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February 19, 2015

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PUBLIC SERVICE
COMMISSION

Via Hand-Delivery

Mr. Jeffrey Derouen
Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, KY 40602

Re: In the Matter of: An Examination of the Application of the Fuel
Adjustment Clause of East Kentucky Power Cooperative, Inc.
from November 1, 2013 through April 30, 2014
PSC Case No. 2014-00226

Dear Mr. Derouen:

Enclosed please find for filing with the Commission in the above-referenced case an original and ten (10) copies of East Kentucky Power Cooperative, Inc.'s Petition for Rehearing regarding the above-styled matter. Please return a file-stamped copy to me.

Do not hesitate to contact me if you have any questions.

Very truly yours,

David S. Samford

Enclosures

M:\Clients\4000 - East Kentucky Power\1700 - FAC Cases\
Correspondence\Ltr. to Jeff Derouen No. 2 - 150219

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

IN THE MATTER OF:

**AN EXAMINATION OF THE APPLICATION)
OF THE FUEL ADJUSTMENT CLAUSE OF)
EAST KENTUCKY POWER COOPERATIVE,) CASE NO. 2014-00226
INC. FROM NOVEMBER 1, 2013 THROUGH)
APRIL 30, 2014)**

**EAST KENTUCKY POWER COOPERATIVE, INC.'S
PETITION FOR REHEARING**

Comes now East Kentucky Power Cooperative, Inc. ("EKPC" or the "Company"), by counsel, pursuant to KRS 278.400 and other applicable law, and for its petition requesting that the Commission grant rehearing of the Order entered herein on January 30, 2015 (the "Order"), respectfully states as follows:

I. Introduction

This case presents a question regarding the extent to which energy purchases made within the context of EKPC's participation in the Day-Ahead and Real-Time Energy Markets administered by PJM Interconnection, LLC ("PJM"), are recoverable through the Company's Fuel Adjustment Clause ("FAC") tariff. In data requests posed by Commission Staff prior to the hearing held in this matter, and in the context of the hearing itself, an issue arose as to whether certain such energy purchases may be passed through the FAC in light of language set forth in an order entered by the Commission on May 2, 2002, in Case No. 2000-00496-B, which limits the recovery of energy purchases to those that have a net energy cost below the highest variable cost

of the utility's available generating units.¹ In the Order, the Commission found that power purchases "in excess of [EKPC]'s own highest-cost generating unit available to be dispatched to serve native load during the reporting expense month should be disallowed for recovery for the period under review."² Accordingly, the Commission directed EKPC to refund \$8,538,787 in power purchases that were made primarily during the height of the 2014 polar vortex, when EKPC lacked capacity to serve its native load and was forced to rely upon PJM to avoid curtailments. Thus, the disallowance equates to an \$8.5 million penalization for successfully acquiring approximately 450 MW of energy in PJM (250 MWs of which exceeded EKPC's prior winter peak) to avoid curtailments.³

It is vitally important that certain apparent inconsistencies in the Order be resolved and that EKPC be made better aware of how the Commission intends to address certain attendant issues arising by virtue of EKPC's participation in the PJM Energy Markets. As it now stands, the Order creates multiple incentives and consequences which EKPC believes to have been unintended, in addition to other areas where the Order appears to be inconsistent with earlier Commission precedent and the plain language of 807 KAR 5:056 (the "FAC Regulation").

II. Argument

A. The Order Misapplies the FAC Regulation

The FAC Regulation states that "[f]uel costs...shall be the most recent actual monthly cost of: ... (c) the net energy cost of energy purchases...when such energy is purchased on an

¹ See *In the Matter of An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00496-B (Ky. P.S.C. May 2, 2002).

² Order, p. 9.

