

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter Of:

AN EXAMINATION OF THE APPLICATION OF)
THE FUEL ADJUSTMENT CLAUSE OF DUKE)
ENERGY KENTUCKY, INC. FROM NOVEMBER) Case No. 2014-00229
1, 2013 THROUGH APRIL 30, 2014)

BRIEF OF DUKE ENERGY KENTUCKY, INC.

Comes now Duke Energy Kentucky, Inc. (Duke Energy Kentucky or the Company), by counsel, and for its brief in the above-captioned case, respectfully states as follows:

I. INTRODUCTION

This case presents a question regarding the extent to which energy purchases made within the context of Duke Energy Kentucky's participation in the Day-Ahead and Real-Time Energy Markets administered by PJM Interconnection, LLC (PJM), are recoverable through the Company's Fuel Adjustment Clause (FAC) tariff. Although post-hearing briefing in FAC cases is rather unusual, the Company submits this brief to address this limited issue. Based upon the plain language of the Company's FAC tariff and the corresponding Commission regulation, the dispatch procedures of the PJM energy market, and the record of this proceeding, the Company respectfully submits that all energy purchases made through PJM, exclusive of those made as a result of forced outages, are entirely recoverable through its FAC pursuant to 807 KAR 5:056 Section 1(3)(c).

II. BACKGROUND

A. The Company

Duke Energy Kentucky is an investor-owned utility engaged in the business of furnishing natural gas and electric services to various municipalities and unincorporated areas in northern Kentucky. With respect to its retail electric service, the Company serves approximately 138,000 customers in Boone, Campbell, Grant, Kenton, and Pendleton counties. The Company currently owns and operates approximately 1,077 megawatts (MW) of net installed generating capacity at three generating stations. The Company is a member of PJM, which is a regional transmission organization (RTO) that maintains responsibility for the reliability of electric energy supply within its footprint.

B. Procedural History

On August 13, 2014, the Commission entered an order establishing this matter to examine the application of the Company's FAC from November 1, 2013, through April 30, 2014. Throughout the course of this proceeding, Commission Staff propounded four (4) separate requests for information and the Company provided timely responses to each. On November 12, 2014, the Commission conducted a public hearing and ordered that the Company provide post-hearing data request responses by November 26, 2014, and file a post-hearing brief by December 10, 2014. The Company filed its post-hearing data request responses on November 25, 2014, and, with the filing of this brief, this case now stands submitted for a decision.

C. Commission Jurisdiction and Authority

It is well-established that the Commission only possesses such powers as granted by the General Assembly.¹ However, the scope of the powers expressly granted by the General Assembly to the Commission to regulate the “rates” and “service” of utilities is plenary in nature, unless otherwise expressly limited or expressed by statute.² In the present proceeding, the Commission’s authority to determine the extent to which certain energy purchases are recoverable through the Company’s FAC tariff is clear and unmistakable.

Pursuant to KRS 278.030(1), “[e]very utility may demand, collect and receive fair, just and reasonable rates for the services rendered or to be rendered by it to any person.” The Commission is afforded significant discretion in determining what rates are “fair, just and reasonable,” and may, while exercising its discretion, embrace various considerations, calculations and methodologies to arrive at an end result.³ Ultimately, the Commission’s goal is

¹ See *Boone Co. Water and Sewer Dist. v. Public Service Comm’n*, 949 S.W.2d 588, 591 (Ky. 1997); *Simpson Co. Water Dist. v. City of Franklin*, 872 S.W.2d 460, 462 (Ky. 1994); *Com., ex rel. Stumbo v. Kentucky Public Service Comm’n*, 243 S.W.3d 374, 378 (Ky. App. 2007); *Cincinnati Bell Tel. Co. v. Kentucky Public Service Comm’n*, 223 S.W.3d 829, 836 (Ky. App. 2007); *Public Service Comm’n v. Jackson Co. Rural Elec. Co-op., Inc.*, 50 S.W.3d 764, 767 (Ky. App. 2000).

² See KRS 278.040(2); *Kentucky Public Service Comm’n v. Commonwealth of Kentucky, ex rel. Conway*, 324 S.W.3d 373, 383 (Ky. 2010) (“In sum, we agree with the view that the PSC had the plenary authority to regulate and investigate utilities and to ensure that rates charged are fair, just, and reasonable under KRS 278.030 and KRS 278.040.”).

