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May 9, 2017

**VIA HAND DELIVERY**

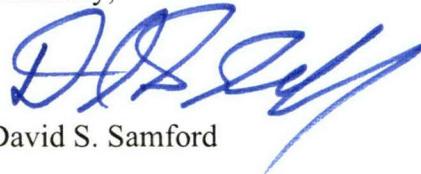
Ms. Talina R. Mathews, Ph.D.  
Executive Director  
Kentucky Public Service Commission  
P.O. Box 615  
211 Sower Boulevard  
Frankfort, KY 40602

Re: PSC Case No. 2017-00002

Dear Dr. Mathews:

Please find enclosed for filing with the Commission in the above-referenced case an original and ten copies of the Brief of East Kentucky Power Cooperative, Inc. ("EKPC"). Please return a file-stamped copy to my office.

Sincerely,



David S. Samford

Enclosures

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COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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COMMISSION

IN THE MATTER OF:

AN EXAMINATION OF THE APPLICATION )  
OF THE FUEL ADJUSTMENT CLAUSE OF )  
EAST KENTUCKY POWER COOPERATIVE, )  
INC. FROM NOVEMBER 1, 2014 THROUGH )  
OCTOBER 31, 2016 )

CASE NO. 2017-00002

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BRIEF OF  
EAST KENTUCKY POWER COOPERATIVE, INC.

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Comes now East Kentucky Power Cooperative, Inc. ("EKPC"), by counsel, pursuant to the direction of the Commission as given at the hearing held in this matter on April 18, 2017, and for its Brief in the above-captioned fuel adjustment clause ("FAC") proceeding, respectfully states as follows:

**I. Introduction**

This case presents two related questions. First, the Commission must determine whether 807 KAR 5:056, Section 1(12) requires it to re-establish the amount of fuel costs recovered through base rates. Upon concluding that the regulation does *not* require such a re-establishment to take place, the Commission must then determine whether it should re-establish the base fuel cost anyway. EKPC submits that this question should also be answered in the negative in light of several important factors and Commission precedent.

**II. Background**

EKPC is an electric generation and transmission cooperative that provides electricity to approximately 530,000 retail customers. EKPC is owned by sixteen Members, all of whom are

distribution cooperatives. EKPC owns four active electric generation stations: (1) the John Sherman Cooper Generating Station (“Cooper Station”) near Burnside, Kentucky; (2) the H. L. Spurlock Generating Station near Maysville, Kentucky; (3) the J. K. Smith Generating Station (“Smith Station”) near Trapp, Kentucky; and (4) the Bluegrass Generating Station (“Bluegrass Station”) near LaGrange, Kentucky. Altogether, EKPC currently has approximately 3,009 megawatts (MWs) of wintertime net electric generating capacity in its fleet.

The Commission initiated the current six month and two year review case on February 6, 2017. EKPC filed responses to information requests propounded by Commission Staff on February 24, 2017. EKPC received the Commission Staff’s second set of information requests on March 6, 2017 and the Commission’s third set of information requests on March 28, 2017. EKPC tendered responses on March 20, 2017 and April 7, 2017, respectively. The Commission held a hearing on April 18, 2017, which resulted in two additional post-hearing information requests. EKPC tendered responses on April 28, 2017. With the filing of this Brief, the case is ripe for adjudication.

### **III. Argument**

#### **A. Overview of the FAC Regulation and Applicable Precedent**

The purpose for having a fuel adjustment rate mechanism in a utility’s tariff is well-established in Commission precedent. An FAC tariff is:

... a means for [an electric] utility to recover from its customers its current fuel expense through an automatic rate adjustment without the necessity for a full regulatory rate proceeding. This rate may increase or decrease from one billing cycle to the next depending on whether the utility’s cost of fuel increased or decreased in the same period. The rate provides for a straight pass-through of fuel costs, with no allowance for a profit to the utility.<sup>1</sup>

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<sup>1</sup> *In the Matter of East Kentucky Power Cooperative’s Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases*, Order, Case

In Kentucky, each electric utility has an FAC tariff that conforms to certain regulatory prescriptions that have been set forth in regulations promulgated by the Commission. The current iteration of the Commission's FAC regulation, 807 KAR 5:056, became effective on April 7, 1982.<sup>2</sup> The preamble to the regulation states that, "Fuel adjustment clauses which are not in conformity with the principles set out below are not in the public interest and may result in suspension of those parts of such rate schedules."<sup>3</sup> In accordance with the Filed Rate Doctrine (KRS 278.160) and the FAC regulation, EKPC prepared and tendered a proposed FAC tariff that the Commission accepted. Though EKPC's FAC tariff has been revised from time to time over the intervening decades, its current tariff became effective on June 1, 2011.

