COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF DUKE ENERGY KENTUCKY, INC. FROM NOVEMBER 1, 2013 THROUGH APRIL 30, 2014	))))	CASE NO. 2014-00229

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 Duke Energy Kentucky, Inc. ("Duke Kentucky") for the six-month period that ended on April 30, 2014. Duke Kentucky responded to four rounds of information requests, and the Commission held a public hearing in this matter on November 12, 2014. Duke Kentucky filed a post-hearing brief on December 10, 2014. There are no intervenors in this matter. All information requested at the hearing has been filed, and the case now stands submitted for a decision.

Commission Staff questioned Duke Kentucky about the recovery of power purchases through the FAC. Specifically, Duke Kentucky was asked whether it was limiting recovery, through the FAC, of power purchased under either of the following circumstances: 1) when experiencing a planned outage, or 2) when not experiencing an outage but making power purchases to meet its load. Duke Kentucky responded that it was not limiting recovery of these purchases through the FAC in either scenario.[1]

[1] Responses to the Commission's Initial Request for Information (filed Aug. 27, 2014) ("Commission's First Request"), Items 27 and 28.

<u>DISCUSSION</u>

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. [2]

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.[3]

In a March 21, 2005 Order in Case No. 2004-00430,[4] 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

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[2] 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.

[3] *Id.* at 5.

[4] 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), Order.

> 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.[5]

Duke Kentucky is a member of PJM Interconnection, Inc. ("PJM"), a regional transmission organization ("RTO"). Duke Kentucky claims that all of its power purchases are "economic" if 1) they are cheaper than the generation available from Duke Kentucky's own resources and are obtained outside of PJM's Day-Ahead or Real-Time markets or 2) the purchases are made in the PJM Day-Ahead and Real-Time markets under security constrained economic dispatch and commitment.[6] Duke Kentucky asserts that energy purchases from PJM for any reason are "economic" by definition because such purchases replace a higher-cost unit that was not dispatched.[7] Duke Kentucky states that limiting recovery of purchases to its owned resources does not make sense in an RTO "...because a utility's highest cost generating unit available to serve native load, due to the PJM system-wide dispatch and commitment of the PJM market could be virtually any unit in PJM."[8] Duke Kentucky further states that if only its owned resources were used to determine the highest-cost available generating unit, multiple assumptions would have to be made, thereby ignoring Duke Kentucky's participation in an RTO.[9] Duke Kentucky also claims that "it is impossible to determine

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

[6] Response to Commission Staff's Second Request for Information (filed Sept. 26, 2014) ("Staff's Second Request"), Item 2.b., at 3.

[7] *Id.*

[8] *Id.* at 4.

[9] *Id.* at 5.

which of the Company's units, at any given hour, would have been the highest cost in PJM as any available unit that was not dispatched by PJM will always be a greater cost than the price of energy purchased."[10]

Duke Kentucky states that there are problems with limiting power purchase recovery through the FAC to the highest-cost generating unit because: 1) there are times within an hour where a unit may not be economic and is not dispatched but, due to locational marginal price ("LMP") volatility, the unit may appear to have been economic after the fact upon the settlement of the final hourly LMP price; and 2) there are factors beyond Duke Kentucky's control that may limit a unit dispatch decision by PJM that provides benefits to customers, such as when PJM does not allow certain units to run, despite their appearing to be economic, due to grid reliability concerns.[11]

In its post-hearing brief, Duke Kentucky argues that its position is consistent with the letter and spirit of the FAC and its filed tariff, which virtually mirrors the FAC regulation, 807 KAR 5:056. Duke Kentucky claims that because of the similarity between its tariff and 807 KAR 5:056(3), "any interpretation of the relevant regulatory provision necessarily impacts the Company's filed tariff."[12]

DECISION

The Commission made its interpretation of the FAC regulation in 2002 and was clear in the 496B Order that power purchases were either "economy energy purchases" or "non-economy energy purchases" and that "non-economy energy purchases" were

[10] *Id.* at 6.

[11] Response to Commission Staff's Third Request for Information (filed Oct. 20, 2014) ("Staff's Third Request"), Item 2.a.(1), at 4 and 5.

