COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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	)))))	CASE NO. 2014-00226

ORDER

Pursuant to 807 KAR 5:056, the Commission established this case on August 13, 2014, to review and evaluate the operation of the Fuel Adjustment Clause ("FAC") of East Kentucky Power Cooperative, Inc. ("East Kentucky") for the six-month period that ended on April 30, 2014. Grayson Rural Electric Cooperative Corporation ("Grayson") was granted intervention in this matter. Kentucky Industrial Utility Customers, Inc. requested intervention but subsequently withdrew its request. The Commission established a procedural schedule, and Commission Staff ("Staff") and Grayson propounded requests for information to East Kentucky. The Commission held a public hearing in this matter on November 12, 2014. East Kentucky and Grayson filed post-hearing briefs on December 17, 2014. All information requested at the hearing has been filed and the case now stands submitted for a decision.

Power Purchases

East Kentucky filed a Memorandum on February 18, 2014 ("February 2014 Memo") with its monthly FAC filing stating its belief that power purchases made to meet load when all available generation is operating are fully includable for recovery through the FAC.[1] Further, during the course of this proceeding, East Kentucky stated its belief that power purchases made when it is experiencing a planned outage are also fully includable for recovery through the FAC.[2]

DISCUSSION

In FAC review proceedings in 2002, the Commission set forth the definition of "economy energy purchases" and "non-economy energy purchases" and the recoverability of each through the FAC. Discussing "economy energy purchases," the Commission stated:

> 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. [3]

Discussing "non-economy energy purchases," the Commission stated:

> 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.[4]

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[1] February 2014 Memo at 3, which was attached to the Commission's August 13, 2014 Order, Appendix B.

[2] Response to the Commission's Initial Request for Information ("Commission's First Request"), Item 28.

[3] Case No. 2000-00496-B, *An Examination by the Public Service Commission of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001* (Ky. PSC May 2, 2002), Order ("496B Order") at 4.

[4] *Id.* at 5.

In the March 21, 2005 Order in Case No. 2004-00430,[5] the Commission modified its definition of "non-economy energy purchases" stating that:

> The definition of 'non-economy energy purchases' set forth in our Order in Case No. 2000-00496-B too narrowly construes 807 KAR 5:056 and conflicts with the regulation. A more accurate definition of non-economy energy purchases recognizes that the energy costs thereof may be greater or less than the variable cost of the highest cost generating unit available to serve native load.[6]

In January 2014, East Kentucky began recovering all of its power purchases through its FAC rather than limiting the recovery of such purchases as required in the 496B Order. The amount of power purchases that East Kentucky recovered through the FAC during the review period that were in excess of the variable cost of its highest-cost generating unit available to serve native load was $8,538,787.[7]

On June 1, 2013, East Kentucky became a fully integrated member of PJM Interconnection, Inc. ("PJM"), a regional transmission organization ("RTO"). East Kentucky states that, upon becoming fully integrated into PJM, it did not change its methodology of excluding power purchases above its highest-cost generating unit for recovery through the FAC. However, upon "closer review" in January 2014, East Kentucky determined that ". . . because its load is served from an economic, reliability constrained dispatch via the PJM energy market, then EKPC is always utilizing what is deemed to be the most economic dispatch of resources regardless of whether or not it

[5] Case No. 2004-00430, *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* (Ky. PSC Mar. 21, 2005).

[6] *Id.* at 6.

[7] Response to Staff's Second Request ("Staff's Second Request"), Item 5, at 3.

is owned generation or energy supplied from the market."[8] Therefore, East Kentucky concluded that its self-owned highest-cost generation is no longer the measure to be utilized for the calculation. East Kentucky argues that its highest-cost generating unit available to serve native load is now the highest-cost generation that was sold into the PJM Reliability Pricing Model auction.[9] East Kentucky further claims that it no longer makes "non-economy purchases" because all of its purchases are "economy purchases."[10]

East Kentucky states that the Commission's 496B Order was written at a time when regional energy markets were young and before utilities had gained experience with the markets. East Kentucky claims that the underlying facts of this proceeding are very different from those that existed at the time of the 496B Order, and that, if the dicta in the 496B Order were applied in the PJM context, "it would quite likely undermine the very purpose of the FAC regulation, which is to minimize fuel cost volatility for ratepayers."[11]

In its post-hearing brief,[12] East Kentucky argues that: 1) its energy purchases from PJM are recoverable expenses under its FAC tariff; 2) its FAC tariff requires recovery of all energy purchases from PJM that are used to serve native load; 3) its FAC tariff requires recovery of all net energy costs of power purchased based on economic dispatch principles; and 4) Commission precedent in the 496B Order is

[8] Response to the Commission's First Request, Item 28, at 1 and 2.

[9] Response to Staff's Second Request, Item 2, at 2.

