COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY REGARDING ENTRANCE INTO REFINED COAL AGREEMENTS, FOR PROPOSED ACCOUNTING AND FUEL ADJUSTMENT CLAUSE TREATMENT, AND FOR DECLARATORY RULING	))))))	CASE NO. 2015-00264

ORDER

Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively "LG&E/KU" or "Companies") filed an application with the Commission on August 19, 2015, requesting, pursuant to KRS 278.040(3), KRS 278.300, KRS 278.310, and 807 KAR 5:001, Section 19, that the Commission issue a declaratory order and grant approval for entrance into various agreements relating to proposed refined coal production arrangements at the Companies' Ghent, Mill Creek, and Trimble County generating stations. With the application, LG&E/KU filed (1) a request that the Commission schedule an informal conference ("IC") in order to discuss issues relevant to the application, and (2) a request for confidential treatment of certain items filed as part of, or in conjunction with, the application. The application included a request that the Commission consider this matter as expeditiously as possible and issue an order by October 15, 2015.

Kentucky Industrial Utility Customers, Inc. ("KIUC") requested and was granted intervention. An IC was held at the Commission's offices on September 3, 2015, which was attended by representatives of LG&E/KU, KIUC, and Commission Staff ("Staff"). As a result of the discussions at the IC and the agreement among the parties to an abbreviated discovery period, a procedural schedule was established pursuant to an Order issued on September 9, 2015.

On September 25, 2015, in a cover letter filed with their responses to requests for information, LG&E/KU informed the Commission that, due to certain project delays, the Companies were requesting a decision by December 1, 2015, instead of by October 15, 2015. On October 14, 2015, counsel for LG&E/KU notified counsel for KIUC and Staff by electronic mail ("email") that the Federal Energy Regulatory Commission ("FERC") had denied LG&E/KU's petition for a limited waiver of FERC's accounting regulations,[1] which impeded LG&E/KU's plan to establish a uniform accounting treatment for the proposed refined coal arrangement in each of the jurisdictions in which LG&E/KU operate.[2] LG&E/KU stated that, due to FERC's denial of their petition, they would update the Commission on their proposed course of action no later than the end of October.[3] On October 16, 2015, the Commission issued an Order extending the time for ruling on whether the agreements constitute evidences of indebtedness beyond the 60-day period specified in KRS 278.300(2).

On October 30, 2015, LG&E/KU tendered a motion to amend its application, and an amended application that modified the accounting treatment for the proposed transaction. In the amended application, LG&E/KU requested the issuance of a

[1] The October 14, 2015 email is attached as an Appendix to this Order.

[2] In addition to FERC, LG&E/KU have been in discussion with the Virginia State Corporation Commission Staff regarding a similar request for accounting treatment in connection with the refined coal project.

[3] *See* the October 14, 2015 email.

declaratory order and approval of all agreements by December 15, 2015. On November 17, 2015, the Commission granted the Companies' motion to amend and accepted as filed the amended application. Discovery is complete and the matter now stands submitted to the Commission for a decision upon the existing evidentiary record.

BACKGROUND

LG&E/KU have been engaged in discussions with Clean Coal Solutions, LLC ("CCS") regarding the implementation of refined coal processes at certain of the Companies' generating sites. CCS intends to have corporate subsidiaries ("CCS Subsidiaries") install and operate refined coal production facilities ("Facility" or, collectively, "Facilities") at the aforementioned generating stations. CCS's refined coal production process involves chemically treating feedstock coal to reduce Nitrogen Oxide ("NO_x") and mercury emissions while not affecting the thermal output associated with coal combustion. LG&E/KU did not conduct competitive bidding for the Facilities due to the limited number of potential suppliers, but evaluated the CCS proposal against the proposal of another supplier of a similar refined coal process. As a result of these evaluations, LG&E/KU chose CCS, which has implemented 17 similar refined coal projects in the United States, including one at the Tennessee Valley Authority's Paradise Generation Station in Muhlenberg County, Kentucky.[4]

At no cost to LG&E/KU, the CCS Subsidiaries will perform the installation and operation of the Facilities at the Companies' Ghent, Mill Creek, and Trimble County generating stations under licenses granted by LG&E/KU for use of an area less than one-half acre at each site. Under the proposal, LG&E/KU will sell feedstock coal to a CCS subsidiary at the weighted average cost of coal in inventory at the specific

[4] Application at 3.

generating station. After treatment, the resulting refined coal would be resold to the Companies at the same price at which the feedstock coal was initially sold.[5] Based upon a ruling from the Kentucky Department of Revenue, the Companies will not incur any liability for Kentucky's coal severance tax arising from the sale of feedstock coal by the Companies and resale of refined coal to the Companies.[6]

