COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	)	
COMMISSION OF THE APPLICATION OF THE	)	
FUEL ADJUSTMENT CLAUSE OF LOUISVILLE	)	CASE NO. 96-524
GAS AND ELECTRIC COMPANY FROM	)	
NOVEMBER 1, 1994 TO OCTOBER 31, 1996	)	

O R D E R

This proceeding involves a review of the operation of the fuel adjustment clause (FAC) of the Louisville Gas and Electric Company (LG&E) for the two-year period ending October 31, 1996. By this Order, the Commission finds that LG&E incorrectly calculated its cost of fuel for the period in question and orders LG&E to reduce its fuel cost by $1,881,460 when calculating its next monthly fuel adjustment charge. The Commission further finds that current base period fuel cost requires no adjustment and directs no change in LG&E s present base period fuel cost.

PROCEDURAL HISTORY

On November 14, 1996, the Commission, pursuant to Administrative Regulation 807 KAR 5:056, Section 1(12), initiated a review of the operation of LG&E s FAC for the two-year period ending October 31, 1996. As part of its review, the Commission ordered LG&E to submit certain information concerning its FAC, its fuel usage and the operation of its FAC. Following the intervention of the Kentucky Industrial Utility Customers (KIUC) and the Attorney General (AG), the Commission established a procedural schedule for this proceeding.

After discovery and the filing of written testimony, the Commission conducted a public hearing on April 16, 1997. Testifying before the Commission were: Randall Walker, LG&E s Manager of Rates and Regulatory Affairs; Robert E. Lyon, LG&E s Director of Resource and Electric System Planning; Gregory K. Winter, LG&E s Director of Corporate Accounting; William G. Gilbert, LG&E s Fuels Administration Manager; Rick T. Melloan, LG&E s Director of Central Engineering and Construction Management; Alan S. Taylor, Senior Consultant, Hagler Bailly Consulting, Inc.; and, David Brown Kinloch. After the filing of briefs, this case was submitted for decision on May 28, 1997.

DISCUSSION

Background

An FAC is a means for [an electric] utility to recover from its customers its current fuel expense through an automatic rate adjustment without the necessity for a full regulatory rate proceeding. This rate may increase or decrease from one billing cycle to the next depending on whether the utility s cost of fuel increased or decreased in the same period. The rate provides for a straight pass-through of fuel costs, with no allowance for a profit to the utility. Kentucky Power Company, Case No. 6877 (Ky. P.S.C. Dec. 15, 1977) at 2.

Administrative Regulation 807 KAR 5:056 permits electric utilities to establish FACs to adjust their rates to reflect changing fuel prices. It requires that an FAC provide for periodic adjustment per KWH [kilowatt hour] of sales equal to the difference between the fuel costs per KWH sale in the base period and in the current period. 807

KAR 5:056, Section 1(1). It establishes an adjustment factor based upon the following formula:

Adjustment Factor	**<u>Monthly Fuel Costs</u>** **Monthly Sales**	**-**	**<u>Base Fuel Costs</u>** **Base Sales**

This factor, which is also expressed in terms of cents per KWH, is multiplied by the customer s usage to determine his or her monthly FAC charge. The charge, which may be positive or negative, appears as a separate line item on the customer s bill.

Administrative Regulation 807 KAR 5:056, Section 1, provides the following formula to determine monthly and base fuel costs:

Fuel Costs ($)	**Fuel Consumed in Utility s Own Plants** **+** **Fuel Cost of Purchased Power** **+** **Energy Cost of Power Purchased on Economic Dispatch** **-** **Cost of Fuel Recovered Through Intersystem Sales**

Monthly and base sales are determined using the following formula:

Sale (Kwh)	**Generation** **+** **Purchases** **+** **Interchange-In** **-** **Intersystem Sales** **-** **Total System Losses**

Because adjustments are automatic, the Commission performs periodic reviews of each FAC. Administrative Regulation 807 KAR 5:056, Section 1(11), requires the Commission to conduct public hearings on a utility s past fuel adjustments and to order a utility to charge off and amortize, by means of a temporary decrease of rates, any adjustments it finds unjustified due to improper calculation or application of the charge or improper fuel procurement practices. Administrative Regulation 807 KAR 5:056, Section 1(12), requires the Commission to hold biennial hearings to review and evaluate the past operations of the clause, disallow improper expenses and to the extent appropriate reestablish the fuel clause . . . .