³ See *National Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 513 (Ky. App. 1990) (“[The Commission] has many appropriate rate-making methodologies available to it, and it must have some discretion in choosing the best one for each situation. Again, we must look more to whether the result is fair, just and reasonable rather than at the particular methodology used to reach the result.”) (citation omitted); see also *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Company*, 983 S.W.2d 493, 498 (“[T]he Commission has discretion in working out the balance of interest necessarily involved and that it is not the method, but the result, which must be reasonable.”) (citing *Federal Power Comm’n v. Hope Natural Gas*, 320 U.S. 591, 64 (1944)).

to reach a reasonable decision that effectively balances the interests of a utility and its ratepayers.⁴

III. DISCUSSION

A. Energy Costs Recoverable Under 807 KAR 5:056 Section 1(3)(c)

The FAC regulation, codified at 807 KAR 5:056, defines the various types of fuel costs that are recoverable through a utility's FAC. Under 807 KAR 5:056 Section 1(3)(c), one type of recoverable cost is the "net energy cost of energy purchases, exclusive of capacity or demand charges (irrespective of the designation assigned to such transaction) when such energy is purchased on an economic dispatch basis." Thus, if energy is purchased on an economic dispatch basis, the cost of that energy (less capacity or demand charges) is entirely recoverable under an FAC. A plain reading of the provision may lead to no other reasonable interpretation.

Of course, in both this matter and in previous cases before this Commission, much attention has been paid to the second sentence of Section 1(3)(c), which states: "Included therein may be such costs as the charges for economy energy purchases and the charges as a result of scheduled outage, all such kinds of energy being purchased by the buyer to substitute for its own higher cost energy." Essentially, this second sentence is comprised of a permissive, non-exclusive, and illustrative list that is included to expound upon the types of costs that are deemed recoverable under the first sentence of Section 1(3)(c). Charges as a result of a scheduled outage, for example, may be included in the net energy cost of energy purchased on an economic dispatch basis, and are therefore recoverable; similarly, charges for economy energy purchases

⁴ See *National Southwire, supra*, at 513 (quoting *Jersey Central Power & Light Co. v. Federal Energy Regulatory Comm'n*, 810 F.2d 1168, 1177 (D.C. Cir. 1987) ("In reviewing a rate order courts must determine whether or not the end result of that order constitutes a reasonable balancing, based on factual findings, of the investor interest in maintaining financial integrity and access to capital markets and the consumer interest in being charged non-exploitative rates...those choices must still add up to a reasonable result.")).

may be included in the net energy cost of energy purchased on an economic dispatch basis, and are also therefore recoverable. Based on the unambiguous language of the regulation, it is clear that the fundamental characteristic of an energy purchase that determines if the net energy cost⁵ of that purchase is recoverable under Section 1(3)(c) is whether it was made on an economic dispatch basis.

1. Energy Purchases Made through the PJM Energy Market are Purchased on an Economic Dispatch Basis and are Therefore Recoverable Under 807 KAR 5:056 Section 1(3)(c)

Pursuant to tariffs approved by the Federal Energy Regulatory Commission (FERC), Duke Energy Kentucky offers all of its available generation to PJM and purchases its expected or actual customer energy load from the PJM Day-Ahead or Real-Time Energy Market, respectively.⁶ During the period under review, the Company met all of its energy needs through the PJM Energy Market and did not purchase any energy outside of PJM.⁷ Because energy acquired through PJM is purchased on an economic dispatch basis, the net energy cost of all the Company's energy purchases is recoverable by virtue of 807 KAR 5:056 Section 1(3)(c).

To acknowledge that energy purchased through PJM is energy purchased on an economic

⁵ Capacity and demand charges are not recoverable under Section 1(3)(c) and must be excluded to arrive at the recoverable "net energy cost" of energy purchases made on an economic dispatch basis. In this matter, none of the expenses under review include capacity or demand charges because all of the Company's energy purchases were made through PJM's energy market, which is separate and distinct from PJM's capacity market. *See* Duke Energy Kentucky's Response to Commission Staff's Second Request for Information, Request No. 2(a) (filed Sept. 26, 2014); *see also* Duke Energy Kentucky's Response to Commission Staff's Fourth Request for Information, Request No. 1(a) (filed Nov. 5, 2014).

⁶ *See* Duke Energy Kentucky's Response to Commission Staff's Second Request for Information, Request No. 2(b).