After completing the installation of the Facility at each respective generating station, the CCS Subsidiaries anticipate either selling or leasing the Facilities to tax equity investors who would be able to use the tax credits available from the refined coal process to reduce their federal income taxes.[7] The Companies' agreements with the CCS Subsidiaries would be terminated upon the lease or sale of any of the Facilities to tax equity investors, and LG&E/KU would then negotiate similar agreements with the investors. The LG&E/KU agreements with the tax equity investors would likely contain similar obligations and responsibilities as contained in their agreements with the CCS Subsidiaries, but would have a longer term (expected to run to the fourth quarter of 2021, unless the existing tax credit is extended).[8] LG&E/KU will have the option of not proceeding with an agreement with a tax equity investor and will not guarantee or warrant the performance of any of the Facilities.

The tax benefits of refined coal production currently amount to $6.60 per ton of coal. For use of the generating station sites and the provision of services related to managing and transporting coal to and from the Facilities, LG&E/KU will receive Site

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[5] *Id.* at 4.

[6] Amended Application at 7.

[7] CCS, through an affiliate, would operate the Facilities after being leased or sold.

[8] Application at 5.

Licensing fees and Coal Yard Services fees.[9] Based on the Companies' forecasted coal usage, the estimated total amount of these fees annually could be as much as $19.6 million on a combined basis.[10]

ACCOUNTING TREATMENT REQUESTED

The Companies amended their application to revise the accounting treatment requested for the proceeds derived from the refined coal agreements. LG&E/KU stated that it sought uniform accounting treatment for the proceeds from the refined coal arrangements in each of the jurisdictions in which the Companies operate because having different accounting treatments in the different jurisdictions would create significant and burdensome administrative and system costs. LG&E/KU originally proposed to pass the proceeds of the refined coal arrangements to their customers through their Fuel Adjustment Clause ("FAC"). However, FERC issued an order on October 13, 2015, in Docket No. EL15-92-000, denying the Companies' request for the same accounting treatment in FERC's jurisdiction as they had requested in this proceeding. To avoid having to maintain separate books and accounting entries for FERC and for this Commission, the Companies amended their application in this proceeding to request approval to establish a regulatory liability for the proceeds from the proposed refined coal arrangement.

By establishing a regulatory liability, LG&E/KU ensure that the benefits resulting from the refined coal agreements will inure to their Kentucky retail customers. The

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[9] *Id.* at 6.

[10] This amount includes $10.1 million at the Ghent station, $5.9 million at the Mill Creek station and $3.6 million which reflects the Companies' 75 percent ownership of the Trimble County Station.

regulatory liability, and how the benefits would flow to the Companies' customers, would be addressed in the Companies' next base rate cases.

The accounting treatment proposed by LG&E/KU is that the proceeds be recorded as follows:

> (1) Payments received for Coal Yard Services and for Site Licensing – credit to Account 254, Other Regulatory Liabilities.
>
> (2) Any termination or reservation fees – credit to Account 254, Other Regulatory Liabilities.

LG&E/KU state that, if the proposed accounting treatment is not approved, the benefits of the transaction prior to any test year used for the Companies' next base rate cases would not be received by customers.

FINANCING APPROVAL

The proposed refined coal agreements would involve the long-term purchase of such coal for a period of approximately six years (through the fourth quarter of 2021). The Companies do not believe that the agreements require approval under KRS 278.300, pursuant to the Commission's findings in Administrative Case 350.[11] Therein, the Commission encouraged, but did not require, utilities to file long-term power purchase contracts for pre-approval when it stated, "In addition, these contracts may well require prior approval under KRS 278.300 if they constitute evidence of

[11] Administrative Case 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, 1997) ("Admin. 350").

indebtedness. In particular, the inclusion in such contracts of minimum payment obligations or take/pay provisions may necessitate prior approval."[12]

While the Companies state that the obligations under the contemplated refined coal agreements are not an evidence of indebtedness under the traditional application of KRS 278.300, they recognize that the Commission may determine otherwise. Hence, if the Commission determines that the agreements' required purchases and payments constitute evidence of indebtedness under KRS 278.300, the Companies ask that the Commission grant approval to allow them to enter into such evidence of indebtedness.

