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February 28, 2005

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PUBLIC SERVICE
COMMISSION

Hon. Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40602-0615

Re: Case No. 2004-00430
East Kentucky Power Cooperative

Dear Ms. O'Donnell:

Enclosed please find an original and ten copies of Salt River's motion to intervene, motion for a rehearing, memorandum and attached testimony in support of rehearing.

Very truly yours,

FULTON, HUBBARD & HUBBARD

Regina Rapier Beckman

Regina Rapier Beckman

RRB/dds
Enclosures

REGINA:SALT RIVER-PSC022805.LTR

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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

EAST KENTUCKY POWER COOPERATIVE'S)
REQUEST FOR A DECLARATORY RULING ON)
THE APPLICATION OF ADMINISTRATIVE) CASE NO. 2004-00430
REGULATION 807 KAR 5:056 TO ITS PROPOSED)
TREATMENT OF NON-ECONOMY ENERGY)
PURCHASES)

MEMORANDUM IN SUPPORT OF SALT RIVER'S MOTION FOR A REHEARING

PROCEDURAL BACKGROUND

On October 5, 2004 , East Kentucky Power Cooperative, Inc. ("EKPC") filed a letter with the Public Service Commisson ("Commission") requesting an interpretation from the Commission regarding EKPC's proposed reporting procedure for non-economy purchases under the Fuel Adjustment Clause ("FAC"). No evidence or comments were submitted by any of the parties to the proceeding. On February 7, 2005, the Commission denied the request of EKPC.

ARGUMENT

It is Salt River's position that EKPC should not be allowed to charge through the FAC all purchases that EKPC make when demand for native load exceeds available capacity. EKPC requested leave to charge $0.00 through its fuel cost for all non-economy purchases. However, Salt River's concern is not necessarily for non-economy purchases but for purchases made to cure capacity deficiency. Purchases made to cure capacity deficiency should not be computed through the FAC and the savings this would produce would save money for all member systems of EKPC and their respective members. This treatment is not prevented by Salt River's interpretation of KRS 278.160(2) and 807 KAR 5:056.

ISSUES

(I) Non- economy purchases vs. reliability purchases

Salt River agrees with the Commission's discussion of economy energy purchases and non-economy energy purchases as stated in its previous Order entered in this case. Economy energy purchases displace the energy production of one system and are purchases from a more economical source in one system substituted for that being produced in another system. (February 7, 2005 Order at pages 3, 4; Case No. 2000-00496-B, 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 at pages 2-5 (Ky. PSC. May 2, 2002)). Non-economy purchases are defined as 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. (February 7, 2005 Order at pages 3-4; Case No. 2000-00496-B at pages 2-5.) It is Salt River's position that the purchases discussed in EKPC's letter were not non-economy purchases or economy purchases.

In EKPC's letter of October 5, 2004, EKPC stated that it was proposing to absorb the cost of non-economy purchases of electric energy in those hours when all available EKPC installed generation capacity is fully committed to serving native load requirements. However, it is Salt River's position that the purchase of electric energy in those hours when all available EKPC installed generation capacity is fully committed to serving native load requirements is not necessarily a non-economy purchase but more accurately described as a reliability purchase.

It is Salt River's position that reliability purchases should not be passed on through the FAC.

When EKPC purchases power to cure a capacity deficiency, such purchase may not have an energy cost greater than the avoided variable cost of the utility. As reflected in the attached testimony of Larry Hicks, purchases made to cure capacity deficiency often are less than the avoided variable cost of the utility highest cost of the utility's highest cost generating unit available to serve native load during that FAC month and accordingly are not non-economy purchases. Also, since these purchases are not displacing native load they do not qualify as economy purchases. Thus it is Salt River's position that purchases to cure a capacity deficiency are reliability purchases.

East Kentucky Power recovers the cost of these reliability purchases in its tariff and should not be allowed to recover for these again through the Fuel Adjustment Clause. As illustrated in the example given in the testimony of Larry Hicks (copy attached hereto), when EKPC applies the FAC for a purchase to cure capacity it actually over reports its actual cost of fuel. Salt River asks that EKPC not under report or over report its actual cost of fuel, but that EKPC be required to report in a manner that more accurately reports its cost of fuel.

(II) Compliance with KRS 278.160(2) and 807 KAR 5:056.

The Commission states that EKPC's proposal violates 807 KAR 5:056. However, Salt River's position is that 807 KAR 5:056 and the Commission's interpretation of this regulation in Case No. 2000-00496-B do not cover the purchases discussed above that Salt River calls "reliability purchases". These purchases are basically left unaddressed.

Administrative Regulation 807KAR 5:056 Section 1(3) provides (emphasis ours):

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.

