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 THE) CASE NO. 96-524
LOUISVILLE GAS AND ELECTRIC COMPANY)
FROM NOVEMBER 1, 1994 TO OCTOBER 31, 1996)

O R D E R

On February 9, 1999, the Commission found that the Louisville Gas and Electric Company (LG&E) had incorrectly calculated its FAC charge for the period from November 1, 1994 to October 31, 1996 and directed LG&E to reduce its monthly fuel cost on a one-time basis by $1,881,460 to reflect unreported fossil fuel costs recovered through intersystem sales during the review period. More specifically, we found that, in calculating its cost of fuel for each month within the review period, LG&E had failed to include in the cost of fossil fuel recovered through intersystem sales the cost of fuel associated with line losses incurred to make such sales. We also found that a 3 percent line loss factor should be used to calculate this cost. LG&E and Kentucky Industrial Utility Customers (KIUC) have petitioned for rehearing on the Order of February 9, 1999. KIUC has moved to strike portions of LG&E s Petition for Rehearing. We deny both petitions. We further grant in part and deny in part KIUC s Motion to Strike.

KIUC s Motion to Strike

Attached to LG&E s Petition for Rehearing are the affidavits of William A. Bosta, J. Scott Williams, and Paul M. Normand. Arguing that these affidavits fail to meet the statutory requirements of KRS 278.400 as the information contained in those affidavits could have been offered in the original hearing, KIUC has moved to strike them. It argues that the purpose of rehearing is to apprise the Commission of newly discovered evidence and to correct factual or mathematical errors. LG&E s affidavits do not present such evidence, KIUC argues, nor are they offered to correct any factual or mathematical errors. KIUC contends that the affidavits serve no purpose other than relitigation of this matter.

LG&E contends that the affidavits are submitted for a proper purpose and should be considered. It asserts that the affidavits of Bosta and Williams address issues first raised in the February 9, 1999 Order and that the affidavits are necessary to refute the Commission s findings regarding how other electric generating utilities calculated the cost of fossil fuel recovered through intersystem sales and the Commission s review of LG&E s methodology for calculating fuel costs. LG&E submits that Normand s affidavit was tendered only to demonstrate what evidence LG&E would present if rehearing were granted.

KRS 278.400 provides that [u]pon rehearing any party may offer additional evidence that could not with reasonable diligence have been offered on the former hearing. The statute is intended to provide closure to Commission proceedings by limiting rehearing to new evidence not readily discoverable at the time of the original hearings. It requires parties to Commission proceedings to use reasonable diligence in

the preparation and presentation of their case and serves to prevent piecemeal litigation of issues.

Our review indicates that the affidavits of Williams and Normand address issues that have been previously litigated and involve evidence which LG&E could easily have presented at hearing. In his affidavit, Williams addresses Commission review of LG&E s past methodology for calculating fuel costs, specifically referring to a Commission Staff field review conducted in 1991. LG&E raised this issue at hearing. It repeatedly emphasized its consistency with Commission practices and referred to the Commission Staff field audits in its brief[1] and in cross-examination.[2]

In his affidavit, Normand presents the results of his initial review of the appropriateness of LG&E s FAC calculations as they apply to the recovery of energy losses for intersystem sales. Normand s affidavit addresses a critical issue in this proceeding. This evidence, however, was readily available at the time of hearing. Normand filed written testimony and subsequently testified before the Commission on the same issue in another FAC proceeding during the same time period.[3] LG&E, moreover, had notice that line loss factor was a critical issue. Both Intervenors presented testimony on the subject. LG&E had every opportunity to present evidence on the line loss and chose not to do so.

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[1] Initial Brief of Louisville Gas and Electric Company at 5-6.

[2] Transcript at 57-58.

[3] Normand filed testimony in Case No. 96-523, An Examination By The Public Service Commission of The Application of The Fuel Adjustment Clause of Kentucky Utilities Company From November 1, 1994, to October 31, 1996. He appeared before the Commission on April 15, 1997.

Both affidavits represent evidence that was clearly available at the time of the original proceeding and that LG&E chose not to present. They fail to meet the standard set forth in KRS 278.400 and should be stricken.

