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PUBLIC SERVICE
COMMISSION

# COMMONWEALTH OF KENTUCKY

# BEFORE THE

# PUBLIC SERVICE COMMISSION OF KENTUCKY

**IN THE MATTER OF**

| | | |
|---|---|---|
| **AN EXAMINATION OF THE APPLICATION** | ) | |
| **OF THE FUEL ADJUSTMENT CLAUSE OF** | ) | |
| **KENTUCKY POWER COMPANY FROM** | ) | **CASE NO. 2007-00522** |
| **MAY 1, 2007 THROUGH OCTOBER 31, 2007** | ) | |

***DIRECT TESTIMONY OF ERROL K WAGNER***
**ON BEHALF OF**
**KENTUCKY POWER COMPANY**

**February 1, 2008**

**DIRECT TESTIMONY OF**
**ERROL K WAGNER, ON BEHALF OF**
**KENTUCKY POWER COMPANY**
**BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY**

**CASE NO. 2007-00522**

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# DIRECT TESTIMONY OF ERROL K WAGNER, ON BEHALF OF KENTUCKY POWER COMPANY BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

## I. Introduction

**Q: PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

**A:** My name is Errol K. Wagner. My position is Director of Regulatory Services, Kentucky Power Company ("Kentucky Power, KPCo or Company"). My business address is 101A Enterprise Drive, Frankfort, Kentucky 40602.

## II. Background

**Q: PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.**

**A:** I received a Bachelor of Science degree with a major in accounting from Elizabethtown College, Elizabethtown, Pennsylvania in December 1973. I am a Certified Public Accountant. I worked for two certified public accounting firms prior to joining the Pennsylvania Public Utility Commission Staff in 1976. In 1982, I joined the American Electric Power Service Corporation ("AEPSC") as a Rate Case Coordinator. In 1986, I transferred from AEPSC to Kentucky as the Assistant Rates, Tariffs and Special Contracts Director. In July 1987, I assumed my current position.

**Q: WHAT ARE YOUR RESPONSIBILITIES AS DIRECTOR OF REGULATORY SERVICES?**

**A:** I supervise and direct the Regulatory Services of the Company, which has the responsibility for rate and regulatory matters affecting Kentucky Power. This includes the preparation of and coordination of the Company's exhibits and testimony in rate cases and any other formal filings before state and federal regulatory bodies. Another responsibility is assuring the proper application of the Company's rates in all classifications of business.

**Q: TO WHOM DO YOU REPORT?**

**A:** I report to the President of Kentucky Power, Mr. Timothy C. Mosher, who is also located in Frankfort, Kentucky.

**Q: HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

**A:** Yes. I have testified before this Commission in numerous regulatory proceedings involving the adjustment in electric base rates, the fuel adjustment clause, the operation of the environmental cost recovery mechanism, approval of certificates of public convenience and necessity and other regulatory matters. I also testified in Case No. 2005-00341, KPCo's last case seeking a general adjustment in electric base rates.

## III. Purpose of Testimony

**Q: WHAT IS YOUR UNDERSTANDING OF THE PURPOSE OF THIS PROCEEDING?**

**A:** The Kentucky Public Service Commission (KPSC) issued its January 23, 2008 Order in Case No. 2007-00522 for the purpose of examining the Fuel Adjustment Clause (FAC) of KPCo for the six-month period ending October 31, 2007.

**Q: HAS THE COMPANY RESPONDED TO THE STAFF'S DATA REQUESTS, INCLUDING SUB-PARTS, IN APPENDIX B TO THE COMMISSION'S JANUARY 23, 2008 ORDER IN THIS CASE?**

**A:** Yes.

## IV. Transmission Line Loss Issue

**Q: ARE YOU FAMILIAR WITH THE RECENT ORDER BY THE FEDERAL ENERGY REGULATORY COMMISSION (FERC) WHICH REQUIRES PJM TO CHANGE ITS METHODOLOGY FOR DETERMINING AND ALLOCATING THE COSTS ASSOCIATED WITH TRANSMISSION LINE LOSSES?**

**A:** Yes. FERC Docket No. EL06-55 required PJM to implement a locational marginal loss methodology for the determination of transmission line losses. Effective June 1, 2007, FERC ordered that the new marginal loss methodology (post-June 1, 2007 methodology) replace the existing average loss method of accounting for transmission line losses, with the stated goal of achieving a more efficient dispatch of generation resources across the PJM footprint.

