COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

EAST KENTUCKY POWER COOPERATIVE, INC.'S FILING OF A PROPOSED CONTRACT WITH GALLATIN STEEL COMPANY	)))	CASE NO. 94-456

O R D E R

IT IS ORDERED that East Kentucky Power Cooperative, Inc. ("East Kentucky") shall file an original and 10 copies of the following information with this Commission, with a copy to all parties of record. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the person who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible. East Kentucky's response to this request is due no later than February 27, 1995.

1. Refer to Section 6(c) of the Special Agreement for Electric Service ("Agreement") between East Kentucky, Owen Electric Cooperative ("Owen"), and Gallatin Steel Company ("Gallatin"). Explain why Gallatin's future demand charges are established at specific levels, in specific years, that appear to have no correlation to rate adjustments that may be implemented as a result

of Case No. 94-336[1] or any future rate cases that may be filed by East Kentucky. Contrast this to Section 6(g) which indicates East Kentucky's energy adders will be escalated to match the percentage increases approved in future base rate cases before the Commission.

2. The automatic scheduled increases in East Kentucky's demand charges are 12.4 percent in 1998 and 8.8 percent in 2001.

a. How were the amounts and the years for these scheduled increases determined?

b. If these scheduled rate increases are based on forecasted increases in East Kentucky's costs, what events or projects are driving the forecasted cost increases?

3. Appendix A to this Order is a Commission decision in Case No. 90-068[2] rejecting a 10-year agreement in part because it provided for automatic rate increases not tied to cost of service. Do the facts or circumstances of the proposed Agreement differ from those set out in Appendix A such that this case warrants a different decision from that rendered in Case No. 90-068?

4. The response to Item 1(b) of the Commission's Order of December 22, 1994 shows the differences in Gallatin's projected demand if measured over a 15-minute period rather than a 60-minute period as set forth in Section 1.g of the Agreement. If demand

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[1] Case No. 94-336, The Application of East Kentucky Power Cooperative, Inc. for an Adjustment to its Wholesale Power Tariffs.

[2] Case No. 90-068, A Service Agreement Between Newport Steel Corporation and The Union Light, Heat and Power Company, Order dated September 27, 1990.

were redefined to be measured over 15 minutes, would Gallatin design or operate its facilities any differently in an attempt to reduce its demand? If yes, provide Gallatin's revised demand for both Phase I and Phase II and explain why East Kentucky elected not to measure demand over a 15-minute period.

5. In response Item 4(b) of the Commission's Order of December 22, 1994, East Kentucky indicated that the Gallatin interruptible load should not be subject to a fuel adjustment clause ("FAC") calculation.

a. What specific actions does East Kentucky intend to take in the preparation of its monthly FAC report to show the derivation of its system average fuel cost excluding the Gallatin interruptible load?

b. To ensure proper monitoring of the costs and revenues associated with the Gallatin load, can East Kentucky file, as a supplement to its FAC report, a monthly schedule based on its "with and without" production cost modeling, in the same general format as used in the response to Item 3 of the December 22, 1994 Order? If yes, can that schedule be modified to also show revenues from the Gallatin load, by service category?

6. The response to Item 6 of the Commission's Order of December 22, 1994 indicates the demand rates for the ten minute and ninety minute interruptible service are discounted from East Kentucky's Section C demand rate; however, the demand rate for firm service is based on East Kentucky's Section A rate. The response generally explains why Section A was the basis for the firm demand

rate. Explain why the interruptible demand rate is based on Section C's rate rather than Section A.

7. Refer to the response to Item 8(a) of the Commission's Order of December 22, 1994, page 4 of 4. Assume that actual investment or extra-ordinary operation and maintenance cost exceed the estimated levels by amounts great enough to cause the equivalent monthly cost to exceed the $47,000 facilities charge.

a. What options are available for East Kentucky to recover the higher levels of cost from Gallatin?

b. Does the Agreement address the possibility of the monthly equivalent cost exceeding the amount of the facilities charge? If yes, provide the citations. If no, explain why there is no provision in the Agreement to cover this potential outcome.