We further find that Bosta s Affidavit should not be stricken. In his affidavit, Bosta discusses the method that other utilities have used to calculate the cost of fossil fuel recovered through intersystem sales. The differences in methods by which the electric utilities in this state calculate this cost was first mentioned in the February 9, 1999 Order. The information contained in the Bosta Affidavit, therefore, does not relitigate the issue.

<u>LG&E s Petition for Rehearing</u>

In its petition for rehearing,[4] LG&E requests that the Order of February 9, 1999 be vacated as unlawful and unreasonable. In the alternative, LG&E requests that the Orders be modified so that the Commission s interpretation of Administrative Regulation 807 KAR 5:056 and the method for calculating FAC charges be made effective only prospectively and that additional evidence be taken on the issue of the appropriate line loss factor to use in calculating monthly fuel cost.

LG&E first contends that the Order violates Administrative Regulation 807 KAR 5:056 in that it renders Section 1(11) of that Regulation meaningless and ineffective. Section 1(11) provides:

> At six (6) month intervals, the commission will conduct public hearings on a utility's past fuel adjustments. The commission will order a utility to charge off and amortize, by means of a temporary decrease of rates, any adjustments it

[4] LG&E s Petition addresses not only this case, but the 3 six-month review proceedings that followed. This Order addresses only the issues concerning Case No. 96-524. By separate Order issued this day, we have addressed the issues peculiar to those cases.

> finds unjustified due to improper calculation or application of the charge or improper fuel procurement practices.

Pursuant to Section 1(11), the Commission conducted three six-month review proceedings for the period from November 1, 1994 to April 30, 1996.[5] In each instance the Commission issued Orders approving LG&E s billed charges and credits. By requiring refunds of charges billed during these periods, LG&E contends, the Commission by its Order of February 9, 1999 eviscerates the previous orders. The Commission, it argues, has effectively nullified and made meaningless Section 1(11). [6]

LG&E further argues that Section 1(12) of Administrative Regulation 807 KAR 5:056, which authorizes the Commission to conduct a two-year review of an electric utility s FAC, does not allow the Commission to overturn the results of its earlier six-month review proceedings. This section, LG&E contends, permits the Commission only to adjust base rates to reflect accumulated fuel cost increases and decreases.

The Commission finds no merit in this argument. LG&E s position contradicts the language of Section 1(12). That Section provides:

> Every two (2) years following the initial effective date of each utility's fuel clause the commission in a public hearing will review and evaluate past operations of the clause, **disallow improper expenses** and to the extent appropriate

[5] Case No. 94-462-A, An Examination By The Public Service Commission of The Application of The Fuel Adjustment Clause of The Louisville Gas And Electric Company From November 1, 1994 To April 30, 1995 (September 27, 1995); Case No. 94-462-B, An Examination By The Public Service Commission of The Application of The Fuel Adjustment Clause of The Louisville Gas And Electric Company From May 1, 1995 To October 31, 1995 (April 10, 1996); and Case No. 94-462-C, An Examination By The Public Service Commission of The Application of The Fuel Adjustment Clause of The Louisville Gas And Electric Company From November 1, 1995 To April 30, 1996 (October 11, 1996).

[6] LG&E s Petition for Rehearing at 8.

> reestablish the fuel clause charge in accordance with subsection (2) of this section. [Emphasis added.]

The power to disallow an expense implies the power to reject it and to order its refund. If the charges reviewed during six-month review proceedings are not reviewable at the two-year proceeding, then the latter becomes meaningless.

However, disallowing charges approved in a six-month review proceeding does not render Section 1(11) meaningless. The six-month and two-year review proceedings are intended to complement each other. The six-month review proceedings provide for interim review of an electric utility s FAC charges. These charges remain subject to review and change until the more comprehensive two-year review proceeding is conducted. This method ensures a complete review of the operation of a utility s FAC and provides greater assurance that the utility is properly calculating its FAC charges and is passing only proper and reasonable fuel expenses through its FAC.

