

132 FERC ¶ 61,055
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Kentucky Utilities Company

Docket No. ER08-1588-000

Frankfort Electric and Water Plant Board
City of Barbourville, Kentucky
City of Bardstown, Kentucky
City of Bardwell, Kentucky
City of Benham, Kentucky
City of Berea, Kentucky
City of Corbin, Kentucky
City of Falmouth, Kentucky
City of Madisonville, Kentucky
City of Nicholasville, Kentucky
City of Paris, Kentucky
City of Providence, Kentucky

Docket No. EL09-6-000

v.

Kentucky Utilities Company

ORDER ACCEPTING REVISED SERVICE AGREEMENT

(Issued July 16, 2010)

1. In this order, the Commission conditionally accepts the addition of proposed section 3.8.6 to the Amended and Restated Agreement (Amended Agreement), pursuant to which Kentucky Utilities Company (KU) provides service to the Kentucky

Municipals.¹ Section 3.8.6 provides that KU is under no obligation to provide renewable resources to the Kentucky Municipals.

I. Background

2. KU is a public utility that owns and operates electric generation, transmission, and distribution facilities in Kentucky, with limited operations in Tennessee and Virginia. KU is a wholly-owned subsidiary of E.ON U.S. LLC, a Kentucky corporation and public-utility holding company. KU and its affiliate Louisville Gas and Electric Company (LG&E) own or control, directly or indirectly, approximately 8,650 MW of generation capacity, operate a joint electric balancing authority, and own approximately 4,925 circuit miles of electric transmission lines.

3. Each of the Kentucky Municipals owns and operates a municipal electric distribution system in Kentucky and is a partial wholesale requirements customer of KU.² KU currently provides the Kentucky Municipals with an offset to their bills in recognition of electricity generated by the Southeastern Power Administration.

4. On September 29, 2008, in Docket No. ER08-1588-000, KU filed, pursuant to section 205 of the Federal Power Act (FPA),³ amended and restated contracts to replace the rate schedules pursuant to which the Kentucky Municipals receive service from KU (September 2008 Filing). KU proposed to replace the stated rates charged to the Kentucky Municipals with formula rates and to modify the terms and conditions of the existing service agreements (Original Contracts) for each of the Kentucky Municipals. On October 27, 2008, the Kentucky Municipals filed a complaint against KU in Docket No. EL09-6-000, pursuant to section 206 of the FPA, regarding the same issues.⁴

5. On November 26, 2008, the Commission consolidated the proceedings, accepted KU's proposed rates, terms, and conditions of service to the Kentucky Municipals, suspended the rates for five months to become effective on May 1, 2009, set the matter

¹ The Kentucky Municipals are the Frankfort Electric and Water Plant Board, and the Cities of Barbourville, Bardstown, Bardwell, Benham, Berea, Corbin, Falmouth, Madisonville, Nicholasville, Paris (Paris), and Providence, Kentucky.

² Additionally, Paris owns and operates approximately 12 MW of local generation.

³ 16 U.S.C. § 824d (2006).

⁴ 16 U.S.C. § 824e (2006).

for hearing, held the hearing proceedings in abeyance, and established settlement procedures.⁵

6. On May 6, 2009, KU filed an offer of partial settlement,⁶ and KU and the Kentucky Municipals filed a joint motion to brief the Commission on the one outstanding issue: the treatment of Renewable Resources under the Amended Agreement.⁷ Specifically, KU proposes to include a section 3.8.6, which states:

Buyer will be under no obligation to pay for any Renewable Resources^[8] procured by Seller absent approval by FERC of a filing by Seller under FPA Section 205 to charge rates for such resources to Buyer. If Buyer procures or develops a Non-Seller Source^[9] that falls within a statutory or regulatory definition of “renewable,” whether such renewable resource is required by law or otherwise, Buyer will exercise its rights under Section 2.3.2 and in such instance Seller agrees to waive the five (5) year notice thereunder only to the extent

⁵ *Kentucky Utilities Co.*, 125 FERC ¶ 61,242 (2008) (November 26 Order).

⁶ The partial settlement was certified to the Commission as uncontested by the presiding judge on June 10, 2009, and accepted by the Commission on November 2, 2009. *Kentucky Utilities Co.*, 129 FERC ¶ 61,099 (2009).

⁷ The Amended Agreement is the amended and restated service agreement for each of the Kentucky Municipals as agreed to during the settlement process. According to KU, the terms and conditions contained in each of the Amended Agreements are “substantially similar,” with the exception of the Amended Agreement for Paris. *See* KU’s Explanatory Statement in Support of Settlement Agreement at 5 (May 6, 2009).