<u>LG&E s Methodology for Calculating Cost of Fuel Recovered Through Intersystem Sales</u>

KIUC and the AG argue that LG&E during the review period incorrectly reported its cost of fuel recovered through intersystem sales. When calculating the cost of fuel recovered through intersystem sales, LG&E bases its cost of fuel on the total KWH sold. For example, if LG&E sells 100 KWH to an intersystem customer, it determines the cost of fuel recovered from that sale by calculating its cost to generate 100 KWH and subtracts this cost from total fuel costs to determine its monthly fuel cost.

KIUC and the AG argue that this methodology fails to reflect line losses incurred to make intersystem sales. Line losses are [t]he amount of power or commodity lost between the utility s generating facilities or production source and the customers premises or any two intermediate points in the utility system. Public Utilities Reports, Inc., <u>P.U.R. Glossary for Utility Management</u> 83 (1992). Some power, usually in the form of heat, is lost when transmitting the energy from its place of generation to the point of delivery. For example, a utility may generate 103 KW of electricity to sell 100 KW. The three additional KW represent line losses incurred when transmitting the electricity.

KIUC and the AG contend that all fuel costs related to intersystem sales must be deducted from a utility s total fuel costs. In support of their position, they refer to

Administrative Regulation 807 KAR 5:056, Section 1(3)(d), which requires the deduction of [t]he cost of fossil fuel recovered from intersystem sales including the fuel costs related to economy energy sales and other energy sold on an economic dispatch basis. KIUC and the AG further contend that the fuel costs associated with transmitting intersystem sales energy from the power plant to the point of delivery are related to intersystem sales. If the intersystem sales did not occur, they assert, then there would be no intersystem line losses.

If this interpretation is correct, then LG&E s current method overstates fuel costs and requires retail customers to pay a higher fuel charge. It has the effect of forcing retail customers to subsidize LG&E s intersystem sales. Fuel costs related to intersystem sales line loss are being allocated to and borne by LG&E s retail customers, not LG&E s intersystem customers.

KIUC further argues that LG&E s current method allows double recovery of fuel costs related to intersystem line loss. It argues that LG&E s intersystem sales are made at market-based prices that are greater than the variable cost of the sale. In addition to the fuel costs associated with each sale, KIUC contends, the variable cost of each sale includes components such as variable O&M costs, emission allowance costs, and fuel costs associated with line losses. LG&E reports these components to the Commission as Other Charges that are not considered in the calculation of the FAC charge. Because LG&E is selling power at prices that exceed its variable costs, KIUC asserts, it is already recovering the cost of fuel related to intersystem sales line loss from its off-system customers.

As further proof of this alleged double recovery, KIUC notes that comparability provisions of Federal Energy Regulatory Commission Order 888 require LG&E to charge its own intersystem sales the same transmission costs that it charges other transmission transactions. As LG&E s transmission tariffs currently provide for a line loss factor of 3 percent, KIUC asserts, LG&E is recovering a 3 percent line loss factor from all of its intersystem sales.

LG&E responds that its methodology is supported by long standing practice. It has consistently applied this methodology since 1978 when the Commission promulgated Administrative Regulation 807 KAR 5:056. Neither the Commission nor Commission Staff has taken exception to the methodology in any formal Commission review or Commission Staff audit. LG&E contends that any change in the methodology for the current review period would be unreasonable and unfair. Finally, it contends that its FERC transmission service tariff is irrelevant to this proceeding.

