

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

LG&E Energy Marketing Inc.	Docket Nos.	ER94-1188-035
		ER94-1188-034
		ER94-1188-033
Louisville Gas & Electric Company		ER98-4540-004
		ER98-4540-003
		ER98-4540-002
Kentucky Utilities Company		ER99-1623-004
		ER99-1623-003
		ER99-1623-001
WKE Station Two Inc.		ER98-1278-010
		ER98-1278-009
		ER98-1278-008
Western Kentucky Energy Corporation		ER98-1279-006
		ER98-1279-005
		ER98-1279-004
		EL05-99-000

ORDER ON UPDATED MARKET POWER ANALYSIS,
INSTITUTING SECTION 206 PROCEEDING AND
ESTABLISHING REFUND EFFECTIVE DATE

(Issued May 5, 2005)

1. On November 19, 2004, as amended on March 29, 2005, April 8, 2005, and April 13, 2005, LG&E Energy Marketing Inc. (LEM), Louisville Gas & Electric Company (LG&E), Kentucky Utilities Company (KU), WKE Station Two Inc. (WKE Two), and Western Kentucky Energy Corporation (WKEC) (collectively the LG&E Parties) submitted for filing updated market power analyses in compliance with the Commission's order issued on May 13, 2004.¹ The May 13 Order addressed the

¹ *Acadia Power Partners, LLC, et al.*, 107 FERC ¶ 61,168 (2004) (May 13 Order).

procedures for implementing the market power analysis announced on April 14, 2004, and clarified on July 8, 2004.² In addition, the LG&E Parties are amending their tariffs to include the Commission's market behavior rules.³

2. The filing, as amended, indicates that the LG&E Parties pass the pivotal supplier screen in all control areas but fail the wholesale market share screen for each of the four seasons in LG&E's and KU's control area (LGEE) and in the Big Rivers Electric Corporation control area (BREC), which is one of the markets first-tier to LGEE where the LG&E Parties also control generation.⁴

3. As the Commission stated in the April 14 Order, where an applicant is found to have failed either generation market power screen, such failure provides the basis for instituting a proceeding under section 206 of the Federal Power Act (FPA)⁵ and establishes a rebuttable presumption of market power in the section 206 proceeding. Accordingly, as discussed below, in this order, the Commission institutes a proceeding pursuant to section 206 of the FPA to determine whether the LG&E Parties may continue to charge market-based rates and establishes a refund effective date pursuant to the provisions of section 206. The instant section 206 proceeding, as well as any resulting mitigation or refunds, is limited to the LGEE and BREC control areas because the filing indicates that these are the geographic market for which the LG&E Parties fail the wholesale market share screen.

4. In addition, the LG&E Parties state that they pass the pivotal supplier screen and the wholesale market share screen in the Southern Company Control Area (SOCO). However, as discussed below, the Commission is unable to conclude that the LG&E Parties satisfy the Commission's generation market power standard for market-based rate authority in the SOCO control area. Accordingly, in this order, the Commission directs the LG&E Parties to make a compliance filing within 30 days of the date of this order to revise its generation market power analysis for the SOCO control area.

² *AEP Power Marketing, Inc., et al.*, 107 FERC ¶ 61,018 (April 14 Order), *order on reh'g*, 108 FERC ¶ 61,026 (2004) (July 8 Order).

³ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218 (2003), *order on reh'g*, 107 FERC ¶ 61,175 (2004).

⁴ The LG&E Parties' analysis shows that it has a market share as high as 82 percent in the LGEE control area and 100 percent in the BREC control area in one season.

⁵ 16 U.S.C. § 824e (2000).

5. This order, including the refund effective date, will protect customers from excessive rates and charges that may result from the exercise of market power.

Background

6. On May 30, 2002, the LG&E Parties filed a market power analysis employing a Supply Margin Assessment.

7. In the April 14 Order, as clarified by the July 8 Order, the Commission adopted two indicative screens for assessing generation market power: a pivotal supplier screen and a wholesale market share screen. The Commission stated that passage of both screens establishes a rebuttable presumption that the applicant does not possess generation market power, while failure of either screen creates a rebuttable presumption that the applicant has generation market power. The Commission further stated that applicants and intervenors may, however, rebut the presumption established by the results of the initial screens by submitting a Delivered Price Test. Alternatively, an applicant may accept the presumption of market power or forego the generation market power analysis altogether and go directly to mitigation.⁶ The May 13 Order directed the LG&E Parties to file, within 180 days of the issuance of that order, revised generation market power analyses based on these two indicative screens.⁷

8. The LG&E Parties filed an updated market power analysis on November 19, 2004, in Docket No. ER94-1188-035 *et al.*, in compliance with the Commission's May 13 Order (November 2004 filing). The LG&E Parties also filed revised tariff sheets to the market-based rate tariffs of LG&E Energy Marketing Inc., Louisville Gas & Electric Company & Kentucky Utilities Company, WKE Station Two Inc., and Western Kentucky Energy Corporation to include the Commission's market behavior rules.