[12] Duke Kentucky's Post-Hearing Brief (filed Dec. 10, 2014) at 17.

limited for recovery through the FAC. Although the Commission modified the definition of "non-economy energy purchases" in Case No. 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,"[13] 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."[14]

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."[15] To the extent that Duke Kentucky purchases power from PJM that exceeds the avoided variable generation cost of its own highest cost unit available to be dispatched, 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" that is limited for recovery through the FAC. Duke Kentucky's argument regarding problems with limiting recovery of the purchases through the FAC relates to the dispatch of a unit

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

[14] 496B Order at 5 (emphasis added).

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

and appears to stem from an assumption that the highest-cost unit used to establish the limitation must have been dispatched. This is not the case. The phrase "highest cost generating unit available to be dispatched" means that the highest-cost unit is available to be dispatched, but is not required to have been dispatched in order to be considered the highest-cost unit.

Furthermore, Duke Kentucky's claim that "any available unit that was not dispatched by PJM will always be a greater cost than the price of energy purchased"[16] indicates to the Commission that limiting recovery through the FAC to Duke Kentucky's highest cost unit is not problematic, as any power purchased from PJM would be less than Duke Kentucky's highest-cost unit and, therefore, would fall below the limit for recovery through the FAC.

The Commission did not, and does not, declare that the cost of power purchases made above the limit for recovery through the FAC is not recoverable. In fact, the Commission stated in the 496B Order that:

> 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.[17]

The purpose of the FAC regulation was to establish a uniform mechanism whereby jurisdictional 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

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[16] Response to Staff's Second Request, Item 2.b., at 6.

[17] 496B Order at 5.

base rates.[18] 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. As the Commission stated in the 496B Order:

> 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, EKPC may apply to the Commission for immediate rate recovery of those costs.[19]

While Duke Kentucky's tariff virtually mirrors the FAC regulation, the Commission clearly set forth its interpretation of that language in 2002. Accordingly, the Commission finds that its current affirmation of that interpretation has no impact on Duke Kentucky's tariff.

Duke Kentucky stated that there were no power purchases recovered through its FAC during the review period which were in excess of the variable cost of its highest-cost generating unit available to serve native load; however, Duke Kentucky calculated an amount of $11,787 in excess of its highest-cost unit in July 2013, a month which falls

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

[19] *Id.*

outside the six-month review period.[20] 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 to "order a utility to charge off and amortize any adjustments it finds unjustified due to improper calculation or application of the charge or improper fuel procurement practices."[21] Therefore, the Commission finds the following:

1. Purchase power costs of $11,787 in excess of Duke 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 in Duke Kentucky's upcoming two-year review proceeding covering the period November 1, 2012 through October 31, 2014.

2. Duke Kentucky should immediately begin limiting recovery of power purchases through the FAC, excluding power purchases made to substitute for a forced outage,[22] 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 the FAC since the end of the review period should be disallowed in future FAC review proceedings.

4. The Commission finds that, in the next FAC review proceedings covering the two-year period November 1, 2012, through October 31, 2014, the Commission will

[20] Response to Staff's Third Request, Item 2.c., at 3.

[21] 807 KAR 5:056, Section 11.

[22] 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.

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 further finds that Duke Kentucky should file testimony in the next FAC review proceeding on the specific codes that 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.

5. Outside of the issue of which RTO billing codes are appropriate for inclusion in the FAC, the Commission finds that there is no evidence of improper calculations or application of Duke Kentucky's FAC charges or improper fuel procurement practices during the period under review.

IT IS THEREFORE ORDERED that:

1. Purchase power costs of $11,787 shall be disallowed for recovery in Duke Kentucky's upcoming two-year review proceeding covering the period November 1, 2012 through October 31, 2014.

2. Duke Kentucky shall immediately begin limiting recovery of purchased power costs through its 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 Duke Kentucky's FAC since the end of the review period shall be disallowed in future FAC review proceedings.

4. 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.

5. Duke 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.

6. Except for the issue of which RTO billing codes are appropriate for inclusion in the FAC, the charges and credits billed by Duke Kentucky through its FAC for the period November 1, 2013 through April 30, 2014 are approved.

By the Commission

ENTERED

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KENTUCKY PUBLIC SERVICE COMMISSION

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