⁷ *See* Duke Energy Kentucky's Response to Commission Staff's Second Request for Information, Request No. 1(a).

dispatch basis is to understand one of the fundamental functions and purposes of RTOs.⁸ An RTO such as PJM performs a security constrained economic commitment and security constrained economic dispatch process for all generation in its footprint in determining which assets to commit and dispatch.⁹ PJM has access to complete information regarding the operation of its Day-Ahead and Real-Time Energy Markets in making the determination to commit and dispatch a unit.¹⁰ Because of the efficient and informed nature of PJM's dispatch methodology, a utility's energy purchases in PJM's Day-Ahead and Real-Time Energy Markets are the most economic means available to satisfy customer load.¹¹ Stated another way, energy acquired through PJM is purchased on an economic dispatch basis.

Importantly, the foregoing is accurate whether or not the available generation operated by a particular utility (such as Duke Energy Kentucky) is dispatched within PJM. If an available generation unit owned by the Company is dispatched within PJM, it is because that unit is more economic than other, higher-priced generation. Conversely, if an available unit is not dispatched, it is because it is not the most economic available generation.¹² In either case, the energy purchased by the Company to serve its native load is the most economic energy available

⁸ Notably, Section 1234 and 1832 of the Energy Policy Act of 2005 (EPAcT), which require studies and reports to Congress regarding the benefits of economic dispatch, define "economic dispatch" to mean "the operation of generation facilities to produce energy at the lowest cost to reliably serve consumers, recognizing any operational limits of generation and transmission facilities." See 42 U.S.C. § 16432 and § 16524; see also *Joint Boards on Security Constrained Economic Dispatch*, 112 FERC ¶ 61,353 at p. 14 (2005) (FERC adopting EPAcT definition of "economic dispatch"). The reports to Congress mandated by the EPAcT specifically describe RTOs such as PJM as a method of implementing security constrained economic dispatch on a regional basis. See, e.g., *Security Constrained Economic Dispatch: Definition, Practices, Issues, and Recommendations* (Report to Congress), Federal Energy Regulatory Commission, July 31, 2006.

⁹ *Id.*

¹⁰ See Duke Energy Kentucky's Response to Commission Staff's Third Request for Information, Request No. 2(a)(1) (filed Oct. 20, 2014).

¹¹ See Duke Energy Kentucky's Response to Commission Staff's Second Request for Information, Request No. 2(b).

¹² *Id.*

to the Company's customers.¹³ Moreover, the energy purchased by the Company is always less expensive than the energy produced by the highest cost generating unit available to serve native load; this is true because, in light of the system-wide dispatch and commitment of the PJM regional marketplace, the highest cost generating unit available to serve native load could be virtually any available (though, due to its cost, not dispatched) unit within the PJM footprint.¹⁴

As is evident, PJM's security constrained economic dispatch methodology ensures that the Company's energy purchases are executed on an economic dispatch basis, thus satisfying the standard set forth in 807 KAR 5:056 Section 1(3)(c). However, it should be noted that, once PJM's economic dispatch process results in the operation of one or more of the Company's generation units, there is essentially a "second round" of economic dispatch conducted by the Company. After a generating unit is dispatched, the actual energy costs consumed in that generating unit are allocated to either native or non-native load based on a stacking process, allocating the lowest cost resources to native load first.¹⁵ An after-the-fact generation model is used to economically dispatch, on an hourly basis, the demand (load) with available supply resources (generation or purchases) which are economically stacked.¹⁶ Duke Energy Kentucky's modeling/stacking process is designed to align with and follow the financial commitments made

¹³ Even when the Company has no available generation (*e.g.*, when all of its generation has been dispatched or when one or more of its generation units experiences a scheduled or forced outage), the energy the Company purchases through PJM's security constrained economic dispatch construct remains the most economic energy available. Though, ostensibly for policy reasons, the FAC regulation limits the recovery of energy purchased during times of forced outages, there is no such limitation on the recovery of energy purchased due to a scheduled outage. In fact, Section 1(3)(c) of the relevant regulation specifically states that "charges as a result of scheduled outage" may be included in the recoverable net energy cost of energy purchased on an economic dispatch basis. *See* Duke Energy Kentucky's Response to Commission Staff's First Request for Information, Request Nos. 27 and 28 (filed Aug. 27, 2014); *see also* Duke Energy Kentucky's Response to Commission Staff's Second Request for Information, Request No. 2(b).

¹⁴ *Id.*; *see also* Duke Energy Kentucky's Response to Commission Staff's Second Request for Information, Request No. 2(e).

¹⁵ *See* Duke Energy Kentucky's Response to Commission Staff's First Request for Information, Request No. 29(a).