9. On March 8, 2005, the Director, Division of Tariffs and Market Development – South, acting pursuant to delegated authority, issued a data request seeking additional information relating to the LG&E Parties' submittal.

⁶ In addition, as the Commission stated in the April 14 Order, the applicant or intervenors may present evidence such as historical sales data to support whether the applicant does or does not possess market power. *See* April 14 Order, 107 FERC ¶ 61,018 at P 37.

⁷ *See* May 13 Order at Ordering Paragraph (A).

10. On March 29, 2005, April 8, 2005, and April 13, 2005, the LG&E Parties filed their response to the data request (March 2005 filing, April 2005 filings).

Description of the LG&E Parties' November 2004 Compliance Filing as Amended

11. In its filing, the LG&E Parties submitted the results of the two generation market power screens. As required in the May 13 Order, the LG&E Parties also provided updated information on the other three parts of the Commission's four-part market-based rate analysis. The LG&E Parties state they lack market power over transmission, cannot erect barriers to entry, and will not engage in prohibited affiliate relationships or reciprocal dealing.

12. The LG&E Parties state that they pass the pivotal supplier screen in the LGEE control area and in each directly interconnected first-tier control area. The LG&E Parties state that they fail the wholesale market share screen for each of the four seasons considered in the LGEE control area. The LG&E Parties further state that they pass the wholesale market share screen in each directly interconnected control area except the BREC control area where they fail in all four seasons.

13. In attempting to rebut the presumption that they have market power as indicated by their failure of the wholesale market share screen, the LG&E Parties argue that the Commission's market share screen ignores the fact that the wholesale load that is seeking supplies within the LGEE control area is small and mostly subject to cost-based rates for at least five years. Further, the LG&E Parties state that there is sufficient competing supply located within the control area, or that is able to be imported, to supply at least three times the peak wholesale demand. In addition, the LG&E Parties argue that in the BREC control area, the generation they lease and operate is used to serve the requirements load of wholesale customers within the BREC control area pursuant to existing contracts and that there has been little excess generation available after consideration of the contractual commitment of the LG&E Parties to serve customers in the control area.

Notice of Filings and Responsive Pleadings

14. Notice of the May 30, 2002, filing was published in the *Federal Register*, 67 Fed. Reg. 41,974 (2002), with interventions or protests due on or before June 24, 2002. None was filed.

15. Notice of the November 19, 2004, filing was published in the *Federal Register*, 69 Fed. Reg. 70,436 (2004), with interventions or protests due on or before December 10, 2004. None was filed.

16. Notice of the March 29, 2005, filing was published in the *Federal Register*, 70 Fed. Reg. 19,072 (2005), with interventions or protests due on or before April 19, 2005. None was filed. Notice of the April 8 and 13, 2005, filings was published in the *Federal Register*, 70 Fed. Reg. 20,890 (2005), with interventions or protests due on or before April 25, 2005. None was filed.

Discussion

Procedural Matters

17. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedures, 18 C.F.R. § 385.214 (2004), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

Market-Based Rate Authorization

18. The Commission allows power sales at market-based rates if the seller and its affiliates do not have, or have adequately, mitigated market power in generation and transmission and cannot erect other barriers to entry. The Commission also considers whether there is evidence of affiliate abuse or reciprocal dealing.⁸

Generation Market Power

19. The LG&E Parties state in their compliance filing, as amended, that the LG&E Parties' share of uncommitted capacity in the LGEE and BREC control areas exceeds 20 percent in each of the four seasons during the time period considered. Consequently, the LG&E Parties fail the market share screen in the LGEE and BREC control areas.

