

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

SETTING RATES AND TERMS AND	) CASE NO. 8566
CONDITIONS OF PURCHASE OF	) A. KENTUCKY POWER COMPANY
ELECTRIC POWER FROM SMALL POWER	) B. KENTUCKY UTILITIES COMPANY
PRODUCERS AND COGENERATORS BY	) C. BEREA COLLEGE ELECTRIC
REGULATED ELECTRIC UTILITIES	) D. LOUISVILLE GAS AND ELECTRIC COMPANY
	E. UNION LIGHT, HEAT AND POWER COMPANY
	F. BIG RIVERS ELECTRIC CORPORA- TION, GREEN RIVER ELECTRIC CORPORATION, HENDERSON-UNION RECC, MEADE COUNTY RECC, JACKSON PURCHASE ELECTRIC CORPORATION
	G. EAST KENTUCKY POWER COOPERA- TIVE, INC., BIG SANDY RECC, BLUEGRASS RECC, CLARK RECC, CUMBERLAND VALLEY RECC, FAR- MERS RECC, FLEMING-MASON RECC, FOX CREEK RECC, GRAY- SON RECC, HARRISON RECC, INTER-COUNTY RECC, JACKSON COUNTY RECC, LICKING VALLEY RECC, NOLIN RECC, OWEN COUN- TY RECC, SALT RIVER RECC, SHELBY RECC, SOUTH KENTUCKY RECC, TAYLOR COUNTY RECC

O R D E R

On June 28, 1984, the Public Service Commission ("Commission") issued an Order setting rates, terms and conditions of purchase of electric power by utilities from Qualifying Facilities ("QFs") in Kentucky. On July 18, 1984, Union Light, Heat and Power Company ("ULH&P") filed an application for rehearing on three issues: timing

of avoided cost capacity payments, firm purchase rate cap on calculation of avoided capacity costs, and method of purchase rate cost recovery by utilities.

Timing of Capacity Payments to QFs

ULH&P contends that the Commission erred in its determination that capacity-related payments should commence when, "the presence of each QF capacity permits the downsizing or deferral of a future capacity addition on the part of [Cincinnati Gas and Electric Company] CG&E." ULH&P contends that, "there can be no savings to ratepayers associated with the alteration of a facility's construction schedule until after actual commercial operation of that facility begins" and a "subsidy" to QFs would result if payment is required. The Commission does not concur with ULH&P's position. The costs to the utility of constructing a generating facility are incurred as the facility is constructed and not when it is placed in rate base. During the construction interim the utility is either collecting a current return on Construction Work in Progress ("CWIP") or accumulating Allowance for Funds Used During Construction ("AFUDC") which will ultimately be paid by consumers. It is, therefore, the opinion of the Commission that the avoided capacity costs occur at the time the utility defers, downsizes or cancels the generating facility and not when placed in rate base. Therefore, the Commission denies ULH&P rehearing on this issue.

Firm Purchase Rate Cap on Capacity Payment

ULH&P contends that the Commission erred in denying "the Company's proposal that capacity payments to a QF be limited in amount to the extent of any firm purchased power contract." In support of the

petition, ULH&P alleges that the Commission's Order is in conflict with the capacity purchase rates approved for Kentucky Power Company ("Kentucky Power") in this proceeding. Furthermore, ULH&P asserts that "there is no evidence in the instant record whatsoever to provide any indication as to the level at which an avoided cost rate would serve as a so called 'disincentive'." ULH&P contends that this Commission cannot reach this conclusion "without any review or analysis of a qualifying facility's cost of service or rate of return."

The Commission does not concur with ULH&P's contentions on this issue. ULH&P has either misunderstood or misinterpreted the tariff approved for Kentucky Power in this proceeding. Kentucky Power's tariff contains two distinct contract periods, each with a distinct capacity purchase rate. Period I is for a contract period of 2 to 8 years' duration based on rates for off-system sales. Period II is for contracts exceeding 8 years and the capacity purchase rate is based on the installed cost of the last unit declared in commercial operation, escalated by the Handy-Whitman Construction Index. Kentucky Power has not capped its capacity purchase rate by its firm purchase contract rates and the treatment of the ULH&P and Kentucky Power tariff proposals have been consistent in the Order. Second, the Commission rejects ULH&P's contention that there is no evidence in the record that its proposed firm purchase cap is a disincentive to QFs. The Federal Energy Regulatory Commission ("FERC"), in the section-by-section analysis of its Order in Docket 79-55 (page 42), stated, "The Commission has therefore provided that the rate for purchases meets the statutory requirements if it equals avoided costs...." By definition, any cap on capacity purchase rate would not only act as a

disincentive, since it would result in less than full avoided costs purchase rates, but it would also be contrary to the FERC rule. Therefore, the Commission denies ULH&P's petition for rehearing on this issue.

#### Method of Cost Recovery

ULH&P alleges that the Commission erred in failing to provide a method of cost recovery by which utilities will be authorized to recover payments to QFs from the utilities' retail ratepayers. ULH&P contends that recovering this revenue through the fuel adjustment clause ("FAC") would promote development of QF production, provide a convenient forum to update tariffs and would minimize cash flow problems for the utilities. The Commission does not concur with ULH&P's contention. The FAC as presently constructed does not provide the flexibility to permit adequate consideration of the issues involved with small power production and cogeneration. The Commission is of the opinion that the clause does not permit full pass through of demand costs related to small power production and cogeneration. Further, ULH&P has not demonstrated that the financial impact of not passing the costs through the FAC is significant. Also, as stated in its Order, the Commission intends to monitor the development of small power production and cogeneration in rate case proceedings. ULH&P has provided no new evidence to persuade the Commission to change its position. Therefore, the Commission denies ULH&P's petition for rehearing on this issue.

#### FINDINGS AND ORDERS

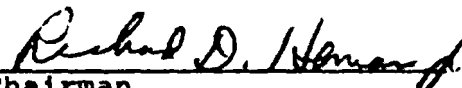
The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that for all the reasons

previously discussed ULH&P's Application for Rehearing should be denied in total as specified in the above sections of this Order.

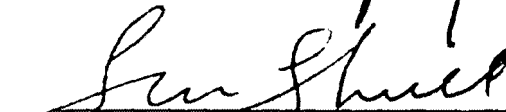
IT IS THEREFORE ORDERED that ULH&P's Application for Rehearing be and it hereby is denied in total as previously indicated.

Done at Frankfort, Kentucky, this 2nd day of August, 1984.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary