

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY AND KENTUCKY	)	
UTILITIES COMPANY FOR A CERTIFICATE	)	CASE NO.
OF PUBLIC CONVENIENCE AND NECESSITY	)	2002-00029
FOR THE ACQUISITION OF TWO	)	
COMBUSTION TURBINES	)	

O R D E R

Louisville Gas and Electric Company ( LG&E ) and Kentucky Utilities Company ( KU ) filed a joint application on January 23, 2002, requesting a Certificate of Public Convenience and Necessity and a Certificate of Environmental Compatibility for the acquisition of two 152 Megawatt ( MW ) combustion turbines ( CTs ). Per the application, LG&E and KU estimated the total installed cost of the two CTs to be \$124 million.<sup>1</sup> An unregulated affiliate, LG&E Capital Trimble County LLC ( TCLC ), which is a subsidiary of LG&E Capital Corp., purchased the turbines from General Electric in April 2001. The construction of the CTs began in June 2001 at LG&E s Trimble County Generating Station in Trimble County, Kentucky on approximately three acres of land that LG&E sold to TCLC in conjunction with the synthetic lease

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<sup>1</sup> In response to Item 1 of Commission Staff s data request dated March 11, 2002, LG&E and KU indicated that actual costs would possibly be less than estimated costs due to actual capitalized interest costs being lower than the \$11.5 million included in the estimated cost of the project. Lower interest rates and entering into a synthetic lease arrangement were cited as the reasons for the reduced interest costs.

arrangement entered into for purposes of financing the construction. The CTs are expected to be in operation by June 1, 2002.

LG&E and KU state that the CTs are needed to reliably serve their customer loads, and that acquiring these CTs is the most reasonable, least-cost option available to meet those loads. Based on each utility's existing capacity and load, the application proposes that LG&E own 29 percent of both CTs, with KU owning the remaining 71 percent. In assessing their need for additional capacity, LG&E and KU issued a Request For Proposal ( RFP ) for purchased power on February 26, 2001. The responses to that RFP indicated that acquiring the two CTs would be the least-cost alternative for meeting LG&E's and KU's load requirements.

LG&E's and KU's planning reserve margin is based on a range of 11 percent to 14 percent and they have committed to maintaining a target reserve margin near the upper end of that range. Based on their 2001 load forecasts, without additional capacity, LG&E's and KU's combined forecast reserve margin for 2002 will be 12.1 percent. With the acquisition of one CT, the forecast reserve margin for 2002 will increase to 14.5 percent, while the acquisition of both CTs will increase the forecast reserve margin to 16.8 percent. For 2003, the reserve margin is forecast to be 9 percent with no capacity additions and 14 percent with both CTs installed.

LG&E and KU point out that the resource assessment they relied upon in selecting the proposed CTs as the next increment of capacity was based on their 2000 load forecasts. Those forecasts indicated a capacity deficiency for 2002 approximately 100 MW greater than the deficiency indicated by their 2001 load forecasts. Based on

the 2000 forecasts, additional capacity of roughly 250 MW would be needed to produce a planning reserve margin of 14 percent in 2002.

The Attorney General ( AG ) and Kentucky Industrial Utility Customers, Inc. ( KIUC ) requested and were granted intervention in this proceeding. Subsequent to an informal conference on February 6, 2002, the Commission established a procedural schedule which provided for two rounds of discovery, intervenor testimony, and a public hearing. Testimony was filed by the AG and a public hearing was held at the Commission s offices on April 19, 2002. KIUC raised no objection to the acquisition of the two CTs.

#### BACKGROUND

LG&E received an air permit from the Natural Resources and Environmental Protection Cabinet on June 22, 2001 for the two CTs. LG&E and KU intended to construct the CTs and in June 2001 were preparing an application requesting the Commission to issue a certificate authorizing the construction. However, on June 19, 2001, the Governor issued Executive Order 2001-771, which imposed a 180-day moratorium on the Commission s acceptance of such applications. Due to this delay, construction was begun by the utilities unregulated affiliate, TCLC. On January 11, 2002, the moratorium was revised by Executive Order 2002-50 to allow the Commission to accept applications for certificates to construct, but not to issue such certificates. The moratorium was later revised on January 23, 2002 by Executive Order 2002-95 to allow a certificate to be issued if the application concerns generation required for Kentucky customers during the summer of 2002.

### AG POSITION

Based on the planning reserve margins used by LG&E and KU, the AG states that one CT is justified for 2002, but that two CTs will push the reserve margin above the upper end of the target range. The AG does not claim that the reserve margin for 2002 with the addition of both CTs will be unreasonable; rather, he claims that Executive Order 2002-95 prohibits the Commission from granting a certificate for both CTs because the new electric generation is not required to serve Kentucky's electric customers during the summer of 2002. With a 16.8 percent forecast reserve margin for 2002 based on the most recent load forecasts, the AG argues that two CTs are not required to serve LG&E's and KU's customers during the summer of 2002. The AG maintains that the Commission should approve the acquisition of one CT for 2002 and approve the acquisition of the second CT for 2003.

The AG points out that in recent years LG&E and KU have been adding gas-fired peaking capacity and that in this case LG&E and KU considered only natural gas-fired generation for meeting their increasing load requirements. Due to the volatile nature of both natural gas supply and prices, the AG contends that LG&E and KU should examine other alternatives such as additional capacity at LG&E's Falls of the Ohio hydroelectric plant.