³ See *In the Matter of an Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc., from November 1, 2013 through April 30, 2014*, Order, Case No. 2014-00226, App. B, p. 1 (Ky. P.S.C. Aug. 13, 2014).

economic dispatch basis.”⁴ The next sentence of the regulation lists “economy energy purchases” as one category of expenses that may be included in the calculation of what constitutes net energy costs of energy purchases made on an economic dispatch basis.⁵ While there are certainly areas of overlap between the terms “net energy cost of energy purchases...purchased on an economic dispatch basis” and “economy energy purchases,” the plain text of the FAC Regulation confirms that these terms are not identical, nor were they ever intended to be.⁶ Although included in EKPC’s post-hearing Brief, the Order does not address this argument in any meaningful respect. Instead, the Order focuses upon the definitions of “economy energy purchases” and “non-economy energy purchases” set forth in Case No. 2000-00496-B and Case No. 2004-00430. In so doing, the Commission ignores the criteria for energy cost recovery set forth in the first sentence of Section 1(3)(c) and instead bases its decision upon an illustrative example of the application of such criteria, which is the subject matter of the second sentence of Section 1(3)(c). This result is inconsistent with principles of legal construction because it fails to give effect to the intent behind the promulgation of the FAC

⁴ 807 KAR 5:056, Section 1(3)(c).

⁵ Likewise, in Section 1(3)(d) of the FAC Regulation, fuel costs are broken into two categories: “economy energy sales *and* other energy sold on an economic dispatch basis.” (Emphasis added). The conjunctive “and” confirms that “economy energy sales” and “energy sold on an economic dispatch basis” do not describe the exact same thing. Reading these two items as separate terms is the only way that the FAC Regulation can be construed harmoniously. The same reasoning applies to Section 1(3)(c), which concerns energy purchases.

⁶ Confirmation of this fact is seen in the use of “shall” in the first sentence of 807 KAR 5:056, Section 1(3)(c), and “may” in the second sentence. See KRS 446.010(26), (39); *Kentucky Public Service Comm’n v. Shadoan*, 325 S.W.3d 360, 363-364 (Ky. 2010) (discussing and distinguishing between mandatory and permissive duties of local planning commissions); *Fox v. Grayson*, 317 S.W.3d 1, 13 (Ky. 2010) (“Of course, as the Governor correctly points out, the word *may* generally signifies something as being permissive in nature in contrast to the word *shall*, which generally signifies something being mandatory.”) (citation omitted).

Regulation,⁷ it renders the first sentence of Section 1(3)(c) meaningless,⁸ and it fails to achieve harmony in Section 1(3)(c) as a whole.⁹

Thus, when the Order states, “[w]hether a utility is a member of an RTO that dispatches economically does not impact the determination of the whether the purchase is an ‘economy energy purchase’ as interpreted by the Commission’s 496B Order,” the Commission is correct. But simply because a purchase may not be an “economy energy purchase” as interpreted in Case No. 2000-00496-B does not necessarily mean that said purchase was made on a non-economic dispatch basis. In other words, because the subject power purchases do not fit within one specific example of an energy purchase that satisfies the economic dispatch criteria, the Commission holds that the energy purchase could never satisfy the criteria. That syllogism is fallacious and leads to an illogical conclusion.

EKPC does not dispute that the Commission’s precedent in Case No. 2000-00496-B and Case No. 2004-00430 provided the applicable rule of interpretation of the FAC Regulation for over a decade or that this precedent has continuing legal and practical value for future cases that fall within the orbit of these cases’ gravamen. However, this is not such a case. EKPC’s entry

⁷ A tariff should be construed in the same manner as a statute. See *W.P. Brown & Sons Lumber Co. v. Louisville & N.R. Co.*, 7 F. Supp. 593, 594 (W.D. Ky. 1934) (“The quoted language seems to me clear and unambiguous, and, as a legally established rate tariff has the force and effect of a statute, it should be construed in the same manner as statutes are construed. Applying that rule of construction, there being no ambiguity in the wording of the tariff, it should be construed as written.”); see also *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Co.*, 983 S.W.2d 493, 500 (Ky. 1998) (“The fundamental rule in statutory interpretation is to give effect to the legislative intent.”) (citation omitted). The intent of the FAC Regulation is well-described in the Order in Case No. 6877. See Note 13, *infra*, and accompanying text.

⁸ See *Pub. Serv. Comm'n of Kentucky v. Com.*, 320 S.W.3d 660, 668 (Ky. 2010) (“The courts will not interpret a portion of a statute in a way that would render other parts of the same statute or the larger statutory scheme meaningless.”) (citing *Lewis v. Jackson Energy Cooperative Corporation*, 189 S.W.3d 87 (Ky. 2005); *Commonwealth v. Phon*, 17 S.W.3d 106, 108 (Ky. 2000)).

