

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION )  
OF THE FUEL ADJUSTMENT CLAUSE OF ) CASE NO. 2006-00509  
KENTUCKY UTILITIES COMPANY FROM )  
NOVEMBER 1, 2004 TO OCTOBER 31, 2006 )

O R D E R

Pursuant to Administrative Regulation 807 KAR 5:056, the Commission, on December 18, 2006, established this case to review and evaluate the operation of the fuel adjustment clause (“FAC”) of Kentucky Utilities Company (“KU”) for the 2-year period ended October 31, 2006, and to determine the amount of fuel cost, if any, that should be transferred (rolled-in) to KU’s base rates to re-establish its FAC charge.

In establishing this review, the Commission ordered KU to submit certain information concerning its fuel procurement, fuel usage, and the operation of its FAC. KU submitted this information on January 22, 2007 and filed supplemental information in response to a Commission staff data request on February 23, 2007. On May 3, 2007, KU filed revised tariffs, which included the effect of the Environmental Cost Recovery roll-in approved by the Commission’s Order in Case No. 2006-00129.<sup>1</sup> Kentucky Industrial Utility Customers, Inc. (“KIUC”) and the Attorney General of the Commonwealth of Kentucky, through his

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<sup>1</sup> Case No. 2006-00129, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005, and January 31, 2006, and for the Two-Year Billing Period Ending July 31, 2004, Order dated January 31, 2007.

Office of Rate Intervention (“AG”), are intervenors in this proceeding. A public hearing was held on May 10, 2007.

### FUEL CLAUSE EVALUATION AND REVIEW

Administrative Regulation 807 KAR 5:056, Section 1(12), states:

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 reestablish the fuel clause charge in accordance with subsection (2) of this section.

In this 2-year review, KIUC and the AG allege that KU incurred approximately \$5.6 million in improper expenses through its membership in the Midwest Independent System Operator (“MISO”) regional transmission organization<sup>2</sup> and that these improper expenses were charged to KU’s ratepayers through its FAC. KIUC argues that KU should be required to refund approximately \$5.1 million of this amount to its ratepayers, with interest. Having considered the agreements of all parties, we find that no improper expenses were incurred and, therefore, no refund is required.

### BACKGROUND

For 17 months of the 2-year review period, KU operated under MISO’s Day 2 Energy Markets, which were approved and implemented under the authority of the Federal Energy Regulatory Commission (“FERC”). Under MISO’s dispatch orders, KU was at times required to dispatch its generating units out of economic order. In these instances, pursuant to its FERC tariff, MISO compensated KU through a pool of monies known as Revenue Sufficiency Guarantee (“RSG”) Distributions, monies which MISO collected from

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<sup>2</sup> Although it is no longer a member, from April 2005 through September 2006, KU was a member of MISO and it operated under MISO’s “Day 2 Energy Markets.”

its members, including KU. The compensation received by KU from this money pool was in the form of RSG Make Whole Payments.

### KIUC'S POSITION

KIUC contends, for the hours in which KU received RSG Make Whole Payments, that MISO's dispatch orders caused KU to incur \$5.6 million in excessive, or improper, fuel costs, which were charged to ratepayers via the FAC. KIUC claims that KU received Make Whole Payments as compensation for over 90 percent of these excess fuel costs, and that KU should be required to refund to its ratepayers the amount it was compensated.

KIUC's argument is that KU was compensated for excess fuel costs through RSG Make Whole Payments when it also recovered these costs from its ratepayers through its FAC. Inasmuch as its compensation from MISO results in KU being "made whole" for nearly all of its excess fuel costs, KIUC contends that ratepayers should not be required to also bear the excess costs, because to do so would result in double-recovery.

### Supporting and Ancillary Arguments

Recovery Through FAC. KIUC contends that a 2-year FAC review case, rather than a general rate case, is the proper forum for addressing the issue of KU's RSG Make Whole Payments. KIUC claims that the recent general rate case<sup>3</sup> of The Union Light, Heat and Power Company d/b/a Duke Energy Kentucky ("Duke Kentucky") established a precedent for the FAC treatment it proposes for KU's Make Whole Payments. In the unanimous settlement in that case, Duke Kentucky agreed to have its MISO Make Whole Payments

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<sup>3</sup> Case No. 2006-00172, An Adjustment of the Electric Rates of The Union Light, Heat and Power Company d/b/a Duke Energy Kentucky, Inc., Order dated December 21, 2006.

deducted from the fuel costs it reports to the Commission via its FAC filings. KIUC argues that the Commission, by accepting this treatment for Duke Kentucky, found that such treatment was in compliance with Administrative Regulation 807 KAR 5:056, the FAC regulation. KIUC further argues that the FAC of KU must similarly comply with Administrative Regulation 807 KAR 5:056 without deviation. In its brief, KIUC states, “By approving this treatment of Duke Kentucky’s make whole payments, the Commission determined that MISO make whole payments are related to fuel costs and can be credited to customers through a utility’s FAC.”

