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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio for Approval of a Market Rate Offer to Conduct a Competitive Bidding Process for Standard Service Offer Electric Generation Supply, Accounting Modifications, and Tariffs for Generation Service.	))))))	Case No. 10-2586-EL-SSO

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INITIAL POST-HEARING BRIEF OF THE OHIO MANUFACTURERS' ASSOCIATION

I. INTRODUCTION

On November 15, 2010, Duke Energy-Ohio ("Duke") filed an application for approval of a market rate offer ("MRO") pursuant to Ohio Revised Code Section ("R.C.") 4928.142 (the "MRO Application") with the Public Utilities Commission of Ohio ("Commission"). The Ohio Manufacturers' Association ("OMA") filed a motion to intervene in this proceeding on December 7, 2010 to protect the interests of manufacturers in Duke's service territory in southern Ohio. Hearings were held, and evidence was taken, on the MRO Application from January 4, 2011 though January 19, 2011. Pursuant to the schedule established by the Attorney Examiners assigned to this matter, the OMA respectfully submits its initial post-hearing brief.

II. LEGAL ARGUMENT

Duke's proposed MRO fails to satisfy the requirements set forth in R.C. 4928.142 and Section 4901:1-35-03 of the Ohio Administrative Code ("OAC").

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A. Standard of Review.

R.C. 4928.142 and Ohio Administrative Code ("OAC") Rule 4901:1-35-03 set forth the requirements that an MRO application must satisfy prior to Commission approval. Included among these requirements are that an electric distribution utility provide:

- A five year blending period as part of its first MRO application;[1]
- "pro forma financial projections of the effect of the CPB plan's implementation, ... upon generation, transmission, and distribution of the electric utility, for the duration of the CBP plan,"[2]
- "projected generation, transmission, and distribution rate impacts by customer class and rate schedules for the duration of the CBP plan."[3]

Duke's MRO application fails to satisfy these requirements.

B. Duke's proposed blending period violates R.C. 4928.142(D), thereby rendering its MRO Application fatally deficient.

R.C. 4928.142(D) requires Duke to blend its standard service offer price (obtained through a competitive bid process) with its existing electric security plan ("ESP") price. More specifically, R.C. 4928.142(D) mandates that:

> The first application filed under this section by an electric distribution utility that, as of July 31, 2008, directly owns, in whole or in part, operating electric generating facilities that had been used and useful in this state shall require that a portion of that utility's standard service offer load for the first five years of the market rate offer be competitively bid under division (A) of this section as follows: ten per cent of the load in year one, not more than twenty per cent in year two, thirty per cent in year three, forty per cent in year four, and fifty per cent in year five.

No party in this proceeding contests the fact that this is Duke's first MRO application filed with the Commission. No party in this proceeding contests Duke's ownership of electric generating facilities

[1] R.C. 4928.142(D)

[2] OAC Rule 4901:1-35-03 (B)(2)(b)

[3] OAC Rule 4901:1-35-03(B)(2)(c)

as of July 31, 2008. Yet, Duke's MRO Application proposes a two-year blending period followed by a full and complete transition to 100% market prices in year 3 of its MRO. In essence, Duke proposes a two-year blending period that is in direct violation of R.C. 4928.142(D).

The General Assembly's unambiguous language in R.C. 4928.142(D) mandates, through the use of the word "shall," that "a portion of that utility's standard service offer for the first five years of the market rate offer be competitively bid under division (A) of this section as follows: ten per cent of the load in year one, not more than twenty per cent in year two, thirty per cent in year three, forty per cent in year four, and fifty per cent in year five." Duke's application, however, asks the Commission to follow the statutory requirements in years one and two, but to ignore the statutory percentages in years three through five.[4]

Duke's proposal also implicitly requests that the Commission abdicate its statutory obligation to "determine the actual percentages for each year of years one through five."[5] The Commission, however, cannot ignore the unambiguous language in R.C. 4928.142(D) requiring it to establish a five year blending period as part of Duke's first MRO filing.

For all of the above-stated reasons, Duke's MRO application fails to satisfy the statutory requirements in R.C. 4928.142(D), and should be denied.

C. Duke's request for alteration of the blending periods set forth in R.C. 4928.142(D) is premature and contrary to the unambiguous language in R.C. 4928.142(E).

R.C. 4928.142(E) provides the Commission with limited discretion to alter the blending percentages approved by the Commission. However, R.C. 4928.142(E) specifically states that

[4] See argument in Section III.C below explaining that the Commission only has the power to consider altering the blending percentages beginning in year 2 of the MRO.

[5] See R.C. 4928.142(D).

such discretion can only be exercised at some time in the future—namely after the beginning of year two of the MRO (or sometime in 2013 in this case).

R.C. 4928.142(E) establishes that:

> ***Beginning in the second year*** of a blended price under division (D) of this section and notwithstanding any other requirement of this section, the commission ***may*** alter ***prospectively*** the proportions specified in that division to mitigate any effect of an ***abrupt or significant change*** in the electric distribution utility's standard service offer price that would otherwise result in general or with respect to any rate group or rate schedule but for such alteration. (Emphasis added).

As emphasized above, the words "beginning in the second year," "may," and "abrupt or significant change" impose three important limitations on the Commission's discretion to alter any blending percentages approved in this case.

First, the phrase "beginning in the second year" specifically identifies the time in the future when the Commission may exercise its authority to alter the blending percentages established under R.C. 4928.142(D). Rather than stating that such alteration could occur as part of a utility's MRO proceeding, the General Assembly specifically identified the "second year" of the MRO as the proper time for the Commission to consider exercising its discretion to alter the blending percentages.[6] Thus, allowing the Commission to alter the statutorily-mandated blending percentages in R.C. 4928.142(D) as part of Duke's MRO proceeding would violate the unambiguous language in R.C. 4928.142(E).[7]

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[6] *Id.* (Staff witness Strom noted that any alteration to the blending period "needs to be determined at a later time").

[7] *Id.* at 1116 (Staff witness Strom testified that the Commission cannot alter the blending percentages today as part of this proceeding, explaining "[t]oday is not the time to alter it. The alteration is supposed to happen at some later time no earlier than year 2"). The Commission Staff agrees with this reasonable interpretation of the statute. See Tr. Vol. V at 1104 (Staff witness Strom testified that any alteration, including a shortening of the blending period "should happen in the context of no earlier than year 2, meaning at a time when they [Duke] are in the second year of the MRO").