¹⁶ *Id.*

in the PJM Day-Ahead and Real-Time Energy Markets and in accordance with PJM's tariffs.¹⁷ As a result of this process, the Company's native customers always receive the least cost generation in the Day-Ahead Market. In the real time market, native customers also receive the least cost generation available at the time, honoring prior day-ahead commitments.¹⁸

The economic dispatch processes described herein benefit Duke Energy Kentucky's customers and help to ensure that the rates they pay are not only fair, just, and reasonable, but truly economic. Based upon the plain language of 807 KAR 5:056 Section 1(3)(c), the Company's net energy cost of energy purchases made through PJM (and, therefore, on an economic dispatch basis) is recoverable through the Company's FAC.

B. Recent Commission Precedent Does Not Invalidate the Company's Position

The foregoing discussion relies exclusively on a plain reading of 807 KAR 5:056 Section 1(3)(c) and the facts attendant to energy purchases through PJM's economically-dispatched marketplace. Although further examination of the issue presented may be unnecessary, the Company is compelled to discuss certain Commission precedent that arguably relates to, though does not control, the matter presently under consideration.

Throughout the past few decades, the Commission has had occasion to evaluate and interpret the FAC regulation due to challenges that have arisen with respect to the regulation's application. For instance, the effectiveness of the FAC regulation was significantly questioned by the Commission during the mid- to late 1990's as the wholesale electric market in the United States underwent significant structural changes. The fact that utilities began to increasingly rely on purchases of power from other generators to supply native load led the Commission to

¹⁷ See Duke Energy Kentucky's Response to Commission Staff's Second Request for Information, Request No. 1(b)(1). PJM's energy markets are regulated by FERC, and principles of federal preemption preclude the Commission from negating characteristics of these markets as approved by FERC.

reconsider the efficacy of the FAC regulation. In Case No. 2000-00496-B, the Commission expressed its concern that changes in the electric power wholesale market, “when coupled with the increasing use of purchased power to meet native load requirements, will lead to disparate treatment of purchased energy costs.”¹⁹ To address this issue, the Commission developed a revised interpretation of 807 KAR 5:056 Section 1(3)(b)-(c) which it believed would “ensure a uniform treatment of fuel costs by all electric utilities subject to [its] jurisdiction, provide a greater degree of certainty as to the fuel expenses eligible for recovery through a FAC, and encourage reasonable and economically efficient energy procurement practices, while continuing to protect the interests of utility ratepayers.”²⁰

As part of its interpretation announced in Case No. 2000-00496-B, the Commission defined two terms that would be employed in future Commission proceedings involving fuel adjustment clauses. The first term, “economy energy purchases,” is mentioned in 807 KAR 5:056 Section 1(3)(c) and was defined by the Commission to encompass:

...purchases that an electric utility makes to serve native load, that displace its higher cost of generation, and that have an energy cost less than the avoided variable generation cost of the utility’s highest cost generating unit available to meet native load during the FAC expense month.²¹

The second term defined by the Commission, “non-economy energy purchases,” is not contained in 807 KAR 5:056. It was defined to mean:

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

...purchases made to serve native load that have an energy cost greater than the avoided variable cost of the utility's highest cost generating unit available to serve native load during the FAC expense month.²²

These definitions were intended to provide guidance for utilities in applying 807 KAR 5:056, Section 1(3)(b)-(c). However, for an unknown reason, the regulation itself was never amended and utility tariffs that omitted these new terms have been consistently accepted as fair, just and reasonable by the Commission.²³ The extent to which these definitions are relevant today is further called into question by a series of subsequent Orders of the Commission which limit the language of the Commission's May 2, 2002 Order in Case No. 2000-0496-B.

First, in a trio of cases dating back to 1994 but not finally resolved until 2002, the Commission determined that Kentucky Utilities Company (KU) and Louisville Gas & Electric Company (LG&E) "had improperly calculated their FAC charges" relating to inter-system sales and system line loss.²⁴ After nearly eight years of litigation, the Commission accepted a Settlement Agreement that required KU and LG&E to collectively refund \$1.67 million to ratepayers.²⁵ In addition, the Commission, KU, LG&E, Kentucky Industrial Utility Customers, Inc. (KIUC) and the Office of the Attorney General (AG) stipulated that 807 KAR 5:056, Section 1(3) would be interpreted, on a prospective basis, by using substantially similar definitions for "economy energy purchases" and "non-economy power purchases" as those adopted in Case No. 2000-0496-B. In accepting the Settlement Agreement, however, the Commission noted that it "is not a perfect resolution of the contested issues in these [15 FAC]

²² *Id.*

²³ Because these definitions were never expressly incorporated into the FAC regulation or required to be included in the Company's tariff, they are not within the scope of the filed rate doctrine. *See* Section III(C), *infra*.