In weighing the parties arguments, the Commission looks to the purpose and intent of Administrative Regulation 807 KAR 5:056. When promulgating this regulation, we stated that:

> The adjustment factor will be based on the actual cost of fossil fuel consumed **for the purpose of supplying energy to the utility s customers**. Recognition of inter-system purchases and exchanges may be provided by **exclusion of fuel costs incurred because of inter-system energy sales**, including fuel costs related to economy energy sales; by inclusion of the fuel cost of energy purchased from other systems; and where energy is purchased on an economic dispatch basis to replace the purchaser s own higher generating costs, the price paid for economy energy.

Kentucky Power Company, at 17 (emphasis added). Clearly, our intent was to permit recovery only of fuel costs related to the provision of service to retail customers and to ensure that utilities do not recover from their retail customers fuel costs already recovered from non-retail customers.

Re Pennsylvania Power & Light Co., 6 FERC &61,036, 27 PUR4th 609 (Jan. 15, 1979), supports this view. In that proceeding, the FERC considered an FAC methodology that allegedly understated the cost of fuel recovered from intersystem sales. Reviewing the purpose of Order 517 the Order which established the FERC s FAC Regulation and upon which Administrative Regulation 807 KAR 5:056 is modeled,[1] the FERC declared:

> In Order 517, we noted that the purpose of the fuel clause is to pass on to customers the increases or decreases in the fuel costs *actually* incurred by the utility. We also stated that the purpose was to make utilities whole for increased costs associated with changes in fuel costs. Section 35.14(a)(2)(iv) of our regulations is an adjustment to the fuel clause designed to ensure that while a utility will be made whole for the increased fuel costs, it will not be permitted to recover from two separate purchasers (the wholesale customers and the intersystem customers) for the same increase in fuel costs. By requiring the utilities to deduct from the fuel clause what has already been recovered from intersystem purchasers, §35.14(a)(2)(iv) ensures that wholesale customers will not pay for fuel costs already paid by the intersystem customers.
>
> However, PP&L s proposed fuel clause would permit PP&L to collect from its wholesale customers a portion of the fuel costs already recovered from intersystem purchasers. . . . This is not what we intended to allow when we authorized the use of fuel clauses. While we believe that a utility should be made whole for increased costs, we do not believe that a utility should be made whole and plus some.

27 PUR4th at 613 (footnote omitted).

[1] See Kentucky Power Company, Case No. 6877 (Ky. PSC. Dec. 15, 1977) at 11.

As it currently calculates its fuel costs, LG&E complies with neither the intent nor the literal language of Administrative Regulation 807 KAR 5:056. By failing to include the cost of fuel associated with intersystem sales line losses in the cost of fossil fuel recovered from intersystem sales, LG&E foists upon its retail customers fossil fuel costs that are clearly <u>related</u> to intersystem sales and <u>unrelated</u> to the provision of retail service. To the extent that LG&E s charges for intersystem sales provide for recovery of such costs, LG&E s current methodology allows for double recovery of these costs.

While the Commission acknowledges that LG&E s methodology is of long standing, until this Order, we have never expressly addressed that methodology.[2] Moreover, during the same period in which LG&E used its methodology, two of the remaining three electric generation utilities in this state East Kentucky Power Cooperative and American Electric Power - included the cost of fuel associated with their intersystem sales line losses in the cost of fossil fuel recovered from intersystem sales. As both methodologies are mutually exclusive, our acceptance of East Kentucky Power Cooperative and American Electric Power s methodology demonstrates that the Commission had neither accepted LG&E s methodology nor its interpretation of Administrative Regulation 807 KAR 5:056.

[2] The Commission focused little attention on this aspect of LG&E s FAC in part because, until recently, intersystem sales constituted an insignificant portion of LG&E s operations. In 1986, for example, LG&E produced and purchased a total of 8,989,161,000 KWH of electricity. Of this amount, intersystem sales accounted for only 302,678,185 KWH, or 3.37 percent of LG&E s total sources available for sale. In 1996, LG&E produced and purchased a total of 14,735,164,911 KWH of electricity and had intersystem sales of 3,589,090,000 KWH. Intersystem sales had grown 1,086 percent and accounted for 24.36 percent of LG&E s total sources available for sale. (These figures are based upon LG&E s monthly FAC reports for 1986 and 1996.)