Second, the Ohio Supreme Court long ago explained that "the statutory use of the word 'may' is generally construed to make the provision in which it is contained optional, permissive, or discretionary, at least where there is nothing in the language or in the sense or policy of the provision to require an unusual interpretation." *Dorrian v. Scioto Conservancy Dist.* (1971), 27 Ohio St.2d 102, paragraph 1 of syllabus and 107 (citations omitted). There is no language in the statute, or policy underlying the statute that requires an unusual interpretation of the word "may." Allowing the Commission to alter the blending percentages at the current time would force the Commission into the untenable position of trying to determine right now what the generation rates might be for time periods several years into the future to ensure there is not an abrupt or significant change harmful to customers. It is clear that the Commission's discretion to alter the blending percentages is optional—and cannot take place until some time in the future, if at all.

Finally, the ability of the Commission to exercise its discretionary authority is limited by a condition precedent—namely a finding of an "abrupt or significant change in the electric distribution utility's standard service offer price that would otherwise result in general or with respect to any rate group or rate schedule but for such alteration." As the Commission's authority to alter the blending period only exists in year two of the MRO (or sometime in 2013 in this case), it follows that a Commission inquiry regarding an abrupt or significant change in the standard service offer price should occur as closely as possible to the proposed alteration. As electricity markets are volatile and dynamic by nature, a finding by the Commission of an abrupt and significant change as part of this MRO proceeding would be imprudent, untimely, and contrary to R.C. 4928.142(E).

For the above-stated reasons, Duke's MRO Application violates the unambiguous language in R.C. 4928.142(E), and should be denied.

D. Duke's failure to identify the effect of its competitive bid plan on transmission rates as a result of the costs associated with Duke's migration to PJM violates OAC Rules 4901:1-35-03(B)(2)(b) and 4901:1-35-03(B)(2)(c), thereby rendering its MRO Application fatally deficient.

OAC Rule 4901:1-35-03 (B)(2)(b) requires an MRO application to include "pro forma financial projections of the effect of the CPB plan's implementation, ... upon generation, transmission, and distribution of the electric utility, for the duration of the CBP plan." Additionally, OAC Rule 4901:1-35-03(B)(2)(c) requires "projected generation, transmission, and distribution rate impacts by customer class and rate schedules for the duration of the CBP plan." The record now before the Commission is devoid of any explanation by Duke as to how the cost of its realignment from MISO to PJM will figure into transmission rates. No such information is contained in either the Application or the record of this case, and the consequences of Duke's proposed integration into PJM cannot be fully known at this time. In fact, Duke witness Wathen does not even know the costs associated with the move to PJM, including the amounts of the MISO exit fee and MTEP charges.[8] Instead, Duke simply proposes Rider BTR as a non-bypassable rider to recover certain transmission costs, including the MTEP costs, RTEPP costs, MISO exit fees, and PJM integration fees associated with Duke's migration from MISO to PJM.

As a result of Duke's failure to provide the necessary information regarding its transmission rates, the Commission is left in the difficult position of having to approve a CBP when the potentially significant upward push on rates (in particular transmission rates) remains a possibility. Already, Duke is on record indicating that Duke "is exercising its rights ... to recover all costs billed to the Company under FERC-approved tariffs"[9]—namely the MTEP costs, RTEPP costs, MISO exit fees, and PJM integration fees associated with Duke's migration from

[8] Tr. Vol. III at 674.

[9] Direct Testimony of William Don Wathen Jr. filed on November 15, 2010 ("Duke Exhibit 16") at 25.

MISO to PJM. Such costs are expected to be in the tens if not hundreds of millions of dollars and will dramatically alter the rates that Duke's Ohio retail customers will pay for decades.

Perhaps more notable is the fact that Duke's affiliate in Kentucky—an affiliate for whom Don Wathen also serves as General Manager and Vice President of Rates—recently chose not to recover these same transmission costs (MTEP, RTEP, MISO exit fees and PJM integration costs) from Duke's retail customers in Kentucky. In fact, the Kentucky Public Service Commission ("PSC") explained that Duke Kentucky made the following commitments as part of its application for the Kentucky PSC's approval of its move to PJM:

- "Duke Kentucky will not seek to recover in base rates or in any adjustment mechanism any exit fee imposed by the Midwest ISO in conjunction with the move to PJM," including a commitment not to seek a deferred recovery of the MISO exit fee;"[10]

- "Duke Kentucky will not seek to double-recover in a future rate case the transmission expansion fees that it may be charged by both the Midwest ISO and PJM in the same period or overlapping periods;"[11] and

- "Duke Kentucky will hold its customers harmless from the costs of integration into PJM."[12]

The Kentucky PSC not only accepted these commitments, but specifically required that:

- "Duke Kentucky should not seek to recover, in base rates or in any type of rate mechanism, an exit fee or any other type of fee imposed by the Midwest ISO in conjunction with Duke Kentucky's move from the Midwest ISO to PJM, regardless of how that fee is identified or labeled, and regardless of whether or not such fee is approved by FERC;"[13]

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[10] *In the Matter of 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* (December 22, 2010 Order), Kentucky PSC Case No. 2010-00203 at 17. A copy of the December 22, 2010 Order is attached hereto as Exhibit A.

[11] *Id.* at 6.

[12] *Id.*

[13] *Id.* at 5.

- "Duke Kentucky should not seek to double-recover in a future rate case the transmission expansion fees that it may be charged by the Midwest ISO and PJM in the same period or overlapping periods, nor should it seek to defer and/or amortize any transmission expansion fees its incurs for Midwest ISO transmission expansion projects which received approval when it was a member of the Midwest ISO, regardless of whether or not such fees are approved by FERC;"[14] and

- "Duke Kentucky should not seek to recover, in base rates or in any type of rate mechanism, its costs of integration into PJM, nor should it seek to defer and/or amortize any PJM integration costs it incurs in conjunction with its alignment with PJM, regardless of whether or not such fees are approved by FERC;[15]

Duke Kentucky accepted each of these conditions by letter dated December 29, 2010.[16] This Commission must similarly protect Ohio customers.

