COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY POWER COMPANY FOR APPROVAL OF RENEWABLE ENERGY PURCHASE AGREEMENT FOR WIND ENERGY RESOURCES BETWEEN KENTUCKY POWER COMPANY AND FPL ILLINOIS WIND, LLC.	)))))	CASE NO. 2009-00545

O R D E R

On December 29, 2009, Kentucky Power Company ("Kentucky Power") filed an application seeking authority to enter into a Renewable Energy Purchase Agreement ("Wind Contract") with FPL Illinois Wind, LLC ("FPL Wind"). Under the terms of the Wind Contract, Kentucky Power would purchase from FPL Wind a 100 MW share of the electrical output and environmental attributes of FPL Wind's Lee-DeKalb Wind Energy Center for a 20-year term.

The Office of the Attorney General, by and through his Office of Rate Intervention ("AG"), and Kentucky Industrial Utility Customers, Inc. ("KIUC") filed for and were granted intervention. A procedural schedule was established providing for two rounds of discovery to Kentucky Power, the filing of intervenor testimony, and one round of discovery to the intervenors. Kentucky Power was allowed to file its rebuttal testimony on April 30, 2010. An evidentiary hearing was scheduled on May 25, 2010. The parties filed simultaneous post-hearing briefs by June 8, 2010. The matter now stands submitted for a decision.

DISCUSSION

Kentucky Power states that the Wind Contract will enable it to diversify its fuel mix in furtherance of its corporate goals and those of its parent company, American Electric Power ("AEP"). According to Kentucky Power, the Wind Contract will position it to better meet growing environmental requirements and impending government portfolio mandates for renewable energy and to take advantage of federal tax benefits and will provide it access to renewable energy certificates to benefit its customers.

Kentucky Power states that, although no national renewable portfolio standard ("RPS") currently exists, there have been efforts by the federal government to reduce the emission of carbon dioxide and require increasing amounts of energy to be generated by renewable resources. At the state level, Kentucky Power cites a 2008 report issued by Kentucky Governor Steven L. Beshear entitled "Intelligent Energy Choices for Kentucky's Future: Kentucky's 7-Point Strategy for Energy Independence." That report also proposed a renewable energy standard which would require utilities over time to increase their use of renewable sources of generation. In addition, Kentucky Power notes that legislation was introduced in the Kentucky General Assembly in 2010 that would mandate the use of renewable resources for generating electricity, although the legislation was not enacted. Kentucky Power also cites the enactment in neighboring states of renewable generation requirements as support for its position that such a requirement in Kentucky is inevitable.

While it acknowledges that no mandatory renewable standard now exists, Kentucky Power argues that, once such a standard is enacted, the increased demand for renewable generation will cause the prices for renewable energy to increase, making the pending wind power contract even more economically beneficial. Kentucky Power estimates the rate impact to a customer using 1,000 kWh per month as an increase of approximately 71 cents per month. Assuming a 39.3-percent capacity factor, the annual cost to purchase power under the Wind Contract is estimated to be $14.3 to $14.5 million.[1] This additional annual cost was included in Kentucky Power's proposed rates as filed in its pending rate application, Case No. 2009-00459.[2]

The AG and KIUC oppose the Wind Contract and recommend that the Commission reject it for numerous reasons. First, they assert that there is currently no federal or state renewable energy requirement and that the purchase of wind power is thus a discretionary expense that residential customers and industrial manufacturers cannot afford at this time. Second, they maintain that Kentucky Power has no need for the energy expected to be provided by the Wind Contract because Kentucky Power is energy long and the wind purchase would only exacerbate that situation. Although the AG and KIUC acknowledge that Kentucky Power is a capacity deficit member of the AEP Pool, they note that the 100 MW Wind Contract would only be credited for 36.5 MW of Pool capacity due to the intermittent nature of wind power. Third, the AG and KIUC argue that the Wind Contract is not economic on a net present value basis.

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[1] At a 39.3-percent capacity factor, the annual cost of the Wind Contract is $20 million. However, Kentucky Power would realize capacity equalization payment savings of between $5.3 million and $5.7 million annually. After appropriate jurisdictional allocation, the net base rate increase to Kentucky retail ratepayers from the Wind Contract would be between $14.3 million and $14.5 million on an annual basis.

[2] Case No. 2009-00459, Application of Kentucky Power Company for a General Adjustment of Electric Rates, filed January 15, 2010.