**B. The FAC Regulation Expressly Makes the Task of  
Re-Establishing the Base Fuel Cost Discretionary, Not Mandatory**

The process for reviewing and construing statutes is well-established in Kentucky jurisprudence:

As we have previously indicated, our goal in construing a statute is to give effect to the intent of the General Assembly. To determine legislative intent, we look first to the language of the statute, giving the words their plain and ordinary meaning. The statute must be read as a whole and in context with other parts of the law. Where a statute is unambiguous, we need not consider extrinsic evidence of legislative intent and public policy. We presume, of course, that the General Assembly did not intend an absurd or manifestly unjust result. As a matter of application, all statutes are to be liberally construed to promote the objects and carry out the intent of the General Assembly.<sup>4</sup>

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No. 2004-00430 (Ky. P.S.C. Feb. 7, 2005) (*quoting In the Matter of Kentucky Power Company*, Order, Case No. 6877, p. 2 (Ky. P.S.C. Dec. 15, 1977)).

<sup>2</sup> See 8 Ky.R. 822.

<sup>3</sup> 807 KAR 5:056, Section 1.

<sup>4</sup> *Richardson v. Louisville/Jefferson County Metro Govt.*, 260 S.W.3d 777, 779 (Ky. 2008) (citations omitted); see also *Com., ex rel. Stumbo v. Kentucky Public Service Comm'n*, 243 S.W.3d 374, 381 (Ky. App. 2007).

Regulations are to be interpreted in the same manner as statutes as a matter of law.<sup>5</sup> The portion of the FAC regulation that is at issue in this proceeding is Section 1(12), which states:

Every two (2) years following the initial effective date of each utility's fuel clause the commission in a public hearing will review and evaluate past operations of the clause, disallow improper expenses and to the extent appropriate reestablish the fuel clause charge in accordance with subsection (2) of this section.

The regulation imposes upon the Commission three biennial tasks: (1) reviewing and evaluating the past operation of the FAC; (2) disallowing improper expenses; and (3) re-establishing the fuel clause charge that is applicable in base rates. It is critical to note, however, that the first two tasks carry with them no qualification while the third task is expressly conditioned by the modifying phrase, "to the extent appropriate." Thus, the clear and unambiguous meaning of 807 KAR 5:056, Section 1(12) is that the base fuel charge need not be re-established in the course of every two year review. This understanding is further buttressed by the fact that KRS 278.183(3) includes the same qualifying language, which evidences legislative concurrence in the Commission's retention of discretion as to whether to re-establish the base fuel charge in the FAC context. The obligations to evaluate the past operation of the FAC and to disallow any improper expenses are mandatory. The obligation to re-establish the base fuel charge component is purely discretionary and requires consideration of the unique facts of each case.

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<sup>5</sup> See *Commonwealth, Cabinet for Health & Family Servs. v. Owensboro Med. Health Sys., Inc.*, 500 S.W.3d 225, 226 (Ky. Ct. App. 2016) ("...in the construction and interpretation of administrative regulations, the same rules apply that would be applicable to statutory construction and interpretation.' In doing so, we adhere to the 'plain meaning rule,' meaning that the plain meaning of the statute or regulation controls." (citations omitted)).

### **C. The Commission Should Exercise Its Discretion to Not Re-Establish the Base Fuel Cost**

East Kentucky and its Owner-Members respectfully request the Commission to leave the base fuel charge unchanged. In response to Commission Staff's initial information requests, EKPC stated that – after an analysis of its past, current, and projected fuel costs – a fuel charge of 2.776 cents/kWh should be used as the base fuel cost over the next two years if the Commission determined that it was necessary to re-establish the base fuel charge to align with EKPC's most recent experience.<sup>6</sup> Such a change would amount to a 0.238 cents/kWh reduction from the current base fuel cost of 3.014 cents/kWh.<sup>7</sup> While the Commission certainly has the discretion to reduce the base fuel charge component and, by extension, raise the fuel adjustment charge component, there are several factors which make such a decision unnecessary, inappropriate and unreasonable in this circumstance.

First, EKPC believes that the cost of coal, natural gas and market purchase prices have been low, particularly during the last 12 months of the current review period. As stated in response to information requests, "East Kentucky anticipates there will be increases in these costs during the next two years."<sup>8</sup> Reducing the base fuel charge now could easily require it to be re-established at its current rate in two years.

Second, EKPC and its Owner-Members are different than traditional investor owned utilities in that a greater time lag exists for passing along fuel costs. In the investor owned utility community, fuel charges are generally passed along to customers within two months. For

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<sup>6</sup> See EKPC Response No. 1 to Commission Staff's Initial Information Request, p. 2 (Feb. 24, 2017). EKPC also proposed that May 2015 should be utilized as the month best representative of fuel costs expenses during the review period.

