

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 DECLARATORY)	CASE NO.
ORDER AND APPROVAL PURSUANT TO KRS)	2014-00321
278.300 FOR A CAPACITY PURCHASE AND)	
TOLLING AGREEMENT)	

ORDER

On September 19, 2014, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") submitted an application requesting that the Commission grant approval for a four-year Capacity Purchase and Tolling Agreement ("Agreement") with Bluegrass Generation Company, LLC ("Bluegrass"). LG&E and KU (collectively "the Companies") also requested that the Commission issue a declaratory order with regard to certain costs associated with the Agreement being recoverable through their Fuel Adjustment Clause ("FAC") tariffs pursuant to KAR 5:001, Section 19, and with regard to required minimum payments creating evidence of indebtedness pursuant to KRS 278.300. Kentucky Industrial Utility Customers, Inc. ("KIUC") requested and was granted full intervention. An Informal Conference ("IC") was held at the request of the Companies on October 10, 2014, to discuss the issues in this case. The Companies responded to Commission Staff ("Staff") requests for information which were distributed at the IC, and which were attached to the IC memorandum filed in the record of this proceeding on October 14, 2014. KIUC had no questions for the

Companies. This case now stands submitted for a decision based on the evidentiary record.

The Agreement

Bluegrass is a limited liability company organized and existing under the laws of the State of Delaware. It owns and operates, through a third party, three natural gas-fired simple-cycle electric generating units at a facility in Oldham County, Kentucky.¹ Bluegrass was selected from six respondents who provided proposals in response to a Request for Proposals ("RFP") issued by the Companies in May 2014 following their reevaluation of capacity and energy needs through 2019. The Companies report that they will have a reserve margin shortfall from 2015 through 2018, but will be slightly above the minimum reserve margin in 2019 due to the termination of the wholesale power agreements of nine KU municipal customers.² The RFP sought proposals from respondents who could provide 100-350 megawatts ("MW") of capacity and energy from 2015 through 2020. The Companies concluded that the Bluegrass Agreement provides them the ability to achieve a reliable reserve margin during peak conditions in the near term while minimizing revenue requirements and will allow them to revisit their supply situation based on the development of load and reserve margins over the next 12 to 24 months.³

The Agreement entitles the Companies to 165 MW of firm generation capacity and output from Bluegrass's Unit No. 3 ("Unit No. 3") from May 1, 2015 through April 30,

¹ Application Exhibit 5, Agreement, page 1.

² Application, Exhibit 6, Analysis of May 2014 RFP Responses, page 3.

³ *Id.*, page 7.

2019.⁴ The Companies describe the Agreement as a favorable opportunity for meeting a portion of their capacity and power supply requirements in order to maintain a reliable reserve margin at times of system peak.⁵ Pursuant to a detailed reserve margin analysis performed by the Companies, which is included in Exhibit 6 of the Application, 100 percent of the obligations under the Agreement will be allocated to LG&E. The Agreement allows the Companies, with 30 days' notice, to change the allocation percentages between the Companies from time to time.⁶

The Companies state that the Agreement allows them to schedule energy with a minimum notice period. Pursuant to the Agreement, the Companies must take a minimum of 30 hours of production each calendar year. The Companies' reserve margin analysis indicates that they will schedule energy approximately 500 to 700 hours annually.⁷ Unit No. 3 will be designated by the Companies as a network resource delivering energy to native load customers using firm network transmission service. The Companies are responsible for the delivery of natural gas through firm transportation agreements to the site of Unit No. 3 and for securing electric transmission service in their balancing area. The Agreement provides performance guarantees in the form of a guaranteed heat rate of 10,900 Btu/kWh; an availability incentive; and a letter of credit and parent guarantee.⁸

⁴ Application, page 2.

⁵ *Id.*

⁶ Application, page 3.

⁷ *Id.*

⁸ IC Memorandum Attachment 2, Overview of Short-term Capacity Need and Bluegrass Generation Agreement, page 5.

The Companies provided expected capacity and fixed operation and maintenance ("O&M") charges associated with the Agreement from 2015 through 2019. The Companies estimate annual total minimum payments of \$6.4 million in 2015; \$9.6 million in 2016; \$9.7 million in 2017 and 2018; and \$3.2 million in 2019.⁹ The Companies provided documents¹⁰ in support of their choice of Bluegrass as the least-cost alternative to meet their short-term capacity needs. According to the Companies, other proposals provided in response to their RFP were eliminated due to being non-firm, lack of electric transmission transfer capability, and lack of transmission balancing area cost advantages.¹¹

Request for Declaratory Order – FAC Recovery

According to the Companies, they believe it is appropriate to recover the cost of fuel and fuel transportation associated with the Agreement through the FAC pursuant to the definition of "Fuel costs" as set out in 807 KAR 5:056(1)(3)(a) and (b).¹² The Companies state that the Agreement is considered an Operating Lease from an accounting standpoint, and that they will designate Unit No. 3 as a network resource, dispatching it as though they owned it. The fuel and transportation costs related to operating the unit will be booked by the Companies in the same manner as costs that are recovered for similar units that they own.¹³

⁹ Application, page 4.