Moreover, this position is consistent with Commission precedent. In <u>Kentucky Utilities Company</u>, Case No. 9631 (September 10, 1987), Kentucky Utilities Company argued that the scope of an investigation into its fuel costs should be limited to the time period since its last completed six-month review. Rejecting this contention, the Commission held that all FAC charges collected since the utility s last completed two-year review were subject to review and refund:

> The Commission finds that every periodic Fuel Adjustment Clause review of KU starting with Case No. 8590 has resulted in Interim orders imposing a potential refund obligation. The last time that the Commission approved KU s fuel costs in a two year review was for the two years ended October 1980. Consequently, all fuel revenues collected since November 1, 1980, have been collected subject to refund . . . .

Id. at 2-3. See also Case No. 90-360-C, Big Rivers Electric Corporation (July 21, 1994) (wherein the Commission, in a two-year review proceeding, ordered refunds of FAC charges previously approved during two six-month review proceedings).

LG&E next assails, as contrary to the record, the Commission s finding that the assignment of fuel costs associated with line losses incurred to make intersystem sales to retail customers constitutes a double recovery from retail ratepayers. LG&E asserts that it receives no double recovery because the revenues associated with intersystem sales were credited back against its revenue requirement in its last general rate case.[7] It further argues that the February 9, 1999 Order is erroneous because the determination of double recovery is based only upon the consideration of the fuel adjustment clause and fails to consider the balance between the FAC and base rates incorporated in LG&E s general rate case.

In response to this argument, KIUC notes that LG&E did not contest the Commission s finding that the fuel costs associated with intersystem sales line losses are related to intersystem sales and must be credited against the jurisdictional fuel cost. It further notes that LG&E did not contest the Commission s finding that intersystem sales are priced at market based rates, which are in excess of LG&E s variable costs, and thus that LG&E is compensated for these line losses from the intersystem purchaser. KIUC contends that its witness direct testimony in this case completely refutes the argument now put forth by LG&E concerning the intersystem sales credit

[7] Case No. 90-158, Adjustment of Gas And Electric Rates of Louisville Gas And Electric Company.

incorporated in the last general rate case, and that LG&E did not challenge that testimony until the filing of its petition for rehearing.

The Commission finds LG&E s argument ignores two key points. First, in LG&E s last general rate case, both revenues and expenses associated with intersystem sales were incorporated in the calculation of LG&E s overall revenue requirement. Second, Administrative Regulation 807 KAR 5:056 clearly requires that the costs recovered through intersystem sales be excluded from FAC calculations. If the Commission were to apply LG&E s logic, then all intersystem sale expenses must be assigned to retail ratepayers. LG&E has not made such a proposal. LG&E furthermore does not explain why one type of expense associated with intersystem sales -- the fuel costs associated with line losses for intersystem sales -- should be treated differently than other intersystem sales expenses. The first proposition violates Administrative Regulation 807 KAR 5:056. The latter proposition is unsupportable, for there is no justification for assigning one portion of the intersystem sales expenses to retail customers while the remainder of those costs are assigned to intersystem sales customers. The balance established in LG&E s last general rate case is maintained by either following the practice used in that case or by a complete and total allocation of costs between retail and intersystem sales customers. LG&E s approach disrupts that balance and is rejected.

LG&E next argues that the Order of February 9, 1999 represents a radical departure from longstanding Commission interpretation of Administrative 807 KAR 5:056 and is not supported by cogent reasons. It contends that since 1978 the Commission has approved without comment the method by which the utility calculated

its fuel cost. It notes that routine Commission Staff field reviews never challenged LG&E practice. It asserts that the Commission has failed to provide a cogent reason for its radical departure. LG&E Petition for Rehearing at 19.

The Commission acknowledges that LG&E s practice is long-standing. Until the current proceeding, however, this practice has not been the subject of a contested proceeding or a formal Commission ruling. LG&E refers to no Commission proceeding in which the practice was directly discussed, addressed or subjected to focused review. We believe the issue to be one of first impression. The Intervenors efforts required the Commission to closely examine Administrative Regulation 807 KAR 5:056 and the Commission s application of that regulation.[8] LG&E has failed to cite any Order of the Commission which expressly contradicts the findings or conclusions of the Order of February 9, 1999.

Contrary to LG&E s assertions, the Commission in its February 9, 1999 Order provided a lengthy explanation of its reasoning and of the problems with LG&E s practice. We discussed the history of Administrative Regulation 807 KAR 5:056 and its relationship with the Federal Energy Regulatory Commission s FAC Regulation, upon which Administrative Regulation 807 KAR 5:056 is modeled. In that Order, the Commission clearly explains how LG&E s current practice leads to double recovery of some of its fuel costs.