⁸ “Renewable Resources” are defined as: “electric generation facilities (whether directly or indirectly owned or leased) or purchased power contracts from any such generation facility, to the extent that such facility and/or purchased power fall(s) within the definition of ‘renewable’ (or any like or similar term) established under any Renewable Portfolio Standard or other Law, as may be applicable to either Party.” Amended Agreement, §1.1.

⁹ “Non-Seller Source” is defined as any resource not procured by KU under the Amended Agreement to serve the buyer’s (i.e. the municipal party to the agreement) retail load, or that the buyer procures or develops for unanticipated load (an increase in load not planned for by KU) or non-conforming load (load that, more than once per hour, increases or decreases beyond certain thresholds). Amended Agreement, §1.1.

necessary to accommodate Buyer's procurement or development of any such renewable resource. Notwithstanding the above obligation to meet in good faith, Seller shall be under no obligation to procure Renewable Resources on behalf of Buyer, nor shall Buyer have any rights to energy from Renewable Resources procured or utilized by the Seller to serve Seller's retail load, absent a written agreement between the Parties regarding the rates, terms and conditions of service for such procurement and authorization from the Kentucky Public Service Commission, if Seller determines such authorization is applicable.

7. Both parties filed Initial Briefs on June 1, 2009, and Reply Briefs on July 1, 2009.

II. Discussion

8. As an initial matter, we note that neither party disputes that the Original Contracts give KU the right unilaterally to propose a modification under section 205 of the FPA. Indeed, as discussed below, the Kentucky Municipals assert that KU's section 205 filing is *flawed*, not that it is barred by contract.¹⁰ Accordingly, our review of this proposed section 3.8.6 must focus on whether KU's proposal is just and reasonable. For the reasons discussed below, we find that it is.

A. Undue Discrimination

9. The Kentucky Municipals argue in their initial brief that KU is attempting to keep for its preferred customers – what it describes as its retail rather than wholesale native load customers – the least expensive Renewable Resources available for delivery to Kentucky.¹¹ They argue that this is unduly discriminatory, especially given that the Kentucky Municipals will bear costs and confer savings associated with the Renewable Resources in which they would not share. The Kentucky Municipals state that the undue

¹⁰ Nor did the Kentucky Municipals challenge KU's section 205 rights at the time of KU's September 2008 Filing proposing modifications.

¹¹ Initial Brief of Kentucky Municipals at 13. Both parties acknowledge, however, that the inclusion of Renewable Resources into KU's power purchases could *raise* the Kentucky Municipals' rates. See Initial Brief of KU at 17 ("renewable resources are typically more expensive than KU's baseload generation") and Initial Brief of Kentucky Municipals at 12 ("renewable resources generally represent relatively expensive capacity but relatively inexpensive energy.").

discrimination inherent in KU's position is highlighted by a form letter sent by KU to public officials of each Municipal. The letter asserts that a carbon cap-and-trade tax or a 15 percent mandate for renewable electricity is foreseeable and, based upon predicted environmental and tax law developments, if enacted, would require KU to substantially increase its charges to the Kentucky Municipals.¹²

10. In its initial brief, KU states that any claims of undue discrimination are unfounded because KU's retail customers and the Kentucky Municipals are not similarly situated.¹³ KU states that the Commission and the courts have found that public utilities may charge different rates to customers as long as the customers are not similarly situated and there are good reasons for the differences. KU points out that, in Kentucky, retail customers are captive customers and do not have the opportunity to use the transmission system to choose alternative suppliers. Consequently, if there is a renewable portfolio standard or similar requirement for Renewable Resources, KU will be obligated to provide those Renewable Resources to its retail customers, in part because the retail customers cannot procure such resources themselves. In contrast, KU argues that there is no evidence that the Kentucky Municipals are similarly situated to KU's retail customers. Rather, KU argues that, as wholesale customers, the Kentucky Municipals can procure Renewable Resources at any time, for any reason.¹⁴

11. In its reply brief, the Kentucky Municipals argue that they are indeed similarly situated to KU's retail customers. They contend that, by definition, wholesale customers purchase power in bulk power markets. However, they argue that this does not obviate jurisdictional public utilities' obligations to treat their native load wholesale customers comparably to their retail customers.¹⁵ To the contrary, the Kentucky Municipals state that requiring such comparability is one of the FPA's fundamental purposes.¹⁶

12. In its reply brief, KU states that it has no legal obligation to share resources purchased for its retail customers with any wholesale customer. KU states that the Kentucky Municipals have not pointed to a regulation or statute that would entitle them to receive this type of power from a partial wholesale supplier, nor have they established

¹² *Id.*

¹³ Reply Brief of KU at 20.

¹⁴ *Id.* at 20-21.