KIUC opines that the treatment of the Make Whole Payments of KU should be consistent with that of Duke Kentucky. If KU prevails on this issue, KIUC argues that the Duke Kentucky FAC must be modified to eliminate the credit for MISO Make Whole Payments in order that all of the FACs be consistent.

Interest. KIUC argues that interest should be added to the amount to be refunded to ratepayers. Given that more than 2 years have passed since the beginning of the period in which the excess fuel costs were incurred, KIUC claims that KU will profit from its purported improper actions if interest is not included. KIUC contends that the appropriate interest rate should be either KU’s weighted cost of capital or, at a minimum, the cost of short-term debt for KU, with its preference being the weighted cost of capital.

Single-Issue Rate-making. KU, in its rebuttal testimony, opposes KIUC’s position on the basis that it only considered one item of cost related to KU’s membership in MISO without looking at all of its MISO costs and revenues. KU argues that KIUC’s proposal constitutes single-issue rate-making, which is prohibited by law. KIUC does not dispute that its position constitutes single-issue rate-making. However, it argues that an FAC

review proceeding dealing with the issue of fuel costs is, by definition, a single-issue rate proceeding and that it would be inappropriate to consider KU's other MISO-related costs and revenues in anything other than a general rate case. KIUC goes on to point out that, in light of KU no longer being a member of MISO, there will be no future rate case in which KU's other MISO-related costs and revenues would be considered.

#### AG'S POSITION

The AG sponsored no witnesses; however, he did cross-examine witnesses at the hearing and also filed a post-hearing brief. In his brief, the AG joins in KIUC's arguments and recommends that KU be required to refund excess fuel costs to its ratepayers. However, the AG does not address whether or not interest should be added to the amount refunded.

#### KU'S POSITION

KU makes several arguments against KIUC's and the AG's positions. The most pertinent of these arguments are discussed in the following paragraphs.

Given that the dispatch of its power plants was dictated by MISO pursuant to its FERC tariff, KU argues that it did nothing improper in operating its generating units and, therefore, did not incur any excessive or improper fuel costs. It also argues that the principle of federal preemption prohibits the Commission from disallowing costs incurred under a FERC-approved tariff.

KU contends that RSG Make Whole Payments are not fuel related and, therefore, cannot be included for recovery through the FAC. It states that Make Whole Payments do not meet the definition of fuel costs established in Administrative Regulation 807 KAR 5:056. KU also identifies several previous Commission decisions which it claims reflect a

strict interpretation of the FAC and which support its contention that Make Whole Payments are not fuel costs or fuel related.

KU claims that KIUC's attempt to isolate RSG Make Whole Payments and ignore 33 other MISO Day 2 costs and revenues constitutes single-issue rate-making and should be rejected as such. Only MISO's Schedule 10 charges, which cover its administrative costs, have been included in KU's rates. Given that Make Whole Payments are not fuel related, KU argues that they and all other MISO-related costs and revenues would be more properly addressed in a general rate case rather than a review of its FAC.

According to KU, the Duke Kentucky rate case settlement does not establish a precedent that must be followed in this proceeding given that the terms of the settlement stated that it would have no precedential value. The settlement arose in the context of a general rate case in which all of Duke Kentucky's MISO-related costs and revenues were recognized. KU contends that KIUC's attempt to use one component of that settlement to cherry-pick a single revenue item is improper and is further evidence of single-issue rate-making.

If RSG Make Whole Payments are recognized, KU argues that RSG Distributions it paid to MISO must also be recognized. These socialized uplift costs are collected by MISO to fund RSG Make Whole Payments. If the Commission decides to include Make Whole Payments as a reduction to fuel costs in calculating KU's FAC, KU contends that its RSG Distributions must also be recognized as an offset against the Make Whole Payments.

