

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**In the Matter of** )  
**Market-Based Rates for Public Utilities** )  
 )

**Docket No. RM04-7-000**

**PREPARED REMARKS OF MICHAEL BEER  
ON BEHALF OF LG&E ENERGY LLC**

**January 27, 2005**

Good afternoon, Mr. Chairman, Commissioners, and Staff. My name is Michael Beer. I am Vice President of Federal Regulation and Policy for LG&E Energy LLC (LG&E) in Louisville, Kentucky. Thank you for allowing me to speak today. This topic is of intense interest for my Company, as I am sure it is for the rest of the industry – both customers and utilities alike.

LG&E is the holding company that operates two integrated utility companies that serve both retail and wholesale customers primarily in Kentucky, with a limited number of customers in Virginia and Tennessee. The combined companies own approximately 7,665 MW of net baseload and peaking generation facilities. Louisville Gas and Electric and Kentucky Utilities (KU) both operate under the regulatory authority of the Kentucky Public Service Commission (KyPSC) in a non-retail access environment. As such, all capacity constructed and operated by the two companies is justified on the basis of serving the needs of firm native load customers on a least-cost basis. In Kentucky, this firm native load obligation effectively extends to thirteen municipal electric systems that are also served by KU under FERC approved, long-term, cost-based contracts with a five-year cancellation provision. Thus in the context of this proceeding, it can be posited that, at the very least, the geographic definition of the default market should be

clarified to recognize wholesale load that is treated equally with retail native load in the eyes of the Company and the KyPSC as effectively firm native load.

As I said a moment ago, all of these resources are included in the Kentucky jurisdictional rate bases of LG&E's two utility companies. The capacity costs associated with these units are, therefore, recovered in their entirety from the retail and wholesale customers that make up the utilities' native load.

The companies' combined fleet of generation is only large enough to serve the utilities' peak native load plus a required reserve margin. This fact is critical because at no time have either of the utilities planned for or constructed new generation for any purpose other than fulfilling their statutory obligation to serve their native load customers. It is only during periods when certain units are not fully needed to serve native load that the Company seeks to maximize the value of this temporarily available energy through short-term, non-firm sales into the wholesale energy spot market. Any margin realized on these sales flows back to the utilities' native load customers and serves to reduce the revenue requirements associated with these units. LG&E believes, therefore, that as a threshold matter, it is inappropriate to subject this capacity so dedicated to serve native load to any type of market power analysis or mitigation. Energy sales are intermittent, short-term, non-firm economy exchanges, the long-term availability of which should not be relied upon by anyone in the marketplace.

Having stated the case for excluding certain capacity from any type of market power analysis, let me address the broader question of the day. FERC's April 2004 adoption of indicative price screens for determining market power potential has caused great concern with LG&E and well as many in the industry. In order to keep my remarks short, I am going to focus on two issues of particular concern to LG&E. First, LG&E believes that the indicative screens

fail to paint a true picture of the marketplace in which the subject entity operates. Second, there is a great need for FERC to refine its tests to provide further guidance upfront as to whether an entity will ultimately be found to have market power.

As regards my first point, I recognize that many parties have commented that the indicative screens fail to accurately portray the potential for an entity to exercise market power. LG&E agrees with many of these comments and strongly believes that, at the very least, the screens must be refined to more accurately reflect the realities of the marketplace. Such analyses, at the end of the day, must incorporate specific reality-based considerations in the measurement of market power, target customer specific concerns, and recognize the obligations of buyers to properly plan their procurement strategies. It is imperative that in addition to creating screens to identify possible market power, FERC also review what mitigation procedures already exist, including both *de jure* mitigation by state commissions and contracting parties, and *de facto* mitigation that requires FERC to examine the circumstances of actions that have prompted the filing of a complaint.

In particular, LG&E believes that the screens, as currently formulated, only tell half the story of the marketplace. The amount of generation that a seller owns or controls beyond the needs of its native load is only half of a larger equation. The other half is how much energy potential customers demand or might demand. In this regard, I believe that the concept of “contestable load” analysis discussed by several entities in their updated market power analysis filings – including LG&E – warrants careful review and consideration by the Commission. While any screen or test will almost necessarily over- or under-represent an entity’s ability to exercise market power, the failure of the current screens to consider how much potential wholesale load is in the marketplace is a gross shortcoming.

Along these same lines, a second factor that any screen or test must take into consideration is the geographic location of the actual demand. Most of LG&E's short-term wholesale energy sales occur at a generation bus in the LG&E control area. None of these sales, however, sink within the LG&E control area. Rather, the customer wheels this power outside LG&E's control area where even FERC's indicative screens show that LG&E lacks market power. It is this sink area that should be the geographic area of interest for this kind of transaction. The location of the source of the power should not be part of the analysis. Again, the issue here is that FERC's market power screens or tests must look at the demand side of transactions at issue.

My second major point today is the need for greater upfront certainty as to whether an entity will ultimately be found to have or lack market power. While I appreciate FERC's desire to keep its market power tests flexible, so that entities can demonstrate that notwithstanding a screen failure the opposite is true, such flexibility creates uncertainty, which is harmful to the market. This said, whatever test or tests FERC ultimately uses must contain an option for entities to demonstrate that, notwithstanding any failure, they lack market power.

Under the current screens, however, too many entities are failing, creating too much uncertainty in the marketplace. Almost every vertically integrated utility has failed one or both of FERC's indicative screens in its home control area. I expect that, as FERC looks beyond these screens at the actual facts in the marketplace – such as by looking at contestable load – FERC will find that many of these entities lack the ability to exercise market power.

It is antithetical to the concept of promoting dynamic markets for wholesale power, however, to leave so many entities in limbo – with refund liability for market-based sales – for the period of time that it will take FERC to make a final determination whether an entity has the

potential to exercise market power. Market participants need more certainty as to their regulatory status if they are going to enter into short- or, particularly, long-term power sales transactions in an effort to keep the wholesale markets moving fluidly. Accordingly, in fashioning future tests for market power, FERC must focus its tests more so as to not “overcapture” potentially-problematic situations and thus stifle market dynamics.

Thank you for your time. I welcome any questions you might have.