For the above-stated reasons, this Commission should prohibit Duke from recovering any costs associated with its move from MISO to PJM, including but not limited to MTEP costs, RTEPP costs, MISO exist fees, and PJM integration fees, as part of this proceeding or any other proceeding. Alternatively, the Commission should specifically state that it is not approving cost recovery and will address the cost recovery issue as part of a separate proceeding.[17]

III. CONCLUSION

For the reasons stated herein, Duke's MRO Application fails to comply with Ohio law. Accordingly, OMA respectfully requests that the Commission deny the MRO Application.

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[14] *Id.* at 17-18.

[15] *Id.* at 18.

[16] *In the Matter of 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* (January 6, 2011 Order), Kentucky PSC Case No. 2010-00203 at 2. A copy of the January 6, 2011 Order is attached hereto as Exhibit B.

[17] See Direct Testimony of Tamara S. Turkenton filed on December 28, 2010 (Staff Ex. 1), at 15 (testifying: "Staff points out that MISO exit fees, PJM entrance fees, and RTEP expansion planning costs and other similar type costs are the subject of open proceedings at FERC and the Commission, Since these types of costs have not yet been approved by FERC or the Commission for Duke, Staff recommends that deciding the appropriateness of what specific rider MISO exit fees, PJM entrance fees, and RTEP expansion planning fees are recovered are at best premature. Those decisions should be the subject of another proceeding and not part of this MRO proceeding.").

Respectfully submitted on behalf of
OHIO MANUFACTURERS' ASSOCIATION

Matthew W. Warnock
BRICKER & ECKLER LLP
100 South Third Street
Columbus, OH 43215-4291
Telephone: (614) 227-2300
Facsimile: (614) 227-2390
E-mail: mwarnock@bricker.com

Kevin Schmidt
The Ohio Manufacturers' Association
33 N. High Street, Suite 600
Columbus, OH 43215
Telephone: 614-629-6816
E-mail: kschmidt@ohiomfg.com
Counsel for the Ohio Manufacturers' Association

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing was served upon the parties of record listed below this 27th day of January 2011 *via* electronic mail.

Matthew W. Warnock

Amy B. Spiller
Associate General Counsel
Elizabeth H. Watts
Assistant General Counsel
Rocco O. D'Ascenzo
Senior Counsel
Duke Energy Business Services
139 East Fourth Street, 1313-Main
Cincinnati, OH 45202

John W. Bentine
Mark Yurick
Matthew S. White
Chester, Wilcox & Saxbe, LLP
65 East State Street, Suite 1000
Columbus, Ohio 43215-4213
jbentine@cwslaw.com
myurick@cwslaw.com
mwhite@cwslaw.com

David F. Boehm
Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202
dboehm@bkllawfirm.com
mkurtz@bkllawfirm.com

Michael D. Dortch
Kravitz, Brown & Dortch, LLC
65 East State Street, Suite 200
Columbus, OH 43215
mdortch@kravitzllc.com

Ann M. Hotz
Kyle L. Verrett
Jody M. Kyler
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
hotz@occ.state.oh.us
verret@occ.state.oh.us
kyler@occ.state.oh.us

William T. Reisinger
Nolan Moser
Trent A. Dougherty
Ohio Environmental Council
1207 Grandview Avenue, Suite 201
Columbus, Ohio 43212-3449
will@theoec.org
nolan@theoec.org
trent@.theoec.org

Samuel Randazzo
Joseph Oilker
McNees Wallace & Nurick LLC
21 East State Street, 17th Floor
Columbus, OH 43215
sam@mwncmh.com
joliker@mwncmh.com

Mark A. Hayden
FirstEnergy Service Company
76 South Main Street
Akron, OH 44308
haydenm@firstenergycorp.com

4353476v3

David A. Kutik
Jones Day
North Point
901 Lakeside Avenue
Cleveland, OH 44114
dakutik@jonesday.com

M. Howard Petricoff
Stephen M. Howard
Vorys, Sater, Seymour, and Pease LLP
52 East Gay Street
PO Box 1008
Columbus, OH o 43216-1008
mhpetricoff@vorys.com
smhoward@vorys.com

Grant W. Garber
Jones Day
325 John H. McConnell Blvd., Suite 600
Columbus, OH 43215-2673
gwgarber@jonesday.com

Mary Christensen
Counsel for People Working Cooperatively, Inc.
8760 Orion Place, Suite 300
Columbus OH 43240
mchristensen@columbuslaw.org

Barth E, Royer
Bell & Royer Co., LPA
33 South Grant Avenue
Columbus, Ohio 43215
barthrover@aol.com

Gary A. Jeffries
Senior Cotmsel
Dominion Resources Services, Inc.
501 Martindale Street, Suite 400
Pittsburgh, PA 15212
Gary.A.Jeffries@dom.com

Thomas J. O'Brien
Bricker & Eckler LLP
100 South Third Street
Columbus, Ohio 43215
tobrien@bricker.com

Douglas E. Hart
Attorney for The Greater Cincinnati Health Council
441 Vine Street, Suite 4192
Cincinnati, OH 45202
dhart@douglasehart.com

David C. Rinebolt
Colleen L. Mooney
Ohio Partners for Affordable Energy
231 West Lima Street
P.O. Box 1793
Findlay, OH 45839-1793
drinebolt@ohiopartners.org
cmooney2@columbus.rr.com

Cynthia Fonner Brady
Senior Counsel
Constellation Energy Resources LLC
550 W. Washington St., Suite 300
Chicago, IL 60661
Cynthia.brady@constellation.com

Steven Beeler
John Jones
Assistant Attorneys General
Public Utilities Commission of Ohio
180 East Broad Street
Columbus, Ohio 43215
Steven,beeler@puc.state.oh.us
John.jones@puc.state.oh.us

Richard Chamberlain
Behrens, Wheeler & Chamberlain
6 N.E. 63rd Street, Suite 400
Oklahoma City, OK 73105
rdc_law@swbell.net

Kevin J. Osterkamp
Roetzel & Anderss, LPA
155 E. Broad Street, 12th Floor
Columbus, OH 43215
kosterkamp@ralaw.com

Anne M. Vogel, Attorney for
AEP Retail Energy Partners LLC
1 Riverside Plaza, 29th Floor
Columbus, OH 43215
amvogel@aep.com

Matthew J. Satterwhite
American Electric Power Service
Corporation
1 Riverside Plaza, 29th Floor
Columbus, OH 43215
mjsatterwhite@aep.com

Terrence O'Donnell
Christopher Montgomery
Bricker & Eckler LLP
100 South Third Street
Columbus, Ohio 43215
tobrien@bricker.com

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

On May 20, 2010, Duke Energy Kentucky, Inc. ("Duke Kentucky") filed an application for authority to transfer functional control of its transmission facilities from the Midwest Independent System Transmission Operator ("Midwest ISO") to the PJM Interconnection Regional Transmission Organization ("PJM"). The Midwest ISO and PJM, both of which are Regional Transmission Organizations ("RTOs"), requested and were granted full intervention in this case.

