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Rocco O. D'Ascenzo
Senior Counsel

VIA OVERNIGHT DELIVERY

November 25, 2008

2008-00489

RECEIVED

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**PUBLIC SERVICE
COMMISSION**

Ms. Stephanie Stumbo
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602-0615

Re: Rider PSM (Profit Sharing Mechanism)

Dear Ms. Stumbo:

Enclosed please find an original and twelve copies each of the application for Duke Energy Kentucky, Inc.'s Rider PSM.

Please date-stamp the extra two copies and return to me in the enclosed envelope.

Sincerely,

Rocco O. D'Ascenzo
Senior Counsel

cc: Dennis G. Howard II

NOV 26 2008

PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of an Application of)
Duke Energy Kentucky, Inc. to Modify)
Rider PSM Off-System Sales Profit Sharing Mechanism)
To Account for Changes in Off-System Sales Due to)
The Initiation of the Midwest Independent System Operator)
Ancillary Services Market)

Case No. 2008- 00489

VERIFIED APPLICATION OF DUKE ENERGY KENTUCKY, INC., TO MODIFY RIDER PSM, OFF-SYSTEM POWER SALES AND EMISSION ALLOWANCE SALES PROFIT SHARING MECHANISM TO ACCOUNT FOR CHANGES IN OFF-SYSTEM SALES DUE TO THE MIDWEST INDEPENDENT SYSTEM OPERATOR ANCILLIARY SERVICE MARKET

To the Honorable Kentucky Public Service Commission:

Duke Energy Kentucky, Inc., ("Duke Energy Kentucky" or the "Company") respectfully petitions the Kentucky Public Service Commission ("Commission") for an order permitting modification to Duke Energy Kentucky's Rider PSM - Off-System Power Sales and Emission Allowance Sales Profit Sharing Mechanism ("Rider PSM") to account for changes in off-system sales due to initiation of the Midwest Independent System Operator, Inc., ("MISO") Ancillary Services Market ("ASM"). In support of this Application, Duke Energy Kentucky states as follows:

- 1. Duke Energy Kentucky is a Kentucky corporation and a public utility as defined in Section 278.010 of the Kentucky Revised Statutes ("KRS") and is subject to the Commission's jurisdiction. Duke Energy Kentucky is engaged in the business of furnishing gas and electric services to various municipalities and unincorporated areas in Boone, Campbell, Gallatin, Grant, Kenton and Pendleton Counties in the Commonwealth of Kentucky.

2. Duke Energy Kentucky's address is 1697 A-Monmouth Street, Newport, Kentucky 41017.

3. Duke Energy Kentucky's articles of incorporation are on file with the Commission in Case No. 2006-000563 and is incorporated by reference herein pursuant to 807 KAR 5:001, Section 8(3).

4. Communications regarding this Application should be addressed to:

Rocco O. D'Ascenzo
Senior Counsel
Amy B. Spiller
Associate General Counsel
Duke Energy Business Services, Inc.
139 East Fourth Street, Room 2500 ATII
P.O. Box 960
Cincinnati, OH 45201-0960

5. The Commission approved Duke Energy Kentucky's Rider PSM in its December 21, 2006 Order in Case No. 2006-172 ("Order").¹ Rider PSM was designed as the mechanism to accomplish Duke Energy Kentucky's sharing of revenues with retail customers due to off-system sales of Duke Energy Kentucky's generation fleet as well as emission allowance sales. Specifically, Duke Energy Kentucky's customers receive one-hundred percent (100%) of the first \$1,000,000 benefit of net margins from off-system sales. Net margins above \$1,000,000 are shared equally (50/50) between the Company and customers. In addition, Duke Energy Kentucky's customers receive 100 percent (100%) of the net margin on sales of emission allowances. In its Order, the Commission stated that Rider PSM will "remain in effect until modified in a future proceeding."²

¹ *In the Matter of: Application of the Union Light, Heat and Power Company d/b/a Duke Energy Kentucky for an Adjustment of electric Rates*, (Order)(December 21, 2006).

² *Id.*

6. MISO is a non-profit, member-based organization committed to being the leader in electricity markets by providing its customers with valued service, reliable, cost-effective systems and operations, dependable and transparent prices, open access to markets, and planning for long-term efficiency. MISO manages one of the world's largest energy markets using security-constrained economic dispatch of generation. Market operations include a Day-Ahead and Real-Time Energy Markets, and a Financial Transmission Rights ("FTR") Market. These markets, often referred to as Day 2 markets, are operated and settled separately.

7. On January 6, 2009, MISO plans to launch its ASM. Ancillary services are defined as services necessary to support capacity and the transmission of energy from resources to loads while maintaining reliable operation of the transmission system in accordance with good utility practice. The ASM will provide a market to facilitate the most efficient supply of reserves as well as reconcile operating practices with market incentives so that market participants are compensated for providing overall system reliability. The addition of the ASM is intended to provide incentives needed for short-term system reliability; complete the wholesale short-term markets resulting in appropriate price signals; enable demand response resources to participate in the market; encourage investment in flexible generation resources which will reduce the need to take out-of-merit actions to maintain reliability; and reduce operating reserve costs with the goal of putting downward pressure on overall energy prices. The ASM will include Regulation,³ and Contingency Reserves⁴ - including both spinning and supplemental reserves.

