

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

VERIFIED APPLICATION OF LOUISVILLE)	
GAS AND ELECTRIC COMPANY AND)	
KENTUCKY UTILITIES COMPANY)	CASE NO. 2014-00321
FOR A DECLARATORY ORDER AND)	
APPROVAL PURSUANT TO KRS 278.300)	
FOR A CAPACITY PURCHASE)	
AND TOLLING AGREEMENT)	

VERIFIED APPLICATION

Louisville Gas and Electric Company (“LG&E”) and Kentucky Utilities Company (“KU”) (LG&E and KU, collectively, the “Companies” or the “Buyers”) hereby request, pursuant to KRS 278.040(3), KRS 278.300, KRS 278.310 and 807 KAR 5:001, Section 19, that the Commission issue a declaratory order and grant approval for a Capacity Purchase and Tolling Agreement as more fully described herein by November 18, 2014. In support of this Application, the Companies state as follows:

1. LG&E’s full name is Louisville Gas and Electric Company. LG&E’s post office address is 220 W. Main Street, Louisville, KY 40202. LG&E was incorporated in Kentucky on July 2, 1913, and is in good standing in Kentucky. A copy of LG&E’s good standing certificate from the Kentucky Secretary of State is attached as Exhibit 1. LG&E is a utility as defined by KRS 278.010(3)(a) and (b) and as of December 31, 2013, provides retail electric service to approximately 397,000 customers in nine counties in Kentucky and retail gas service to approximately 321,000 customers in seventeen counties in Kentucky. A description of LG&E’s properties is set out in Exhibit 2 to this Application.

2. KU’s full name is Kentucky Utilities Company. KU’s post office address is One Quality Street, Lexington, Kentucky 40507. KU was incorporated in Kentucky on August 17,

1912, and in Virginia on November 26, 1991 (and effective as of December 1, 1991), and is in good standing in both Kentucky and Virginia. Copies of KU's good standing certificates from the Kentucky Secretary of State and the Virginia State Corporation Commission are attached as Exhibit 3. KU is a utility as defined by KRS 278.010(3)(a) and as of December 31, 2013, provides retail electric service to approximately 514,000 customers in seventy-seven counties in Kentucky. A description of KU's properties is set out in Exhibit 4 to this Application.

The Agreement

3. This Application relates to the Capacity Purchase and Tolling Agreement dated August 26, 2014, (the "Agreement") between the Companies (as the "Buyers"), and Bluegrass Generation Company, LLC as Seller (the "Seller"). Buyers will be entitled to 165MW of firm generation capacity and output from the Seller's Unit No. 3 (the "Unit") located in Oldham County, Kentucky, beginning May 1, 2015, subject to certain conditions precedent. The term of the Agreement is through April 30, 2019. The Agreement is expressly conditioned upon the Buyers' obtaining regulatory approval. A redacted copy of the Agreement is attached hereto as Exhibit 5.¹

4. The Companies have determined that entrance into the Agreement presents a favorable opportunity for meeting a portion of their capacity and power supply requirements in order to maintain a reliable reserve margin at time of system peak. Attached to this Application as Exhibit 6 is the Companies' resource analysis of the various options evaluated in order to determine that the Agreement is the best option to ensure adequate generating capacity to reliably meet their supply requirements.

¹ Filed concurrently with this Application is the Companies' Petition for Confidential Protection for portions of the Agreement, and for the resource analysis attached hereto as Exhibit 6.

5. LG&E's and KU's obligations under the Agreement are several, not joint. The Agreement also allows the Buyers on 30 days' notice to the Seller to change the allocation percentages from time to time during the term of the agreement. Since the execution of the Agreement, the Companies have completed their detailed reserve margin analysis, and determined to allocate 100 percent of the obligations to LG&E, thereby permitting the Companies the option, but not the obligation, during the term of the Agreement to have a portion of the Agreement's obligations allocated to KU in the event circumstances change. The reserve margin analysis supporting this allocation is shown in Exhibit 6. Buyers' notice to Seller to change the allocation percentages and Seller's waiver of the full 30-day notice period are attached as part of Exhibit 5.

6. The Agreement allows the Companies to schedule energy with a minimum notice period. The Agreement also requires that the Companies take a minimum of 30 hours of production during each calendar year. However, based on the analysis shown in Exhibit 6, the Companies expect to schedule energy for approximately 500 to 700 hours annually. When the Companies schedule energy they will take delivery of the power from the Unit at the Bluegrass plant's interconnection point with Buyers (i.e., LG&E's Buckner (345kV) substation). The Companies plan to designate Unit No. 3 as a network resource and deliver the energy to their native load customers using firm network transmission service. The Companies have started this process by submitting a transmission service request for the contracted capacity of the Unit. Under the Agreement, Seller has guaranteed the Unit's heat rate to be 10,900 Btu/kWh. Should this heat rate not be achieved, Seller shall provide Buyers a credit to offset their additional fuel cost.