[10] Response to the Commission's First Request, Item 26.b.(1), at 3.

[11] Response to the Commission's First Request, Item 26.b.(2), at 5.

[12] Brief of East Kentucky Power Cooperative, Inc. (filed Dec. 17, 2014).

distinguishable and should not be regarded as controlling or persuasive authority in this proceeding.

PJM Codes

East Kentucky stated in its February 2014 Memo that it included two additional PJM billing codes in the FAC for recovery beginning in January 2014: Code 1375 – Balancing Operating Reserves (Balancing Charges); and Code 2375 – Balancing Operating Reserves (Balancing Credits). East Kentucky stated that it had initially indicated that it would not include these codes in its FAC calculations but that it would continue to evaluate and review the nature of the PJM billing codes.[13] East Kentucky argues that the peak-demand events that occurred in January 2014 affected its previous evaluation of the codes, and that the billing codes ". . . reflect the charges and credits resulting from generators in PJM being called upon to bring units on to provide energy beyond the levels having already cleared the market."[14] East Kentucky states that it was a purchaser of this additional generation in order to meet native-load requirements in January 2014, and it is reasonable to include the net of billing codes 1375 and 2375 in the FAC for recovery.[15] East Kentucky stated at the hearing that these two codes reflect the same type of costs that it recovered through the FAC prior to joining PJM.[16]

As previously mentioned, East Kentucky began including the two PJM codes in its FAC calculation in January 2014. If East Kentucky had included the codes in the seven-month period of June 2013 (when it became a full PJM member) through

[13] February 2014 Memo at 3.

[14] *Id.* at 3.

[15] *Id.*

[16] November 14, 2014 Hearing Transcript at 11:13:50.

December 2013, East Kentucky's fuel costs would have been less by $522,754.[17] Included in that amount is a total of $68,818 for the months of November and December 2013,[18] which fall within the review period.

Grayson filed a post-hearing brief in which it objected to East Kentucky's use of PJM codes 1375 and 2375. Grayson claims that East Kentucky's decision to begin using these codes in January 2014 is arbitrary and "prohibited by the regulation and the applicable statutory scheme that demands that rates be fair, just, and reasonable."[19]

DECISION

Power Purchases

East Kentucky's FAC tariff includes language that virtually mirrors 807 KAR 5:056. Relying on this language and on the Commission's interpretation of the regulation as set forth in the 496B Order, East Kentucky was limiting recovery through the FAC of power purchases made when needed to meet load until January 2014. For purchases made during a planned outage, East Kentucky states that it "has never separately accounted for the replacement energy during planned outages since those are recoverable through the regulation."[20]

The Commission was clear in its 496B Order that power purchases were either "economy energy purchases" or "non-economy energy purchases," and that "non-economy energy purchases" were limited for recovery through the FAC. Although the Commission modified the definition of "non-economy energy purchases" in Case No.

[17] Response to the Commission's First Request, Item 26.c.(3).

[18] *Id.* 37,551 (November 2013 total) + 31,267 (December 2013 total) = 68,818.

[19] Grayson Post-Hearing Brief at 4.

[20] Response to Staff's Second Request, Item 8.a., at 2.

2004-00430 to recognize "that the energy costs thereof may be greater or less than the variable cost of the highest cost generating unit available to serve native load",[21] it did not modify the requirement that the utility recover through the 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."[22]

The Commission defined "economy energy purchases" 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.[23]

To the extent that East Kentucky purchases power from PJM that exceeds the avoided variable generation cost of its own highest-cost unit available, those purchases are not "economy energy purchases." Whether a utility is a member of an RTO that dispatches economically does not impact the determination of whether the purchase is an "economy energy purchase" as interpreted by the Commission's 496B Order. If a purchase does not meet the definition of an "economy energy purchase," then it must be considered a "non-economy energy purchase," which is limited for recovery through the FAC. However, the Commission did not, and does not, declare that these purchases are not recoverable. In fact, the Commission stated in the 496B Order that:

[21] Case No. 2004-00430, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Mar. 21, 2005), Order at 6.

[22] 496B Order at 5 (emphasis added).

[23] *Id. at 4 (emphasis added).*

> 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.[24]

The purpose of the FAC regulation is not to minimize fuel cost volatility for ratepayers, as stated by East Kentucky, though it could be argued that limiting recovery of purchases through the FAC would minimize fuel-cost volatility more effectively than the unlimited recovery advocated by East Kentucky. The purpose of the FAC regulation was to establish a uniform mechanism whereby jurisdictional electric utilities could recover (or refund), on a monthly basis, fuel costs incurred that were in excess of (or less than) the amount of fuel costs included in their base rates.[25] Having such a mechanism in place should reduce the frequency of base rate cases. It 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. The Commission believes it is important to maintain the limitation for recovery through the FAC of "non-economy energy purchases" in order to incentivize utilities to keep outages to a minimum and to have sufficient capacity to meet load. In the 496B Order, the Commission stated:

> In reaching our interpretation, we are mindful of EKPC's concerns regarding power purchases made under emergency circumstances. We recognize that in such circumstances wholesale power markets may significantly exceed the fuel cost of EKPC's highest cost generating unit available to serve native load. In those circumstances,

[24] *Id.* at 5.