20. As the Commission noted in the April 14 Order, once the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) becomes a single market and performs functions such as a central commitment and dispatch with Commission-approved market monitoring and mitigation, the Midwest ISO presumptively would be considered a single geographic market for purposes of our generation dominance

⁸ See, e.g., *Progress Power Marketing, Inc.*, 76 FERC ¶ 61,155 at 61,919 (1996); *Northwest Power Marketing Co., L.L.C.*, 75 FERC ¶ 61,281 at 61,899 (1996); *accord Heartland Energy Services, Inc.*, 68 FERC ¶ 61,223 at 62,062-63 (1994).

screens.⁹ The Commission notes that LG&E and KU are members of the Midwest ISO and that the LGEE control area is within the Midwest ISO geographic footprint. Therefore the default relevant geographic market for the generation market power analyses involving the LGEE control area is the Midwest ISO and not the LGEE control area as used by the LG&E Parties. The LG&E Parties have provided no reason why they use the more narrow LGEE control area for study purposes. Accordingly, the LG&E Parties are directed to revise their generation market power analyses using the Midwest ISO as the relevant geographic market or, alternatively, explain why the LGEE control area is the proper relevant geographic market.

21. In their submission, the LG&E Parties present alternative evidence including historical sales data and other data that they believe to be relevant to rebut the presumption of market power. The LG&E Parties state that they do not have market power in the LGEE control area primarily because their wholesale sales are either: (1) made under contracts with evergreen provisions that cannot be terminated without a five- year advance notice from either party and entitle the customer to cost-based rates subject to the Commission's oversight; (2) made to buyers seeking to sell outside the LGEE control area; or (3) made only rarely to a single customer for backup power. Further, the LG&E Parties claim that they do not have market power in the BREC control area primarily because they have little excess generation available after consideration of their contractual commitment to serve requirements and other load of wholesale customers in the BREC control area.

22. The Commission stated in the April 14 and July 8 Orders that applicants may present historical evidence to show that the applicant satisfies the generation market power concerns. The evidence that will be considered is historical sales and/or access to transmission to move supplies within, out of, and into a control area.¹⁰ The Commission will further examine the information the LG&E Parties submitted in conjunction with other evidence submitted in the section 206 proceeding we institute herein.

23. As outlined in the April 14 Order, the LG&E Parties' failure of the wholesale market share screen provides the basis for the Commission to institute the instant section 206 proceeding, which is limited to the LGEE and BREC control areas, to examine

⁹ The Midwest ISO became a single market and began performing the central commitment and dispatch functions with Commission-approved market monitoring and mitigation on April 1, 2005.

¹⁰ April 14 Order, 107 FERC ¶ 61,018 at P 102; July 8 Order, 108 FERC ¶ 61,026 at P 80.

whether the LG&E Parties may continue to charge market-based rates and establishes a rebuttable presumption of market power. This order establishes a refund effective date in order to put in place the necessary procedural framework to promptly impose an effective remedy, in case the Commission determines that such a remedy is required. Our decision to establish a refund effective date does not constitute a determination that refunds will be ordered.

24. The Commission's decision to institute the instant section 206 proceeding does not constitute a definitive finding by the Commission that the LG&E Parties have market power in the LGEE and BREC control areas. As discussed in the April 14 and July 8 Orders, the indicative screens are conservatively designed to identify the subset of applicants who require closer scrutiny.

25. Accordingly, for the BREC control area, the LG&E Parties will have 60 days from the date of issuance of this order finding a screen failure to: (1) file a Delivered Price Test analysis; (2) file a mitigation proposal tailored to their particular circumstances that would eliminate the ability to exercise market power; or (3) inform the Commission that they will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.¹¹

26. For the LGEE control area, discussed above, the Commission directs the LG&E Parties to file, within 60 days from the date of issuance of this order, a revised generation market power analysis using the Midwest ISO as the relevant geographic market or, alternatively, an explanation as to why the LGEE control area is the proper relevant geographic market. If the LG&E Parties choose to continue to assert that the LGEE control area is the proper relevant market, then the Commission directs the LG&E Parties, for the LGEE control area, within 60 days from the date of issuance of this order, to: (1) file a Delivered Price Test analysis; (2) file a mitigation proposal tailored to their particular circumstances that would eliminate the ability to exercise market power; or (3) inform the Commission that they will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.

27. In cases where, as here, the Commission institutes a section 206 proceeding on its own motion, section 206(b) requires that the Commission establish a refund effective date that is no earlier than 60 days after publication of notice of the initiation of the Commission's proceeding in the *Federal Register*, and no later than five months subsequent to the expiration of the 60-day period. In order to give maximum protection

¹¹ April 14 Order, 107 FERC ¶ 61,018 at P 201, 207-209.

to customers, and consistent with our precedent,¹² we will establish a refund effective date at the earliest date allowed. This date will be 60 days from the date on which notice of the initiation of the proceeding in Docket No. EL05-99-000 is published in the Federal Register. In addition, section 206 requires that, if no final decision has been rendered by that date, the Commission must provide its estimate as to when it reasonably expects to make such a decision. Given the times for filing identified in this order, and the nature and complexity of the matters to be resolved, the Commission estimates that it will be able to reach a final decision by September 30, 2005.