¹⁵ Reply Brief of Kentucky Municipals at 10.

¹⁶ *Id.* at 10, *citing FPC v. Conway Corp.*, 426 U.S. 271 (1976).

a case of undue discrimination or preference.¹⁷ KU further states that discrimination is not implicated here because the Kentucky Municipals have the contractual, regulatory, and commercial means to procure their own resources, whereas KU's retail customers must rely on KU for all their power needs.¹⁸

Commission Determination

13. The Kentucky Municipals, as partial requirements customers of KU, are not similarly situated to KU's retail native load customers. As KU points out, retail native load customers are captive customers, while the Kentucky Municipals have the option to reduce their dependence on KU with other sources of power. In this regard, the Kentucky Municipals are not similarly situated to retail native load customers because the Kentucky Municipals have a choice of suppliers and access to the wholesale market.

14. Proposed section 3.8.6 recognizes this difference, permitting Kentucky Municipals to reduce their partial requirements service from KU in order to acquire Renewable Resources. We also note that, because the Kentucky Municipals can opt out of their contract with KU in 2016, KU faces greater risk with regard to the costs of any Renewable Resources it purchases on their behalf than it would for its retail customers. If the Kentucky Municipals decide to exercise their termination rights, KU will be stranded with the costs of any renewable power that it purchased on Kentucky Municipals' behalf. Moreover, proposed section 3.8.6 permits the Kentucky Municipals to reduce their requirements, with a waiver of the five year notice provision, and procure their own Renewable Resources, regardless of whether required by law or otherwise, and, as more fully set forth below, KU will file to amend its rate formula to exclude costs associated with Renewable Resources in order to protect Kentucky Municipals from such costs.

15. Therefore, we find that section 3.8.6 is not unduly discriminatory or preferential.

B. Cost Protection

16. In their initial brief, the Kentucky Municipals argue that they will likely be responsible for bearing the costs of Renewable Resources, regardless of whether they benefit from them.¹⁹ While they acknowledge that KU states that the Kentucky

¹⁷ Reply Brief of KU at 23.

¹⁸ *Id.* at 24.

¹⁹ Initial Brief of Kentucky Municipals at 13.

Municipals will not be under any obligation to pay for any Renewable Resources, the Kentucky Municipals claim they will be negatively affected by related costs nonetheless. The Kentucky Municipals outline several reasons why they are likely to bear the costs irrespective of whether KU excludes Renewable Resources from the generation used to supply the Kentucky Municipals.²⁰

17. For example, the Kentucky Municipals state that KU has not explained how it would change its formula rates to segregate from the inputs the costs associated with Renewable Resources.²¹ The Kentucky Municipals explain that this issue is complicated by the fact that separating the costs of Renewable Resources from system-wide power supply costs is extremely difficult, since the costs caused by Renewable Resources extend beyond the direct costs of the renewable unit or power purchase.²² The Kentucky Municipals cite a report issued by the U.S. Department of Energy on wind energy, which indicates that the integration of wind resources can increase the costs of regulation and load following and, in some cases, gas supply charges.²³ The Kentucky Municipals state that KU has not committed to even try to remove the indirect costs of Renewable Resources from its rates. The Kentucky Municipals state that the proposed language in section 3.8.6 only proposes at most to remove the direct costs of Renewable Resources, and KU has not committed even to remove those direct costs. The Kentucky Municipals state that the proposed new language in section 3.8.6 provides that KU would need to make a section 205 filing before collecting such costs. The Kentucky Municipals state that this language does not preclude KU from contending that it already has made and received Commission acceptance of such a section 205 filing because the formula rate contained in KU's September 2008 filing provides for roll-in. As a result, the Kentucky Municipals argue that the proposed new language in section 3.8.6 amounts to a one-way option under which KU could supply renewable power to, or withhold it from, the Kentucky Municipals if it wished to do so, and in either event charge them for the Renewable Resources.

18. Furthermore, in their initial brief, the Kentucky Municipals assert that KU has not committed to removing from the Kentucky Municipals' rates the indirect costs caused by integrating Renewable Resources.²⁴ For example, the Kentucky Municipals state that

²⁰ *Id.* at 13-19.

²¹ *Id.* at 7.

²² *Id.* at 14.