⁹ See *Hale v. Combs*, 30 S.W.3d 146 (Ky. 2000); *Lewis v. Jackson Energy Co-op. Corp.*, 189 S.W.3d 87, 95 (Ky. 2005); KRS 446.080.

into PJM and its full participation in PJM's Energy Markets have taken it outside the factual context where the definitions of "economy energy purchases" and "non-economy energy purchases" have any useful application.¹⁰ EKPC is no longer its own balancing authority and it relies upon the PJM Energy Market on a daily basis, not just in exigent circumstances.¹¹ Because EKPC sells and purchases 100% of its energy into and from the PJM Energy Market every hour of every day, its highest-cost generating unit to serve native load is now simply a synthetic calculation that bears no direct correlation to the actual price that EKPC pays or receives for energy that it purchases or generates. Section 1(3)(c) of the FAC Regulation is premised upon whether the energy is purchased upon an "economic dispatch basis," and thus EKPC's purchases in the PJM Energy Market must be eligible for FAC recovery.

B. The Order is Internally Inconsistent

In addition to analyzing the subject power purchases under what EKPC believes to be the wrong portion of Section 1(3)(c) of the FAC Regulation, the Order also contains multiple inconsistencies which will only further create confusion in the future. For example, one of the most glaring inconsistencies is the statement that the FAC "was never meant to allow the utility to recover 100 percent of fuel costs incurred on a monthly basis, as evidenced by the restrictions set out in the regulation."¹² This statement is wrong for multiple reasons. First, the restrictions on recovery set forth in 807 KAR 5:056, Section 1(3)(b)-(c) apply only to: (1) fuel costs related

¹⁰ Another weakness in the continued reliance upon the definition "economy energy purchase" is illustrated in the way generation dispatch order is increasingly being determined by environmental mandates. While a particular generating unit may be "available" from an operational perspective, it may be unable to operate due to emission limits or other environmental constraints. The rapid proliferation of environmental obligations was not a concern when the FAC Regulation was first promulgated or when the Commission subsequently adopted the definition of an "economy energy purchase." For this and other reasons, the FAC Regulation is becoming less relevant to the actual operational realities of the electric power industry.

¹¹ EKPC's Response to Commission Staff's Initial Data Request, Request No. 26b(2) (filed Aug. 27, 2014).

¹² Order, p. 8.

to purchases for forced outage substitutions; (2) capacity and demand charges for energy purchases; and (3) energy purchases made on a non-economic dispatch basis. None of these express restrictions are at issue in this case. Second, the statement in the Order is contradicted by one of the two orders upon which the Commission's decision is based. In Case No. 2004-00430, the Commission included a lengthy quotation from a 1977 order in Case No. 6877, which held the FAC is "... a means for [an electric] utility to recover from its customers its *current fuel expense* through an automatic rate adjustment without the necessity for a full regulatory rate proceeding."¹³ The ability to recover current fuel expenses could not be clearer. Likewise, the Commission went on to state in Case No. 2004-00430:

The [FAC] regulation prescribes a strict procedure for accounting and reporting fuel costs and requires the reporting of *all fuel costs*. It does not allow any discretion to a utility to ignore or underreport such costs that are otherwise considered a "fuel cost" or to use other than actual costs. The regulation makes no exceptions and provides for no variations or deviations from the stated reporting methodology.¹⁴

When the order in Case No. 2004-00430 is read in its entirety, it is clear that the subject utility's intended purpose for not reporting "all fuel costs" was to pay for the fuel expenses through margins, which the Commission prohibited.¹⁵

Third, the statement in the Order is also inconsistent with the plain language of Section 1(3)(b) of the FAC Regulation, which states that "the actual identifiable fossil...fuel costs associated with energy purchased for reasons other than identified in paragraph (c) of this

¹³ *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430 (Ky. P.S.C. Feb. 7, 2005) (quoting *In the Matter of Kentucky Power Company*, Order, Case No. 6877, p. 2 (Ky. P.S.C. Dec. 15, 1977)) (emphasis added).

¹⁴ *Id.*, p. 5 (emphasis added).

