

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

VERIFIED APPLICATION OF LOUISVILLE)
GAS AND ELECTRIC COMPANY AND)
KENTUCKY UTILITIES COMPANY)
REGARDING ENTRANCE INTO REFINED)
COAL AGREEMENTS, FOR PROPOSED) CASE NO. 2015-00264
ACCOUNTING AND FUEL ADJUSTMENT)
CLAUSE TREATMENT AND FOR)
DECLARATORY RULING)

VERIFIED APPLICATION

Louisville Gas and Electric Company (“LG&E”) and Kentucky Utilities Company (“KU”) (LG&E and KU, collectively, the “Companies”) 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 entrance into various agreements relating to proposed refined coal production arrangements at the Companies’ Ghent, Mill Creek and Trimble County generating stations, as more fully described herein. 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, 2014, provides retail electric service to approximately 400,000 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 (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, 2014, provides retail electric service to approximately 515,000 customers in seventy-seven counties in Kentucky. A description of KU's properties is set out in Exhibit 4 to this Application.

The Refined Coal Production Agreements

3. This Application relates to the proposed installation and operation of refined coal production facilities at the Companies' Ghent, Mill Creek and Trimble County generating stations (the "Generating Stations"). Section 45 of the U. S. Internal Revenue Code provides a tax credit¹ for up to ten years to entities that produce refined coal ("Refined Coal") for sale to an unrelated third party used to produce steam. The tax credit expires in 2021 and, except and if extended, will not be available thereafter. In order to qualify for the tax credit, the Refined Coal must show a minimum reduction of NO_x emissions by 20% and SO₂ or mercury emissions by 40% compared to the emissions from the unrefined or feeder coal. The facility producing the Refined Coal must also have been in service prior to the end of 2011. Thus, there are a limited number of such facilities in existence. The Companies believe that the proposal discussed in this Application provides them with an opportunity to generate an economic benefit for their customers by reducing fuel costs charged through the Fuel Adjustment Clause, while both encouraging the economical use of coal and potentially reducing emissions. In addition, it is

¹ The Refined Coal Tax Credit was added to Section 45 of the Internal Revenue Code by the American Jobs Creation Act of 2004.

possible, but not guaranteed, that the Companies will realize other cost savings, such as lower reagent expenses as a result of using the Refined Coal.

4. The Companies propose entering into up to three separate Operation Agreements (the “Operation Agreements”) with subsidiaries (the “CCS Subsidiaries”) of Clean Coal Solutions, LLC a Colorado limited liability company (“CCS”) with respect to each Generating Station. A representative draft of the Operation Agreement, in substantially final form, is attached hereto as Exhibit 5. Under the Operation Agreements, the CCS Subsidiaries would undertake the installation and operation of refined coal production facilities (“Refined Coal Production Facilities”) at the Generating Stations. CCS is the exclusive licensee of certain proprietary technology to produce Refined Coal by chemically treating feedstock coal to reduce NOx and mercury emissions. The refined coal production process will not affect the thermal output, in terms of British Thermal Units (“BTUs”) associated with combustion. The refined coal production process is described in Exhibit 6, attached hereto.

5. The Companies evaluated CCS’ proposal versus that of another supplier offering a similar process. Because of the limited number of potential suppliers, the Companies did not undertake competitive bidding, but negotiated with both suppliers to obtain the best agreement. Attached as Exhibit 7 is a redacted comparison of the proposals from both suppliers. As a result of this analysis, CCS was selected. In addition, the Companies note that CCS has already implemented 17 similar Refined Coal production projects, including one at TVA’s Paradise Station in Muhlenberg County.

6. The CCS Subsidiaries would undertake the installation and operation of the Refined Coal Production Facilities at the Generating Stations without cost to the Companies.²

²As noted earlier, there are a limited number of qualifying Refined Coal Production Facilities in existence. The Companies are seeking approvals from not only this Commission, but from the Federal Energy Regulatory

To allow them to do so, the Companies would grant non-exclusive licenses to use a portion (the Refined Coal Production Facility will occupy less than one-half acre at each Generating Station plus access) of the real estate at each Generating Station for the duration of the arrangement. The location of the licensed areas would be subject to the Companies' needs.³

7. The Companies would supply the feedstock coal to the Refined Coal Production Facility at each Generating Station from the coal deliveries and inventory at the Generating Station. The Companies would sell feedstock coal to the respective CCS Subsidiaries at the Companies' weighed average inventory cost. After production, the Refined Coal would be resold to the Companies at the same price the feedstock coal was originally sold.