²³ *Id.*

²⁴ *Id.*

even if KU were able to modify its demand and energy pricing formula so as to remove the demand and energy costs caused by Renewable Resources, transmission charges to the Kentucky Municipals will still include the transmission system costs of integrating on-system resources.²⁵ Finally, the Kentucky Municipals allege that KU's definition of Renewable Resources will evolve over time since the definition is explicitly tied to renewable portfolio standards or other laws.²⁶ The Kentucky Municipals argue that, because the category of Renewable Resources is starting from a narrow or null baseline definition, it is far more likely to expand than contract. The Kentucky Municipals posit that it is conceivable that the definition of renewable could be expanded to include resources as diverse as nuclear power plants and coal mine waste units which would allow KU to withhold their output from the Kentucky Municipals after the Kentucky Municipals have already borne their costs.²⁷

19. In its initial brief, KU asserts that it will exclude the costs of Renewable Resources from the Kentucky Municipals' wholesale rates.²⁸ KU states that, since Renewable Resources are more expensive than existing baseload generation, it does not wish to take on the risk of purchasing such non-least cost resources on behalf of the Kentucky Municipals. KU further states that, when it procures Renewable Resources under a renewable portfolio standard or otherwise, its increased costs should be borne by KU's retail load, the customers for whom the power is being purchased.²⁹ Therefore, KU states that section 3.8.6 is reasonable because it follows the traditional principle of charging rates based on cost causation and ensures that the Kentucky Municipals do not pay for higher cost power that KU would not buy in the ordinary course.³⁰

20. In its reply brief, KU asserts that the interim and settled rates contain placeholders in the formula to exclude non-jurisdictional costs, such as the costs of Renewable Resources, from the Kentucky Municipals' rates.³¹ Furthermore, KU states that, when costs related to Renewable Resources are ripe for exclusion from the rate formula, KU

²⁵ *Id.* at 16.

²⁶ *Id.*

²⁷ *Id.* at 17-18.

²⁸ Initial Brief of KU at 17.

²⁹ *Id.* at 17-18.

³⁰ *Id.*

³¹ Reply Brief of KU at 19.

commits to provide an itemized accounting of the costs to be excluded from the Kentucky Municipals' rates. However, KU states that the actual impact that Renewable Resources may have on its system is, at this time, theoretical, as KU has not yet purchased any Renewable Resources for the benefit of its retail customers.³² KU states that, when it does begin purchasing such resources, "the Kentucky Municipals will need evidence in order to prove that an increase in their charges has resulted from KU's importation of Renewable Resources."³³

21. With respect to the Kentucky Municipals' concerns regarding transmission system costs KU explains that it merely passes on to the Kentucky Municipals charges equal to the open access transmission tariff (OATT) rate for delivery of power to the Kentucky Municipals' delivery points. It states that any costs related to any system upgrades required to accommodate Renewable Resources will be allocated under its OATT, consistent with Commission policy.³⁴

22. KU rebuts the Kentucky Municipals' argument that costs will not be adequately segregated by pointing out that it has been quite successful to date in segregating its affiliate LG&E's costs from the rates that KU charges, and further points out that the Kentucky Municipals have never complained of inadequate segregation, even though the two utilities' systems are planned and dispatched as a single system. With respect to the Kentucky Municipals' concerns that the language of section 3.8.6 does not require KU to remove costs associated with Renewable Resources from the Kentucky Municipals' rates, KU also commits to never charge the Kentucky Municipals for Renewable Resources absent a written agreement between itself and Kentucky Municipals or direction from the Commission to do so.³⁵

23. Finally, in response to the Kentucky Municipals' concern that the definition of Renewable Resources may change over time, KU explains that its proposal to exclude Renewable Resources will only be effective on a going-forward basis, and that, absent an express legal or regulatory directive, it will exclude only new Renewable Resources, not pre-existing resources.³⁶

³² *Id.*

³³ *Id.* at 19-20.

³⁴ *Id.* at 20.

³⁵ *Id.* at 21.

³⁶ *Id.* at 22.

Commission Determination

24. We agree with the Kentucky Municipals that proposed section 3.8.6 is reasonable only so long as KU is able to remove the direct and indirect costs related to KU's Renewable Resources from the rates it charges the Kentucky Municipals. However, although the Kentucky Municipals argue that it will be impossible for KU to remove all such costs, we note that KU has not yet incorporated any Renewable Resources into its generation portfolio, so any such costs are not yet ripe for exclusion at this point.³⁷

25. However, we of course expect KU to abide by its commitments, and ensure that direct and indirect costs related to Renewable Resources are excluded. We likewise expect KU to identify with specificity in any rate filing that KU makes the costs that are excluded, if and when it integrates Renewable Resources into its generation portfolio. To include any such costs related to Renewable Resources in its rates, KU would first need to make a filing pursuant to section 205 of the FPA seeking recovery of such costs in its rates.