<sup>7</sup> See EKPC Response No. 1 to Commission Staff's Initial Information Request, p. 2 (Feb. 24, 2017).

<sup>8</sup> EKPC Response No. 1 to Commission Staff's Initial Information Request, p. 1 (Feb. 24, 2017).

cooperatives such as EKPC, however, as much as a four month delay may occur between the time when the fuel costs are incurred and when they are passed on to retail customers.<sup>9</sup> This lag has a disruptive effect upon EKPC's Member's financial performance and, under extreme circumstances, could distort a cooperative's financial ratios.

Third, EKPC notes that re-establishing the base fuel charge is a process that has no financial benefit whatsoever for customers. Since a utility makes no profit on the costs of its purchased fuel and market power purchases, any reduction in the base fuel charge will require a corresponding increase in the fuel adjustment charge. Even if there was a material incongruity between actual fuel prices and the currently established fuel base charge, the very design of the FAC tariff eliminates any possibility of unfairness that could accrue to the customers or the utility. In ratemaking, it is the result that is to be scrutinized and not necessarily the method of arriving at that result; substance matters over form.<sup>10</sup> The Commission has taken heed of this bedrock regulatory principle in prior Orders where it has declined to re-establish a base environmental cost component in the context of KRS 278.183.<sup>11</sup> The Commission should be consistent with its precedent and allow the same logic to prevail here.

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<sup>9</sup> See Hearing Video Record 10:05:50 (April 18, 2017). Should the Commission decide to re-establish the base fuel cost component, EKPC has asked the Commission to mitigate the lag by delaying the change in the fuel charge factors for EKPC's Owner-Members by two months.

<sup>10</sup> See *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 513 (Ky. App. 1990) (“[The Commission] has many appropriate rate-making methodologies available to it, and it must have some discretion in choosing the best one for each situation. Again, we must look more to whether the result is fair, just and reasonable rather than at the particular methodology used to reach the result.”) (citation omitted); see also *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Company*, 983 S.W.2d 493, 498 (Ky. 1998) (“[T]he Commission has discretion in working out the balance of interest necessarily involved and that it is not the method, but the result, which must be reasonable.”) (citing *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591 (1944)).

<sup>11</sup> See *In the Matter of An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Two-Year Billing Period Ending June 30, 2009*, Order, Case No. 2009-00316, p. 3, (Ky. P.S.C. Jan. 20, 2010) and *In the Matter of An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Two-Year Billing Period Ending June 30, 2011*, Order, Case No. 2012-00273, p. 3, (Ky. P.S.C. Dec. 12, 2012).

Finally, any change in the base fuel rate will provoke questions from many of EKPC's Owner-Member's retail customers.<sup>12</sup> EKPC was not implying at the April 18, 2017 hearing that these retail customers were incapable of understanding the change in rates.<sup>13</sup> To the contrary, it sought to point out that any time spent having to explain an unnecessary change in rate components is inefficient both for the customer and Owner-Member cooperative.<sup>14</sup> Re-establishing the base fuel charge will result in some amount of time having to be spent explaining the Commission's action to retail customers. In the absence of such a change, that time would be put to better use.

The Commission may choose to re-establish the base charge, but doing so will unreasonably create otherwise unnecessary work for EKPC's Owner-Members without providing any economic benefit to customers. In anticipation that actual fuel prices are likely to increase in the future and in light of EKPC's Owner-Member's agreement that the current base fuel charge is reasonable,<sup>15</sup> the Commission should decline to exercise its discretion to re-establish the base fuel charge. The existing base fuel cost per KWh is representative of the fuel cost currently being experienced by EKPC and should be retained.<sup>16</sup>

#### **IV. Conclusion**

WHEREFORE, on the basis of the foregoing, EKPC respectfully requests that the Commission find that the re-establishment of a base fuel charge in the context of a two year review

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<sup>12</sup> See Hearing Video Record 10:02:28 (April 18, 2017).

<sup>13</sup> See *id.*

<sup>14</sup> See EKPC Response No. 4a to Commission Staff's Second Information Request (Mar. 20, 2017); see also Hearing Video Record 10:00:17 (April 18, 2017).

<sup>15</sup> See EKPC Response No. 1 to Commission Staff's Initial Information Request, p. 2 (Feb. 24, 2017).

<sup>16</sup> See *In the Matter of an Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of East Kentucky power Cooperative Corporation from November 1, 1980, to October 31, 1982*, Order, Case No. 8588, p. 2 (June 3, 1983).

case is discretionary and that it further would exercise its discretion to refrain from establishing a new base fuel charge in light of the specific circumstances of this proceeding.

Done this 9<sup>th</sup> day May, 2017.

Respectfully submitted,



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