By Order dated June 24, 2010, a procedural schedule was established for this case which included: (1) the filing of testimony by Duke Kentucky in support of its application; (2) two rounds of discovery on Duke Kentucky; (3) an opportunity for intervenors to file testimony; (4) one round of discovery on intervenors; (5) a formal hearing; and (6) the filing of post-hearing briefs. Neither the Midwest ISO nor PJM filed intervenor testimony. A public hearing was held on November 3, 2010 and all parties filed post-hearing briefs. The matter now stands submitted for decision.

EXHIBIT

A

STANDARD OF REVIEW

Duke Kentucky's request falls within the Commission's jurisdiction under KRS 278.218, which governs a change in ownership or control of assets of an electric utility where those assets have an original book value of $1,000,000 or more. That statute provides, in part, that "[t]he commission shall grant its approval if the transaction is for a proper purpose and is consistent with the public interest."[1] While the statute does not define "public interest," the Commission has, in the context of a transfer of a utility, interpreted the "public interest" as follows:

> [A]ny party seeking approval of a transfer of control must show that the proposed transfer will not adversely affect the existing level of utility service or rates or that any potentially adverse effects can be avoided through the Commission's imposition of reasonable conditions on the acquiring party. The acquiring party should also demonstrate that the proposed transfer is likely to benefit the public through improved service quality, enhanced service reliability, the availability of additional services, lower rates or a reduction in utility expenses to provide present services. Such benefits, however, need not be immediate or readily quantifiable.[2]

While the application in this case involves the transfer of functional control of utility assets, rather than a transfer of ownership of a utility, the same criteria applies in determining whether the proposed transfer satisfies the "public interest" standard.[3]

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[1] KRS 278.218(2).

[2] Case No. 2002-00018, Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GmbH, at 7 (Ky. PSC May 30, 2002).

[3] Case No. 2002-00475, Application of Kentucky Power Company d/b/a American Electric Power, for Approval, to the Extent Necessary, to Transfer Functional Control of Transmission Facilities Located in Kentucky to PJM Interconnection, L.L.C. Pursuant to KRS 278.218 (Ky. PSC Aug. 25, 2003).

Duke Kentucky's Application

Duke Kentucky's proposed move from the Midwest ISO to PJM is directly tied to the move of its parent, Duke Energy Ohio, Inc. ("Duke Ohio"), from the Midwest ISO to PJM. Nearly all of the transmission facilities used to serve Duke Kentucky's customers are owned by Duke Ohio. The only transmission assets owned by Duke Kentucky are 18 138 kV high-side connections, including breakers and switches, to the Duke Ohio transmission system. Duke Kentucky states that, since it is not interconnected to any other utility in the Midwest ISO, realignment with PJM will keep outage coordination and related functions of these 18 connections under the functional control of a single transmission operator. That operator, PJM, will also control the Duke Ohio transmission system to which Duke Kentucky's facilities are connected.

With its interconnectivity to the Duke Ohio system and its effective status as a transmission dependent utility, Duke Kentucky states that it is in the public interest for it to make the same move, from the Midwest ISO to PJM, as Duke Ohio. That move will permit Duke Kentucky to participate fully in PJM markets and avoid potential inefficiencies, operational complexities, and additional costs that would result from creating a Midwest ISO/PJM seam that would affect Duke Kentucky's generation as well as its load.[4]

Prior to transferring its transmission assets to PJM, Duke Kentucky is required to obtain the approval of this Commission, as well as that of the Federal Energy Regulatory Commission ("FERC"). Duke Kentucky filed a joint application with Duke

[4] Duke Kentucky's application, at 15.

Ohio for FERC approval of their realignment with PJM, and FERC has granted that approval.[5]

Duke Kentucky's application cites various benefits to Duke Ohio of the proposed realignment, including lower RTO administration fees, a portion of which are allocated to Duke Kentucky, and aligning co-owners of Duke Ohio's jointly owned generating units into a single RTO for future investment planning and improved efficiencies in Ohio's competitive wholesale and retail power supply markets. Duke Kentucky's application points out that, even if it does not move from the Midwest ISO to PJM, once Duke Ohio moves to PJM, all of Duke Kentucky's generation, which is located in Ohio and Kentucky, will be in PJM, since it is dependent on the Duke Ohio transmission system. Unless Duke Kentucky also moves to PJM, the Duke Kentucky generation will be in PJM but the load will be in the Midwest ISO, creating potential inefficiencies and additional, unnecessary costs.[6]

Duke Kentucky states that PJM's capacity market should facilitate off-system sales and that the three-year forward-looking nature of the PJM market should provide a greater degree of certainty with regard to future capacity prices. Duke Kentucky also states that its ability to engage in off-system sales will likely be enhanced in the PJM market and that this will benefit both Duke Kentucky and its customers because of its off-system sales profit-sharing mechanism, Rider PSM, which was implemented in

[5] FERC Docket Nos. ER10-1562-000 and ER10-2254-000, Order dated October 21, 2010.

[6] Duke Kentucky referred to this arrangement as one requiring it to pseudo-tie its load to PJM through the Midwest ISO and pseudo-tie its generation from PJM to the Midwest ISO.

conjunction with the acquisition of Duke Kentucky's existing generating facilities from Duke Ohio.

Duke Kentucky performed a financial analysis to determine the level of benefits that would likely result from joining PJM rather than remaining in the Midwest ISO. That analysis reflected the sale of both capacity and energy in the Midwest ISO market compared to the PJM market. The study included the estimated costs of RTO realignment, the level of capacity reserve requirements in each RTO, and the level of excess capacity and energy that would be available to sell into each market. The Duke Kentucky analysis showed that membership in PJM would be more financially beneficial to ratepayers than remaining in the Midwest ISO.[7]

In addition to the benefits of avoiding inefficiencies related to creating a Midwest ISO/PJM seam and the likely enhancement of off-system sales, Duke Kentucky offers the following commitments as part of its effort to demonstrate that its proposed move from the Midwest ISO to PJM is in the public interest:

1. Duke Kentucky will not seek to recover in base rates or in any adjustment mechanism any exit fee imposed by the Midwest ISO in conjunction with the move to PJM.[8]

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[7] Duke Kentucky requested and was granted confidential protection for its financial analysis, and copies were made available to intervenors on a confidential basis.

[8] Duke Kentucky clarified and expanded on this commitment at the November 3, 2010 hearing by also committing not to seek a deferral of the Midwest ISO exit fee.

2. Duke Kentucky will not seek to double-recover in a future rate case the transmission expansion fees that it may be charged by both the Midwest ISO and PJM in the same period or overlapping periods.

3. Duke Kentucky will hold its customers harmless from the costs of integration into PJM.

Based on these commitments, the previously discussed enhancements in off-system sales if it joins PJM, and the avoidance of costs and operational complexities that will be experienced if it is not in the same RTO as Duke Ohio, Duke Kentucky states that the transfer of control of its transmission facilities from the Midwest ISO to PJM will be in accordance with the law, for a proper purpose, and in the public interest.

PJM's Position

PJM did not file testimony or issue any information requests, but it did file a post-hearing brief. In its brief, PJM focuses on a number of issues that were raised at the November 3, 2010 hearing.

The first of those issues is PJM's methodology for allocating among its members the costs of new transmission projects included in the PJM Regional Transmission Expansion Plan. For new transmission projects in PJM that will operate at 500 kV or above, known as "Regional Facilities," costs are allocated to all loads on an annual load-ratio share basis. For new transmission projects that will operate at below 500 kV, costs are allocated on a "beneficiary pays" basis, as determined by a computer model that analyzes the transmission constraint that necessitates the new facility. PJM allocates the cost of the Regional Facilities, including any lower-voltage facilities needed to support the Regional Facilities, on an annual basis. Consequently, new members in

PJM are required to pay their load-ratio share of the Regional Facilities approved prior to their membership.

The next issue discussed by PJM is its capacity market and the ability of generation-owning members of PJM to bid all of their capacity into the Reliability Pricing Model ("RPM") auctions and then buy back at market prices sufficient capacity to meet the needs of their load. Alternatively, generation owners can select a Fixed Resource Requirement ("FRR") whereby they reserve sufficient capacity to serve their load, with the ability to bid any excess into the RPM market, subject to certain limits. PJM also explained that, under either RPM or FRR, Duke Kentucky will be required to maintain a capacity reserve margin that is set by PJM. However, that margin will be lower than what would be needed on a stand-alone basis due to the load diversity of Duke Kentucky's non-coincident peak and the PJM coincident peak.

PJM also discussed the types of transmission services it offers and the impact of those services on Duke Kentucky's ability to sell capacity into the PJM market. Currently, as a non-member of PJM, Duke Kentucky is unable to sell capacity into PJM because it must rely on point-to-point transmission service and there is not sufficient transmission capacity available to make such sales. However, if Duke Kentucky becomes a member of PJM, its generation will be designated as network resources, and it will then be eligible for network transmission service which would allow for the sale of capacity into the PJM market.

Finally, PJM addressed its rules for retail customers participating in PJM's demand-response programs. PJM allows retail customers to participate in such programs either directly or through Curtailment Service Providers. However, if the utility sells less than 4 million MWh annually, which Duke Kentucky does, the prior approval of the relevant electric retail regulatory authority must be obtained for demand response to be offered into PJM. For those utilities that sell in excess of 4 million MWh annually, the relevant electric retail regulatory authority has the ability to prohibit retail customers from participating in demand response; but, absent such a prohibition, PJM will allow participation.

MISO's Position

The Midwest ISO also did not file testimony, but it did issue two information requests to Duke Kentucky and it responded to an information request from Duke Kentucky. In its post-hearing brief, the Midwest ISO states that it recognizes that RTO membership is voluntary, and it fully supports its members' rights to elect to withdraw. The Midwest ISO characterizes the issue here as not being Duke Kentucky's contractual right to realign, but Duke Kentucky's failure to satisfy either the proper purpose or the public interest criteria set forth in KRS 278.218. Based on a claim of insufficient evidentiary support for the realignment, the Midwest ISO opposes Duke Kentucky's move to PJM and recommends that the transfer be denied.[9]

[9] The Midwest ISO's post-hearing opposition to Duke Kentucky's transfer seems to be in contrast to both its request to intervene "to either clarify Duke's responses or respond to issues more directly," Midwest ISO Motion to Intervene at 3, and its testimony in a prior case that, upon a utility's request to exit, the Midwest ISO "would not be in a position to protest, other than to provide what we could provide in terms of facts to the Commission for their consideration." Case No. 2010-00043, Application of Big Rivers Electric Corporation for Approval to Transfer Functional Control if Its Transmission System to Midwest Independent Transmission System Operator, Inc., September 15, 2010 Hearing, video transcript, 16:33-16:35. See also Duke Kentucky's post-hearing brief at 3-4.

The Midwest ISO claims that Duke Kentucky has failed to demonstrate that there will not be adverse effects on service or rates resulting from its proposed move from the Midwest ISO to PJM. It also claims that Duke Ohio is the focus and intended beneficiary of the realignment with PJM, and that Duke Kentucky's decision to realign was not made independently, but was pre-ordained by its transmission dependence on Duke Ohio and by Duke Ohio's decision to exit the Midwest ISO and join PJM.

According to the Midwest ISO, Duke Kentucky has provided little information in support of its decision to realign with PJM other than the financial interests associated with Duke Ohio selling generation into the PJM capacity market. It argues that Duke Kentucky has not adequately supported claims of operational complexities, potential inefficiencies, and additional costs to pseudo-tie its generation to the Midwest ISO as a means of remaining a member while Duke Ohio moves to PJM. It also contends that Duke Kentucky's criticism of pseudo-tying arrangements is inconsistent with the existing operation of Duke Ohio and Duke Kentucky generation physically located in PJM.

The Midwest ISO also asserts that Duke Kentucky's failure to meet the statutory criteria for approval of the proposed transfer creates a number of alternatives for the Commission, including: (1) denying the application now; (2) deferring a decision until Duke Kentucky files supplemental information to support its application; (3) approving the application now but delaying the actual transfer date until January 1, 2014; or (4) approving the application now but prohibiting the imposition of any realignment costs or risks on ratepayers, while providing that any benefits of the realignment be shared with ratepayers.