C. Entitlement to Slice of System Power

26. In their initial brief, the Kentucky Municipals state that they believe that a load-proportionate share of the Renewable Resources in KU's system power portfolio – both the costs and any credits – should be included in the power sold to the Kentucky Municipals under the Amended Agreement. In support, they state that, in “filing rates and terms for a slice of system power sale, [KU] expressly based its filing on the Appalachian Power Company's [(Appalachian)] filing in Docket No. ER06-848-000, [where] Appalachian expressly contracted to sell a slice of its entire generation fleet.”³⁸ The Kentucky Municipals state that, in this instance, since KU did not carve out any particular generation type, KU signaled that it would be selling output from its entire generation fleet, consistent with Appalachian's approach. The Kentucky Municipals further claim that KU operates an integrated system in which all generating resources are used together, as needed to serve the aggregate system load, including the firm loads of KU's full or partial requirements wholesale customers.³⁹ Thus, the Kentucky Municipals

³⁷ Similarly, the issue of the possibility of a change in what constitutes a Renewable Resource is premature. If circumstances change, so that the exclusion of Renewable Resources may no longer be just and reasonable, Kentucky Municipals are free to file a complaint.

³⁸ Initial Brief of Kentucky Municipals at 6.

³⁹ The Kentucky Municipals cite *Kentucky Utilities Co.*, Opinion No. 116, 15 FERC ¶ 61,002, Opinion No. 116-A, 15 FERC ¶ 61,222 (1981).

conclude that service was priced and delivered according to a “slice-of-system” rate methodology.⁴⁰

27. In its initial brief, KU argues that the plain language of both the Amended Agreement and the Original Contracts do not entitle the Kentucky Municipals to Renewable Resources procured by KU for its retail customers.⁴¹ According to KU, those contracts do not contain any language that obligates KU to provide electricity from any specific resource or resource mix, nor do the contracts state that the Kentucky Municipals should be supplied from a slice-of-system resource mix, but rather are silent as to the types of resources that KU may use to supply the Kentucky Municipals. KU states that, although the Kentucky Municipals may argue that a previous course of performance entitles them to a slice of KU’s system supply, evidence of a course of performance is not admissible unless it is shown that the contract pursuant to which service was provided is unclear, which is not the case here.⁴² Furthermore, KU argues that, even if its course of performance modified the Original Contracts, KU would still be entitled to make a filing under section 205 of the FPA to modify the Original Contracts, and the Commission would still have to examine whether the proposed rate, including section 3.8.6, is just and reasonable.

28. In their reply brief, the Kentucky Municipals reassert their claim that, under the Amended Agreement, KU has contracted to sell a representative slice of its entire resource portfolio, because this is the meaning of “generic” requirements service.⁴³ The Kentucky Municipals allege that the rates in this proceeding were filed on the basis that KU would provide supply from whatever prudent resource mix it procured on a nondiscriminatory basis. Additionally, they argue that, since every contract implicitly contains an obligation of good faith and fair dealing, where one party has discretion over

⁴⁰ *Citing Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 FR 21540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036, *order on reh’g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, at 30,414, *order on reh’g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh’g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff’d in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff’d sub nom. New York v. FERC*, 535 U.S. 1 (2002).

⁴¹ Initial Brief of KU at 18.

⁴² *Id.* at 19.

⁴³ Reply Brief of Kentucky Municipals at 2.

an element of performance, that discretion must be exercised in a manner that is fair to the other party. Thus, they maintain, KU must provide a mix of resources just as a United States Court of Appeals decision found that vehicle dealers must include a fair share of desirable models in the mix of cars allocated to each dealer.⁴⁴ The Kentucky Municipals also allege that open-ended contracts must be construed in light of the parties' course of performance, and state that KU has long incurred higher system costs in order to address the many environmentally-based constraints on its system resource procurement and operation, with no previous attempt to insulate the Kentucky Municipals from those costs. The Kentucky Municipals also argue that KU's interpretation would nullify certain provisions of the Amended Agreement which fail to carve-out resources with particular characteristics. They maintain that, if KU was free to identify portions of its system as the source of the Kentucky Municipals' supply and price its sales accordingly, KU's obligation to sell requirements power would be illusory and without constraints as to the selection of costs to which the contract would base output prices. Finally, the Kentucky Municipals state that, in the absence of a clearly expressed contrary intent, contracts should be interpreted to be consistent with trade usage, and the long-standing trade usage is that requirement power sales are made from the seller's entire resource portfolio.⁴⁵

29. In its reply brief, KU asserts that it has no contractual obligation to provide the Kentucky Municipals with slice-of-system power, and that the Kentucky Municipals cite no contract language, law, or regulation that imposes such an obligation on KU.⁴⁶ KU also disputes the Kentucky Municipals' argument that, even if the original contracts do not require sales of slice-of-system power, the Commission's standard ratemaking principles do. KU admits that, although the Commission prefers rolled-in rates, this ratemaking preference cannot be converted into an "extra-contractual obligation."⁴⁷ KU states that, in *Nevada Power Co.*,⁴⁸ the Administrative Law Judge required Nevada Power to roll in the hydroelectric power (and its costs) into the rates it charged its wholesale customer unless Nevada Power Company could provide contractual support

⁴⁴ *Id.* at 2 (citing *Stone Motor Co. v. General Motors Corp.*, 293 F.3d 456, 465-467 (8th Cir. 2001)).

