

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE)
COMMISSION OF THE APPLICATION OF THE)
FUEL ADJUSTMENT CLAUSE OF AMERICAN) CASE NO. 2000-00495-B
ELECTRIC POWER COMPANY FROM MAY 1,)
2001 TO OCTOBER 31, 2001)

ORDER

Pursuant to Administrative Regulation 807 KAR 5:056, the Commission on December 20, 2001 established this case to review and evaluate the operation of the fuel adjustment clause (FAC) of American Electric Power Company (AEP) for the 6 months ended October 31, 2001.

As part of this review, AEP, pursuant to Commission Order, submitted certain information concerning its compliance with Administrative Regulation 807 KAR 5:056. A public hearing was held on February 19, 2002 at which the following persons testified: Errol Wagner, AEP's Director of Rates; Todd William Alleshouse, Energy Production Manager of AEP's Big Sandy Generating Plant; and Steven D. Baker, AEP's Manager of Case Management.

The Commission previously established AEP's base fuel cost at 11.45 mills per Kwh.¹ A review of AEP's monthly fuel clause filings shows that the actual fuel cost incurred for the 6-month period under review ranged from a low of 10.16 mills in May 2001 to a high of 13.07 mills in October 2001, with a 6-month average of 11.10 mills.

¹ Case No. 2000-495, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of American Electric Power Company from November 1, 1998 to October 31, 2000 (March 15, 2001).

During this proceeding, the Commission examined the appropriate treatment under Administrative Regulation 807 KAR 5:056 for purchased power costs incurred to serve native load.² More specifically, we inquired about the types of power purchases that qualify as economy power purchases and the treatment of power purchases that are not considered economy power purchases.

Administrative Regulation 807 KAR 5:056, Section 1(3),³ governs the recovery of purchased energy costs through an electric utility's FAC. It permits the inclusion of economy energy purchases, exclusive of capacity or demand charges, in the cost of fuel as calculated for FAC purposes when such energy is purchased on an economic dispatch basis. It also permits the recovery of actual identifiable fossil and nuclear fuel costs associated with energy purchased in non-economy transactions.

² See Transcript at 28-31.

³ Fuel costs (F) shall be the most recent actual monthly cost of:

(a) Fossil fuel consumed in the utility's own plants, and the utility's share of fossil and nuclear fuel consumed in jointly owned or leased plants, plus the cost of fuel which would have been used in plants suffering forced generation or transmission outages, but less the cost of fuel related to substitute generation; plus

(b) The actual identifiable fossil and nuclear fuel costs associated with energy purchased for reasons other than identified in paragraph (c) of this subsection, but excluding the cost of fuel related to purchases to substitute for the forced outages; plus

(c) The net energy cost of energy purchases, exclusive of capacity or demand charges (irrespective of the designation assigned to such transaction) when such energy is purchased on an economic dispatch basis. Included therein may be such costs as the charges for economy energy purchases and the charges as a result of scheduled outage, all such kinds of energy being purchased by the buyer to substitute for its own higher cost energy; and less

(d) The cost of fossil fuel recovered through intersystem sales including the fuel costs related to economy energy sales and other energy sold on an economic dispatch basis.

(e) All fuel costs shall be based on weighted average inventory costing.

In a highly regulated electric power wholesale market in which power suppliers routinely identified on their billing statements the portions of energy purchases attributable to fuel cost and to demand or capacity charges, this regulation was relatively easy to administer. With the recent restructuring of the wholesale electric power market, however, few wholesale suppliers continue to engage in such billing practices. AEP reports that none of its wholesale power suppliers provide this information.⁴ To comply with the requirements of Administrative Regulation 807 KAR 5:056, it uses historical pricing information and reports the fuel cost of its power purchases as 80 percent of total purchase price.⁵

The Commission is concerned that these new market conditions, when coupled with the increasing use of purchased power to meet native load requirements, will lead to disparate treatment of purchased energy costs. Some electric utilities are treating energy purchases that supplement, but do not displace native generation, as economy purchases and seeking recovery of the total purchase cost through their FACs. Some electric utilities, no longer receiving billing information that identifies the fuel portion of their non-economy power purchases, are treating the entire purchase as a fuel cost. Other electric utilities, also lacking detailed billing information, are attempting to estimate the cost of the fuel portion of such transactions based on historic billing information. As a result, uniform treatment of fuel costs is being eroded creating the potential for recovery of non-fuel related costs through FACs.