7. The Agreement requires the Companies to pay a capacity charge of \$4.15/kW-month, a fixed operating-and-maintenance (“O&M”) charge of \$0.70/kW-month, escalated annually at 2.5%, a variable O&M charge of \$0.55/MWh, escalated annually at 2.5%, and a start-up charge of \$8,500, escalated annually at 2.5%. The expected capacity charge and fixed O&M charge over the term of the Agreement are shown below:

Year	Capacity Charge (\$ million)	Fixed O&M (\$ million)	Annual Total Fixed Charges(\$ million)
2015	5.5	0.9	6.4
2016	8.2	1.4	9.6
2017	8.2	1.5	9.7
2018	8.2	1.5	9.7
2019	2.7	0.5	3.2

In addition, under certain circumstances, i.e., delivery of more than 264,000 MWh (1,600 hours of operation) of electricity during any annual period, the Companies may also be responsible for obtaining additional NOx and SO2 emissions allowances. However, as stated above, this is well above the number of hours expected to be scheduled from the Unit.

8. The Agreement, which qualifies as an Operating Lease for accounting purposes under Financial Accounting Standards Board Accounting Standards Codification 840, *Leases*, includes a tolling arrangement, with the Companies purchasing and causing to be delivered to the Seller’s facility all the natural gas to be used in the Unit to generate the electricity for the Companies. In a similar, but traditional power purchase arrangement, the Companies would rely upon the Seller to supply the fuel for the Unit, and pay Seller the cost of that fuel as part of the purchase price. In order to ensure that fuel can be delivered to the Unit at peak times in the

summer, the Companies will be procuring firm gas transportation from Texas Gas Transmission. Obtaining firm summer gas transportation is a condition precedent for the Agreement to take effect. This arrangement will allow the Companies to directly manage the risks of the cost and availability of the fuel used to generate the energy received from the Unit in the same manner as with the Companies' owned units on the Texas Gas Transmission system.

Declaration on Fuel Adjustment Clause Recovery

9. Pursuant to 807 KAR 5:001, Section 19, the Companies request the Commission issue an order declaring that certain costs associated with the Agreement will, subject to six month and two-year reviews conducted pursuant to 807 KAR 5:056, be recoverable through the Companies' fuel adjustment clause tariffs. The Commission's regulation 807 KAR 5:056 allows for recovery of certain fuel and energy costs. Specifically, 807 KAR 5:056(1)(3)(a) and (b) defines "Fuel costs" as including:

* * *

- a. Fossil fuel consumed in the utility's own plants, and the utility's share of fossil and nuclear fuel consumed in jointly owned or leased 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 paragraph (c) of this subsection, but excluding the cost of fuel related to purchases to substitute for the forced outages

* * *

10. As noted previously, the Agreement is considered an Operating Lease from an accounting standpoint and the Companies plan to designate Unit No. 3 as a network resource, and dispatch it as if it were an owned unit. As such, the Companies believe it is appropriate to recover the cost of fuel and fuel transport purchased by the Companies necessary to operate the

Unit under the tolling arrangement through the Fuel Adjustment Clause. The Companies plan to charge the fuel and transportation costs used to operate the Unit under the tolling arrangement to FERC Account No. 547, *Fuel*, and then book all costs to FERC Account No. 151, *Fuel Stock*. This is exactly how these costs are recovered for similar units owned by the Companies. In addition, under the terms of the Agreement, the Monthly Fuel Adjustment terms provide a credit from Seller to the Buyer should the unit fail to achieve the guaranteed heat rate. This credit will be reflected in Account 151 and flowed back through Account 547, Other Production Fuel Expense, in the calculation of the monthly fuel adjustment clause factor. In doing so, customers will receive the benefit of the credit through the fuel adjustment mechanism. The fuel costs incurred to operate the Unit under the Agreement are therefore fuel costs for purposes of fuel adjustment clause recovery under 807 KAR 5:056(1)(3)(a) or (b).

11. Other state and federal regulatory commissions have approved the recovery of costs associated with tolling arrangements.²

Declaration on Application of KRS 278.300 to the Agreement

12. As discussed above, the Agreement requires that Buyer take a minimum of 30 hours of production during each calendar year, and includes payment of a Monthly Capacity Payment as well as a Fixed Operating and Maintenance Payment. The Companies expect to incur the fixed charges shown above or a total of \$38.7 million over the four year term of the Agreement.

² See e.g. *RE Public Service Company of Colorado*, Colorado Public Utilities Commission, Docket No. 10A-327E, Decision No. C10-1196, November 4, 2010 (Allowing Buyer under tolling agreement to recover cost of fuel Buyer provided, as well as tolling fees, through Buyer's Electric Commodity Adjustment rider); *Clero Power LLC*, ex parte, Louisiana Public Service Commission, Order No. V-32223, March 28, 2013 (Allowing flow through fuel adjustment clause of cost of fuel provided under tolling agreement, as well as variable O&M and CT start-up charges); *Entergy Gulf States, Inc. and Entergy Louisiana, LLC*, ex parte Louisiana Public Service Commission, Order No. U-30050, June 20, 2007 (Allowing Buyer under tolling agreement to recover costs, including fuel and start-up charges, through fuel adjustment clause.).