[25] *See* Case No. 2004-00430, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Feb.7, 2005), Order at 2. (FAC is a mechanism for an electric utility to recover its current fuel expense without need for a full rate proceeding.)

EKPC may apply to the Commission for immediate rate recovery of those costs.[26]

807 KAR 5:056 requires the Commission, at six-month intervals, to conduct public hearings on a utility's past fuel adjustments. It further requires "the commission order a utility to charge off and amortize, by means of a temporary decrease in rates, any adjustments it finds unjustified due to improper calculation or application of the charge or improper fuel procurement practices."[27] Therefore, the Commission finds that:

1. Purchase power costs of $8,538,787 in excess of East Kentucky'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. East Kentucky should immediately begin limiting recovery of power purchases through the FAC, excluding power purchases made to substitute for a forced outage,[28] to the fuel cost of its highest-cost generating unit available to be dispatched to serve native load during the reporting expense month.

3. Power purchases in excess of the fuel cost of East Kentucky's highest-cost generating unit available to be dispatched to serve native load during the reporting expense month that have been recovered through the FAC since the end of the review period should be disallowed in future FAC review proceedings.

4. Because the $8,538,787 of power purchases was collected over a four-month period, East Kentucky should be required to credit this amount through its FAC

[26] 496B Order at 5.

[27] 807 KAR 5:056(11).

[28] Power purchases made to substitute for a forced outage are limited for recovery through the FAC to the lesser of the assigned or the substitute power.

over four months in equal amounts of $2,134,696.75 beginning with the first FAC monthly filing following the date of this Order.

5. Outside of the power purchases in excess of East Kentucky's own highest-cost generating unit available to be dispatched to serve native load during the reporting expense month as discussed herein, and the issue of which RTO billing codes are appropriate for inclusion in the FAC, the Commission finds that there is no evidence of improper fuel calculations or application of East Kentucky's FAC charges or improper fuel procurement practices.

PJM Codes

Having reviewed the record of this proceeding regarding this issue, the Commission finds that additional information is needed in order to determine whether East Kentucky's inclusion of specific PJM codes in its calculation of the FAC is appropriate. In the next FAC review proceedings covering the two-year period November 1, 2012, through October 31, 2014, the Commission will examine the issue of RTO billing codes and the appropriateness of their inclusion in the FAC calculation for those utilities that are members of an RTO. The Commission also finds that East Kentucky should file testimony in the next FAC review proceeding on the specific codes that are included in the FAC calculation and an explanation why each is appropriate for inclusion, subject to the recovery limitation discussed in this Order.

IT IS THEREFORE ORDERED that:

1. Purchase power costs of $8,538,787 are disallowed for recovery by East Kentucky through its FAC for the review period.

2. East Kentucky shall immediately begin limiting recovery of power purchases through the FAC, excluding power purchases made to substitute for a forced outage, to the fuel cost of its highest-cost generating unit available to be dispatched to serve native load during the reporting expense month.

3. Power purchases in excess of the fuel cost of its highest-cost generating unit available to be dispatched to serve native load during the reporting expense month that have been recovered through East Kentucky's FAC since the end of the review period shall be disallowed in future FAC review proceedings.

4. Beginning with its first FAC filing made subsequent to the date of this Order, or as amended if filed prior to the date of this Order, and continuing for a total of four consecutive months, East Kentucky shall include a credit of $2,134,696.75 to refund to customers a total of $8,538,787 for power purchases in excess of the fuel cost of its highest-cost generating unit available to be dispatched to serve native load during the reporting expense month.

5. The issue of RTO billing codes and the appropriateness of their inclusion in the FAC calculation shall be examined in the next FAC review proceedings covering the two-year period November 1, 2012, through October 31, 2014 for those electric utilities that are members of an RTO.

6. East Kentucky shall file testimony in the next FAC review proceeding on which codes are included in the FAC calculation and an explanation for why each is appropriate for inclusion, subject to the recovery limitation discussed in this Order.

7. Except for the power purchases in excess of East Kentucky's own highest-cost generation unit available to be dispatched to serve native load during the reporting expense month as discussed herein, and the issue of which RTO billing codes are appropriate for inclusion in the FAC, the charges and credits billed by East Kentucky through its FAC for the period November 1, 2013 through April 23, 2014 are approved.

By the Commission

ENTERED

JAN 30 2015

KENTUCKY PUBLIC
SERVICE COMMISSION

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