COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Electronic 2016 Integrated Resource Planning	)	
Report of Kentucky Power Company to The	)	Case No. 2016-00413
Kentucky Public Service Commission	)	

ATTORNEY GENERAL'S COMMENTS

Comes now the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and tenders the following comments in this matter.

A. The Commission Should Closely Scrutinize the Continuation of the Rockport UPA

While it is encouraging to see that Kentucky Power Company (KPCo) is examining the cost-effectiveness of its supply side resources, the IRP Report in this docket is premised in part upon the major assumption that KPCo will continue its Rockport Unit Power Agreement (UPA),[1] under which it receives 15% of the energy and capacity (393 MW) of Rockport units 1 and 2.[2] In fact, the Company has apparently decided to postpone any potential decision regarding the continuation of the UPA until the filing of its 2019 IRP.[3] For several reasons, the Attorney General

1 IRP Report, Executive Summary, p. 13 of 1497; *see also* discussion regarding KPCo's "Preferred Plan," p. 148/1497.
2 In its response to AG 1-6, KPCo stated that Rockport Unit 1 is owned by KPCo affiliates Indiana Michigan Power Co. (I&M) and AEP Generating Company (AEG), while Unit 2 is owned by Wilmington Trust Co., which leases an undivided 50% share of Unit 2 to I&M, and an undivided 50% share to AEG. Under the terms of the UPA, KPCo is entitled to 30% of the output of AEG's share in the Rockport Units.
3 *See* response to Sierra Club 1-1 (a)-(b), "At this time, [t]he Company anticipates addressing an extension of the Rockport UPA coincident with the filing of the Company's 2019 Integrated Resource Plan."

believes KPCo's analyses regarding the cost-effectiveness of its Rockport UPA have been inadequate, and warrant the Commission's close scrutiny.

First, the current version of the Rockport UPA, apparently executed in 2004,[4] requires KPCo to pay a return on equity (ROE) of 12.6% [5] to Rockport's owners/ lessors. As set forth in FERC Docket ER13-286, this ultra-high ROE level has been in place since 1988. The 12.6% ROE level is significantly higher than the 2004 average ROE of approximately 11% awarded to electric utilities,[6] and likewise is significantly higher than both the 9.6% average authorized ROEs for electric utilities in 2015-2016 (+23.8%),[7] and the 9.8% ROE (+22.2%) KPCo was allowed to earn in its most recent rate case.[8] Although the IRP Report in the current docket does reflect at least some analysis of the cost-effectiveness of the Rockport UPA, that analysis apparently does not assess the cost to KPCo's ratepayers, to whom the financial burden of the Rockport UPA's 12.6% ROE is ultimately passed. Accordingly, the IRP Report's cost analysis is inadequate.

Second, the costs of the turbine upgrades at both Rockport units,[9] as well as plant modifications and capital expenditures necessary to achieve compliance with the EPA's Effluent Limitations Guidelines Rule do not appear to have been

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4 Response to AG 1-7. The current UPA is scheduled to expire on Dec. 7, 2022. *See also* response to AG 1-8.
5 Response to AG 1-4.
6 Source: "Rate Case Summary, Q. 2 2013 Financial Update," Edison Electric Institute, p. 1, accessible at: <http://www.eei.org/resourcesandmedia/industrydataanalysis/industryfinancialanalysis/QtrlyFinancialUpdates/Documents/QFU_Rate_Case/2013_Q2_Rate_Case.pdf >
7 Source: Regulatory Research Associates, "Regulatory Focus," Jan. 18, 2017, p. 1.
8 Case No. 2014-00396, Final Order dated June 22, 2015, p. 42.
9 Although the turbine upgrades will provide KPCo with approximately 10.8 MW of additional power (IRP Report, pp. 61-62 of 1497), there is no indication KPCo has any need for this additional power, especially considering the sharply diminishing demographics of its service territory (IRP Report, p. 13/1497).

adequately taken into consideration.[10] The extraordinarily high cost that KPCo and its ratepayers are required to pay under the Rockport UPA ROE, and the additional Rockport capital costs for which KPCo will be partly responsible, must be taken into full consideration in order to adequately determine the true cost-effectiveness of the Rockport UPA.