⁴⁵ *Id.* at 4-5.

⁴⁶ Reply Brief of KU at 4.

⁴⁷ *Id.* at 12.

⁴⁸ *Id.* citing *Nevada Power Co.*, 1 FERC ¶ 63,046 (1977) (*Nevada Power*), *aff'd* 3 FERC ¶ 61,273 (1978), *aff'd sub nom. Nevada Power Co. v. FPC*, 589 F.2d 1002(9th Cir. 1979).

for its proposal to treat the hydroelectric power differently. According to KU, *Nevada Power* supports its proposal to modify the contract terms and rates to exclude Renewable Resources from the service provided to the Kentucky Municipals.

Commission Determination

30. As discussed above, there is nothing in the Original Contracts that precludes KU from proposing a just and reasonable *change* in the existing rates, pursuant to section 205 of the FPA. We also find that the Original Contracts do not give Kentucky Municipals any contractual entitlement to any Renewable Resources that KU may procure because the contract only provides that KU meet the Kentucky Municipals' electric requirements, with no reference to any specific generating resource. There are no provisions in the contract that expressly provide, in so many words, for such rights.⁴⁹

31. We also disagree with the Kentucky Municipals' claim that they are entitled to renewable power given the parties' course of performance. Because the Kentucky Municipals have provided no persuasive evidence of ambiguity, and we see no ambiguity in the contract, there is no reason to look to course of performance. Moreover, while, until now, KU has provided power from what is sometimes referred to as a slice-of-the-system, nothing in the Original Contract (or the Amended Agreement) addresses specific resource entitlements. Indeed, proposed section 3.8.6 does not fundamentally alter KU's obligation to sell cost-based requirements power to the Kentucky Municipals until at least 2016. While the Kentucky Municipals argue that, where a contract gives one party the discretion over an aspect of performance, that discretion must be used in a manner that is fair to the other party, we find that proposed section 3.8.6 is indeed fair to the Kentucky Municipals; section 3.8.6 gives the Kentucky Municipals the option to reduce their requirements in favor of Renewable Resources without notice, and, while KU will not be

⁴⁹ *Texas Eastern Transmission Corp. v. FPC*, 306 F.2d 345, 347-48 (5th Cir. 1962), *cert. denied*, 37 U.S. 941 (1963); *accord, Boston Edison Co. v. FERC*, 856 F.2d 361,367 (1st Cir. 1988); *Cities of Campbell and Thayer v. FERC*, 770 F.2d 1180, 1190 (D.C. Cir. 1985); *Mitchell Energy Corp. v. FPC*, 519 F.2d 36, 40-41 (5th Cir. 1975); *City of Chicago v. FPC*, 385 F.2d 629, 640 (D.C. Cir. 1967); *see also Ohio Power Company v. FERC*, 744 F.2d 162, 167 n.5 (D.C. Cir. 1984) (major public utility inexperienced in making rate filings can properly be held to the letter of the language it drafted, i.e., is fairly chargeable with the ability to state what it means); *Papago Tribal Utility Authority v. FERC*, 610 F.2d 914, 929 (D.C. Cir. 1979) (major public utility is fairly chargeable with ability to state what it means); *Consolidated Gas Supply Corp. v. FERC*, 745 F.2d 281, 291 (4th Cir. 1984), *cert. denied*, 472 U.S. 1008 (1985) ("It is a reasonable interpretation device to conclude that what someone has not said, someone has not meant.").

providing the Kentucky Municipals power from KU-acquired Renewable Resources, KU will not be charging the Kentucky Municipals for Renewable Resources either.