If a refund is required, KU states that any interest should be calculated at the Three-Month Commercial Paper Rate, the rate the Commission has consistently used for refund calculations in both FAC cases and general rate cases.

## ANALYSIS AND CONCLUSION

Based on its review of the evidence, the Commission finds that KIUC's and the AG's arguments are not persuasive and that KU incurred no excessive or improper fuel costs during the 2-year review period ending October 31, 2006. In support of this finding, we provide the following discussion.

Most significantly, as KU states, RSG Make Whole Payments are not fuel related. They clearly do not conform to the definition of fuel costs included in the Commission's FAC regulation. Also, including Make Whole Payments in the FAC would be inconsistent with past Commission decisions in which it found: (1) that amounts held in escrow for excessive fuel charges imposed by a fuel supplier were not fuel costs recoverable through the FAC;<sup>4</sup> and (2) that damages awarded by courts for fraudulent utility fuel procurement practices, while fuel related, were not fuel costs recoverable through the FAC.<sup>5</sup> Therefore, it would not be appropriate to require that items unrelated to fuel costs, such as RSG Make Whole Payments, be included in the calculation of KU's FAC.

Isolating one of over 30 MISO-related items for inclusion in KU's FAC constitutes single-issue rate-making, which is prohibited by law. While the Commission's FAC regulation establishes a single-issue rate-making mechanism for fuel cost recovery, RSG Make Whole Payments are neither fuel costs nor fuel related and, therefore, are not appropriate for inclusion in the FAC. Furthermore, adopting KIUC's proposal would be

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<sup>4</sup> Case No. 1993-00113, Application of Kentucky Utilities Company to Amortize, By Means of Temporary Decrease in Rates, Net Fuel Cost Savings Recovered in Coal Contract Litigation, Order dated December 8, 1993.

<sup>5</sup> Case No.1990-360-C, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Big Rivers Electric Corporation From November 1, 1991 to April 30, 1992, Order dated July 21, 1994.

inconsistent with the Commission's decision in Case No. 2004-00460 in which we rejected the MISO tracker proposed by KU.<sup>6</sup> In that case, the Commission found there was no statutory authority for approving a surcharge (tracker) limited to a single issue such as MISO revenues and expenses without demonstrating that KU's existing rates were insufficient. Given that Make Whole Payments are not fuel related, that same reasoning would need to be applied in the matter of RSG Make Whole Payments. In other words, KIUC would have to demonstrate that KU's rates are excessive, which it has not done.

The Duke Kentucky settlement establishes no precedent for this case. The clear language of the settlement agreement stated that it had no precedential value. Even if that were not the case, that unanimous settlement is clearly distinguished from this case because: (1) it was approved to resolve all rate-making issues in a general rate case in which all of Duke Kentucky's MISO costs and revenues were recognized; and (2) its treatment of Duke Kentucky's Make Whole Payments was established on a prospective basis only. As KU points out, only one item of MISO costs (administrative) has been recognized in its rates. Adopting KIUC's proposal to impose the same treatment of RSG Make Whole Payments on KU as was approved for Duke Kentucky, while not recognizing all other MISO revenues and expenses, would be both inconsistent and inequitable.

Finding that RSG Make Whole Payments are not fuel related and, therefore, cannot be flowed through the FAC, essentially renders the issue of federal preemption moot. However, it should be noted that the principle of federal preemption was applicable to the

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<sup>6</sup> Case No. 2004-00460, Application of Kentucky Utilities Company for Approval of New Rate Tariffs Containing a Mechanism for the Pass-Through of MISO-Related Revenues and Costs Not Already Included in Existing Base Rates, Order dated April 15, 2005.



Commission's approval of the Duke Kentucky settlement. On a prospective basis, the principle of federal preemption required the Commission to recognize all of Duke Kentucky's MISO costs and revenues, including the Make Whole payments. Given that they are revenues which vary from month-to-month, it was appropriate to recognize Duke Kentucky's Make Whole Payments through some sort of crediting mechanism (the FAC, a separate tracker, etc.). The Commission considers the fact that the Make Whole Payments are being reflected in the FAC to largely be a matter of convenience for Duke Kentucky.

Within the context of a general rate case settlement, this is not the first time the Commission has allowed non-fuel items to be included in another utility's FAC. Kentucky Power Company's System Sales Clause factor has been included in its FAC factor pursuant to settlements in its last two general rate cases, the first of which dates back to 1991, with the more recent settlement having been approved in 2006.