B. The Commission Should Require KPCo's Examination of the Cost-Effectiveness of its Supply Side Resources to Include a Ratepayer Cost Impact Measure

As set forth in the preamble to the Commission's IRP regulation, 807 KAR 5:058, electric utilities must provide ". . . load forecasts and resource plans . . . to meet future demand with an adequate and reliable supply of electricity ***at the lowest possible cost for all customers*** within their service areas. . . ." [emphasis added]. Additionally, Resource Assessment and Acquisition Plans must:

> (1) . . . . include the utility's resource assessment and acquisition plan for providing an adequate and reliable supply of electricity to meet forecasted electricity requirements ***at the lowest possible cost***. The plan shall consider the potential impacts of selected, key uncertainties and shall include assessment of potentially ***cost-effective*** resource options available to the utility. . . . .
> (4) The utility shall describe and discuss its resource assessment and acquisition plan which shall consist of resource options which produce adequate and reliable means to meet annual and seasonal peak demands and total energy requirements identified in the base load forecast ***at the lowest possible cost***.[11] [Emphasis added].

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[10] *See* response to PSC 1-4: "The turbine upgrade projects will require additional capital investment in the Rockport units that will result in an increased demand charge;" response to PSC 1-30; and response to AG 2-9, in which KPCo acknowledges that: (a) the Rockport turbine upgrades could also result in increased energy charges to KPCo; and (b) only the capital costs associated with the upgrades have been incorporated into the IRP.
[11] 807 KAR 5:058 § 8 (1), (4).

Indeed, this Commission has long held to a "least-cost" standard in determining whether to approve supply-side resources. The Commission in *In Re Energy Policy Act of 1992*, Administrative Case No. 350, Order dated Oct. 25, 1993, p. 3, stated:

> "The Commission finds that the market will operate to assign prices based on overall risk, not simply the risk associated with a highly leveraged capital structure. A utility can purchase power ***if that is the least cost option***. On the other hand, a utility can build for its own use ***if that is the least cost option***. Moreover, a utility holding company is not restricted from building an EWG for nonaffiliated sales incorporating the maximum degree of leverage the market will bear."[Emphasis added]

In Case No. 8624, *Application of Kentucky Utilities for an Adjustment of Rates*, the Commission discussed the fact that KU was bringing new generation on line when it was not needed. The Commission noted:

> "The commission is concerned about KU's load forecasting, and about such related issues as the benefits to be realized by cost-effective conservation programming, pursuing the development of small power production and cogeneration, and the extent to which it would be economically beneficial for KU to purchase power from and/or sell power to neighboring utilities. ***These concerns are the heart of the commission's belief that it has an obligation to pursue, for Kentuckians, an energy strategy that represents <u>least cost</u>*** consistent with appropriate reliability, and the further belief that the least cost system does not exist." [12] [Emphasis added]

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[12] 52 P.U.R. 4th 408, Order dated March 18, 1983, p. 21. *See also, In Re: Application of East Ky. Power Coop. Inc. for a Certificate of Public Convenience And Necessity, and a Site Compatibility Certificate,* Case No. 2005-00053, Order dated Aug. 29, 2006 (Commission utilized exhaustive analysis to determine whether EKPC's self-construct bids were in fact the least-cost options*);* and *In Re: A Review of the Adequacy of Kentucky's Generation Capacity and Transmission System*, Admin. Case 387, Order dated Dec. 20, 2001, p. 36 (". . . ULH&P will soon need to address the issue of meeting its post-2006 power requirements in the most reasonable, ***least costly manner***."(Emphasis added)).

Although KPCo's IRP Report states that "[t]he goal of the IRP process is to ensure a reliable supply of power and energy to customers at the least ***reasonable*** cost,"[13] it appears that the company interprets the word "reasonable" from the company's sole perspective. More importantly, KPCo thus misstates the actual legal standard to which it should be held: the "least ***possible*** cost."[14] KPCo's analysis regarding costs is inadequate and fails to meet the least-cost standard absent a ratepayer cost impact measure which, at a minimum, addresses the following cost items, on a per unit basis, year over year since the last IRP filing: (a) the dollar value of each resource placed in ratebase; (b) fuel costs; (c) environmental costs; (d) return on equity paid for any purchased power agreement; (d) annual levels of fuel adjustment charges, environmental cost recovery mechanisms, and all other tracking mechanisms; and (e) capital expenditures.

C. The Commission Should Investigate Whether Continuation of the Rockport UPA Under the Current 12.6% ROE Provides an Undue Subsidization to KPCo's Affiliates

Given the extraordinarily high ROE governing the Rockport UPA, the Attorney General believes an investigation is warranted to determine whether KPCo is unjustly enriching Rockport's owners to the detriment of its own jurisdictional ratepayers. The fact that KPCo's management has failed to address[15] the unusually

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13 IRP Report, p. 27/1497.