**Q: PLEASE DESCRIBE THE POST-JUNE 1, 2007 METHODOLOGY FOR BILLING TRANSMISSION LINE LOSSES.**

**A:** The post-June 1, 2007 methodology requires PJM to account for incremental or marginal transmission line losses in the dispatch of energy and the calculation of locational marginal prices (LMP). Under this method, the marginal cost of transmission line losses are factored into the marginal cost of energy (i.e., the LMP price) and the LSEs are only billed for the actual energy excluding variable transmission losses necessary to meet their load requirements. Transmission line losses are settled financially with PJM as separate charges and credits and recorded by AEP in Account 4470207 for the charges or Account 4470208 for the credits. In essence, under the post-June 1, 2007 methodology, marginal transmission line losses are settled financially in the form of charges and credits that appear on the PJM bill.

**Q: HOW WERE TRANSMISSION LINE LOSSES ACCOUNTED FOR PRIOR TO THE IMPLEMENTATION OF THE POST-JUNE 1, 2007 METHODOLOGY?**

**A:** Prior to June 1, 2007, PJM billed LSEs, and other transmission users for the generation necessary to serve load including transmission line losses, which effectively "grossed-up" their load for average transmission line losses. For example, if a load requirement for a given hour was 100 MWhs at the meter, and the average loss factor was 3%, the load would be grossed-up to 103 MWhs to account for energy necessary for the load and for the associated transmission line losses. Thus, KPCo was responsible for the cost to generate 103 MWhs, including the fuel costs associated with the energy required to fulfill the load requirement and that associated with average transmission line losses. These costs would be accounted for in either the 501 Fuel Costs account or in the 555 Purchased Power account.

**Q: HOW DOES THE FERC ORDER AND THE RESULTING CHANGE IN THE POST-JUNE 1, 2007 METHODOLOGY AFFECT KENTUCKY POWER?**

**A:** The post-June 1, 2007 methodology will affect the Company's (1) net energy costs, (2) calculation of fuel costs associated with its net energy requirements (internal load) in the determination of its Kentucky fuel expense, and (3) share of AEP off-system sales margins.

**Q: PLEASE EXPLAIN EACH OF THESE EFFECTS.**

**A:** Beginning June 1, 2007, marginal transmission line losses are included in the LMP and therefore settled financially, resulting in AEP and KPCo's load obligation and the associated fuel costs to fulfill their load requirements being reduced. This occurs because AEP and KPCo now settle their internal load obligations with PJM without the gross-up for MWhs associated with average transmission line losses. Using the example given above, the load requirement would be 100 MW. The post-June 1, 2007 methodology results in AEP assigning fewer MWhs and the associated fuel costs to net energy requirements (internal load requirements). The MWhs formerly associated with average transmission line losses prior to June 1, 2007 are still generated, but are now available for additional off-system sales. Both the fuel and marginal transmission line loss costs associated with the additional MWhs no longer used to serve internal load follow the off-system sales transaction. To the extent that KPCo's own generation is allocated to off-system sales, KPCo credits or reduces its net energy requirements and fuel costs for its own generation allocated to these sales in calculating its Kentucky jurisdictional fuel expenses.

Finally, because the post-June 1, 2007 methodology results in additional MWhs assigned to off-system sales, additional margins (revenues less variable costs) are realized by AEP and are shared among the AEP East Pool members. KPCo's member-load-ratio share of AEP off-system sales margins is included as credits to Kentucky jurisdictional customers in the monthly System Sales Tracker calculation.

## V. <u>Fuel Adjustment Clause</u>

**Q: HOW DOES KENTUCKY POWER'S FUEL ADJUSTMENT OPERATE?**

**A:** Regulation 807 KAR 5:056 governs the operation of Kentucky Power's fuel adjustment clause. Section 3 of the regulation states "(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 forced outages." These two types of expenses are captured in Accounts 501 and 555. Thus, in making its fuel adjustment clause calculations, Kentucky Power uses its 501 and 555 costs.