8. The arrangement will not impact the Companies' coal procurement from the market, and will not require any changes to the Companies' Corporate Fuel and By-Products Procurement Procedures.

9. Upon installation and successful operation of each Refined Coal Production Facility, the respective CCS Subsidiaries anticipate, either through selling or leasing their facilities to one or more tax equity investors (the "Tax Equity Investors"), who utilize the tax credits available for Refined Coal to reduce their effective federal income tax rates.

Commission and the Virginia State Corporation Commission as well. It is possible that a sufficient number of remaining Refined Coal Production Facilities will not be available at the completion of the regulatory approval process. In such case, Operating Agreements would not be entered into for all three Generating Stations.

³ The original book value of those portions of the real estate subject to the license, at all three stations combined, is less than one million dollars. Thus, the requirements for Commission approval under KRS 278.218 are not implicated. In addition, the limited license is similar to the license rights granted to other contractors providing services to the Companies at the Generating Stations, and the Companies do not believe the license rises to the level of transfer of "ownership or control" within the meaning of KRS 278.218. For these reasons, and because CCS's activities will be primarily directed at serving the Companies' operations, the Companies also do not believe the Commission's admonition in its June 11, 2002 Order in Case No.2002-00029, that real property at the Companies' generating stations not be sold or leased without Commission approval, is implicated. However, please note that with the Companies' consent, the Refined Coal Production Facilities may also be used to process coal from outside the Companies' inventory. If this does occur, any net benefits generated from third party coal would also flow to the Companies' customers.

10. Upon sale or lease of the Refined Coal Production Facility, CCS, through an affiliate, would operate the Refined Coal Production Facility on behalf of the Tax Equity Investor.

11. The Operation Agreement between each CCS Subsidiary and the Companies would be terminated and superseded by agreements between the Tax Equity Investor and the Companies. The Tax Equity Investor and KU or LG&E, depending upon ownership of the Generating Station, would negotiate and enter into replacement, longer term agreements memorializing the duties and obligations of the parties. Those duties and obligations may be broken out into a number of separate agreements, but would be similar to the duties and obligations under the Operation Agreement, including the sale, treatment, and repurchase of coal, provision of coal inventory, site license and coal yard services, as well as the fees therefor. While at this time, there is no Tax Equity Investor directly identified to acquire the potential Refined Coal Production Facilities to be located at the Companies' Generating Stations, such development can be reasonably expected. This revised arrangement would then continue for the remainder of the Refined Coal Production Facility's lifespan (expected to be until the fourth quarter of 2021, unless the tax credit is extended), subject to early termination for operating, safety, environmental, financial, tax or other circumstances. It is the Companies' expectation and intention that the basic terms set out in the Operation Agreements would not be materially altered, or, if so, only in a manner consistent with the Companies' overall operating, commercial and financial needs, and consistent with market conditions and the fact of the longer-term nature of these arrangements which run through the Refined Coal Production Facility's lifespan. The Companies would not be obligated to proceed with any agreement with a Tax Entity Investor, and would in no event guarantee or warrant the performance of the Refined Coal Production

Facilities. All of the preceding agreements are referred to, collectively, as the “Refined Coal Agreements” or “Agreements”.⁴ Upon execution, the Companies would file copies of any executed Agreements with the Commission.

12. The tax benefits available for refined coal production are adjusted for inflation, and currently amount to \$6.60 per ton of Refined Coal. In return for the applicable CCS Subsidiary’s (or the Tax Equity Investor’s) use of the site at the Generating Stations and the provision of certain services in connection with managing and transporting coal to and from the Refined Coal Production Facility at the Generating Station and similar services, the Companies would receive the estimated fees set out in Exhibit 8, which would be allocated among jurisdictional and non-jurisdictional customers. Based upon forecasted annual coal usage, the total annual fees could potentially amount to \$10.1 million at the Ghent Generating Station, \$5.9 million at the Mill Creek Generating Station and \$3.6 million⁵ at the Trimble County Generating Station.