Done at Frankfort, Kentucky, this 14th day of February, 1995.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 94-456 DATED February 14, 1995.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

A SERVICE AGREEMENT BETWEEN NEWPORT STEEL CORPORATION AND THE UNION LIGHT, HEAT AND POWER COMPANY) CASE NO. 90-068

O R D E R

On March 7, 1990, The Union Light, Heat and Power Company ("ULH&P") filed with the Commission a special contract for retail electric service to Newport Steel Corporation ("NSC"). The contract has a 10 year term commencing February 1990. The contract provides for NSC's electric service to be billed pursuant to ULH&P's Rate TT and Rider LM as on file and approved by the Commission as of January 30, 1990, subject only to subsequent modifications as provided for in the contract.

By Order entered on March 27, 1990, the Commission suspended the proposed contract through September 6, 1990. On May 4, 1990, the Commission requested ULH&P to provide additional information regarding the provision of service to NSC under the proposed contract. The requested information was filed on June 8, 1990. On July 6, 1990, the Commission issued an Order scheduling a hearing for August 1, 1990 and identifying several issues pertaining to the proposed contract with NSC that concerned the Commission. These issues included a history of the various rate schedules used to serve NSC since November 1982, ULH&P's prohibition of cogeneration of electricity by NSC, and the

scheduled increase in rates totaling 20 percent over the life of the contract. On July 30, 1990, a witness for ULH&P filed testimony specifically addressing the Commission's concerns as expressed in its Order dated July 6, 1990.

The contract specifies that NSC intends to install a continuous caster at its existing Wilder, Kentucky plant by June 1, 1991. ULH&P desires to continue to supply the electric power and energy required to operate NSC's Wilder plant and is willing to supply the energy that will be required to operate the new continuous caster facility. The contract also specifies that ULH&P desires to obtain interruptible and curtailable load.

In Sections 3.2 and 3.3 of the contract, specific interruptible and curtailable provisions are established. Until NSC demonstrates to ULH&P that it is engaging in a three furnace operation and that it has the ability to interrupt all furnace load within 10 minutes of notification to interrupt that load, NSC's billing load will be designated as either firm power or curtailable power. Firm power is initially designated to be 6 MW, and may be redesignated by NSC each year. All load in excess of firm power will be deemed curtailable power. NSC will curtail such load within one hour of notice by ULH&P. NSC will receive a credit of $2.38 per KW per month on all curtailable load.

Subsequent to NSC's demonstration of a three furnace operation and the ability to interrupt all load within ten minutes of notification, NSC's billing load will be designated as firm power, curtailable power, or interruptible power. Firm power will be designated annually by NSC and will not be subject to

interruption by ULH&P. Curtailable power will be designated annually by NSC. All load designated as curtailable will be curtailed by NSC upon a one hour notification by ULH&P and only during on-peak hours as established by the North American Electric Reliability Council. Curtailable load will be entitled to a credit of $2.38 per KW per month. Interruptible power will be that load in excess of the sum of firm power and curtailable power and will be interrupted by NSC within a ten minute notification by ULH&P. Interruptible load will be entitled to a credit of $4.45 per KW per month.

The Commission finds that the interruptible and curtailable provisions established by this contract are reasonable and provide appropriate incentives for NSC to manage its load. ULH&P's entire electric system will benefit as a result of such load-management techniques. The Commission encourages the continued utilization of load-management and other demand-side management practices by ULH&P.

Article I of the proposed contract requires NSC to purchase all of its electric power and electric energy requirements from ULH&P during the term of the contract. In addition, the contract specifically prohibits NSC from obtaining power and energy from any other supplier and from engaging in the cogeneration of electricity for the purpose of displacing power and energy provided by ULH&P. ULH&P stated that this prohibition of cogeneration was enacted in order to optimize the opportunity for ULH&P to recover its investment in new service facilities to serve

NSC's expanded load.[1] According to ULH&P, it will spend approximately $1,600,000 to upgrade its service to NSC.