²⁴ *See* Case No. 1994-00461-A; Case No. 1994-00461-B; Case No. 1994-00461-C.

²⁵ *See id.*, Order (Ky. P.S.C., May 17, 2002).

proceedings.”²⁶ Furthermore, Section 4.10 of the Settlement Agreement, which the Commission approved and adopted, expressly provided that “[n]othing in this Settlement Agreement is intended to be, nor shall it be construed as a general regulatory change.”²⁷

Second, in a 2002 Order involving the FAC of American Electric Power Company (AEP), the Commission recognized that the newly-minted definition of “non-economy energy purchases” would be unjust if applied to AEP due to the unique characteristics of the utility’s generation portfolio.²⁸ Rather than literally apply the definition, the Commission authorized AEP to employ a “peaking unit equivalent cost” formula as a proxy for determining the avoided variable cost of its highest cost generating unit. This exception allowed AEP to use the market price of natural gas as the key variable in determining whether it could recover its actual purchased power cost through its FAC. Moreover, the use of a market proxy allowed the Commission to account for the fact that AEP’s energy procurement practices, which were undertaken as part of a multi-state system, were very different from the traditional, vertically-integrated structure of other regulated electric utilities in Kentucky.

Third, the Commission overruled a significant portion of its Order in Case No. 2000-00496-B in Case No. 2004-00430.²⁹ In that case, the Commission considered the situation where a utility was purchasing power to meet native load requirements that were in excess of the

²⁶ See *id.*, Order (Ky. P.S.C., May 17, 2002).

²⁷ See *id.*, Order, Appendix A (Ky. P.S.C., May 17, 2002).

²⁸ See *In the Matter of an Examination by the Public Service Commission of the Application of the Fuel Adjustments Clause of American Electric Power Company from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00495-B (Ky. P.S.C. Oct. 3, 2002).

²⁹ See *In the Matter of East Kentucky Power Cooperative’s Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430 (Ky. P.S.C. March 21, 2005).

utility's available generation capacity. In an Order entered on March 21, 2005, the Commission stated:

The definition of "non-economy energy purchases" set forth in our Order in Case No. 2000-00496-B too narrowly construes 807 KAR 5:056 and conflicts with the regulation. A more accurate definition of non-economy energy purchases recognizes that the energy costs thereof may be greater or less than the variable cost of the highest cost generating unit available to serve native load. To the extent that the definition in our Order in Case No. 2000-00496-B conflicts with our Order of February 7, 2005, we find that it was incorrect and should be overruled.³⁰

The Order in Case No. 2004-00430 substantially altered the Commission's interpretation of 807 KAR 5:056 Section 1(3) as expressed in Case No. 2000-00496-B and other cases. In essence, the Commission's Order returned the FAC to its original purpose of requiring that all fuel expenses associated with the production or purchase of energy should be accounted for and recovered through the FAC. The Commission accomplished this by recognizing that the cost of non-economy energy purchases may be higher or lower than the variable cost of the highest cost generating unit available to serve native load.

Fourth, the commercial realities and structures of the wholesale electric market have again changed in several very fundamental ways since the Commission's Order was entered in Case No. 2000-0496-B. Over the intervening twelve years, FERC has encouraged and fostered the development of distinct wholesale energy and capacity markets by RTOs such as PJM. Some of these changes effectively eliminated the concerns expressed by the Commission in Case No. 2000-00496-B. For instance, the development of separate markets for capacity and energy has virtually assured that capacity and demand charges are not passed through the Company's FAC tariff. Likewise, implementation of security constrained economic dispatch models make certain that utilities participating in PJM are using their generation assets in the most economically

efficient manner possible, thereby lowering energy rates for all customers. The dispatch of generation and the purchase of energy are also conducted under procedures for the Day-Ahead and Real-Time Markets, both of which have been deemed acceptable and in the public interest to FERC. All of these more recent developments must be taken into account when determining whether the Commission's twelve-year-old Order in Case No. 2000-00496-B remains the most accurate application of 807 KAR 5:056 Section 1(3).