EKPC does not provide any information as to "actual identifiable fossil and nuclear fuel cost" with the purchases it makes to cure capacity. It is Salt River's belief that the entire cost of the purchased power to cure deficiency is passed on by EKPC regardless of the source of the cost.

Case No. 2000-00496-B provides that for <u>economy purchases</u> the energy price was either the total charge per unit of energy <u>or</u> the cost exclusive of demand or capacity charges if the vendor lists the components of the total energy price. For <u>non-economy purchase</u> the energy cost was the total charge per unit of energy <u>or</u> the cost exclusive of demand or capacity charge if the vendor listed the components of the total energy price. Further <u>non-economy purchases</u> were capped by permitting through the FAC the lower of the actual energy cost of purchase or the fuel cost of its highest generating unit available to be dispatched to serve native load during the reporting expense month.

As discussed, these purchases to cure capacity do not fit the definition of either <u>economy</u> or <u>non-economy</u> so the Case No. 2000-00496-B interpretation of 807 KAR 5:056 does not apply.

Accordingly the strict language of the regulation should apply requiring only the "actual identifiable fossil and nuclear fuel cost" associated with the energy purchase. If these costs cannot be identified then "$0.00" should be passed through the fuel cost adjustment clause.

The commission also stated that KRS 278.160(2) requires EKPC not to change the procedure due to the rate schedules previously filed. However, that could be remedied by EKPC filing new rate schedules for "reliability purchases".

CONCLUSION

Salt River believes that the current method of reporting requires EKPC to over report its cost of fuel and charge unreasonable rates to its members. For purchases to cure capacity, EKPC should put $0.00 through the fuel adjustment clause or report costs in a manner the Commission deems appropriate that prevents over charging for fuel costs.

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Attorneys for Applicant

CERTIFICATE OF SERVICE

This is to certify that an original and ten copies of the foregoing Memorandum in Support of Motion to Intervene were served by U.S. Mail to Hon. Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Blvd., Frankfort, KY 40602-0615; and by mailing a true and correct copy, first class postage prepaid, to all parties on the attached service list on this the 28th day of February 2005.

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REGINA:SALT RIVER-PSC-MOTION FOR REHEARING

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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

EAST KENTUCKY POWER COOPERATIVE'S	)	
REQUEST FOR A DECLARATORY RULING ON	)	
THE APPLICATION OF ADMINISTRATIVE	)	CASE NO. 2004-00430
REGULATION 807 KAR 5:056 TO ITS PROPOSED	)	
TREATMENT OF NON-ECONOMY ENERGY	)	
PURCHASES	)	

TESTIMONY OF LARRY HICKS

TESTIMONY OF LARRY HICKS

Q.1 Please state your name and address.

A. Larry H. Hicks, 111 W. Brashear, Bardstown, KY.

Q.2 Please provide your educational background and experience for the cooperative.

A. I received a BSC in Accounting from the University of Louisville in 1978 and obtained my MBA from UL in 1997. I was hired as Salt River's Chief Financial Officer in 1990 and was promoted to President and CEO in 1996.

Q.3 In your capacity as President and CEO have you studied the rates issue by East Kentucky Power?

A. Yes.

Q.4 Have you also studied the particular issue of Fuel Adjustment Clause?

A. Yes

Q.5 What comments do you have regarding East Kentucky Power's current application of the fuel adjustment clause for power it purchases to cure a capacity deficiency?

A. The fuel adjustment clause was initiated to allow utilities to pass through the increases and decreases of fuel costs without going through a formal rate case. Ky. Administrative Regulation 807 KAR 5:056 was patterned after the FERC order 517. Both allowed recovery of only the energy portion of "economy purchases" and required utilities to exclude from recovery capacity costs regardless if such costs were explicitly identified.

In 1983, FERC recognized that not allowing utilities to recover part of the total costs of purchases that were less than avoided cost of the fuel to generate the power gave a disincentive for utilities to pursue the lowest cost options. In order 352, FERC redefined "economy purchase" as any purchase that is less than the avoided costs of fuel to generate the power. FERC allow utilities to recover 100% of the costs of "economy purchase".

In this order they also recognized that utilities also purchased power for reliability purposes. They specifically deny recovery of any purchase made to cure a deficiency in capacity.

In the PSC order 2000-00496-B, the Commission defined "economy purchases" as those "[t]hat an electric utility makes to serve native load, that displaces higher costs of generation . . ."

They also defined "non-economy purchases" as "[p]urchases made to serve native load that have an *energy costs greater than the avoided variable costs* of the utilities highest cost generating until available to serve native load during that FAC expense month."

Since purchases to cure a capacity deficiency have no avoided costs, they are not "economy purchases". And since almost all of these purchases in EKPC case are actually *less than the avoided variable costs* of the utilities highest cost generating unit available to serve native load during that FAC expense month, they are not "non-economy" purchases.