In determining the cost of fossil fuel associated with intersystem sales line loss recovered from intersystem sales, the Commission has used a line loss factor of 3 percent. Insofar as this factor is set forth in LG&E s rate schedule for transmission services on file with the FERC and as LG&E uses this factor in determining the cost of its transmission services and intersystem sales, its use is appropriate to determine the actual cost of fossil fuel recovered through intersystem sales. Based upon our calculations, which are shown in the Appendix to this Order, the Commission finds that LG&E underreported its cost of fuel recovered from intersystem sales for the period under review by $1,881,460. The Commission further finds that, upon filing its first monthly fuel adjustment after entry of this Order, LG&E should, in calculating its monthly fuel cost, reduce actual monthly fuel cost by $1,881,460 to reflect these unreported costs.[3]

Fuel Cost Roll-In Methodology

During the proceeding, LG&E requested that the Commission revise the roll-in methodology that it has historically used to adjust base period fuel cost. As the Commission finds that the current base period fuel cost requires no adjustment, LG&E s request is moot and will not be addressed.

[3] KIUC and the AG request interest on all amounts overcollected. Given that the issue of intersystem line losses was first raised in this proceeding and that Administrative Regulation 807 KAR 5:056 makes no specific provision for the payment of interest, the Commission denies this request.

OVEC Charges

The AG asserts that LG&E s present system of accounting renders impossible any determination on the propriety of fuel charges related to energy purchases from OVEC. He contends that LG&E makes record entries of estimated OVEC charges that are trued-up in subsequent months to reflect actual purchases. When LG&E trues-up these purchases, he further asserts, it may not be properly crediting its cost of fuel for any credits. The AG therefore requests that LG&E be required to amend its accounting practices to provide for clear evidence that fuel credits are made for the purposes of the fuel adjustment clause calculation where overestimates of OVEC purchases have been subsequently credited. Having reviewed the evidence of record and carefully considering LG&E s explanation of its accounting for fuel purchases from OVEC, the Commission finds no basis for the AG s concerns and denies his request.

SUMMARY

Having reviewed the evidence of record and being otherwise sufficiently advised, the Commission HEREBY ORDERS that:

1. Upon filing its first monthly fuel adjustment after entry of this Order, LG&E shall, in calculating its monthly fuel cost, reduce actual monthly fuel cost by $1,881,460 to reflect unreported fossil fuel costs recovered through intersystem sales during the review period.

2. In all monthly fuel adjustments filed after the entry of this Order, LG&E shall include in its calculation of cost of fuel recovered from intersystem sales the cost of fuel associated with line losses which it incurred to make intersystem sales.

3. The test month of January 1995 shall be used as LG&E's base period for this review.

4. LG&E's proposed base period fuel cost of 12.57 mills per KWH is retained.

5. This case is closed and shall be removed from the Commission s docket.

Done at Frankfort, Kentucky, this 9th day of February, 1999.

By the Commission

ATTEST:

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Executive Director

APPENDIX

AN APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 96-524 DATED FEBRUARY 9, 1999

Month	**Reported Recovered Intersystem Fuel Cost ($)**	**Unreported Recovered Intersystem Fuel Cost ($)**
November 1994	3,179,241	95,377
December 1994	2,089,443	62,683
January 1995	1,411,308	42,339
February 1995	1,328,993	39,870
March 1995	1,870,211	56,106
April 1995	2,329,699	69,891
May 1995	2,823,961	84,719
June 1995	2,896,155	86,075
July 1995	1,126,093	33,783
August 1995	938,556	28,157
September 1995	1,630,828	48,925
October 1995	1,875,198	56,256
November 1995	3,407,177	102,215
December 1995	1,818,320	54,550
January 1996	2,768,643	83,059
February 1996	2,782,785	83,484
March 1996	4,076,407	122,292
April 1996	3,714,280	111,428
May 1996	3,676,347	110,290
June 1996	3,139,903	94,197
July 1996	3,261,420	97,843
August 1996	2,771,132	83,143
September 1996	2,721,132	81,634
October 1996	5,104,789	153,144
TOTAL	$62,715,333	$1,881,460