The Midwest ISO's brief also raises a number of other issues that were not fully developed in the record, including the impact of Duke Kentucky's exit on the potential membership of another utility, East Kentucky Power Cooperative, Inc. ("East Kentucky Power"), the negotiation of a transmission path through PJM in lieu of membership in PJM, and whether PJM may ultimately acquire control of Duke Kentucky's generating facilities.

ANALYSIS AND FINDINGS

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that Duke Kentucky has provided the minimum level of evidence, consisting of testimony and financial analysis, to support its decision to move from the Midwest ISO to PJM. While a more comprehensive and detailed analysis by Duke Kentucky might have obviated the need to impose additional commitments on the transfer, we are not persuaded by the Midwest ISO's arguments that the move to PJM should be denied.

It is clear that Duke Kentucky's decision to align with PJM was made as a direct result of Duke Ohio's alignment with PJM. However, standing alone, that fact does not nullify Duke Kentucky's decision, since that decision is supported by sufficient evidence. Had Duke Kentucky not been so dependent on the Duke Ohio transmission facilities for serving the Kentucky load, a more in-depth analysis of the costs and benefits of the transfer would have been expected.

We recognize that Duke Kentucky could potentially remain in the Midwest ISO, even though Duke Ohio moves to PJM. Other utilities have developed pseudo-tie arrangements for individual generating plants when the generation is not in the same

RTO as the load. For example, the East Bend generating plant, which is jointly owned by Duke Kentucky and Dayton Power and Light, is now entirely in the Midwest ISO because Duke Ohio's transmission is in that RTO. But, since Dayton Power and Light is a member of PJM, the portion of East Bend owned by Dayton Power and Light is pseudo-tied to PJM. Although Duke Kentucky did not develop specific estimates of the costs associated with pseudo-tying all of its generation to the Midwest ISO, while the transmission serving its load is in PJM, it is clear that avoiding the need for such arrangements will eliminate the incremental costs and administrative complexities associated with such pseudo-tie arrangements.

There is no dispute that Duke Kentucky's interest in realigning with PJM is directly related to the realignment of its parent, Duke Ohio. Given Duke Kentucky's transmission dependence on Duke Ohio, this interest is understandable and appropriate. However, even though the Commission recognizes Duke Kentucky's interest in joining PJM, we must closely examine this move to insure that there is no adverse impact on rates or service and that Duke Kentucky's customers are likely to realize benefits as a result of the RTO realignment. Based on our review of the nature and extent of the commitments offered by Duke Kentucky in its application and testimony, we find it reasonable and necessary to clarify, refine, and expand those commitments as set forth below.

Midwest ISO Exit Fee

Although there was some discussion and clarification at the November 3, 2010 hearing of the projected fees that Duke Kentucky will incur upon exiting the Midwest ISO, there continues to be some uncertainty regarding the exact nature and calculation of the fees to be imposed by the Midwest ISO. Accordingly, the Commission will require Duke Kentucky to commit that it will not seek to recover, in base rates or through any type of rate mechanism, an exit fee or any other type of fee imposed by the Midwest ISO as a result of Duke Kentucky's move to PJM, regardless of how that fee is identified or labeled, and regardless of whether or not the recovery of such fee is approved by FERC.

Transmission Expansion Fees

Duke Kentucky has indicated that it will not seek to double-recover in a future rate case the transmission plan expansion fees that it may be charged by the Midwest ISO and PJM in the same period or overlapping periods. However, Duke Kentucky has also indicated that it does not know the amounts of such future fees, nor does it know in what increments or the time period over which it may be charged fees for the Midwest ISO transmission expansion projects approved during the time it was a member of that RTO. In addition, Duke Kentucky is unsure if its final payment for the Midwest ISO expansion plan projects will be made in one lump sum or over a period of years.

In recognition that the primary factor for Duke Kentucky's move to PJM was Duke Ohio's business decision to make that same move, the Commission finds that Kentucky ratepayers should not be at risk for the payment of any Midwest ISO transmission expansion plan costs that exceed those of PJM. Consequently, we will require Duke Kentucky to commit that it will not seek to double-recover in a future rate case the annual, recurring transmission expansion fees that it may be charged by the Midwest ISO and by PJM in the same period or in overlapping periods, nor will it seek rate recovery, or the deferral and amortization of, the transmission expansion plan fees imposed by the Midwest ISO as a result of the exit for projects approved during the time it was a member of the Midwest ISO, regardless of whether or not the recovery of any such fees is approved by FERC.

Integration Costs

Duke Kentucky has stated that it will hold its customers harmless from the costs of integration into PJM. In cases involving any number of parties, the Commission has been exposed to different interpretations of the term "hold harmless," both in relation to unilateral commitments and to multilateral stipulations, such as settlement agreements. For that reason, the Commission will require Duke Kentucky to commit that it will not seek to recover, in base rates or in any type of rate mechanism, any costs of integration into PJM, nor will it seek to defer and amortize any PJM integration costs it incurs in conjunction with its alignment with PJM, regardless of whether or not such costs are approved by FERC.

PJM Capacity Obligation

Duke Kentucky stated at the November 3, 2010 hearing that no decision had yet been made as to whether it would initially bid its generating capacity into PJM's RPM market or whether it would choose the FRR alternative. Although Duke Kentucky testified that it would likely make a decision on this issue by the end of the year, it was unable to state with certainty who would make that decision, and the record does not disclose the specific criteria that will be used by the decision maker. [10]

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[10] November 3, 2010 Hearing, video transcript, 14:55, 15:30-31.

Prior to Duke Kentucky's acquisition of generating capacity in 2006,[11] the Commission had noted its concern that Duke Kentucky's historic practice of purchasing power under a contract with Duke Ohio could potentially result in Kentucky customers being exposed to the volatility of market-priced power. Now, Duke Kentucky is considering the option of bidding its capacity into PJM's RPM market, and then purchasing capacity from that market sufficient for its load and its reserve obligations. However, Duke Kentucky has not filed a comprehensive analysis comparing the costs and benefits of RPM versus FRR, and the evidence before us in this case is insufficient to show that choosing the RPM option will insulate Kentucky customers from volatility in the PJM market. 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.