The Commission hereby finds that this contractual prohibition of cogeneration runs counter to the Commission's express intent to encourage cogeneration.[2] Moreover, the enactment by Congress of Title II of the Public Utility Regulatory Policies Act of 1978 ("PURPA") establishes a clear public policy in support of cogeneration. Under PURPA, the Federal Energy Regulatory Commission ("FERC") was required to adopt rules to encourage cogeneration and small power production by requiring electric utilities to sell electricity to qualifying cogeneration and small power production facilities and purchase electricity from such facilities. Section 210(f) of PURPA required the state regulatory authority with jurisdiction over electric utilities to implement the FERC rules. The Commission's regulation 807 KAR 5:054 was promulgated in order to implement these FERC rules. ULH&P acknowledged that the intent of PURPA was to encourage cogeneration of electricity.[3]

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1 Response to Commission's Order dated May 4, 1990, Item 17.

2 Case No. 8566, Setting Rates and Terms and Conditions of Purchase of Electric Power From Small Power Producers and Cogenerators by Regulated Electric Utilities, Order dated June 28, 1984.

3 Transcript of Evidence, page 32.

The Commission intends to continue encouraging the development of cogeneration and small power production within the Commonwealth. For this reason, the Commission cannot approve this provision of ULH&P's contract with NSC as long as it prohibits the cogeneration of electricity.

Section 3.5 of the proposed contract establishes a schedule of automatic rate increases to be implemented during the ten year term of the contract. The rate increase schedule specifies effective dates and rate increases which will result in a total 20 percent increase over the term of the contract. The automatic rate increase schedule is as follows: effective June 1, 1991 the rates for service provided to NSC will be increased by 6 percent; effective June 1, 1992 the rates for service will be increased at a rate equivalent to the increase in the Consumer Price Index between December 31, 1990 and December 31, 1991, but not to exceed 4 percent; the difference between the rate in effect on June 1, 1992 and the total 20 percent increase will be effective for the final 12 months of the contract. The contract specifies that NSC can choose to increase its rates up to the 20 percent at any time prior to the last 12 months of the contract.

ULH&P contends that the 20 percent revenue increase was developed to provide NSC with some assurance of rate stability to help justify NSC's investment in the new continuous caster facility and that the 20 percent was based on an estimated 25 percent increase in electric rates related to addition of the

William H. Zimmer Generating Station.[4] Though ULH&P contends that this 25 percent rate increase figure had been widely quoted in the press, it filed no documentation in support. ULH&P contends that in order to arrive at the 20 percent rate increase for NSC, the 25 percent estimated overall rate increase related to the Zimmer plant is multiplied by a factor of 0.8. This factor is similar to that proposed in ULH&P's current rate case before the Commission, Case No. 90-041. In that case, ULH&P has asserted that its cost-of-service study indicates that the residential class should receive an increase of 1.2 times the overall requested rate increase in order to bring their rates in closer alignment with their cost of service. The balance, or 0.8 times the overall increase, would then be allocated to the remaining rate classes, including industrial customers such as NSC.

The Commission finds that a schedule of automatic rate increases, such as that proposed by ULH&P in this contract, does not properly consider cost causation and would result in future rates being established without reference to cost-of-service studies. The Commission will not grant pre-approval to automatic rate increases for any customer (particularly where such increases are to become effective over a 10 year term) that are based on estimated costs with no supporting cost analysis or documentation. The automatic rate increase provision of ULH&P's contract with NSC has not been shown to result in rates that will be fair, just, and

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[4] Response to an Information Request of the Commission during the Hearing, filed on August 13, 1990.

reasonable over the 10 year term of the contract. Therefore, the Commission must reject that provision.

Should ULH&P and NSC decide to revise the proposed contract by deleting the prohibition of cogeneration and the automatic rate increases, the Commission will expedite its investigation and review of such a revised contract.

IT IS THEREFORE ORDERED that ULH&P's proposed contract with NSC be and hereby is denied.

Done at Frankfort, Kentucky, this 27th day of September, 1990.

By the Commission

ATTEST:

Executive Director