¹⁵ *See id.*

subsection...” shall also be considered a recoverable fuel expense. In its post-hearing Brief, EKPC argued that, even if the energy purchased through the PJM Energy Market was not recoverable under 807 KAR 5:056, Section 1(3)(c), it would still be recoverable under Section 1(3)(b) of the regulation because there is no dispute that PJM Energy Market costs are fuel costs.¹⁶ Yet, the Commission did not address this argument at all.

C. The Order Does Not Address Certain Arguments Asserted by EKPC

As set forth above, the Commission did not address EKPC’s argument that the expenses in question are eligible for recovery under Section 1(3)(b) of the FAC Regulation, even if they were not eligible for recovery under Section 1(3)(c). Yet, the Commission has deferred consideration of the applicability of various PJM Billing Codes to the FAC calculation until after the record is developed in the next FAC review case, Case No. 2014-00451, which was initiated on February 5, 2015. The problem with this approach is that the Order requires the refund of certain fuel costs before any determination has been made as to whether selected PJM Billing Codes are appropriate for inclusion in the FAC calculation. By ignoring the applicability of 807 KAR 5:056, Section 1(3)(b), the Commission has, in essence, put the proverbial “cart before the horse” and excluded significant sums from FAC recovery without determining which of the costs billed to EKPC by PJM are fuel related..

The Order also ignores the argument that the FAC Regulation has been inconsistently applied. For instance, Kentucky Power Company has been allowed to use a price proxy to establish the highest-cost generating unit available to it for FAC calculation purposes.¹⁷ EKPC’s

¹⁶ See EKPC’s Post-Hearing Brief, pp. 20-23.

¹⁷ See *In the Matter of an Examination by the Public Service Commission of the Application of the Fuel Adjustments Clause of American Electric Power Company from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00495-B (Ky. P.S.C. Oct. 3, 2002). EKPC is not alleging that Kentucky Power Company’s price proxy mechanism is unreasonable or unlawful. EKPC is simply pointing out that the Commission’s application of the FAC Regulation appears to be inconsistent and, in this case, unreasonable.

participation in the PJM Energy Market is similar to Kentucky Power Company's participation in the AEP Power Pool, yet the Commission has arrived at two completely opposite conclusions. Kentucky Power Company's use of a proxy to establish the highest cost of its generating unit for FAC purposes is one step further removed from EKPC's direct participation in the largest energy market in North America, which is itself operated on a security-constrained economic dispatch basis. It is unreasonable for the Commission to hold that participation in a regional energy market clearly operated upon federally-mandated economic dispatch principles is not acceptable for FAC purposes, while simultaneously allowing Kentucky Power Company to use a price proxy mechanism that is not included anywhere in the FAC Regulation. The Order does not address this anomaly.

D. The Order Creates Multiple, Likely Unintended Incentives and Consequences

The biggest problem associated with the Order is the uncertainty it creates and the likely impact it will have on future decision-making by EKPC and other electric utilities in Kentucky. For instance, in Case No. 2012-00169, the Commission authorized EKPC's transfer of control of certain transmission assets to PJM as part of EKPC's full integration into that regional transmission organization ("RTO").¹⁸ The core benefit of joining PJM was EKPC's ability to reduce capacity reserve requirements and monetize EKPC's seasonal peak diversity from PJM as a whole. However, the Order in this case will penalize EKPC for not being able to directly serve its own peak load by disallowing fuel expenses incurred through PJM when EKPC's own available assets are otherwise fully committed. This appears to be one of the Commission's primary purposes, in fact, as the Order says the exclusion of these fuel costs will "incentivize

¹⁸ *In the Matter of the Application of East Kentucky Power Cooperative, Inc. to Transfer Functional Control of Certain Transmission Facilities to PJM Interconnection, LLC*, Order, Case No. 2012-00169 (Ky. P.S.C. Dec. 20, 2012).

utilities to...have sufficient capacity to meet load.”¹⁹ Thus, the Order is inconsistent with and contradicts the primary motivation for entering into PJM.