**Q: DOES THE POST-JUNE 1, 2007 METHODOLOGY OF RECORDING THE CHARGES AND CREDITS ASSOCIATED WITH MARGINAL TRANSMISSION LINE LOSSES IN ACCOUNTS 4470207 AND 4470208, INSTEAD OF 501 AND 555, AS FORMERLY WAS DONE, PROHIBIT KENTUCKY POWER FROM RECOVERING TRANSMISSION LINE LOSSES THROUGH ITS FUEL ADJUSTMENT CLAUSE?**

**A:** No. Because marginal transmission line losses, on and after June 1, 2007, are now billed separately by PJM, KPCo's share of transmission line losses associated with its internal load energy requirements are recorded on the Company's books in sub-accounts of Account 447 not Accounts 501 or 555 as the costs associated with these transmission line losses were earlier recorded. The amounts recorded in Accounts 4470207 and 4470208 are actual identifiable fossil and nuclear fuel costs associated with energy purchased for reasons other than identified in 807 KAR 5:056 paragraph (c) and thus fall in the paragraph (b) of 807 KAR 5:056. Therefore, the Company is requesting that the Commission enter an order confirming that KPCo can include the charges and credits recorded in Accounts 4470207 and 4470208 in the monthly FAC calculations.

**Q: BEGINNING WITH THE EFFECTIVE DATE OF FERC ORDER EL06-55 (JUNE 1, 2007), WHAT WAS THE AMOUNT OF THE OMITTED MARGINAL TRANSMISSION LINE LOSS CHARGES AND CREDITS ASSOCIATED WITH THE FAC CALCULATIONS?**

**A:** The net amount of KPCo's share of marginal transmission line losses associated with its internal load requirements was approximately $7.0 million (See Exhibit EKW-1) for the seven months ended December 31, 2007. This amount was not included in the calculation of KPCo's total fuel expenses and therefore had the effect of understating the Company's fuel expense in calculating the monthly FAC factor. Exhibit EKW-2, Column 10 shows the effect of the change in the monthly fuel factors after the net cost associated with the marginal transmission line losses is included in the monthly calculations.

**Q: WERE OTHER COMPONENTS OF NET ENERGY COSTS THAT HAD THE EFFECT OF REDUCING THE COMPANY'S FUEL EXPENSES PROPERLY TREATED IN CALCULATING KPCO'S NET ENERGY COSTS FOR THE MONTHS OF JUNE THROUGH DECEMBER 2007?**

Yes. For example, the fuel expenses associated with the additional MWhs allocated to off-system sales were excluded in KPCo's net energy costs and were included in the calculations of the monthly System Sales Tracker. Also, the additional off-system sales margins realized from the additional MWhs allocated to these sales were included in KPCo's monthly System Sales Tracker calculations.

**Q: DOES THE COMPANY HAVE ANY ESTIMATE AS TO THE LEVEL OF ADDITIONAL OFF-SYSTEM SALES MARGINS KPCo CUSTOMERS REALIZED FROM THE ADDITIONAL MWhs ALLOCATED TO THESE SALES AS DISCUSSED EARLIER IN THIS TESTIMONY?**

**A:** Yes. During the seven months ending December 2007 the Company estimates that the increased off-system sales margins realized by the additional MWhs allocated to these sales amounted to approximately $3.9 million, thereby reducing Kentucky Power's customers' bills by approximately $2.5 million.

**Q: DOES THE COMPANY BELIEVE IT IS APPROPRIATE TO INCLUDE THE CHARGES AND CREDITS RELATED TO MARGINAL TRANSMISSION LINE LOSSES THAT ARE RECORDED IN ACCOUNTS NUMBERS 4470207 AND 4470208 IN THE CALCULATIONS MADE UNDER KPCO'S FUEL ADJUSTMENT CLAUSE?**

**A:** Yes. These costs comport with 807 KAR 5:056 and are the same sort of costs that previously were recorded in either Account 501 Fuel Cost or Account 555 Purchased Power and should be included pursuant to 807 KAR 5:056 in the Fuel adjustment clause calculations. Doing so is consistent with the Commission's past practice of allowing recovery through the FAC of fuel costs associated with transmission line losses as well as the Commission's adjustment through the FAC of the level of fuel costs included in base rates. Permitting the recovery of the costs associated with these transmission line losses will ensure Kentucky Power is treated similarly to other electric utilities regulated by this Commission.

## VI. <u>Conclusion</u>

**Q: WHAT RELIEF IS THE COMPANY REQUESTING FROM THE COMMISSION IN THIS PROCEEDING?**

**A:** First, the Company is requesting that the Commission enter an Order confirming that KPCo can include the charges and credits recorded in Accounts 4470207 and 4470208 in the monthly fuel adjustment clause calculations starting with the first monthly filing following the Commission's Order in this proceeding. Second, the Company is requesting that the Order would also confirm that KPCo can recover through the FAC the charges and credits recorded in account numbers 4470207 and 4470208 beginning June 1, 2007 that were omitted from the FAC calculations. KPCo proposes recovering the omitted costs in equal amounts over the same period of time that they were omitted.