Benefits of PJM Membership

The commitments addressed above relate to maintaining the status quo in that they are intended to insure that Duke Kentucky's transfer of functional control of its transmission assets will not adversely affect its customers. However, the Commission's established interpretation of the "public interest" also requires a demonstration that the

[11] Case No. 2003-00252, Application of The Union Light, Heat and Power Company for a Certificate of Public Convenience and Necessity to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchase Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6), Order issued December 5, 2003.

proposed transfer is likely to provide benefits through improved service or reliability, additional services, lower rates, or reduced costs of providing service.

Duke Kentucky has stated that its ability to sell excess power into the PJM market should have a positive impact on its ability to engage in off-system sales and that this will benefit its customers because of its off-system sales profit-sharing mechanism, Rider PSM. While this is a potential benefit, there are potential risks to participating in the PJM market that could diminish or eliminate any benefit. For example, Duke Kentucky's 2008 integrated resource plan shows its generating capacity to be sufficient to meet its peak demand and maintain a 15 percent capacity reserve margin through 2019. However, expanded environmental regulations or climate change legislation could lead to a decrease in its available coal-fired generation, which would have a direct impact on its future levels of off-system energy and capacity sales. With these uncertainties in mind, the Commission will condition its approval of Duke Kentucky's request to join PJM upon Duke Kentucky's commitment to file a revised Rider PSM, to be effective January 1, 2012, that continues to allocate the first $1 million in annual profits to ratepayers, but shares the profits in excess of $1 million annually in the ratio of 75 percent to ratepayers and 25 percent to shareholders, rather than the current ratio of 50:50.

Duke Kentucky also states that one benefit available through membership in PJM is the ability of retail customers to directly participate in PJM's demand-response programs. As outlined by Duke Kentucky, the PJM process for participation by retail customers requires the utility to first evaluate whether the relevant electric retail regulatory authority permits direct participation by retail customers. Duke Kentucky states that its tariffs do not currently allow such direct participation by its customers and that it does not currently plan to participate in PJM's demand-response programs. Duke Kentucky states that, prior to any future decision on customer participation, it will first seek Commission approval.

To ensure clarity for all parties concerning the need for the Commission's prior approval, we will condition the approval of membership in PJM upon Duke Kentucky's commitment that no retail customer will be allowed to participate directly or through a third party in a PJM demand-response program until either: (1) the customer has entered into a special contract with Duke Kentucky and that contract has been filed with, and approved by, the Commission; or (2) Duke Kentucky receives Commission approval of a tariff authorizing such customer participation. In addition, we will require PJM to file a written acknowledgment of this requirement and require PJM to publicize this requirement according to its demand-response program rules.

Other Midwest ISO Issues

The Midwest ISO's brief raises three issues that were not fully developed in discovery and not addressed at the hearing. As to the issue of how Duke Kentucky's move to PJM might impact a future decision by East Kentucky Power to join the Midwest ISO, we note that this case has been here for almost seven months and East Kentucky Power did not request to intervene or otherwise seek to participate. As to Duke Kentucky's ability to negotiate a transmission path through PJM rather than joining PJM, the feasibility of that option was not fully developed. However, we note that nothing prohibits a utility from proposing an asset transfer merely because some of the proposed benefits might be achieved without a transfer. Finally, as to PJM acquiring control of Duke Kentucky's generating assets, the pending application does not request that authority. Until such time as Duke Kentucky expressly requests and is granted our authority to transfer control of its generation, that generation remains under Duke Kentucky's control, where it is subject to our authority and jurisdiction. For all of these reasons, the Commission finds the Midwest ISO's newly raised issues are unpersuasive.

FINDINGS AND SUMMARY OF DECISION

Based on the evidence of record and being otherwise advised, the Commission finds that:

1. Duke Kentucky's request to transfer functional control of its transmission assets from the Midwest ISO to PJM is for a proper purpose and in the public interest and should be approved subject to Duke Kentucky's acceptance of the six conditions specified below and PJM's acceptance of the one condition specified below related to participating in demand-response programs.

2. Duke Kentucky should not seek to recover, in base rates or any type of rate mechanism, an exit fee or any other type of fee imposed by the Midwest ISO in conjunction with Duke Kentucky's move from the Midwest ISO to PJM, regardless of how that fee is identified or labeled, and regardless of whether or not such fee is approved by FERC.

3. Duke Kentucky should not seek to double-recover in a future rate case the transmission expansion fees that it may be charged by the Midwest ISO and PJM in the same period or overlapping periods, nor should it seek to defer and/or amortize any transmission expansion fees it incurs for Midwest ISO transmission expansion projects

which received approval when it was a member of the Midwest ISO, regardless of whether or not such fees are approved by FERC.

4. Duke Kentucky should not seek to recover, in base rates or any type of rate mechanism, its costs of integration into PJM, nor should it seek to defer and/or amortize any PJM integration costs it incurs in conjunction with its alignment with PJM, regardless of whether or not such costs or fees are approved by FERC.

5. Duke Kentucky should file a revised Rider PSM to provide that, effective January 1, 2012, the first $1 million in annual profits from off-system sales is allocated to ratepayers, with any profits in excess of $1 million split 75:25, with ratepayers receiving 75 percent and shareholders receiving 25 percent.

6. No customer should be allowed to participate directly or through a third party in any PJM demand-response program until that customer has entered into a special contract with Duke Kentucky which has been filed with, and approved by, the Commission, or until Duke Kentucky has an approved tariff authorizing customer participation.

7. Duke Kentucky should participate in PJM under a FRR capacity plan until it requests and receives this Commission's approval to participate in the RPM capacity market.

8. The Chief Executive Officer of Duke Kentucky should file, within seven days of the date of this Order, a letter accepting and agreeing to be bound by the conditions set forth in finding paragraphs 2 through 7 above.

9. The Chief Executive Officer of PJM should file, within seven days of the date of this Order, a letter accepting and agreeing to be bound by the condition set forth

in Finding No. 6 above and shall publicize that condition according to its demand response rules.

10. The approval of Duke Kentucky's request to transfer functional control of its 138 kV transmission facilities from the Midwest ISO to PJM and its request to join PJM should not diminish the Commission's authority to review and set Duke Kentucky's electric rates based on the value of its property used to provide electric service.

11. The approval of Duke Kentucky's request to transfer functional control of its 138 kV transmission facilities from the Midwest ISO to PJM and its request to join PJM should not diminish Duke Kentucky's existing obligation to:

a. Regularly file for Commission review an integrated resource plan detailing Duke Kentucky's load, specifying appropriate reserve requirements, and identifying sources of energy, demand-side resources, and projected need for new generation and transmission facilities.

b. Provide regulated service to its customers through the provision of bundled generation, transmission, and distribution electric service.

c. File for a certificate of public convenience and necessity prior to commencing construction of an electric generation or transmission facility.