### LG&E AND KU POSITION

LG&E and KU argue that both CTs will be expected to serve their customers during the summer of 2002. LG&E and KU note that nine of their seventeen CTs are between 30 to 40 years old, and that some of their base load units are between 40 and 50 years old, which may result in unexpected failures. In case of warmer than normal

weather, unexpected extreme forced outages, or undelivered purchased power, the availability of the CTs will be key to LG&E's and KU's ability to serve native load customers without interruption or reliance on the wholesale market. Further, LG&E and KU state that if both CTs are not acquired now, their unregulated affiliate will attempt to enter into a long-term business arrangement for the unacquired unit, rendering it permanently unavailable for a later acquisition by LG&E and KU. As for not considering the alternative of additional capacity at the Falls of the Ohio plant, LG&E and KU state that such run-of-the-river capacity is not suitable for meeting peak demand because power can be generated only when the flow of the Ohio River is at an appropriate level.

## DISCUSSION

### Current Resource Planning

LG&E's and KU's analysis supports the construction of the two CTs as the least cost option for meeting loads in 2002 and 2003 compared to relying on purchase power peaking alternatives. Executive Order 2002-95 has recently been superseded by Executive Order 2002-540, issued May 15, 2002, which lifts the moratorium on the issuance of certificates to construct new power plants. With the termination of the moratorium, the AG's objection to the issuance of a certificate to acquire two CTs now is rendered moot. Based on the evidence of record, the Commission finds that the acquisition of the two CTs is the least cost option to reliably serve LG&E's and KU's customer loads, is reasonable, and should be approved. The Commission also finds that LG&E and KU should continue to analyze the feasibility of adding additional hydro capacity at the Falls of the Ohio plant even though such capacity may not be available when needed to meet peak demand.

The application as filed also requests the Commission to issue a Certificate of Environmental Compatibility, pursuant to KRS 278.025, for the two CTs. However, on April 24, 2002, the Governor signed Senate Bill No. 257, which repealed KRS 278.025 as of that date. Consequently, no Certificate of Environmental Compatibility is now needed.

#### Future Resource Planning

In the last 4 years, LG&E and KU have added four CTs to their system, adding two in 1999 and two more in 2000. In both 1999 and 2000, an unregulated affiliate constructed the CTs on generating sites owned by either LG&E or KU. In both instances, as in this case, LG&E and KU requested a certificate to acquire the CTs after construction had commenced. The Commission recognizes that the land available for new generation at the utilities existing generating sites is finite. We also realize this land is very valuable to the utilities and their customers due to the existing infrastructure that includes both natural gas pipelines and electric transmission lines. Because of the finite nature and value of these sites, we find that LG&E and KU should seek Commission approval prior to entering into the sale or lease of any land located on an existing generation site.

#### Transfer Pricing of CTs

LG&E and KU state that the CTs should be transferred at cost, in accordance with the regulations of the Securities and Exchange Commission ( SEC ). LG&E and KU indicate that this treatment is necessary due to the fact that their parent company, LG&E Energy, is part of the PowerGen registered holding company system.

LG&E sold property to TCLC, in connection with the aforementioned synthetic lease arrangement, in order to establish a site for TCLC's construction of the CTs. The property will be sold back to LG&E at cost when the CTs are transferred to LG&E and KU in accordance with LG&E Energy's Corporate Policies and Guidelines for Inter-Company Transactions (Corporate Guidelines) as adopted by the Commission in Case No. 1997-00300.<sup>2</sup>

The Commission agrees that the CTs should be priced at cost and finds that LG&E and KU should file their final determination of the cost of the transferred CTs within 30 days after the date of the transfer. The determination should be in accordance with the requirements of the SEC and LG&E Energy's Corporate Guidelines. All accounting entries made to the books of LG&E and KU relating to the transfer of the CTs, the allocation of the cost of the CTs between LG&E and KU, and the reacquisition of the land on which the CTs were constructed should also be filed with the Commission within 30 days of the transfer.

IT IS THEREFORE ORDERED that:

1. LG&E is granted a Certificate of Public Convenience and Necessity for the acquisition of 29 percent of two 152 MW CTs constructed by TCLC at LG&E's Trimble County Generating Station by TCLC, and KU is granted a Certificate of Public Convenience and Necessity for the acquisition of the remaining 71 percent.

2. LG&E's and KU's request for a Certificate of Environmental Compatibility is dismissed as moot.

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<sup>2</sup> Case No. 1997-00300, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of Merger (final Order dated September 12, 1997).

3. LG&E and KU shall seek Commission approval prior to entering into a sale or lease of any land located on any existing generation sites.

4. Within 30 days of the date of the transfer of the CTs, LG&E and KU shall file their final determination of the cost of the CTs.

5. Within 30 days of the date of the transfer of the CTs, LG&E and KU shall file all accounting entries made to their books to record the transfer, the allocation of cost of the CTs, and the reacquisition of the land on which the CTs were constructed.

Done at Frankfort, Kentucky, this 11<sup>th</sup> day of June, 2002.

By the Commission

ATTEST:

  
Executive Director