**Q: DOES THAT CONCLUDE YOUR PREFILED DIRECT TESTIMONY?**

**A:** Yes.

**Kentucky Power Company**
**Load Serving Entity (LSE)**
**Net Transmission Line Losses**
**For the Period June 2007 through December 2007**

| Ln No (1) | Month (2) | Year (3) | Charge Acct No. 4470207 (4) | Credit Acct No. 4470208 (5) | Net Monthly Amount (6) |
|---|---|---|---|---|---|
| 1 | June | 2007 | $2,092,442.32 | ($813,497.55) | $1,278,944.77 |
| 2 | July | 2007 | $1,167,867.88 | ($422,027.01) | $745,840.87 |
| 3 | August | 2007 | $2,946,027.74 | ($1,136,813.99) | $1,809,213.75 |
| 4 | September | 2007 | $1,474,422.32 | ($501,783.14) | $972,639.18 |
| 5 | October | 2007 | $1,489,944.20 | ($1,008,842.68) | $481,101.52 |
| 6 | November | 2007 | $1,395,539.09 | ($631,058.03) | $764,481.06 |
| 7 | December | 2007 | $1,886,026.49 | ($895,749.19) | $990,277.30 |
| 8 | Total | | $12,452,270.04 | ($5,409,771.59) | $7,042,498.45 |

**Kentucky Power Company**
**Fuel Adjustment Clause Calculations**
**For the Months June through December 2007**



| Ln No (1) | Month (2) | Year (3) | As Filed Fuel Cost (4) | Net Monthly Line Loss (5) | Revised Fuel Cost (6) | As Filed Sales MWH (7) | Revised Factor (8) | As Filed Factor (9) | Difference (10) |
|---|---|---|---|---|---|---|---|---|---|
| 1 | June | 2007 | $9,828,806 | $1,278,945 | $11,107,751 | 518,644 | $0.02142 | $0.01895 | $0.00247 |
| 2 | July | 2007 | $11,170,414 | $745,841 | $11,916,255 | 550,457 | $0.02165 | $0.02029 | $0.00136 |
| 3 | August | 2007 | $11,924,434 | $1,809,214 | $13,733,648 | 614,693 | $0.02234 | $0.01940 | $0.00294 |
| 4 | September | 2007 | $10,154,999 | $972,639 | $11,127,638 | 501,528 | $0.02219 | $0.02025 | $0.00194 |
| 5 | October | 2007 | $10,449,016 | $481,102 | $10,930,118 | 478,813 | $0.02283 | $0.02182 | $0.00101 |
| 6 | November | 2007 | $12,091,821 | $764,481 | $12,856,302 | 578,309 | $0.02223 | $0.02091 | $0.00132 |
| 7 | December | 2007 | $13,424,480 | $990,277 | $14,414,757 | 634,751 | $0.02271 | $0.02115 | $0.00156 |
| 8 | Total | | $79,043,970 | $7,042,499 | $86,086,469 | 3,877,195 | | | |

Kentucky Power Company
Monthly Line Loss
for the Twelve Month Ending December 31, 2007

| Ln No (1) | Month (2) | Year (3) | Monthly Line Loss Percentage (4) | Six Month Average Line Loss (5) |
|---|---|---|---|---|
| 1 | January | 2007 | 8.401% | |
| 2 | February | 2007 | 7.892% | |
| 3 | March | 2007 | 11.858% | |
| 4 | April | 2007 | 10.233% | |
| 5 | May | 2007 | 8.326% | |
| 6 | June | 2007 | 7.460% | 9.028% |
| 7 | July | 2007 | 3.870% | |
| 8 | August | 2007 | 2.646% | |
| 9 | September | 2007 | 3.753% | |
| 10 | October | 2007 | 4.559% | |
| 11 | November | 2007 | 4.588% | |
| 12 | December | 2007 | 3.957% | 3.896% |

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

COMMONWEALTH OF KENTUCKY

CASE NO. 2007-00522

COUNTY OF FRANKLIN

AFFIDAVIT

Errol K. Wagner, upon first being duly sworn, hereby makes oath that if the foregoing questions were propounded to him at a hearing before the Public Service Commission of Kentucky, he would give the answers recorded following each of said questions and that said answers are true.

Errol K. Wagner

Errol K. Wagner

Subscribed and sworn before me by Errol K. Wagner this 1st day of February, 2008.

Judy K. (Gackett) Rosquist

Notary Public

My Commission Expires January 14, 2009