14 807 KAR 5:058 § 8 (1), (4).

15 In 2013, AEG in FERC Docket No. ER13-286 filed an application to reapprove, *inter alia*, the Rockport UPA's 12.6% ROE. At least one document filed under this docket (Letter from AEP to FERC Secretary Kimberly D Bose, dated Dec. 21, 2012) was provided as a public attachment to KPCo's response to AG data request 1-375 in Case No. 2014-00396; a copy of that attachment is being uploaded as an exhibit to these Comments. Nowhere in this letter or in the other documents attached thereto is there any indication that KPCo or any other AEP affiliate undertook any efforts to re-negotiate or otherwise amend the 12.6% ROE. Moreover, as noted on p. 18 of that document, "In October of 1988, and every October thereafter for the effective duration of AEGCO's formula rate . . .

high ROE its ratepayers are compelled to pay for power derived from the Rockport UPA also appears to indicate that KPCo's stance on continuing the UPA is conflicted between representing the best interests of its ratepayers, and those of its affiliated partners. In light of the fact that KPCo's affiliates own Rockport, the Commission should initiate an investigation to determine whether KPCo's continued reliance upon the Rockport UHP at the 12.6% ROE, constitutes a subsidization of the non-regulated activity of its affiliates Indiana Michigan Power Co. and AEP Generating Co., in violation of KRS 278.2201. Should the Commission initiate such an investigation, it also has the authority under KRS 278.2211 to access the books and records of KPCo's non-jurisdictional affiliates, and order that costs attached to any transactions with those affiliates be disallowed from KPCo's rates.

D. Any Addition of Wind Power as a Supply Side Resource Should Also Take Into Consideration the Potential Impact of PJM Capacity Performance Penalties

Another key assumption stated in KPCo's Preferred Plan is to add "cost-effective wind . . . as needed to continue to diversify its mix of supply-side resources."[16] In response to a Staff data request, KPCo confirmed that although PJM currently ascribes a 13.5% nameplate capacity rating to wind resources, the company's management believes that for planning purposes, intermittent wind resources should be assigned a markedly lower capacity figure – that of 5% -- due to the significant penalties that PJM can impose under its Capacity Performance (CP)

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any state regulatory commission having jurisdiction over the retail rates of purchasers under these agreements, or any other entity representing customers' interest, may file a complaint with the Commission with respect to the specified rate of return on common equity" [emphasis added]. *See also* responses to AG 2-8, AG 1-8 and Sierra Club 2-10.

[16] IRP Report, Executive Summary, p. 13/1497.

Rule, which takes full effect in 2020-2021.[17] The Attorney General does not necessarily disagree with the assessment of KPCo's management regarding the significant financial risk that generators face in light of the CP Rule; rather, he believes that if the company does pursue wind resources for its capacity value, the company should take additional measures to insulate itself and its ratepayers from that additional risk.[18] These measures could include obtaining hedging or insurance products to mitigate that risk. Moreover, he believes it would be appropriate for the IRP Report to reflect the potential costs for any such hedging / insurance product in order to determine the overall cost-effectiveness of such an intermittent wind resource.[19]

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[17] Response to PSC 1-35.

[18] In at least one prior case, the Commission has noted the significant financial risk to which generating resources are exposed under PJM's CP Rule if the generating resource is not available when called upon by PJM. *See, e.g.,* Case No. 2015-00267, *The Application of East Kentucky Power Cooperative, Inc. for Approval of the Acquisition of Existing Combustion Turbine Facilities From Bluegrass Generation Company, LLC, at the Bluegrass Generating Station in Lagrange, Oldham County, Kentucky and for Approval of the Assumption of Certain Evidences of Indebtedness,* Final Order dated Dec. 1, 2015, pp. 28-29.

[19] *See* response to AG 1-2, in which KPCo discusses the potential addition of a wind power supply side resource, but does not discuss the cost of mitigating the financial risk which a PJM CP penalty would pose.

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that: (a) the foregoing is a true and accurate copy of the same document being filed in paper medium; (b) pursuant to 807 KAR 5:001 § 8(7)(c), there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and (c) the original and six (6) copies in paper medium are being filed with the Commission no later than two business days from the date of the electronic filing.

this 21st day of April, 2017