Synthesizing the foregoing authorities is no simple task. On the one hand, Duke Energy Kentucky was given notice in 2002 that the new definitions of "economy energy purchases" and "non-economy energy purchases" would be applied with regard to future interpretations of the FAC regulation. However, without revoking the prior notice to the Company, the Commission accepted a Settlement Agreement in cases involving KU and LG&E just two weeks later that provided those same definitions should not be construed as, and were not intended to be, "a general regulatory change." Then, later in 2002, the Commission entered an Order allowing AEP to use a formulaic calculation to arrive at a proxy for what would be deemed to be its own highest generating cost for FAC purposes. Three years later, the Commission entered another Order pointing out that the FAC regulation must be strictly construed, offers no room for deviations and must be construed in accordance with the filed rate doctrine.³¹ On rehearing in that same case, the Commission found that its 2002 definition of "non-economy energy

³⁰ *Id.*

³¹ See *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430 (Ky. P.S.C. Feb. 7, 2005). Notably, the Commission found in Case No. 2004-00430 that the FAC regulation does not allow any discretion to a utility to ignore or underreport such costs that are otherwise considered "fuel costs" or to use other than actual costs. However, this holding appears to conflict with the Order entered in Case No. 2001-00058, *In the Matter of the Application of The Union Light, Heat and Power Company for Certain Findings under 15 U.S.C. § 79Z* (Ky. P.S.C. May 11, 2001). That Order, entered at a time when the Company's predecessor purchased all of its generation under a full-requirements contract with Cincinnati Gas & Electric Company, permitted ULH&P to utilize a negative FAC factor to address significant overcollections that resulted from the utility's failure to properly reflect its true fuel costs in its FAC.

purchases” was too narrow and must be overruled. Clearly, the FAC regulation has faced challenges, and the Commission’s application thereof has evolved, as a result of the shifting structural mechanics of the wholesale electric markets in which Kentucky utilities participate.

In the present case, and in light of the plain language of 807 KAR 5:056 Section 1(3)(c), Duke Energy Kentucky encourages the Commission to embrace a reasonable interpretation of the FAC regulation. Although the definitions of “economy energy purchases” and “non-economy energy purchases” continue to have a role in the greater scheme of fuel cost recoverability, the nature of the RTO construct is incongruous with the holdings of Case No. 2000-00496-B and its progeny and renders strict reliance thereon misplaced. Quite simply, there are distinctions between utilities that are participating in an RTO and those that are not, and the application of the FAC regulation should not be so rigid as to completely ignore, erode or undermine the benefits of participation in an RTO.³²

To be clear, the Company is not advocating, and does not believe it necessary, that the terms of the FAC regulation be amended to allow the fuel costs at issue to be recoverable. Instead, Duke Energy Kentucky believes that the language of the FAC regulation is adequate so long as effect is given to the plain meaning of the existing text. The application of the FAC regulation as described herein is neither strained nor unnatural. Similar to when the Commission condoned AEP’s use of a “Peaking Unit Equivalent” approach in Case No. 2000-00495-B, the Company requests that the FAC regulation be applied in light of the specific characteristics of the utility and situation presented.

³² See Duke Energy Kentucky’s Response to Commission Staff’s Third Request for Information, Request No. 2(a)(2).

C. The Company's Position is Consistent with the Letter and Spirit of Both the FAC and the Company's Filed Tariff

The purpose of the FAC is well-established in Commission precedent as:

... 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.³³

As a matter of public policy, the FAC regulation fulfills several important purposes.

From the utility's perspective, it reduces regulatory risk and regulatory lag by assuring that the utility is able to recover the most substantial portion of its variable expenses in a timely manner.

From the ratepayer's perspective, the regulation, *inter alia*: (1) reduces the volatility of incremental changes in monthly bills caused by a utility's fuel price fluctuations; (2) avoids the need to pay for the expense of sequential base rate cases; and (3) provides a general benefit of lowering utility borrowing costs as a result of reduced regulatory risk and regulatory lag.

The current iteration of the FAC regulation, which became effective on April 7, 1982, requires a utility to recover its fuel costs on a current basis.³⁴ To that end, the Commission has held:

[The FAC regulation] prescribes a strict procedure for accounting and reporting fuel costs and requires the reporting of all fuel costs. ...The regulation makes no exceptions and provides for no variations or deviations from the stated reporting methodology.³⁵

³³ *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430 (Ky. P.S.C. Feb. 7, 2005) (quoting *In the Matter of Kentucky Power Company*, Order, Case No. 6877, p. 2 (Ky. P.S.C. Dec. 15, 1977)).