13. The Companies propose to pass through to their customers through the Fuel Adjustment Clause the net benefits (i.e. payments less any additional severance taxes, as discussed below, that the Companies can demonstrate would not have been incurred “but for” the arrangement) that the Companies receive.

14. The Companies do not believe that the sale of feedstock coal by the Companies or the resale of Refined Coal to the Companies will incur liability for Kentucky’s coal severance tax, on any portion of the value of the coal sold. To confirm the tax treatment, on July 10, 2015, the Companies requested a Ruling from the Kentucky Department of Revenue on this issue. If

⁴ The Companies do not anticipate that the Refined Coal Agreements would extend beyond expiration of the Refined Coal Tax Credit in 2021.

⁵ Based upon their combined 75% ownership interest in Trimble County, the Companies’ share would be \$3.6 million of the total \$4.9 million fee.

the Department were to issue an adverse ruling or severance tax were to be imposed in the future, the Companies propose to charge this cost against the payments received under the arrangement. A redacted copy of this request is attached as Exhibit 9.

Accounting Treatment

15. To ensure that customers receive the benefits of the transactions noted above through the Fuel Adjustment Clause, the Companies propose that the Commission approve the following accounting treatment:

- a. Payments to Companies for Coal Yard Services – directly credit fuel inventory (151) rather than fuel handling expense (501090).
- b. Payment to Companies for Site Licensing – directly credit fuel inventory (151), rather than Rent from Electric Property (454).
- c. Coal severance taxes – directly charge Account 151, rather than Property and Other Taxes (408).

Absent approval of the proposed accounting treatment, the net benefits received from the transaction would only flow through to customers in a future base rate case filing in which the test year included net benefits.

KRS 278.300

16. As discussed above, the Refined Coal Agreements involve the long-term repurchase of Refined Coal for the duration of the approximately six year term of the Agreements.

17. The Companies do not believe that approval under KRS 278.300 is required 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.”

18. As discussed above, the Refined Coal Agreements constitute requirements contracts that obligate the Companies to purchase Refined Coal over the term of the Agreements. While these specific obligations under the Agreements are not a security or evidence of indebtedness as contemplated under the traditional application of KRS 278.300, these obligations could be viewed as evidence of indebtedness that require prior approval under KRS 278.300. While the Companies do not believe that this is the case, if the Commission determines the required purchase and payments constitute such evidence of indebtedness under KRS 278.300 the Companies request that the Commission grant approval under KRS 278.300.

19. Exhibits 10 and 11 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 10 and 11 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 transactions described herein.

20. Other requirements of the Commission’s regulations are inapplicable. The Companies propose to enter into a long-term arrangement involving the production of Refined Coal, 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)

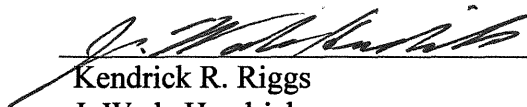
and (1)(d)), and no property is being acquired, constructed, improved or extended (807 KAR 5:001, Section 18(1)(e)). Likewise, no obligations are being discharged or refunded (807 KAR 5:001, Section 18(1)(f)).

20. The Companies note that, as discussed above, there are a finite number of qualified Refined Coal Production Facilities available, and it is possible that as time passes, CCS may locate alternatives for installation of its existing facilities. In addition, the refined coal tax credit is set to end in 2021. Therefore, to ensure that customers receive the economic benefits set out herein, the Companies respectfully request that the Commission review this application as expeditiously as possible and issue its Order in this proceeding by October 15, 2015.

WHEREFORE, Louisville Gas and Electric Company and Kentucky Utilities Company respectfully ask that the Commission enter an order approving the accounting treatment discussed herein and confirm that, subject to the six-month and two-year reviews provided for in 807 KAR 5:056, the benefits and costs, as described above, may be flowed through the Fuel Adjustment Clause mechanism as set out herein. In addition, should the Commission determine that the Agreements constitute evidence of indebtedness under KRS 278.300, the Companies request the Commission approve their entrance into the various Refined Coal Agreements as discussed herein.

Dated: August 19 2015

Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Verified Application was served on the following persons on the 9th day of August, 2015, U.S. mail, postage prepaid:

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