching capacity crisis is also directly contributing to strained relations between PJM and some of it stakeholders, as exemplified in Pennsylvania Governor Josh Shapiro's letter to the PJM Board of Directors dated Jan. 13, 2025, in which he threatened to withdraw the state from PJM.[33] The Governor and PJM recently entered into a black box settlement, which raises questions of whether PJM is driven by engineering and economical principals versus the political agenda of member states. The uncertainty of PJM's capacity and volatile market prices should raise serious concerns for the Commission when evaluating the Company's application.[34]

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[31] Letter from Mark Takahashi, Chair, PJM Board of Managers, to Stakeholders dated Dec. 9, 2024, accessible at: https://www.pjm.com/-/media/DotCom/about-pjm/who-we-are/public-disclosures/2024/20241209-board-letter-outlining-action-on-capacity-market-adjustments-rri-and-sis.pdf [emphasis added]

[32] 2024 Long-Term Reliability Assessment [LTRA]," December 2024, accessible at: https://www.nerc.com/pa/RAPA/ra/Reliability%20Assessments%20DL/NERC_Long%20Term%20Reliability%20Assessment_2024.pdf

[33] Accessible at: https://www.pjm.com/-/media/DotCom/about-pjm/who-we-are/public-disclosures/2025/20250113-pa-gov-shapiro-letter-re-capacity-market-price-cap.pdf

[34] *See, e.g.,* Op-Ed: "Proposed FERC Price Cap Settlement Will Intensify Looming Electric Capacity Crisis," by Anthony "Tony" Campbell, *Utility Dive*, March 10, 2025, accessible at: https://www.utilitydive.com/news/proposed-ferc-pjm-capacity-price-cap-settlement/741938/

IV. CONCLUSION

Although the OAG agrees a scenario could exist that transitioning into PJM's RPM construct may prove cost-effective for DEK and its ratepayers in the short term, the Commission must also address PJM's capacity crisis. The OAG implores the Commission to look not just at potential short term benefits but also the long term implications. As a vertically integrated state Kentucky has been served well adhering to the practice of its utilities meeting native load with steel in the ground generation located within the Commonwealth. The Commission should require DEK and Kentucky's other utilities to build new generation within the Commonwealth to meet capacity. A little over a decade ago the Commission strayed from this practice allowing Kentucky Power to shut down in-state generation in favor of purchasing a generation plant in a neighboring state. Kentucky Power's ratepayers have been paying for this mistake ever since. The "guardrail" recommendations that OAG's experts submitted in this docket will help to mitigate those risks. In addition, if the Commission grants the Company's application, OAG recommends that the Commission consider requiring DEK to submit periodic reporting regarding the amount of capacity purchases the Company makes in the RPM construct, the duration thereof, and the percentage of its total native load that all such purchases constitute.

Respectfully submitted,
RUSSELL COLEMAN
ATTORNEY GENERAL

LAWRENCE W. COOK
J. MICHAEL WEST
ANGELA M. GOAD
JOHN G. HORNE II
ASSISTANT ATTORNEYS GENERAL
1024 CAPITAL CENTER DR., STE. 200
FRANKFORT, KY 40601
(502) 696-5453
FAX: (502) 564-2698
Larry.Cook@ky.gov
Michael.West@ky.gov
Angela.Goad@ky.gov
John.Horne@ky.gov

Certificate of Service

Pursuant to the Commission's Orders in Case No. 2020-00085, and in accord with all other applicable law, Counsel certifies that an electronic copy of the forgoing was served and filed by e-mail to the parties of record.

This 12th day of March, 2025

Assistant Attorney General