28. The filing indicates that the LG&E Parties pass the pivotal supplier and the wholesale market share screens for the SOCO control area. However, the Commission is unable to find here that the LG&E Parties pass the indicative screens in the SOCO control area because the LG&E Parties provided no sources for the information used to compute competing uncommitted capacity in the generation market power analysis for this control area. Therefore, the LG&E Parties are directed to file, within 30 days of this order, revised generation market power screen analyses for the SOCO control area which include cites for the sources of all information used in the analyses.¹³

29. The Commission finds that the LG&E Parties conditionally satisfy the generation market power standard with respect to all areas not subject to the instant 206 proceeding, pending acceptance of the compliance filing directed above.

Transmission Market Power

30. The LG&E Parties state that LG&E and KU are the only affiliates which own or control transmission facilities within the United States, Canada, or Mexico. The LG&E Parties state further that, as a result of not owning or operating transmission facilities, no affiliates besides LG&E or KU have the ability to exercise transmission market power. As for LG&E and KU, the LG&E Parties state that both utilities are members of the Midwest Independent System Operator (Midwest ISO) and that open access to their transmission lines is provided pursuant to the Midwest ISO tariff. Further, no intervenor

¹² See, e.g., *Canal Electric Company*, 46 FERC ¶ 61,153, *reh'g denied*, 47 FERC ¶ 61,275 (1989).

¹³ Applicants can rely on a generation market power analysis for a given independent system operator or regional transmission organization (ISO/RTO) that has been acted upon by the Commission to support its market-based rate application. See *Southern Co. Energy Marketing, Inc.*, 109 FERC ¶ 61,275 (2004) (example of analysis for the SOCO control area).

has raised transmission market power concerns. The Commission finds that the LG&E Parties satisfy the Commission's transmission market power standard for the grant of market-based rate authority.

Other Barriers to Entry

31. The LG&E Parties state that they own and operate certain natural gas distribution facilities that are used almost exclusively to provide retail natural gas service to customers in central Kentucky. The LG&E Parties state further that the Commission's decision granting LG&E's request to charge market-based rates for storage service demonstrates that LG&E's ownership of natural gas facilities does not provide it with the ability to erect barriers to entry.¹⁴ The LG&E Parties further assert they are aware that should LG&E or any other affiliates deny, delay, or require unreasonable terms, conditions, or rates for natural gas service to potential electric competitors of the LG&E Parties in bulk power markets, the Commission could suspend the LG&E Parties' authority to sell power at market-based rates.¹⁵

32. The LG&E Parties further state that they are unable to erect other potential barriers to entry identified by the Commission in other proceedings. The LG&E Parties state, in particular, that none of the LG&E Parties or any of their affiliates engage in the manufacture of electric equipment, or own or control resources that could impede potential competitors from gaining access to alternative generation supplies. No intervenor has raised concerns regarding barriers to entry.

33. Based on the LG&E Parties' representations, the Commission finds that the LG&E Parties cannot erect barriers to entry.

Affiliate Abuse

34. The LG&E Parties state that they all have codes of conduct currently on file with the Commission as part of their respective market-based rate tariffs. The LG&E Parties note that the market-based rate tariffs of LEM, WKEC, and WKE Two prohibit sales under those tariffs to LG&E and KU, the only affiliates of the LG&E Parties with captive electric customers. The LG&E Parties state further that the joint market-based rate tariff of LG&E and KU prohibits sales under that tariff to any affiliates except LEM and

¹⁴ *Louisville Gas & Elec. Co.*, 99 FERC ¶ 62,040 (2002)

¹⁵ *See, e.g., Louisville Gas & Elec. Co.*, 62 FERC ¶ 61,016 (1993).

WKEC.¹⁶ In addition, no intervenor has raised concerns regarding affiliate abuse. Based on these representations, the Commission finds that the LG&E Parties satisfy the Commission's concerns with regard to affiliate abuse.