32. The Kentucky Municipals also argue that Order No. 888-A supports their claim that their contract with KU entitles them to a *pro rata* share of all of KU's generation resources. In support, they quote language from Order No. 888-A, which noted a general ratemaking principle, i.e., it is rare that utilities have separate generating facilities for retail and wholesale customers. "Typically," the Commission said, both sets of customers get energy from the same facilities, each buying a "slice of system."⁵⁰ We disagree that this language supports the Kentucky Municipals' position. Rather, the Commission explained that, prior to the advent of open access, the "typical" arrangement was that utilities planned their systems for their long-term captive customers by rolling in all generating costs, with customers paying average system costs based on all generation. The Commission did not state that there was a *requirement* that all customers must get energy from the same facilities. Moreover, as discussed above, here there is a valid reason for differing treatment of retail and wholesale customers. KU's long-term planning reflects that the Kentucky Municipals are partial requirements customers who can reduce their requirements and procure their own Renewable Resources. The pricing reflects this fact.⁵¹ We also find that Kentucky Municipals' insistence on being served with a *pro rata* share of KU-acquired Renewable Resources is an attempt to extract from KU an additional contractual right that the Commission has never required for partial requirements service.

D. Merger and Exit Settlement Agreements

33. In their initial brief, the Kentucky Municipals assert that excluding Renewable Resources would violate a contractual agreement arising out of a pair of settlement agreements. The Kentucky Municipals state that, in a settlement agreement reached in connection with KU's merger with LG&E,⁵² it was clearly contemplated that the

⁵⁰ Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 at 30,414.

⁵¹ We note that the Commission has previously found that using average system costs is not an appropriate pricing methodology in certain circumstances. *See Golden Spread Electric Coop., Inc., et al. v. Southwestern Public Service Co.*, Opinion No. 501, 123 FERC ¶ 61,047, at P 74-78 (2008).

⁵² Initial Brief of Kentucky Municipals at 8, *citing* a December 5, 1997 agreement among KU, LG&E and the Municipals (Merger Agreement). KU states that the agreement was signed but not filed by Kentucky Utilities at that time and is available as

(continued...)

Kentucky Municipals' energy purchases from KU would represent a slice-of-system share of KU's entire energy portfolio. Additionally, the Kentucky Municipals argue that, in a settlement agreement reached in connection with KU's withdrawal from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO),⁵³ KU committed to extend this slice-of-system arrangement. Specifically, the Kentucky Municipals argue that, by excluding Renewable Resources procured by the KU-LG&E supply system, KU would be violating the Merger Agreement. Also, they argue that KU specifically stated that it would pass through any fuel savings resulting from the merger through the fuel adjustment clause of KU's Commission-approved rate schedules.⁵⁴ In addition, the Kentucky Municipals argue that KU would be violating the Withdrawal Agreement because, when KU withdrew from the Midwest ISO, KU extended its commitment to the slice-of-system arrangement by promising not to issue a termination notice under any existing wholesale power purchase agreement until January 1, 2011 (so that no notice would become effective prior to January 1, 2016).⁵⁵

34. In its reply brief, KU states that the Merger Agreement and the Withdrawal Agreement are irrelevant to the question of whether KU is obligated to provide the Kentucky Municipals with slice-of-system power and do not address whether KU's proposed section 3.8.6 is just and reasonable.⁵⁶ KU maintains that it has not sought to be relieved of any commitments it has made to the Kentucky Municipals and states that it will continue to provide them with cost-based power through January 1, 2016, as provided in the Withdrawal Agreement.⁵⁷ Additionally, KU argues that any benefit that the Kentucky Municipals say they are entitled to under the Merger Agreement cannot fairly be interpreted to include rights to receive shares of any specific resources, and that

part of the Kentucky Municipals' protest filed May 23, 2000 in Docket No. EC00-67-000.

⁵³ *Id.* at 9, *citing* KU's FERC Rate Schedule No. 402 (Withdrawal Agreement).

⁵⁴ *Id.* at 8-9.

⁵⁵ *Id.* at 9 (*citing* KU's FERC Rate Schedule No. 402, Amended Agreement Among Certain Intervenors and Applicants Regarding Applicants' Withdrawal from the Midwest ISO, § 3 (Midwest ISO Withdrawal Agreement)).

⁵⁶ Reply Brief of KU at 4-5.

⁵⁷ *Id.* at 7.

the Merger Agreement expressly states that it does not modify any existing agreements, nor does it inure to the benefit of any third-party beneficiaries.⁵⁸

Commission Determination

35. We find that proposed section 3.8.6 does not violate any contractual commitments contained in the Merger Agreement or the Withdrawal Agreement. The Merger Agreement expressly states that it does not modify any existing agreements, nor does it inure benefits to any third-party beneficiaries. Further, the Withdrawal Agreement only obligates KU to provide cost-based power through 2016 and KU states that it will continue providing the Kentucky Municipals with cost-based power through at least January 1, 2016, as provided for in the Withdrawal Agreement. KU further commits that it will also continue to pass through any fuel savings, as it committed to do in the Merger Agreement. Neither agreement provides that KU is obligated to provide the Kentucky Municipals with electricity from a particular generating unit; we see no such obligation in either agreement.