³⁴ See 8 Ky.R. 822.

³⁵ *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430 (Ky. P.S.C. March 21, 2005) (quoting the Order entered Feb. 7, 2005, in the same case).

In administering fuel adjustment clause tariffs, the Commission has expressed a preference that fuel costs should be the subject of “uniform treatment” such that “the potential for recovery of non-fuel related costs through FACs” is reduced.³⁶ However, and as discussed, the uniformity of the application of the FAC regulation has never been so rigid that the Commission has lost sight of the over-riding legislative mandate to ensure that a utility’s rates are “fair, just and reasonable,” as required by KRS 278.030(1).

In this case, Duke Energy Kentucky seeks to recover, without variation or deviation from the required reporting methodology of the FAC regulation, the actual net energy costs of energy purchased on an economic dispatch basis. The purposes of the FAC regulation, including its object of encouraging economic fuel procurement practices, are furthered by Duke Energy Kentucky’s position as stated herein.

In accordance with the filed rate doctrine (KRS 278.160) and the FAC regulation, Duke Energy Kentucky prepared and tendered a proposed FAC tariff which was accepted by the Commission. Though the Company’s FAC tariff has been revised from time to time, its current FAC tariff became effective on May 31, 2013, and, for purposes of this proceeding, substantially mirrors the definition of “fuel costs” set forth in 807 KAR 5:056, Section 1(3), stating in relevant part:

Fuel cost (F) shall be the cost of:

- (a) Fossil fuel consumed in the Company’s plants plus the cost of fuel which would have been used in plants suffering forced generation or transmission outages, but less the cost of fuel related to substitute generation, plus
- (b) The actual identifiable fossil and nuclear fuel costs associated with energy purchased for reasons other than identified in

³⁶ See *In the Matter of An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001*, Order, Case No. 2000-00496-B (Ky. P.S.C., May 2, 2002).

paragraph (c) of this subsection, but excluding the cost of fuel related to purchases to substitute for the forced outages, plus

- (c) The net energy cost of energy purchases, exclusive of capacity or demand charges (irrespective of the designation assigned to such transaction) when such energy is purchased on an economic dispatch basis. Included therein may be such costs as the charges for economy energy purchases and the charges as a result of scheduled outage, all such kinds of energy being purchased by the Company to substitute for its own higher cost energy; and less
- (d) The cost of fossil fuel recovered through inter-system sales including the fuel costs related to economy energy sales and other energy sold on an economic dispatch basis.
- (e) All fuel costs shall be based on weighted average inventory costing. The cost of fossil fuel shall include no items other than the invoice price of fuel less any cash or other discounts. The invoice price of fuel includes the cost of fuel itself and necessary charges for transportation of fuel from the point of acquisition to the unloading point, as listed in Account 151 of the FERC Uniform System of Accounts for Public Utilities and Licensees.
- (f) As used herein, the term “forced outages” means all non-scheduled losses of generation or transmission which require substitute power for a continuous period in excess of six (6) hours. Where forced outages are not as a result of faulty equipment, faulty manufacture, faulty design, faulty installations, faulty operation, or faulty maintenance, but are Acts of God, riot, insurrection, or acts of the public enemy, then the Company may, upon proper showing, with the approval of the Commission, include the fuel cost of substitute energy in the adjustment.³⁷

Due to the similarity between the Company’s tariff and 807 KAR 5:056(3), any interpretation of the relevant regulatory provision necessarily impacts the Company’s filed tariff. To the extent that the Commission’s interpretive guidance concerning a tariff practically results in an amendment of the tariff, such interpretative guidance runs afoul of KRS 278.160, which

³⁷ Duke Energy Kentucky Rider FAC Tariff P.S.C. No. 2, Fifth Revised Sheet No. 80 (May 31, 2013).

codifies what is commonly referred to as the filed rate doctrine. “[T]he filed rate defines the legal relationship between the regulated utility and its customer with respect to the rate that the customer is obligated to pay and that the utility is authorized to collect.”³⁸ A “rate,” of course, is defined very broadly in KRS 278.010(12). While the Commission is certainly permitted to, and often must, interpret the various provisions of utilities’ tariffs, it may not ignore the plain and ordinary meaning of the tariff or adopt an interpretation of the tariff that is at odds with the plain and ordinary meaning.³⁹

In the present matter, the Company does not propose to recover any net energy costs that are inconsistent with the plain language of its filed tariff, which tariff has been repeatedly accepted by the Commission as fair, just and reasonable. In the event the Commission finds that the Company’s tariff not “fair, just and reasonable,” it must make findings in accordance with KRS 278.270 and prescribe the appropriate terms on a prospective basis. While the difference between informally relying upon interpretive guidance to re-interpret an existing tariff and formally prescribing a particular change to a tariff may seem to be two equally reasonable avenues for arriving at the same legal destination, important principles of due process set forth in KRS 278.160, KRS 278.260, KRS 278.270 and other legal precedent mandate that the plain language of a tariff must be applied until such time as the Commission orders that it be formally changed.