REQUEST FOR EXPEDITED APPROVAL

To qualify for the refined coal tax credit provided pursuant to Section 45 of the U.S. Internal Revenue Code, the refined coal must show a minimum NO_x emissions reduction of 20 percent and a minimum reduction of either sulfur dioxide or mercury emissions of 40 percent, compared to the emissions levels of the feedstock coal.[13] The provisions of the tax credit also require that a facility producing refined coal must have been in service before the end of calendar year 2011, which means that the number of qualifying Facilities is limited.[14] Because of the possibility that CCS may locate other suitable sites for its Facilities, and because the existing tax credit is set to expire at the end of 2021, LG&E/KU request expedited approval to ensure their customers receive the anticipated economic benefits as soon as possible and for as long as possible.

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[12] Admin. 350, Final Order at 8–9.

[13] As stated earlier in the Order, the CCS technology reduces NO_x and mercury emissions.

[14] CCS has three such Facilities currently available, which are the Facilities the Companies intend to have located at the Ghent, Mill Creek, and Trimble County generating stations.

DISCUSSION AND ANALYSIS

Amended Accounting Treatment

As presented by LG&E/KU, the proposed refined coal arrangement will reduce certain emissions and produce monetary benefits to the Companies in the form of fees they will receive for site licensing and coal yard services. LG&E/KU intends to flow the benefits back to their customers. To allow the benefits to inure to their ratepayers, the Companies now propose to establish a regulatory liability for the proceeds allocated to Kentucky retail customers. LG&E/KU will credit the fee payments to Account 254, Other Regulatory Liabilities. When the Companies next file base rate cases, the amounts that were recorded in the regulatory liability account will be addressed in those proceedings.

The Commission notes that it is appropriate that LG&E/KU's customers be the beneficiaries of the benefits of the refined coal arrangement, as the proceeds from the site licensing and coal yard service fees are associated with the procurement of the refined coal. Since the refined coal process will create monetary benefits in the form of fees, the customers who pay the fuel costs and the generating stations' capital costs should benefit from the refined coal processes.

Financing Approval Pursuant to KRS 278.300

The proposed agreements obligate LG&E/KU to purchase refined coal for a period of approximately six years. These agreements constitute "requirements contracts," which are defined as contracts "in which a buyer promises to buy, and a seller to supply, all the goods or services that a buyer needs during a specified period,"[15] and which are intended to assure the buyer of a source for the term of the contract. However, the proposed agreements do not include take/pay provisions like

[15] *Black's Law Dictionary* (10th ed. 2014).

those the Commission cited in Admin. 350. While the agreements do include required purchases at set prices for the refined coal to be sold back to the Companies, the purchase requirements and prices are those at which the Companies sold the feedstock coal to the owners of the Facilities. Thus, LG&E/KU are solely responsible for setting the purchase requirements and prices for the refined coal by establishing the quantities and prices of the feedstock coal that they sell.

For these reasons, the Commission finds that the obligations under the proposed agreements do not constitute evidences of indebtedness under either a traditional application of KRS 278.300 or the Commission's decision in Admin. 350.

SUMMARY OF FINDINGS

The Commission, having reviewed the evidence of record and being otherwise sufficiently advised, finds that:

1. The amended accounting proposed by LG&E/KU for amounts received under the terms of the contemplated refined coal agreements, in the form of Site Licensing and Coal Yard Services fees, is reasonable, and should be approved.

2. The proposed refined coal agreements constitute requirements contracts but are not subject to KRS 278.300 as evidences of indebtedness.

3. LG&E/KU should be authorized to enter into the proposed refined coal agreements, consistent with the descriptions and explanations thereof contained in the record of this proceeding.

4. LG&E/KU have not identified any detrimental environmental impacts, such as detrimental impact on air or water quality, which could arise from the proposed refined coal process. LG&E/KU should continuously monitor the process for potential

detrimental environmental impacts. If any detrimental environmental impacts occur that arise from the proposed refined coal process, LG&E/KU should notify the Commission in writing within ten days of discovery.

IT IS THEREFORE ORDERED that:

1. The amended accounting treatment proposed by LG&E/KU for amounts received under the terms of the contemplated refined coal agreements, in the form of Site Licensing and Coal Yard Services fees, is approved.

2. The proposed refined coal agreements are not evidences of indebtedness subject to KRS 278.300 and do not require Commission approval.

3. LG&E/KU are authorized to enter into the proposed refined coal agreements, consistent with the descriptions and explanations thereof contained in the record of this proceeding.

4. LG&E/KU shall continuously monitor for potential detrimental environmental impacts arising from the refined coal process, and if any detrimental environmental impacts occur that arise from the proposed process, LG&E/KU shall notify the Commission in writing within ten days of discovery and provide the recommended remedy.