EKPC recovers from its rate tariff a demand charge and in most cases an on peak energy charge for any load even those where they have no investment in capacity. In a typical winter month, they will recover revenue for load that exceeds capacity equal to 3 to 4 times their costs of these purchases.

I respectfully submit they are purchases for reliability and should not be recovered through the fuel charge.

Q.6 Please discuss a specific example that illustrates your concerns of charging for purchased power through the fuel adjustment clause to meet capacity needs.

For the month of December, 2004, EKPC purchased 9,471 MWH of energy to offset capacity deficiencies. EKPC bills its members a demand charge based on a coincidental peak. When EKPC system peaked in December they purchased 503 MW to cure their capacity deficiency.

The costs of these purchases were $616,887.78 (an average of $65.13 per MWH) and were charged to EKPC's member in the FAC. The highest price paid for a purchase during this period was $100 per MWH. In comparison, EKPC charged $3,386,149 in natural gas, oil and land fill gas for 32,458 MWH at an average cost of $104.29 per MWH on the December expensed FAC report.

Through its tariff EKPC charged its members $5220 per MWH for 503 MW it had to purchase because it did not have the capacity to produce them. It also charged its members $30.03 per MWH for 9,471 MWH for energy it purchased because it did not have the capacity to produce them.

For the month of December 2004, EKPC charges its members for those 9,471 MWH of energy to offset capacity deficiencies as follows:

Demand Charges ($5.22 KW)	5220/MWH x 503 MW=	$2,625,660.00
Energy Charges (.3003 KW)	30.03/MWH x 9471 MWH=	284,414.13
FAC – purchased power cost to cure deficiency =		616,887.00
		3,526,961.00
		or 372 per MWH

thus for those 9471 MWH, EKPC's members paid $3,526,961 or $372 per MWH.

Larry H. Hicks

Larry H. Hicks

STATE OF KENTUCKY

COUNTY OF NELSON

Before me, a Notary Public, personally appeared the above-named Larry H. Hicks, to me personally known or satisfactorily proven to me to be the signers of the foregoing instrument, who acknowledged that he did sign the foregoing instrument and that the same respectively was his act and deed.

Given under my hand and seal of office, this 25 day of February 2005.

Dorothy A. Coen

NOTARY PUBLIC, KENTUCKY STATE AT LARGE

My Commission expires: 6-19-2006

REGINA:SALT RIVER-HICKS-LARRY.DEPOSITION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

MAR 0 1 2005

PUBLIC SERVICE COMMISSION

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	)	CASE NO. 2004-00430

MOTION TO INTERVENE

Salt River Electric Cooperative Corporation (Salt River), by counsel, hereby requests leave to fully intervene in this action pursuant to 807 KAR 5:00 Section 3(8). As grounds for this motion, Salt River states that the ruling issued in this case concerning rates charged by East Kentucky Power Cooperative ("EKPC") directly affects the amount charged to Salt River by EKPC.

EKPC requested leave to charge $0.00 through the Fuel Adjustment Clause (FAC) when purchases by EKPC were made in hours when all EKPC installed generation capacity was fully committed to meeting native load requirements. If the PSC had granted this relief, the cost of power purchased by Salt River Electric EKPC would have been fair, just and reasonable. EKPC would have ceased recovering both one hundred percent (100%) of purchase power for reliability and capacity charges for capacity it does not have. This would have reduced the cost to EKPC's member systems, including Salt River.

The ruling requires East Kentucky Power to charge rates that are not fair, just and reasonable as required by KRS 278.030(1). Salt River requests leave to intervene and requests permission to file a motion for a rehearing on the issues herein.

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CERTIFICATE OF SERVICE

This is to certify that an original and ten copies of the foregoing Motion to Intervene were served by U.S. Mail to Hon. Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Blvd., Frankfort, KY 40602-0615; and by mailing a true and correct copy, first class postage prepaid, to all parties on the attached service list on this the 28 day of February 2005.

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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	)	CASE NO. 2004-00430

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MOTION FOR REHEARING

Salt River Electric Cooperative Corporation ("Salt River"), by counsel, hereby requests a hearing in the above styled case having simultaneously filed a motion to intervene in this case.

As grounds for this motion, Salt River states that the ruling entered in this case on February 7, 2005 requires East Kentucky Power Cooperative to charge rates that are not "fair, just and reasonable" in violation of KRS 278.030(1).

On October 25, 2004 East Kentucky Power Corporation filed a letter with the Public Service Commission on requesting approval of a proposed change to its fuel adjustment clause ("FAC") reporting procedures.

The parties to this action did not file any comments or submit any evidence regarding this case.

Salt River moves for leave to intervene and submit evidence regarding the fuel adjustment clause (FAC) reporting procedures.

Attached to this motion is a memorandum in support of a rehearing and testimony of Larry Hicks.

FULTON, HUBBARD & HUBBARD

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