Reporting Requirements

35. Consistent with the procedures the Commission adopted in Order No. 2001, an entity with market-based rates must file electronically with the Commission an Electric Quarterly Report containing: (1) a summary of the contractual terms and conditions in every effective service agreement for market-based power sales; and (2) transaction information for effective short-term (less than one year) and long-term (one year or greater) market-based power sales during the most recent calendar quarter.¹⁷ Electric Quarterly Reports must be filed quarterly no later than 30 days after the end of the reporting quarter.¹⁸

36. The LG&E Parties must timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority.¹⁹ Order No. 652 requires that the change in status reporting requirement be incorporated in the market-based rate tariff of each entity authorized to make sales at market-based rates. Accordingly, the LG&E Parties are directed, within 30 days of the date of issuance of this order, to revise their market-based rate tariffs to incorporate the following provision:

¹⁶ This exception to the Commission's general prohibition on affiliate sales at market-based rates was accepted by the Commission in *LG&E Operating Cos.*, Docket No. ER99-1623-000, Letter Order, June 4, 1999.

¹⁷ *Revised Public Utility Filing Requirements*, Order No. 2001, 67 Fed. Reg. 31,043 (May 8, 2002), FERC Stats. & Regs. ¶ 31,127 (2002). Required data sets for contractual and transaction information are described in Attachments B and C of Order No. 2001. The Electric Quarterly Report must be submitted to the Commission using the EQR Submission System Software, which may be downloaded from the Commission's website at <http://www.ferc.gov/doc-filing/eqr.asp>.

¹⁸ The exact dates for these reports are prescribed in 18 C.F.R. § 35.10b (2004). Failure to file an Electric Quarterly Report (without an appropriate request for extension), or failure to report an agreement in an Electric Quarterly Report, may result in forfeiture of market-based rate authority, requiring filing of a new application for market-based rate authority if the applicant wishes to resume making sales at market-based rates.

¹⁹ *Reporting Requirement for Changes in Status for Public Utilities With Market-Based Rate Authority*, Order No. 652, 110 FERC ¶ 61,097 (2005) (Order No. 652).

[insert market-based rate seller name] must timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority. A change in status includes, but is not limited to, each of the following: (i) ownership or control of generation or transmission facilities or inputs to electric power production other than fuel supplies, or (ii) affiliation with any entity not disclosed in the application for market-based rate authority that owns or controls generation or transmission facilities or inputs to electric power production, or affiliation with any entity that has a franchised service area. Any change in status must be filed no later than 30 days after the change in status occurs.

The Commission orders:

(A) The LG&E Parties are directed, within 30 days of the date of issuance of this order, to revise their generation market power analysis for the SOCO control area, as discussed in the body of this order.

(B) The LG&E Parties' updated market power analysis for all relevant markets not subject to the section 206 proceeding instituted herein is hereby conditionally accepted for filing, pending Commission acceptance of the compliance filing directed in Ordering Paragraph (A), as discussed in the body of this order.

(C) The LG&E Parties are directed, within 30 days of the date of issuance of this order, to revise their market-based rate tariffs to incorporate the change in status reporting requirement adopted in Order No. 652.

(D) The LG&E Parties revised tariff sheets incorporating the market behavior rules are hereby accepted for filing, effective December 17, 2003.

(E) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly section 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), the Commission hereby institutes a proceeding in Docket No. EL05-99-000 concerning the justness and reasonableness of the LG&E Parties' market-based rates in the LGEE and BREC control areas, as discussed in the body of this order.

(F) The Secretary shall promptly publish in the *Federal Register* a notice of the Commission's initiation of the proceeding under section 206 of the FPA in Docket No. EL05-99-000.

(G) The refund effective date established pursuant to section 206(b) of the FPA will be 60 days following publication in the *Federal Register* of the notice discussed in Ordering Paragraph (F) above.

(H) For the BREC control area, the LG&E Parties are directed, within 60 days from the date of issuance of this order, to: (1) file a Delivered Price Test analysis; (2) file a mitigation proposal tailored to their particular circumstances that would eliminate the ability to exercise market power; or (3) inform the Commission that they will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.

(I) For the LGEE control area, the LG&E Parties are directed, within 60 days from the date of issuance of this order, to file a revised generation market power analysis using the Midwest ISO as the relevant geographic market or, alternatively, to explain why the LGEE control area is the proper relevant geographic market. If the LG&E Parties choose to continue to assert that the LGEE control area should be used as the relevant geographic market, then the LG&E Parties are directed, for the LGEE control area, within 60 days from the date of issuance of this order, to: (1) file a Delivered Price Test analysis; (2) file a mitigation proposal tailored to their particular circumstances that would eliminate the ability to exercise market power; or (3) inform the Commission that they will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.