By the Commission

ENTERED
NOV 24 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2015-00264 DATED NOV 2 4 2015

Vinsel, Nancy (PSC)

From:	Riggs, Kendrick R. <kendrick.riggs@skofirm.com>
Sent:	Wednesday, October 14, 2015 3:38 PM
To:	Vinsel, Nancy (PSC)
Cc:	mkurtz@bkllawfirm.com; Kurt Boehm; Nguyen, Quang D (PSC); Allyson K. Sturgeon (allyson.sturgeon@lge-ku.com); Hendricks, J. Wade
Subject:	RE: Case No. 2015-00264 - status of Revenue private letter, FERC and Virginia filings
Attachments:	20151013160920-EL15-92-000.pdf

Nancy:

Please find in the attached pdf file the Order Denying Petition For Waiver issued yesterday by the FERC on LG&E/KU's petition for limited waiver of the FERC's accounting regulations in connection with the proposed refined coal arrangement with Clean Coal Solutions LLC. The Companies are reviewing the order and will update the Commission no later than the end of the month on their proposed course of action.

Regards,

Kendrick R. Riggs
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From: Vinsel, Nancy (PSC) [mailto:Nancy.Vinsel@ky.gov]
Sent: Tuesday, October 06, 2015 12:21 PM
To: Sturgeon, Allyson; Riggs, Kendrick R.; Hendricks, J. Wade
Cc: mkurtz@bkllawfirm.com; Kurt Boehm; Nguyen, Quang D (PSC)
Subject: RE: Case No. 2015-00264 - status of Revenue private letter, FERC and Virginia filings

Thank you Allyson.

From: Sturgeon, Allyson [mailto:Allyson.Sturgeon@lge-ku.com]
Sent: Tuesday, October 06, 2015 12:05 PM
To: Vinsel, Nancy (PSC); kendrick.riggs@skofirm.com; wade.hendricks@skofirm.com
Cc: mkurtz@bkllawfirm.com; Kurt Boehm; Nguyen, Quang D (PSC)
Subject: RE: Case No. 2015-00264 - status of Revenue private letter, FERC and Virginia filings

Nancy –

Status Update for Case No. 2015-00264:

1) Kentucky Department of Revenue ruling regarding whether the pending sale of feedstock coal by LG&E/KU or the resale of refined coal would be subject to Kentucky's coal severance tax: We have been advised by the Department that

a draft of the advice letter is in the hands of a Finance and Administration Cabinet attorney who is on vacation this week, and the Department anticipates the letter being released next week upon his return.

2) FERC filing regarding the proposed transaction: The Companies' FERC request was filed on August 14, 2015. It was assigned docket EL15-92-000 and public notice was issued on August 19, 2015. No interventions or protests were filed prior to the September 4, 2015 deadline. Since filing, the Companies have not received any data requests or other inquiries from the FERC staff. As previously mentioned, the Companies did conduct a pre-filing meeting with FERC staff on July 29, 2015. In their application, the Companies requested a FERC decision prior to October 13, 2015. Although FERC staff often accommodates such requests with rulings reasonably proximate to the request date, there is no formal statutory or regulatory timeline applicable to the filing.

3) Virginia filing regarding the proposed transaction: On September 10, 2015, Company representatives and Virginia State Corporation Commission Staff participated in a telephone conference to discuss the Company's requested accounting treatment and associated regulatory approvals in connection with the refined coal project. Following that conference, Virginia Staff submitted several follow-up questions, which were answered on September 30, 2015. The Virginia Commission Staff is expected to advise whether an application to establish a formal case will be necessary within the next ten days.

Allyson K. Sturgeon
LG&E and KU Energy LLC
Phone: (502) 627-2088

From: Vinsel, Nancy (PSC) [mailto:Nancy.Vinsel@ky.gov]
Sent: Friday, October 02, 2015 10:30 AM
To: kendrick.riggs@skofirm.com; wade.hendricks@skofirm.com; Sturgeon, Allyson <Allyson.Sturgeon@lge-ku.com>
Cc: mkurtz@bkllawfirm.com; Kurt Boehm <KBoehm@bkllawfirm.com>; Nguyen, Quang D (PSC) <QuangD.Nguyen@ky.gov>
Subject: Case No. 2015-00264 - status of Revenue private letter, FERC and Virginia filings

Kendrick and Allyson,
Due to the expedited schedule for Case No. 2015-00264, I am emailing to follow up on the status of 1) the Kentucky Department of Revenue ruling regarding whether the pending sale of feedstock coal by LG&E/KU or the resale of refined coal would be subject to Kentucky's coal severance tax; 2) the FERC filing regarding the proposed transaction; and 3) the Virginia filing regarding the proposed transaction.

We ask that you provide the status update by Wednesday, October 7, 2015. You can consider this an ongoing request until an Order is issued by the Commission.

Regards, Nancy

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