³ Regulation Reserve is the unloaded and loaded frequency responsive resource capacity held in reserve for the purpose of managing interconnection frequency and balancing generation with demand plus net scheduled interchange within a specific balancing authority.

⁴ Contingency reserves consist of unloaded resource capacity that is set aside to offset abnormal supply deficiency event, such as the loss of a large generator or a transmission line. Contingency reserves include both spinning and supplemental reserves.

8. Duke Energy Kentucky is a member and market participant in MISO. As a market participant, Duke Energy Kentucky currently offers its generation (energy) into MISO for unit commitment and economic dispatch subject to certain local reliability constraints, and purchases economic energy to satisfy its load obligations. MISO acts as the clearing house for this process. Duke Energy Kentucky, as a MISO market participant, will be required to participate in the ASM upon its implementation. Duke Energy Kentucky may be required to provide or procure ancillary services at any given time based upon reliability needs in the MISO footprint. MISO will clear the reserves in the ASM in a manner similar to how it currently clears energy.

9. Duke Energy Kentucky will be compensated for providing the necessary ancillary services when called upon by MISO. For its participation in the ASM, Duke Energy Kentucky could incur additional costs such as fuel and possible incremental operations and maintenance (“O&M”) expenses. Duke Energy Kentucky proposes that to the extent the sum of the revenues from providing ancillary services for a month exceeds the cost of purchasing ancillary services for load for the same month, the net margin will be flowed through Rider PSM to the Company’s customers as an eligible profit. To the extent that the total costs of purchasing ASM services for load for a month equals or exceeds the revenues from providing the ancillary services for the same month, Duke Energy Kentucky will not flow this difference through the Rider PSM, but instead will absorb the loss and hold its customers harmless. All of the Company’s other rate adjustment riders will continue to operate in the current manner. For example, fuel expenses will flow through the current fuel adjustment clause (“FAC”), similar to how they currently do for all other off-system sales. In its next electric rate case, Duke Energy Kentucky will include in its test year, any incremental costs related to the ASM.

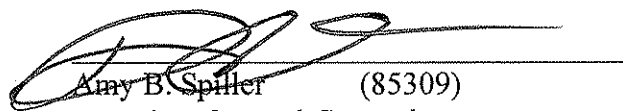
10. Duke Energy Kentucky anticipates that there will be a net benefit to its customers in that the ASM will allow for a more economic provision of ancillary services as well as reduce unnecessary movement in generation units that currently exists due to sudden load changes. Duke Energy Kentucky customers may also benefit from the ability to increase the amount of energy available from its lower cost units by no longer being required to hold back generation to meet its current ancillary service requirements. Customers will also share in the benefit from the ability to sell the ancillary services to the MISO when it is economic. To do this MISO will determine the most efficient unit(s) to hold reserves within the MISO balancing authority for all participants within the MISO footprint.

11. In order to account for these additional services, including the payments for the provision thereof, Duke Energy Kentucky proposes to modify its Rider PSM to include the ability to pass through payments from MISO for providing the ancillary services in the ASM, subject to the conditions described in paragraph 9. Although the MISO ASM was not in existence at the inception of the Rider PSM, the Company's proposed modification of the Rider PSM to include ASM net revenues as an eligible profit is consistent with its designed intent to share with customers the benefits of off-system sales of Duke Energy Kentucky's owned generation. The Company's proposal is merely a modification to expand the benefits flowed through to customers to include the compensation Duke Energy Kentucky receives for providing ancillary services in the newly created MISO ASM. The Company is not requesting any other modifications to the Rider in this Application. All existing provisions regarding the sharing of the off-system sales revenue and emission allowance sales will remain as approved in the Commission's Order. Customers will be held harmless if the costs of providing the ancillary services in the new ASM (exclusive of fuel) exceed revenues received.

WHEREFORE, Duke Energy Kentucky prays that the Commission issue an order at the earliest possible date granting authority to modify the Rider PSM to include as an eligible profit, net revenues from off-system sales related to the provision of ancillary services in the newly created MISO ASM, currently slated to commence on January 6, 2009.

Respectfully submitted,

Duke Energy Kentucky, Inc.



Amy B. Spiller (85309)

Associate General Counsel

Rocco O. D'Ascenzo (92792)

Senior Counsel

Duke Energy Business Services, Inc.

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VERIFICATION

STATE OF OHIO)
) SS:
COUNTY OF HAMILTON)

The undersigned, Paul G. Smith, being duly sworn, deposes and says that he is the Vice President Rates Ohio-Kentucky, that he has personal knowledge of the matters set forth in the foregoing, and that the information contained therein is true and correct to the best of his knowledge, information and belief.



Paul G. Smith, Affiant

Subscribed and sworn to before me by Paul G. Smith on this 25 day of Nov., 2008.



NOTARY PUBLIC

My Commission Expires:




ANITA M. SCHAFER
Notary Public, State of Ohio
My Commission Expires
November 4, 2009

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing filing was served on the following via overnight mail, postage prepaid, this 25th day of November, 2008:

Dennis G. Howard II
Assistant Attorney General
The Kentucky Office of the Attorney General
1024 Capital Center Drive
Frankfort, Kentucky 40602-2000



Rocco O. D'Ascenzo