³⁸ *Cincinnati Bell Telephone Co. v. Kentucky Public Service Com'n*, 223 S.W.3d 829, 837 (Ky. App. 2007) (citing *Big Rivers Elec. Corp. v. Thorpe*, 921 F. Supp. 460 (W.D.Ky.1996)).

³⁹ *W.P. Brown & Sons Lumber Co. v. Louisville & N.R. Co.*, 7 F. Supp. 593, 594 (W.D. Ky. 1934) (“The quoted language seems to be clear and unambiguous, and, as a legally established rate tariff has the force and effect of a statute, it should be construed in the same manner as statutes are construed. Applying that rule of construction, there being no ambiguity in the wording of the tariff, it should be construed as written.”); see also *State ex rel. Laclede Gas Co. v. Public Service Comm’n*, 156 S.W.3d 513, 521 (Mo. App. 2005) (“...our role in interpreting the PSP

D. In the Event all Energy Purchases through the PJM Energy Market are Not Determined to be Purchased on an Economic Dispatch Basis, they are Still Recoverable under 807 KAR 5:056, Section 1(3)(b)

In the event that the Commission disagrees with the Company, and thus finds that: (1) energy purchased through PJM is not done on an economic dispatch basis; (2) the plain language of 807 KAR 5:056 Section 1(3)(c) should not apply the subject energy purchases; and/or (3) the variable cost of the Company's highest cost generating unit available to serve native load (excluding the 1,000+ generating units that are a part of PJM) sets the ceiling for what constitutes a fuel expense recoverable under Section 3(1)(c), then the fuel costs at issue should still be recoverable under Section 1(3)(b) of the FAC regulation. That provision of the regulation states that recoverable fuel costs include the "actual identifiable fossil and nuclear fuel costs associated with energy purchased for reasons other than identified in paragraph (c) of this subsection, but excluding the cost of fuel related to purchases to substitute for the forced outages." Again based on the plain language of the regulation, the fuel costs associated with energy purchased by the Company through PJM is recoverable.

Of course, the Company asserts that recovery of the subject fuel costs under Section 1(3)(c) is most logical and appropriate. However, even if the energy purchases under examination are somehow considered "non-economy energy purchases," the Company's recovery of fuel costs associated therewith should not be limited to the variable or fuel costs of the Company's highest cost generating unit available to serve native load. Based on the

Tariff is to 'ascertain the intent of [Laclede and the Commission] from the language used, to give effect to that intent if possible, and to consider the words used in their plain and ordinary meaning.'").

Commission's holding in Case No. 2004-00430,⁴⁰ the definition of non-economy energy purchases is sufficiently expansive to render recoverable the fuel costs in question.

IV. CONCLUSION

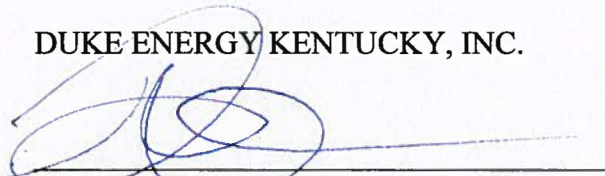
Duke Energy Kentucky contends that the plain language of 807 KAR 5:056 Section 1(3)(c) controls the issue presented in this matter. Because energy acquired through PJM is purchased on an economic dispatch basis, the net energy cost of all the Company's energy purchases is recoverable under the FAC regulation.

WHEREFORE, on the basis of the foregoing, Duke Energy Kentucky respectfully requests that the Commission enter an Order permitting recovery of the subject fuel costs under 807 KAR 5:056 Section 1(3)(c).

Dated this 10TH day of December, 2014.

Respectfully submitted,

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⁴⁰ See *In the Matter of East Kentucky Power Cooperative's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case No. 2004-00430 (Ky. P.S.C. March 21, 2005).