Finding that RSG Make Whole Payments are not fuel related and cannot be flowed through the FAC renders moot the issue of whether to recognize RSG Distributions. It also renders moot the issue of whether interest should be included in any refunds and the question of the appropriate interest rate to use in calculating those refunds.

#### BASE RATE ROLL-IN

KU proposed that the month of October 2006 be used by the Commission as the base period (test month) for the purpose of arriving at the base fuel cost [F(b)] and the kWh sales [S(b)] components of its FAC. It further proposed that its base fuel cost be changed to 25.91 mills per kWh, the fuel cost for the proposed base period. KU's current base fuel cost is 18.10 mills per kWh.

In establishing the appropriate level of base fuel cost to be included in KU's rates, the Commission must determine whether the proposed base period cost per kWh is representative of the level of fuel cost currently being experienced by KU. The Commission's review of generation mix, generation unit outages, and generation unit availability discloses that the month of October 2006 is a reasonably representative generation month of KU. The analysis of KU's monthly fuel clause filings showed that the actual fuel cost incurred for the 2-year review period ranged from a low of 17.05 mills per kWh in November 2004 to a high of 31.09 mills per kWh in August 2006, with an average cost for the period of 22.68 mills per kWh. Based upon this review, the Commission finds that KU has complied with Administrative Regulation 807 KAR 5:056 and that the proposed base period fuel cost of 25.91 mills per kWh should be approved.

#### FINDINGS AND ORDERS

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

1. KU incurred no improper fuel costs during the 2-year review period.
2. KU has complied with the provisions of Administrative Regulation 807 KAR 5:056.
2. The test month of October 2006 should be used as KU's base period for this review.
3. KU's proposed base period fuel cost of 25.91 mills per kWh should be approved.

4. The establishment of a base fuel cost of 25.91 mills per kWh requires a transfer (roll-in) of 7.81 mills per kWh from the FAC rate to KU's base rates and can best be accomplished by a uniform increase in all energy rates.

5. The rates in Appendix A are designed to reflect the transfer (roll-in) to base rates of the differential between the old base fuel cost of 18.10 mills and the new base fuel cost of 25.91 mills per kWh.

6. The rates in Appendix A are fair, just and reasonable and should be approved to be effective with KU's first billing cycle for November 2007.

7. Beginning with its first billing cycle for November 2007, KU should use an FAC rate based on a base fuel cost of 25.91 mills per kWh.

IT IS THEREFORE ORDERED that:

1. The charges and credits applied by KU through the FAC for the period November 1, 2004 to October 31, 2006 are approved.

2. KU's proposed base fuel cost of 25.91 mills per kWh is approved.

3. The rates in Appendix A are approved to be effective with KU's first billing cycle for November 2007.

4. Beginning with its first billing cycle for November 2007, KU shall use an FAC rate based on a base fuel cost of 25.91 mills per kWh.

5. Within 20 days of the date of this Order, KU shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 12<sup>th</sup> day of October, 2007.

By the Commission

Commissioner Clark Abstains

ATTEST:



Executive Director

Case No. 2006-00509

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2006-00509 DATED October 12, 2007

The following rates and charges are prescribed for the customers in the area served by Kentucky Utilities Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

SCHEDULE RS  
RESIDENTIAL SERVICE

Energy Charge per kWh \$ .05646

SCHEDULE GS  
GENERAL SERVICE

Energy Charge per kWh \$ .06599

SCHEDULE A.E.S.  
ALL ELECTRIC SCHOOL

Energy Charge per kWh \$ .05453

SCHEDULE LP  
LARGE POWER SERVICE

Energy Charge per kWh \$ .03282

SCHEDULE LCI-TOD  
LARGE COMMERCIAL/INDUSTRIAL TIME-OF-DAY RATE

Energy Charge per kWh \$ .03282

SCHEDULE MP  
COAL MINING POWER SERVICE

Energy Charge per kWh \$ .03479

SCHEDULE LMP-TOD  
LARGE MINE POWER TIME-OF-DAY RATE

Energy Charge per kWh \$ .03082

SCHEDULE LI-TOD  
LARGE INDUSTRIAL TIME-OF-DAY RATE

Energy Charge per kWh \$ .03282

SCHEDULE VFD  
VOLUNTEER FIRE DEPARTMENT

Energy Charge per kWh \$ .05646

SCHEDULE ST. LT.  
STREET LIGHTING SERVICE

Rate per Light per Month: (Lumens Approximate)