13. The Companies are seeking the Commission's declaration that approval of the Agreement under KRS 278.300 is appropriate under the precedent set in Administrative Case No. 350, *In the Matter of the Consideration and Determination of the Appropriateness of Implementing a Rate Making Standard Pertaining to the Purchase of Long-Term Wholesale Power by Electric Utilities as Required in Section 712 of the Energy Policy Act of 1992*. In its October 5, 1993 Final Order in that proceeding, the Commission encouraged, but declined to require, utilities to file long-term power purchase contracts for pre-approval when it observed, "[T]hese Contracts may well require prior approval under KRS 278.300 if they constitute evidence of indebtedness. In particular, the inclusion in such Contracts of minimum payment obligations or take/pay provisions may necessitate prior approval."³

14. As discussed in Paragraph 6 above, the Agreement contains fixed capacity and O&M charges and requires the Companies to take a minimum amount of production over the four-year term of the Agreement. While these specific obligations under the Agreement are not a security or evidence of indebtedness as contemplated under the traditional application of KRS 278.300, because of the Agreement's minimum payment obligations, the obligations may be viewed as evidence of indebtedness which require prior approval under KRS 278.300. The Companies request the Commission determine the minimum payments constitute such evidence of indebtedness under KRS 278.300 and approve them as evidences of indebtedness under KRS 278.300.

³ On September 12, 2014, the Commission issued Orders in Case Nos. 2013-00250, 2013-00251, and 2013-00252 holding that contracts with minimum purchase or payment requirements for the sale of water for resale to a Commission-regulated water utility, did not require approval as evidence of indebtedness under KRS 278.300. The Commission's determination in Administrative Case No. 350 that approved under KRS 278.300 may be required for certain contracts was based in part upon the fact that credit rating agencies had begun regarding obligations incurred by electric and gas utilities under power purchase agreements and similar contracts as fixed obligations equivalent to debt. The rating agencies have continued doing so to this day, and the Companies continue to account for this view when balancing their capital structures. The Companies therefore believe that Commission's determinations in Administrative Case No. 351 remain appropriate and it is appropriate to seek authorization under KRS 278.300 for these obligations.

15. Exhibits 7 and 8 to this Application contain financial exhibits as required by 807 KAR 5:001, Section 18(2)(a) as described by 807 KAR 5:001, Section 12. Exhibits 7 and 8 also contain information required by 807 KAR 5:001, Section 18(2)(b), although the Companies note that an Indenture of Mortgage or Deed of Trust will not be involved in the transaction described herein.

16. Other requirements of the Commission's regulations are inapplicable. The Companies propose to enter into a power supply contract, not to issue notes, bonds, or similar evidence of indebtedness. Thus, there are no stock, notes or bonds, or uses of the proceeds from same to discuss (807 KAR 5:001, Section 18(1)(c) and (1)(d)), and no property is being acquired, constructed, improved or extended (807 KAR 5:001, Section 18(1)(e)). Likewise, no obligations are being discharged or refunded (807 KAR 5:001, Section 18(1)(f)).

WHEREFORE, Louisville Gas and Electric Company and Kentucky Utilities Company respectfully ask that the Commission enter an order declaring the minimum payments constitute evidence of indebtedness under KRS 278.300, and approving their entrance into the Capacity Purchase and Tolling Agreement dated August 26, 2014, with Bluegrass Generation Company, LLC. The Companies also request that the Commission confirm that, subject to the six month and two year reviews provided for in 807 KAR 5:056, costs, including fuel and related transportation costs, as more specifically described in this Application are recoverable through the Fuel Adjustment Clause mechanism as set out herein. In addition, to accommodate the timing and planning needs of both the Companies and Bluegrass Generation Company, the Companies respectfully request that the Commission issue its Order in this proceeding by November 18, 2014.

Dated: September 19, 2014

Respectfully submitted,



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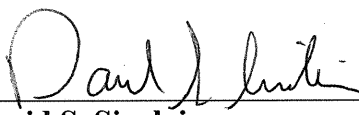
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VERIFICATION

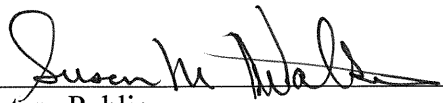
COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **David S. Sinclair**, being duly sworn, deposes and says that he is Vice President, Energy Supply and Analysis for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the foregoing Verified Application and that the content contained therein is true and correct to the best of his information, knowledge and belief.



David S. Sinclair

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 19th day of September 2014.



Notary Public (SEAL)




My Commission Expires:

SUSAN M. WATKINS
Notary Public, State at Large, KY
My Commission Expires **Mar. 19, 2017**
Notary ID # 485723

CERTIFICATE OF SERVICE

This is to certify that Louisville Gas and Electric Company and Kentucky Utilities Company's September 19, 2014 electronic filing of the Verified Application is a true and accurate copy of the same document being filed in paper medium; that the electronic filing has been transmitted to the Commission on September 19, 2014; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original and one copy in paper medium of the Verified Application are being mailed to the Commission on September 19, 2014.



*Counsel for Louisville Gas and Electric Company
and Kentucky Utilities Company*