The AG and KIUC also claim that the wind project is unlikely to achieve a 39.3-percent capacity factor as assumed by Kentucky Power. Because the base rate revenue requirement is premised on the assumption that the wind project will achieve an annual capacity factor of 39.3 percent, they argue that any capacity factor less than 39.3 percent would result in a profit to Kentucky Power, with ratepayers being charged for renewable energy they did not receive. Finally, the AG and KIUC assert that, in the past few years, there have been relatively significant improvements in the efficiency of wind turbines and that these improvements will continue, resulting in greater benefits to those who delay purchasing wind power.

COMMISSION FINDINGS

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that Kentucky Power has requested approval of the Wind Contract as evidence of indebtedness under KRS 278.300, which provides in pertinent part that:

> The commission shall not approve any issue or assumption unless, after investigation of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed assumption of obligation or liability, the commission finds that the issue or assumption is for some lawful object within the corporate purposes of the utility, is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose.[3]

In conducting this investigation of the purposes and uses of the proposed issue and the proceeds thereof, we must consider that this wind power contract is intended to add supplemental generating capacity to Kentucky Power and, thus, we must analyze the

[3] KRS 278.300(3).

need for this additional generating capacity under the Commission's existing statutory authority.

KRS Chapter 278 provides that "[t]he Public Service Commission (PSC) has exclusive jurisdiction over the regulation of utility rates and service. . . ."[4] The touchstone for utility rate-making in Kentucky is the requirement that "[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."[5] The Commission has long recognized that "least cost" is one of the fundamental principles utilized when setting rates that are fair, just, and reasonable.[6]

The fundamental principle of least cost is also embedded in KRS 278.020(1), which prohibits a utility from constructing a new facility to provide service to the public until it has demonstrated both a need for the new facility and that its construction will not result in wasteful duplication.[7] Even though Kentucky Power is not now proposing to construct new generating facilities, its proposal to enter into a long-term contract to purchase such generation will have the same operational and financial implications and impacts to the utility and its ratepayers as if new generation were being constructed. Consequently, in examining the statutory criteria for approving financing under KRS

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[4] KRS 278.040(2).

[5] KRS 278.030(1).

[6] See Public Service Comm'n v. Continental Tel Co., 692 S.W.2d 794, 799 (Ky. 1985) ([O]ne of the important objectives considered by the commission, that is, providing the lowest possible cost to the ratepayers).

[7] See Ky. Utilities Co. v. Public Service Comm'n, 252 S.W.2d 885 (Ky. 1952).

278.300(3), the "purposes and uses of the proposed issue" are for the acquisition of new generation; and for the debt to be "for some lawful object within the corporate purposes of the utility," there must be a need for additional generation and the absence of wasteful duplication.

Here, Kentucky Power acknowledges that, under its most recent assessment of its least-cost generation expansion plan, no additional generating capacity is projected to be needed until 2017, when a combustion turbine is projected to be added.[8] Moreover, as a member of the AEP Eastern Zone,[9] Kentucky Power shares generating capacity with the other operating companies in the Eastern Zone. Although Kentucky Power's peak demand exceeds its capacity, it is able to access low-cost capacity from other members of the AEP Eastern Zone. Thus, it is clear that Kentucky Power does not have a present need for additional generation. In addition, the proposed 20-year wind power contract has not been shown to be least-cost compared to Kentucky Power's available energy sources.

Even though the initial annual cost for the wind energy is projected to be approximately equal to Kentucky Power's cost for energy purchased from the Pool during the test year, the cost for Pool energy has varied above and below that price in past years. In any event, the cost for the wind energy, at approximately $43/MWh, is substantially above Kentucky Power's cost of generation, at roughly $34/MWh. Since

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[8] Direct Testimony of Scott C. Weaver, Exhibit SCW-1B.

[9] In addition to Kentucky Power, the AEP Operating Companies in the Eastern Zone are Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, and Ohio Power Company.

Kentucky Power's generation is sufficient to meet its customers' load during most hours in the year, Kentucky Power has not shown that the 20-year wind power contract will be least-cost when compared to its available energy sources.

