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 AMERICAN ELECTRIC POWER COMPANY FROM MAY 1, 2001 TO OCTOBER 31, 2001	))))))	CASE NO. 2000-00495-B

O R D E R

On May 2, 2002, the Commission approved the fuel charges and credits that American Electric Power (AEP) billed through its Fuel Adjustment Clause (FAC) for from May 1, 2001 to October 31, 2001. In the same Order in which we approved those charges, we set forth our interpretation of Administrative Regulation 807 KAR 5:056 as it pertains to the recovery of non-economy purchased energy costs. More specifically, we declared that Administrative Regulation 807 KAR 5:056 permits an electric utility to recover through its FAC only the lower of the actual energy cost of the non-economy purchased energy or the fuel cost of its highest cost generating unit available to be dispatched to serve native load during the reporting expense month. [1] We further placed AEP on notice that we would apply this interpretation to all energy purchases occurring after April 30, 2002.

AEP, unlike the other electric utilities in this state that generate electricity, operates as part of a multi-state system that relies solely on low-cost base load

[1] Case No. 2000-00495-B, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of American Electric Power Company from May 1, 2001 to October 31, 2001(Ky.PSC May 2, 2002) at 5.

generating units rather than a mix of generating units that includes higher cost peaking units. Expressing its concern that our interpretation failed to consider AEP s unique operating characteristics and would not achieve the Commission s expressed goal of uniform treatment of fuel costs, AEP petitioned for rehearing of our Order of May 2, 2002. On June 11, 2002, we granted AEP s petition.

AEP proposes the use of a proxy mechanism for the energy portion of non-economy energy purchases. Under this proposal, AEP recovers through its FAC non-economy purchased power costs that are the lower of its actual purchased power cost and the peaking unit equivalent cost. [2] AEP s proxy mechanism is based upon the operating characteristics of a General Electric simple cycle gas turbine.[3] The cost of the gas used by this hypothetical turbine will be the sum of the daily midpoint price for Columbia Gas Transmission (delivered Citygate) as published in that day s edition of Platt s Gas Daily and the current tariff rate for Columbia s Park and Lend Rate.

When a power purchase occurs during an expense month, AEP will determine the average daily market price for that month. It will then determine the lowest daily market price for gas for the hypothetical turbine during that month and compare that price to its actual average purchased energy cost for internal uses for the same month.

[2] AEP presented its proposal at an informal conference on June 20, 2002 and subsequently submitted a written explanation of its proposal to Commission Staff and Kentucky Industrial Utility Customers, Inc. No objections to the proposal have been filed with the Commission. For further description of the mechanism, see Letters from Errol Wagner, AEP Director of Regulatory Services, to Gerald Wuetcher, Assistant General Counsel, Public Service Commission (June 28, 2002 and Aug. 12, 2002).

[3] A General Electric simple cycle gas turbine has a heat rate of 10,400 Btu/kWh at 50° Fahrenheit (winter operation) and a heat rate of 10,800 Btu/kWh at 90° Fahrenheit (summer operation). AEP proposes to use the heat rate of 10,400 Btu/kWh for the months of September through May and the heat rate of 10,800 for the months of 10,800 Btu/kWh for the months June through August.

If the actual average purchased energy cost for internal use for the month is 75 percent or less of the lowest daily market price for gas for the hypothetical gas turbine during the same month, AEP will consider this cost as the fuel cost for these purchases. If the actual average purchased energy cost for internal use for the month is greater than 75 percent of the lowest daily market price for gas for the hypothetical gas turbine, then AEP will compare its average purchased energy cost for internal uses with the market price for gas for the hypothetical turbine for each day of the month and exclude for FAC purposes any of the actual purchased energy costs that exceed the daily gas market price.

The Commission recognizes AEP is unique among Kentucky generators as it operates only base load coal-fired units. Our interpretation of Administrative Regulation 807 KAR 5:056, as set forth in our Order of May 2, 2002, permits AEP to recover a lesser portion of the cost of purchased power than other utilities that operate higher cost gas-fired peaking generators. This result could occur even if the supplier and source of supply are the same. This anomaly requires us to consider the use of AEP s proposed proxy mechanism. Based upon our review of the record and being otherwise sufficiently advised, we find that AEP s proposed Peaking Unit Equivalent approach to calculate the level of non-economy purchased power costs to flow through its FAC is reasonable and should be approved.

IT IS THEREFORE ORDERED that:

1. AEP shall use the Peaking Unit Equivalent approach to calculate the level of non-economy purchased power costs to flow through its FAC.

2. AEP shall use the Peaking Unit Equivalent method to calculate the level of non-economy purchased power costs to flow through its FAC on non-economy power purchases made after September 30, 2002.

Done at Frankfort, Kentucky, this 3rd day of October, 2002.

By the Commission

ATTEST:

Executive Director