E. Need to Make a New Section 205 Filing

36. The Kentucky Municipals argue that KU has not made the required section 205 (or section 206) filing to change its formula rate or the slice-of-system nature of the sale it agreed to make.⁵⁹ Rather, the Kentucky Municipals argue that KU inappropriately seeks to make those changes through revisions unilaterally inserted in the contested portion of otherwise uncontested settlement tariff terms and conditions. The Kentucky Municipals state that it is a longstanding principle that utilities may not change their filed rates without first submitting a completed section 205 filing.⁶⁰ The Kentucky Municipals conclude that, between the September 2008 Filing, which provides for slice-of-system sales without excluding Renewable Resources, and the Amended Agreement, which proposes to exclude Renewable Resources from sales to the Kentucky Municipals, KU has failed to make the required proper filing under section 205 of the FPA.⁶¹ In so doing, the Kentucky Municipals believe that KU has improperly avoided the 60-day prior notice period and a potential five-month suspension that might have otherwise applied to its

⁵⁸ *Id.* at 5.

⁵⁹ Initial Brief of Kentucky Municipals at 7.

⁶⁰ *Id.* at 17.

⁶¹ *Id.* at 7, citing *Texas Eastern Transmission Corp. v. FERC*, 102 F.2d 174 (5th Cir. 1996) (*Texas Eastern*); *Kentucky Utilities Co. v. FERC*, 689 F.2d 207 (D.C. Cir. 1982) (*Kentucky Utilities*).

proposal to exclude Renewable Resources, that could have alerted other interested parties,⁶² and that would have allowed the Kentucky Municipals to address unanswered questions. The Kentucky Municipals state that KU has merely provided a narrative description of the revised rates and has not spelled out the formula rate changes it would make to implement its concepts.⁶³

37. KU disagrees with the Kentucky Municipals' assertion that it must submit proposed section 3.8.6 to the Commission as a new section 205 filing. According to KU, section 3.8.6 is part of the evolution of the September 2008 Filing and consideration of it comports with the scope of evaluating a rate filing.⁶⁴ KU also states that the cases the Kentucky Municipals cite for support are inapposite. Additionally, KU states that the Kentucky Municipals' position would discourage utilities from making concessions on their rate filings during negotiations since, according to the Kentucky Municipals' theory, those rates would have to be refiled in a new proceeding. KU states that the standard section 205 process has been followed in this case and that the Kentucky Municipals have been afforded more than adequate due process relative to the change.⁶⁵

Commission Determination

38. We find that no new section 205 filing is necessary. The proceeding currently before the Commission is the product of a settlement that evolved out of KU's September 2008 section 205 filing and is well within the scope of that original filing. Moreover, both parties agreed to brief the Commission on whether proposed section 3.8.6 should be included in the Amended Agreement; in their joint motion filed May 6, 2009, the parties state that they have come to an agreement on all issues except for the just and reasonable treatment of Renewable Resources as defined by and under the terms of the Amended Agreement. Further, we agree with KU that the cases the Kentucky Municipals cite are not applicable to the procedural posture of the instant proceeding. In *Texas Eastern*, the issue was whether a proposed rate change would have retroactive effect, and whether the utility's customers had adequate notice of that retroactive effect. KU in this instance has not yet included any renewable costs in its rates, and thus there is no retroactivity associated with the implementation of proposed section 3.8.6. In *Kentucky Utilities*, the company's rate change filing was deemed deficient because it did not include a rate

⁶² Initial Brief of Kentucky Municipals at 7-8.

⁶³ *Id.*

⁶⁴ *Id.* at 15-16.

⁶⁵ *Id.* at 17-18.

comparison, thus delaying the effective date of the rate. Here, no such rate comparison is necessary or possible because KU has not yet incurred costs related to Renewable Resources. Finally, we note that the issue of Renewable Resources was clearly raised in KU's initial filing in this proceeding.⁶⁶ Accordingly, consistent with the parties' May 6, 2009 joint motion, we find that this issue is properly adjudicated here and there is no need for KU to make a separate section 205 filing.

The Commission orders:

(A) KU's proposed section 3.8.6 is hereby accepted for filing, effective December 1, 2008, as discussed in the body of this order.

(B) KU is hereby directed to amend its rate formula to exclude all costs associated with Renewable Resources, when such costs are ripe for exclusion, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

⁶⁶ In the initial proceeding, the Kentucky Municipals argued that, insofar as they are paying for a slice-of-the-system, they should share in the revenue credits associated with the Renewable Resources. KU stated that it did not disagree with the Kentucky Municipals' arguments and agreed that, to the extent the Kentucky Municipals are paying a slice-of-system share, their rates should reflect cost savings associated with the renewable energy credits.