¹⁰ Application, Exhibit 6, Analysis of May 2014 RFP Responses; and IC Memorandum Attachment 2, Overview of Short-term Capacity Need and Bluegrass Generation Agreement.

¹¹ IC Memorandum Attachment 2, Overview of Short-term Capacity Need and Bluegrass Generation Agreement, page 4.

¹² Application, page 5.

¹³ Application, page 6.

Request for Declaratory Order – KRS 278.300

The Companies state that, because of the Agreement's minimum payment obligations and minimum production requirements, those obligations and requirements may be viewed as evidence of indebtedness which require prior approval under KRS 278.300. The Companies provide a discussion of the Commission's October 5, 1993 Order in Administrative Case No. 350 ("Admin. 350"),¹⁴ in which the Commission encouraged electric utilities to file long-term power purchase contracts for pre-approval. The Companies included an excerpt from that Order which states that long-term power purchase contracts may require prior approval under KRS 278.300 if they constitute evidence of indebtedness, including contracts with minimum payment or take/pay provisions. In a footnote on page 7 of the Application, the Companies acknowledge that the Commission issued Orders in September 2014 in three cases involving water utilities, holding that contracts with minimum purchase or payment requirements for the sale of water for resale to a Commission-regulated water utility did not require approval as evidence of indebtedness pursuant to KRS 278.300. The Companies state that the Commission's finding in Admin. 350 was due in part to credit rating agencies regarding electric and gas utilities' power purchase agreements and other similar contracts as fixed obligations equivalent to debt. Rating agencies continue in this practice, according to the Companies, and because the Companies account for this in balancing their capital structures, they believe that the Commission's finding in Admin. 350 with regard to obtaining prior Commission approval for long-term purchase power contracts

¹⁴ Administrative Case No. 350, *The Consideration and Determination of the Appropriateness of Implementing a Ratemaking Standard Pertaining to the Purchase of Long-Term Wholesale Power by Electric Utilities as Required in Section 712 of the Energy Policy Act of 1992* (Ky. PSC Oct. 5, 1993).

pursuant to KRS 278.300 continues to be appropriate.¹⁵ The Companies therefore request that the Agreement, which contains fixed capacity and O&M charges and requires a minimum amount of production to be taken over the four-year term, be found to constitute evidence of indebtedness and that the Commission approve the minimum payments as evidence of indebtedness pursuant to under KRS 278.300.¹⁶

FINDINGS

After reviewing the record in this proceeding and being otherwise sufficiently advised, the Commission finds that the Companies have established that they are in need of additional capacity and power supply during the term of the Agreement in order to maintain a reliable reserve margin at system peak. The Agreement, pursuant to which the Companies are entitled for four years to 165 MW of firm generation capacity and output from Bluegrass's Unit No. 3, is reasonable and the least cost supply alternative available.

The Commission further finds that the Companies' proposal to recover fuel and transportation costs through the FAC in the same manner as costs that are recovered for similar units that they own is reasonable and should be approved.

With regard to the Companies' request for a declaration that the terms of the Agreement constitute an evidence of indebtedness under KRS 278.300, the Commission finds that the minimum payment obligations in the form of fixed capacity and O&M charges and the requirement that the Companies take a minimum amount of production over the term of the Agreement constitute long-term financial obligations that

¹⁵ Application, page 7, footnote 3.

¹⁶ Application, page 7.

are appropriate for Commission review and approval under KRS 278.300. The Commission further finds that the Companies entering into such indebtedness is for lawful objects within their corporate purposes, is necessary and appropriate for and consistent with the proper performance of their service to the public, is reasonably necessary and appropriate for such purposes, and should therefore be approved.

IT IS THEREFORE ORDERED that:

1. The Companies' agreement to purchase firm generation and capacity from Bluegrass is approved.

2. The Companies' recovery through the FAC of fuel and transportation costs related to the Agreement in the same manner as costs that are recovered for similar units owned by the Companies is approved.

3. The Companies are authorized to incur indebtedness in the form of minimum payment obligations related to fixed capacity and O&M charges and the obligation to take a minimum amount of production over the term of the Agreement.

4. The Companies shall agree only to such terms and prices that are consistent with the parameters set out in its application.

Nothing contained herein shall be construed as a finding of value for any purpose or as a warranty on the part of the Commonwealth of Kentucky or any agency thereof as to the securities authorized herein.

By the Commission

ENTERED
NOV 24 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Executive Director

Case No. 2014-00321

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