	<u>Standard</u>	<u>Ornamental</u>
<u>Incandescent System:</u>		
1,000 Lumens	\$ 2.70	\$ 3.29
2,500 Lumens	\$ 3.56	\$ 4.39
4,000 Lumens	\$ 5.25	\$ 6.22
6,000 Lumens	\$ 7.04	\$ 8.11
<u>Mercury Vapor:</u>		
7,000 Lumens	\$ 7.58	\$ 9.90
10,000 Lumens	\$ 8.95	\$ 11.01
20,000 Lumens	\$ 10.90	\$ 12.56
<u>High Pressure Sodium:</u>		
4,000 Lumens	\$ 5.37	\$ 8.06
5,800 Lumens	\$ 5.89	\$ 8.58
9,500 Lumens	\$ 6.71	\$ 9.60
22,000 Lumens	\$ 10.17	\$ 13.04
50,000 Lumens	\$ 16.75	\$ 19.61

SCHEDULE DEC. ST. LT.  
STREET LIGHTING SERVICE

Rate per Light per Month: (Lumens Approximate)

Decorative Street Lighting Service:

Acorn with Decorative Pole	
4,000 Lumens	\$10.91

5,800 Lumens	\$ 11.56
9,500 Lumens	\$ 12.37
Acorn with Historic Pole	
4,000 Lumens	\$17.00
5,800 Lumens	\$17.63
9,500 Lumens	\$18.46
Colonial	
4,000 Lumens	\$ 7.27
5,800 Lumens	\$ 7.82
9,500 Lumens	\$ 8.56
Coach	
5,800 Lumens	\$26.16
9,500 Lumens	\$26.89
Contemporary	
5,800 Lumens	\$13.26
9,500 Lumens	\$15.87
22,000 Lumens	\$18.79
50,000 Lumens	\$24.95
Gran Ville	
16,000 Lumens	\$39.91

P.O. Light:

Standard (Served Overhead):

Mercury Vapor	
7,000 Lumens	\$ 8.59
20,000 Lumens	\$10.90
High Pressure Sodium	
5,800 Lumens	\$ 4.77
9,500 Lumens	\$ 5.52
22,000 Lumens	\$10.17
50,000 Lumens	\$16.75

Directional (Served Overhead):

High Pressure Sodium	
9,500 Lumens	\$ 6.58
22,000 Lumens	\$ 9.61
50,000 Lumens	\$15.04

P.O. Light:

Metal Halide Commercial and Industrial Lighting

Directional Fixture

12,000 Lumens	\$ 9.84
32,000 Lumens	\$ 14.24
107,800 Lumens	\$ 29.98

Directional Fixture with Wood Pole

12,000 Lumens	\$ 11.86
32,000 Lumens	\$ 16.26
107,800 Lumens	\$ 32.78

Directional Fixture with Metal Pole

12,000 Lumens	\$ 18.45
32,000 Lumens	\$ 22.84
107,800 Lumens	\$ 38.58

Contemporary Fixture

12,000 Lumens	\$ 10.96
32,000 Lumens	\$ 15.82
107,800 Lumens	\$ 32.59

Contemporary Fixture with Metal Pole

12,000 Lumens	\$ 19.58
32,000 Lumens	\$ 24.42
107,800 Lumens	\$ 41.19

P.O. Light:

Decorative HPS (Served Underground)

Acorn with Decorative Pole

4,000 Lumens	\$ 10.91
5,800 Lumens	\$ 11.56
9,500 Lumens	\$ 12.38

Acorn with Historic Pole

4,000 Lumens	\$ 17.00
5,800 Lumens	\$ 17.63
9,500 Lumens	\$ 18.46

Colonial

4,000 Lumens	\$ 7.27
5,800 Lumens	\$ 7.82
9,500 Lumens	\$ 8.56

Coach

5,800 Lumens	\$ 26.16
9,500 Lumens	\$ 26.89

Contemporary

5,800 Lumens	\$ 13.26
9,500 Lumens	\$ 15.87
22,000 Lumens	\$ 18.79
50,000 Lumens	\$ 24.95



Gran Ville	
16,000 Lumens	\$ 39.91

SCHEDULE STOD  
SMALL TIME-OF-DAY SERVICE

Energy Charge per kWh	
On-Peak	\$ .03879
Off-Peak	\$ .02596