[8] As a result of intervenors claims in this case, the Commission asked all electric generating utilities how they calculated the cost of fossil fuel recovered through intersystem sales. <u>See</u> Case No. 96-520, An Examination By The Public Service Commission of The Application of The Fuel Adjustment Clause of American Electric Power Company From November 1, 1994 To October 31, 1996 (May 28, 1997), and Case No. 96-522, An Examination By The Public Service Commission of The Application of The Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. From November 1,1994 To October 31, 1996 (May 28, 1997).

The Commission finds no merit in LG&E s proposal that the interpretation be applied prospectively. LG&E current practice requires retail ratepayers to pay for the cost of fuel associated with intersystem sales line losses. It is contrary to Administrative Regulation 807 KAR 5:056. Having determined that the practice is wrong, the Commission cannot now ignore the regulation and allow LG&E to engage in the practice one more time merely because it has always been done that way. LG&E has no legal right to retain the incorrectly collected charges. They belong to the ratepayers.

LG&E next argues that the Commission s use of a line loss factor of 3 percent for calculating the appropriate level of fuel costs associated with intersystem sales line losses is not supported by any evidence in the record. It contends that neither Intervenor witness who testified in support of the 3 percent amount had any knowledge of how the amount was derived. While acknowledging that its Open Access Transmission Tariff on file with FERC contains a 3 percent line loss factor, it dismisses the use of this factor since it was the product of a negotiated settlement. LG&E argues that the use of an incremental line loss factor is the appropriate method for calculating fuel costs for intersystem sales and that rehearing should be granted to consider this method.

We do not agree. The use of a 3 percent line loss factor is consistent with LG&E s current practices and with its transmission tariffs on file with the FERC. Since FERC requires each utility to provide transmission service on terms and conditions that are the same as, or are comparable to, those applicable to its use of its own system, and since LG&E s tariff currently provides for a 3 percent line loss factor, it is not unreasonable to use the same factor to calculate line loss resulting from intersystem

sales. That the factor was a product of a negotiated settlement is not relevant. The FERC reviewed the negotiated agreement and approved its terms. Louisville Gas and Electric Company, 72 FERC ¶61,078 (1995).

LG&E s contentions regarding the use of an incremental line loss factor are unsupported by the record. LG&E has offered no testimonial or documentary evidence to support the use of an incremental line loss factor. As LG&E had notice that line loss factor was a critical issue and had the opportunity to present evidence on this issue, the Commission finds no reason to reopen this issue for rehearing. LG&E, however, is free to present such evidence in subsequent FAC review proceedings.

KIUC s Petition for Rehearing

KIUC requests that the Commission require the addition of interest on all fuel adjustment overcharges determined in these cases. Its request is based upon fundamental economic fairness. It contends that, unless interest is awarded, the Commission will have allowed LG&E to profit from its overcollections of FAC charges. It further contends that the Commission has the authority to make such award based upon prior legal and administrative precedent.

LG&E opposes KIUC s request. It argues that the Commission lacks the legal authority to make an award of interest. Even if such authority exists, it argues, interest is not appropriate as its actions were based upon a reasonable interpretation of the law and were taken in good faith. Finally, it argues that interest, if awarded, should be computed from February 9, 1999 and should be based upon the average of the Three-Month Commercial Paper Rate as reported by the Federal Reserve Statistical Release.

The Commission finds that an award of interest in not appropriate in this instance. There is no evidence that LG&E acted in bad faith or in an unreasonable manner. It made no efforts to delay the resolution of this proceeding or to conceal its conduct. Accordingly, KIUC s petition should be denied.

IT IS THEREFORE ORDERED that:

1. KIUC s Motion to Strike is granted in part and denied in part.

2. The affidavits of Paul M. Normand and J. Scott Williams, which are attached to the LG&E s Petition for Rehearing, are stricken.

3. LG&E s Petition for Rehearing is denied.

4. KIUC s Petition for Rehearing is denied.

5. 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.

Done at Frankfort, Kentucky, this 11th day of March, 1999.

By the Commission

ATTEST:

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Executive Director