Likewise, in Case No. 2014-00034, the Commission authorized EKPC to offer an economic development rate and agreed that, by virtue of EKPC’s participation in the PJM Capacity and Energy Markets, EKPC did not have to own surplus generating capacity as a prerequisite to serving any new load that qualified for the economic development rate.²⁰ Under the terms of the Order in this case, however, the energy costs associated with serving new economic development load under that scenario would automatically be excluded from recovery under the FAC. Thus, the Order essentially nullifies any incentive for EKPC to pursue new economic development loads.

In addition to the foregoing issues, the Order also effectively calls into question the value of EKPC’s long-term participation in PJM. As part of the integration case, the Commission directed EKPC to prepare and file in 2015 a mechanism for returning certain benefits from EKPC’s participation in the PJM Capacity Market to EKPC’s Members outside of, and in addition to, the historical capital credit payment methodology. EKPC accepted this condition for the integration even though it would delay EKPC’s ability to improve its equity ratio as mandated by the management audit.²¹ Since EKPC became fully integrated into PJM in 2013, it

¹⁹ Order, p. 8.

²⁰ See *In the Matter of the Application of East Kentucky Power Cooperative, Inc. for Approval of an Economic Development Rider*, Order, Case No. 2014-00034, p. 4 (Ky. P.S.C. June 20, 2014). In requesting the deviation, EKPC advised that the EDR customer would assume the cost of incremental capacity to serve the load. The Order, however, puts into question whether the customer would also have to assume the incremental fuel cost associated with the energy.

²¹ Although EKPC has made significant improvement in building equity since the management audit, its equity ratio is still below the minimum amount necessary to allow it to pay capital credits to its Members under either the terms of its Trust Indenture that was approved in Case No. 2012-00249 or the guidelines established by the Rural Utilities Service. Moreover, new federal environmental regulations will very likely force EKPC to undertake additional environmental compliance projects over the course of the next several years.

has reduced its costs to Members by \$14 million through the first ten months of participation in the PJM Energy Markets.²² However, the Order in this case essentially puts EKPC in the position of having to pay for Energy Market savings out of its own margins. The short-term effect of this result is that EKPC's Members are receiving an artificially low cost for power that is comprised of participation in an economically-efficient energy market coupled with non-recovery of a significant portion of the fuel expenses that make that benefit possible. The long-term effect of this result is unsustainable and will likely trigger more frequent base rate increases, not less, as the Order supposes.²³

Finally, the Order cites Case No. 2000-00496-B for the proposition that because EKPC's disallowed fuel expenses all arise from emergency operating conditions where demand exceeded available capacity, then "EKPC may apply to the Commission for immediate rate recovery of those costs."²⁴ EKPC agrees that the Commission has authority under KRS 278.030 and KRS 278.040 to approve such a tariff, however, going to such great lengths to recover costs which the Commission has already found to be reasonably incurred would seem to be unnecessary and redundant. The FAC Regulation should be the principal rate mechanism for recovering reasonably incurred fuel and power purchase expenses.

III. Conclusion

EKPC appreciates the Commission's consideration of the issues presented in this case and articulated in the Order, but respectfully submits that the Order is in error. It improperly applies the criteria for evaluating power purchase costs under 807 KAR 5:056, Section 1(3)(b), ignores other key arguments asserted by EKPC including the applicability of Section 1(3)(c) of

²² See EKPC's Response to Commission Staff's Supplemental Data Request, Request No. 3d (filed Oct. 10, 2014).

²³ Order, p. 8 ("Having such a [FAC] mechanism in place should reduce the frequency of base rate cases.").

²⁴ Order, pp. 8-9 (*quoting* Final Order in Case No. 2000-00496-B).

the FAC Regulation, and includes several statements that are plainly inconsistent with the Commission's prior orders and practice as well as the text of the FAC Regulation itself. Equally troubling, the Order creates significant inconsistencies with regard to the manner in which EKPC should operate within the RTO construct. For each of these reasons, EKPC respectfully requests that the Commission grant the petition for rehearing and conduct further proceedings relevant to this matter.

This 19th day of February 2015.

Respectfully submitted,



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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing was served by depositing same into the custody and care of the U.S. Postal Service, postage pre-paid, on this the 19th day of February, 2015, addressed to the following:

W. Jeffrey Scott
W. Jeffrey Scott, PSC
P. O. Box 608
Grayson, KY 41143



Counsel for East Kentucky Power Cooperative, Inc.