COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF DUKE ENERGY KENTUCKY, INC. REGARDING THE ACQUISITION OF GENERATION STEP-UP TRANSFORMERS AND FOR A DECLARATION ORDER THAT IT IS AN ORDINARY EXTENSION IN THE USUAL COURSE OF BUSINESS	))))))	CASE NO. 2011-00452

ORDER

On November 17, 2011, Duke Energy Kentucky, Inc. ("Duke Kentucky") filed an application requesting a declaratory order that its proposed acquisition of five generation step-up transformers ("GSUs") constitutes an ordinary extension of Duke Kentucky's existing system in the ordinary course of business. In the alternative, Duke Kentucky requested the Commission grant a certificate of public convenience and necessity ("CPCN") for the proposed acquisition.

The GSUs are interconnected to Duke Kentucky's three generating stations at East Bend in Kentucky, Woodsdale in Ohio, and Miami Fort Unit 6 in Ohio. In early 2006, Duke Kentucky completed the purchase of these three generating stations from Duke Energy Ohio, Inc. ("Duke Ohio"). Although the actual generating facilities were transferred to Duke Kentucky, Duke Ohio retained ownership of all transmission facilities at those stations, including the GSUs. Currently, the GSUs are owned and operated by Duke Ohio on behalf of Duke Kentucky pursuant to the terms of a Facilities Operation Agreement. The GSUs are used solely to transform the power generated at the three generating stations to transmission-level voltage for ultimate delivery to Duke Kentucky's customers.

The East Bend station, co-owned by the Dayton Power and Light Company, consists of a single unit, coal-fired generator. East Bend is served by a single 700 MVA step-up transformer bank.

The Woodsdale station consists of six combustion turbine generators that operate using natural gas or propane. The Woodsdale station is served by three 240 MVA step-up transformer banks.

Miami Fort Unit 6 is a single unit, coal-fired generator. Duke Ohio currently owns and operates the other units at the station. Miami Fort Unit 6 is served by a single 180 MVA transformer bank.

BACKGROUND

Duke Kentucky proposes to acquire ownership of these five GSUs so that it can terminate the Facilities Operation Agreement and take over the operation, maintenance, and repair responsibilities for those facilities, which, according to Duke Kentucky, would be consistent with its obligation to provide its customers with safe, reliable, and economic utility service. Duke Kentucky maintains that the transfer is in its best interests and those of its customers, noting that the subject GSUs are used only to serve Duke Kentucky stations and that consolidating the ownership of the three generating stations and the GSUs within Duke Kentucky reduces administrative costs, and simplifies accounting for the facilities by eliminating the need for inter-company charges for the costs of ownership, operation, and maintenance of the GSUs under the Facilities Operation Agreement.

The proposed acquisition will also need to be approved by the Federal Energy Regulatory Commission ("FERC"). Duke Kentucky advises that it, along with Duke Ohio, has filed a joint application pursuant to Section 203 of the Federal Power Act seeking FERC approval of the proposed transfer.

Duke Kentucky contends that the proposed transaction should be considered an ordinary extension of existing systems in the usual course of business and, therefore, exempt from the CPCN requirement of KRS 278.020. In support of its contention, Duke Kentucky states that there is no actual construction or extension of a system involved in the proposed transaction. Duke Kentucky notes that it is only acquiring existing facilities that are already used and useful in serving its customers.

Because the GSUs are already in place and used to serve its customers, Duke Kentucky maintains that the proposed transfer would not be a wasteful duplication of plant, equipment, property, or facilities. Under the terms of the Facilities Operation Agreement, Duke Kentucky pays Duke Ohio a monthly fee of $161,148, or just under $2 million annually, for the step-up transformation service. Duke Kentucky already has the personnel and expertise in place to maintain and operate the GSUs. The proposed acquisition would consolidate the ownership of the three generating stations and the associated GSUs at each plant site under Duke Kentucky, which, as previously stated, would simplify ratemaking and accounting for the facilities by eliminating need for inter-company charges for the costs of ownership, operation, and maintenance of the GSUs under the Facilities Operation Agreement.

Duke Kentucky further asserts that the proposed acquisition would not materially affect its financial condition because the Woodsdale and Miami Fort Unit 6 GSUs would be transferred at the net book value as of the date of the closing and the East Bend GSU, which has reached the end of its useful life and will need to be replaced, would be transferred at its salvage value. As of September 30, 2011, the net book value of the Woodsdale GSU banks is $7,774,498 and the net book value of the Miami Fort Unit 6 GSU is $53,503. At the time of closing, the net book value of these GSUs will be lower than the September 30, 2011 value. The salvage value of the East Bend GSU is $270,000, based on an independent third-party evaluation. Duke Kentucky notes that the acquisition of the East Bend GSU at scrap value will allow it to utilize the equipment as an emergency spare step-up transformer going forward at a reasonable price. The cost to replace the East Bend GSU is approximately $6 million. Duke Kentucky informs the Commission that, pursuant to the terms of the Facilities Operation Agreement, it would be responsible for the replacement costs of the East Bend GSU notwithstanding the proposed transfer. Terminating the agreement would allow Duke Kentucky to be responsible for maintaining the new East Bend GSU going forward.

Lastly, Duke Kentucky states that the acquisition of the GSUs would not compete with or conflict with the existing certificates or services of any other jurisdictional utilities in the area. The GSUs are located on land owned by Duke Kentucky and in close proximity to the three generation stations.

DISCUSSION

KRS 278.020(1) requires a utility to obtain a CPCN prior to constructing any new facility that is intended to furnish regulated utility services to the public. However, this statute also provides an exemption from the certificate requirement if the new facility is an ordinary extension of existing systems in the usual course of business. 807 KAR 5:001, Section 9(3) defines that exemption as follows:

> Extensions in the ordinary course of business. No certificate of public convenience and necessity will be required for extensions that do not create wasteful duplication of plant, equipment, property or facilities, or conflict with the existing certificates or service of other utilities operating in the same area and under the jurisdiction of the commission that are in the general area in which the utility renders service or contiguous thereto, and that do not involve sufficient capital outlay to materially affect the existing financial condition of the utility involved, or will not result in increased charges to its customers.

Having reviewed the application and being otherwise sufficiently advised, the Commission finds that the proposed acquisition of the subject GSUs satisfies the criteria set forth in 807 KAR 5:001, Section 9(3) to be classified as an ordinary extension in the usual course of business. As Duke Kentucky has noted, the proposed acquisition does not involve any construction of new facilities. Rather, the proposed transfer is for the acquisition of existing facilities that are already in use for serving Duke Kentucky's customers and that are already being paid for by Duke Kentucky under the Facilities Operation Agreement. As of December 31, 2010, Duke Kentucky's net electric plant investment is approximately $593,628,113, and its annual electric operating revenues are $347,408,408. With a GSU investment requirement of $8.098 million, the cost of the proposed acquisition will not materially affect Duke Kentucky's financial condition. Likewise, given its relatively limited scope, combined with the cost savings resulting from the acquisition, the proposed transaction would not result in increased charges to Duke Kentucky's customers. In addition, the acquisition of the proposed GSUs will not conflict with the existing certificates or service of other utilities under the Commission's jurisdiction. Therefore, the proposed transfer will not create wasteful duplication of plant, equipment, property, or facilities.

IT IS THEREFORE ORDERED that the proposed transfer of the subject GSUs from Duke Ohio to Duke Kentucky is properly classified as an ordinary extension of existing systems in the usual course of business and a CPCN, pursuant to KRS 278.020(1), is not required for its acquisition.

By the Commission

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KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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