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's request to transfer functional control of its transmission system from the Midwest ISO to PJM is approved subject to the filing, within seven days of the date of this Order, of the written acknowledgements described in finding paragraphs 8 and 9 above.

2. Any customer seeking to participate directly or through a third party in any PJM demand-response program shall do so only in accordance with the procedures set forth in finding paragraph 6 above.

3. Within 20 days of the date of this Order, Duke Kentucky shall file its revised tariff Rider PSM as approved herein, with an effective date of January 1, 2012.

By the Commission

ENTERED
DEC 22 2010
KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Executive Director

Keith L Beall
Esquire
P.O. Box 4202
Carmel, IN 46082-4202

Katherine K Yunker
John B. Park
Yunker & Park, PLC
P.O. Box 21784
Lexington, KY 40522-1784

Honorable Jason R Bentley
Attorney at Law
McBrayer, McGinnis, Leslie & Kirkland PLLC
305 Ann Street
Suite 308
Frankfort, KY 40601

Denise Foster
PJM Interconnection, LLC
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Jacqulynn Hugee
PJM Interconnection, LLC
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Jeanne Kingery
Duke Energy Business Services, Inc.
155 East Broad Street, 21st Floor
Columbus, OH 43215

Anita M Schafer
Senior Paralegal
Duke Energy Kentucky, Inc.
139 East 4th Street, R. 25 At II
P. O. Box 960
Cincinnati, OH 45201

Amy B Spiller
Associate General Counsel
Duke Energy Kentucky, Inc.
139 East 4th Street, R. 25 At II
P. O. Box 960
Cincinnati, OH 45201

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

On December 22, 2010, the Commission issued an Order granting Duke Energy Kentucky, Inc. ("Duke Kentucky") conditional approval to transfer its transmission assets from the operational control of the Midwest Independent System Operator ("Midwest ISO") to the PJM Interconnection Regional Transmission Organization ("PJM"). That Order imposed six conditions precedent that needed to be agreed to by Duke Kentucky, and one condition precedent to be agreed to by PJM. The one condition imposed upon PJM was also one of the six conditions imposed on Duke Kentucky. That condition, set forth as finding paragraph 6 on page 18 of the December 22, 2010 Order, provided that:

> No customer should be allowed to participate directly or through a third party in any PJM demand-response program until that customer has entered into a special contract with Duke Kentucky which has been filed with, and approved by, the Commission, or until Duke Kentucky has an approved tariff authorizing customer participation.

EXHIBIT

B

Duke Kentucky and PJM were required to indicate in writing within seven days of the date of the Order if they individually agreed to accept and be bound by the conditions imposed therein.

On December 29, 2010, Duke Kentucky filed a letter stating that it accepted and agreed to be bound by the six conditions imposed on it by the December 22, 2010 Order and noted that its move to PJM is contingent upon Duke Energy Ohio's successful move to PJM. On that same date, PJM filed a letter acknowledging that a requirement was imposed on Duke Kentucky which prohibited retail customers from participating in a PJM demand-response program without prior Commission approval. However, PJM's letter did not acknowledge that this same condition was imposed on PJM by finding paragraph 9 of the December 22, 2010 Order. Consequently, without PJM's agreement to honor this condition, a customer of Duke Kentucky could enroll in a PJM demand-response program if, at the time of enrollment, Duke Kentucky does not object to PJM, either intentionally or due to inadvertence. Such participation by a customer of Duke Kentucky would be in direct violation of Duke Kentucky's tariff, Ky. P.S.C. Electric No. 2, First Revised Sheet No. 21, Section 5, which prohibits the resale of electricity by customers.

The condition imposed on PJM by our December 22, 2010 Order mirrors the commitment made by PJM in 2004 in conjunction with Kentucky Power Company's application to transfer functional control of its transmission assets to PJM. In that case, the transfer to PJM was approved upon PJM's agreement that:

> Any PJM-offered demand side response or load interruption programs will be made available to Kentucky Power for its retail customers at Kentucky Power's election. No such program will be made available by PJM directly to a retail customer of Kentucky Power . . . . Any such programs would be

subject to the applicable rules of the Commission and Kentucky law.[1]

Based on a review of PJM's December 29, 2010 letter, the Commission finds that one of the conditions precedent to Duke Kentucky's transfer of transmission assets to PJM has not been satisfied.

IT IS THEREFORE ORDERED that the conditional approval granted in our December 22, 2010 Order has not become unconditional and will not become unconditional until either: (a) PJM clarifies its December 29, 2010 letter to acknowledge the requirement that no customer participate in a PJM demand-response program absent prior Commission approval; or (b) the December 22, 2010 Order is modified in response to a timely application for rehearing filed pursuant to KRS 278.400.

By the Commission

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ATTEST:

Executive Director

[1] Case No. 2002-00475, Application of Kentucky Power Company d/b/a American Electric Power, for Approval, to the Extent Necessary, to Transfer Functional Control of Transmission Facilities Located in Kentucky to PJM Interconnection, L.L.C. Pursuant to KRS 278.218 (Ky. PSC May 19, 2004) at 9 and Appendix A thereto at Paragraph No. 4.

Keith L Beall
Esquire
P.O. Box 4202
Carmel, IN 46082-4202

Katherine K Yunker
John B. Park
Yunker & Park, PLC
P.O. Box 21784
Lexington, KY 40522-1784

Honorable Jason R Bentley
Attorney at Law
McBrayer, McGinnis, Leslie & Kirkland PLLC
305 Ann Street
Suite 308
Frankfort, KY 40601

Denise Foster
PJM Interconnection, LLC
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Jacqulynn Hugee
PJM Interconnection, LLC
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Jeanne Kingery
Duke Energy Business Services, Inc.
155 East Broad Street, 21st Floor
Columbus, OH 43215

Anita M Schafer
Senior Paralegal
Duke Energy Kentucky, Inc.
139 East 4th Street, R. 25 At II
P. O. Box 960
Cincinnati, OH 45201

Amy B Spiller
Associate General Counsel
Duke Energy Kentucky, Inc.
139 East 4th Street, R. 25 At II
P. O. Box 960
Cincinnati, OH 45201