Based upon our review of Administrative Regulation 807 KAR 5:056 and in recognition of the recent changes in the wholesale energy market, we find that some

⁴ AEP Response to the Commission's Order of December 20, 2001, Item 22(a).

⁵ AEP Response to the Commission's Order of December 20, 2001, Item 22(b).

clarification of the regulation's treatment of economy energy purchases and non-economy energy purchases is necessary. Economy energy is [e]nergy produced and supplied from a more economical source in one system, substituted for that being produced or capable of being produced by a less economical source in another system." Sierra Pacific Power Co. v. Public Service Commission of Nevada, 634 P.2d 1200, 1203 fn.1 (Nev. 1981). Economy energy sales occur when utilities purchase energy from other utilities that can generate the energy at lower cost. Citizens of State v. Public Service Com'n, 464 So.2d 1194 (Fla.1985).⁶

We view economy energy purchases that are recoverable through an electric utility's FAC as purchases that an electric utility makes to serve native load, that displace its higher cost of generation, and that have an energy cost less than the avoided variable generation cost of the utility's highest cost generating unit available to serve native load during that FAC expense month. When the purchased energy price consists of a total charge per unit of energy, with no separate demand charge, the energy cost is the total charge per unit of energy. Where an energy vendor lists the components of the total energy price, the energy cost is the energy cost exclusive of any demand or capacity charges.

Non-economy energy purchases are purchases made to serve native load that have an energy cost greater than the avoided variable cost of the utility's highest cost generating unit available to serve native load during that FAC expense month. When the purchased energy price of such purchases consists of a total charge per unit of energy, with no separate demand charge, the energy cost is the total charge per unit

⁶ Such transactions are generally considered beneficial to utility ratepayers by permitting purchasing utilities to obtain lower cost power to meet their native load requirements while allowing selling utilities the opportunity to earn additional revenue by the sale of excess power.

of energy. When an energy vendor lists the components of the total energy price, the energy cost is the energy cost exclusive of any demand or capacity charges.

We interpret Administrative Regulation 807 KAR 5:056 as permitting an electric utility to recover through its FAC only the lower of the actual energy cost of the non-economy purchased energy or the fuel cost of its highest cost generating unit available to be dispatched to serve native load during the reporting expense month. Costs for non-economy energy purchases that are not recoverable through an electric utility's FAC are considered non-FAC expenses and, if reasonably incurred, are otherwise eligible for recovery through base rates.

The Commission believes that this interpretation is consistent with the letter and the spirit of Administrative Regulation 807 KAR 5:056. It should ensure a uniform treatment of fuel costs by all electric utilities subject to our jurisdiction, provide a greater degree of certainty as to the fuel expenses eligible for recovery through a FAC, and encourage reasonable and economically efficient energy procurement practices, while continuing to protect the interests of utility ratepayers. We place AEP on notice that this interpretation shall be applied to all energy purchases made after April 30, 2002.

In reaching our interpretation, we are mindful that some power purchases occur under emergency circumstances. We recognize that in such circumstances wholesale power market prices may significantly exceed the fuel cost of an electric utility's highest cost generating unit available to serve native load. In those circumstances, the utility may apply to the Commission for immediate rate recovery of those costs. In reviewing such applications, we will carefully consider, inter alia, the nature of the emergency, the reasonableness of the energy transactions, the effect of non-recovery upon the utility, and all reasonable and lawful means of rate recovery available to the utility.

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds no evidence of improper calculation or application of AEP's FAC charges or improper fuel procurement practices.

IT IS THEREFORE ORDERED that the charges and credits billed by AEP through its FAC for the period May 1, 2001 to October 31, 2001 are approved.

Done at Frankfort, Kentucky, this 2nd day of May, 2002.

By the Commission

ATTEST:


Executive Director