While Kentucky Power justifies the proposed wind power purchase on the basis that a federal or state RPS is inevitable and that it is reasonable to act now in anticipation of such a requirement, the Commission must act within the authority that has been delegated expressly by the General Assembly or that arises of necessity or by fair implication from that express delegation.[10] While it is certainly reasonable for Kentucky Power to take into account for planning purposes the likelihood that an RPS will be enacted, until such a requirement is enacted and it is known and measurable, the Commission is unable to approve a long-term wind power contract that is neither needed nor least-cost when compared to the existing generation resources of Kentucky Power. The Commission also notes that, during the 2010 General Assembly, House Bill 3 was proposed, which would establish an RPS for utilities in Kentucky. Although the legislation was not enacted, that RPS would have mandated the purchase of energy generated from renewable resources located in Kentucky. Thus, since the wind power contract proposed here is for renewable energy generated in Illinois, this contract would not have satisfied the renewable standard as proposed in House Bill 3. In the absence of legislative certainty regarding future renewable mandates, the value of the proposed wind power contract is speculative. There is no mandate at this time for utilities in Kentucky to supply renewable energy. In addition, Kentucky Power has not satisfied its

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[10] Boone Co. Water and Sewer Dist. v. Public Service Comm'n, 949 S.W.2d 588, 591 (Ky. 1997) citing Croke v. Public Service Comm'n, 573 S.W.2d 927 (Ky. App. 1978).

burden of proof to demonstrate that the wind power is needed or that it will over time be least-cost. However, it should be noted that the Commission recognizes the potential value of renewables as a part of a utility's generation portfolio and commends Kentucky Power for its desire to include renewables as a part of its generation portfolio.

IT IS THEREFORE ORDERED that:

1. Kentucky Power's request for approval under KRS 278.300 of a Wind Contract is denied.

2. This matter is closed and removed from the Commission's docket.

By the Commission

Vice Chairman James W. Gardner dissenting.

ENTERED
JUN 28 2010
KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Executive Director

DISSENTING OPINION OF JAMES W. GARDNER

I respectfully disagree with my colleagues' conclusions that the proposed wind contract is neither least-cost nor needed and therefore I must dissent.

First, as the majority opinion notes, Kentucky Power purchases energy from the AEP Pool and other sources. As the table below indicates (per the FERC Form 1 Annual Reports), AEP has made substantial purchases of energy since at least 2006 and has continued making such purchases during the test year.

	Purchased Power Cost	MWh Purchased	Cost per MWh
Calendar year 2006	$111.4 million	2,867,000	$38.51
Calendar year 2007	$136.1 million	3,192,000	$42.64
Calendar year 2008	$180.9 million	3,443,000	$52.69
Test year ended 9/30/09	$123.2 million	2,867,000	$42.97
Totals	$551.6 million	12,369,000	$44.60

Because most of these purchases came from the AEP Pool, these facts may be unique to Kentucky Power, but the conclusion is inescapable: the price Kentucky Power pays for purchased power is approximately $45 per MWh, which is nearly $2 more per MWh than the proposed wind contract of $43 per MWh.

Further, as a result of the AEP solicitation for bids, this particular bid was substantially lower than other bids received. This is also lower by far than the bid that

LG&E/KU received when it recently solicited bids for wind. The testimony we heard indicated that, with the expiration of the federal tax credit, it is unlikely that future solicitations will generate bids as low as this one. Thus, for all of the above-stated reasons, I believe that this contract satisfies Kentucky's least-cost principles.

Second, there is a necessity for this power. As my colleagues recognize, there are great pressures nationally and in Kentucky to increase renewables. After listening to nearly 100 Kentucky Power ratepayers at three public meetings, I worry about the future costs of electricity to these ratepayers. This contract would have been a very small piece of Kentucky Power's portfolio (less than 5 percent). As a Commissioner, I am concerned that ratepayers in a state like Kentucky with no nuclear power, and little potential for in-state renewables (other than biomass), will be facing large rate increases. This modest proposal would have guaranteed a price for 20 years for at least a small portion of Kentucky Power's generation mix and thus I believe it is in fact needed.

My colleagues and I want the same end: the lowest rates possible for electricity. Determining how to reach that common goal has led to this good faith disagreement. These types of disagreements, not only among commissioners, but among utilities and the public, will only be alleviated with clear direction from the elected representatives of the United States and the Commonwealth of Kentucky.

James W. Gardner, Vice Chairman
Kentucky Public Service Commission
dissenting

ENTERED

JUN 2 8 2010

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

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