UTILITY RATEMAKING: The Kentucky PSC Process

Louisville Gas & Electric Co.

Case 2014-00372

March 2015

Kentucky Public Service Commission

PSC
PUBLIC SERVICE
COMMISSION
OF KENTUCKY

RATEMAKING IS A LEGAL PROCESS

- State statutes
- Regulations derived from those statutes
- Legal principles derived from the application of the statutes and regulations

The PSC ratemaking process

Governed by statute – KRS 278

- Rates must be “fair, just and reasonable”
- Investors are entitled to an opportunity to earn a return on equity (equity is the net value of the shareholder investment)
- For non-profit utilities, rates are adequate to meet lender requirements and maintain financial stability

Two-part process

- Revenue requirement
- Rate design

The PSC ratemaking process

Timetable

- 30-day notice of intent required
- Public notice required
- Clock starts when application complete
- Rates can’t take effect for 30 days
- PSC typically imposes suspension period
- Suspension may be for either five or six months, depending on type of rate case
- Case must be completed within 10 months
- Rehearing requests – within 23 days of final order

The PSC ratemaking process

Intervenors

- Kentucky Attorney General - statutory representative of ratepayers in general
- Full intervenors – must show they represent unique interests and will contribute evidence that otherwise might not be brought before the PSC – testimony, discovery, cross-examination

The PSC ratemaking process

Process

- Intervention – may come before filing of application
- Discovery – one or more rounds of data requests to/from parties; from PSC staff
- Public meetings – at PSC discretion
- Public comment
- Evidentiary hearing – not required
- Post-hearing filings
- Final order

The PSC ratemaking process

Settlements

- Must be unanimous – all full intervenors agree
- Partial settlements (stipulations) are allowed
- Settlements typically are “black boxes” – do not specify details of trade-offs in areas such as expenses and rates of return
- However, resulting rates must still meet “fair, just and reasonable” test

The PSC ratemaking process

What is NOT in base rates:

- Low-income assistance program fee
- Ancillary (i.e. – KRA) fees
- Franchise fees
- Local taxes
- Purchased water costs
- Fuel cost adjustment (above or below base fuel cost)
- Commodity cost of natural gas
- Environmental compliance cost for electric utilities – separate by state law
- Demand-side management surcharge (energy efficiency programs – gas & electric) – separate by state law

The PSC ratemaking process

Two-part process

- Revenue requirement is determined first
- Rate design

The PSC ratemaking process

Revenue requirement – base rates

- Bottom-line number for total revenue
- Calculated over a "test year" – 12-month period
- Historic test year – previous 12-month period that ends within three months of filing date – actual numbers
- Forecasted test year – 12 months beginning at the end of six-month suspension period
- Suspension period is five months for historic, six months for forecasted

The PSC ratemaking process

Revenue requirement – base rates

- Allowable expenses
  - routine construction – replacing poles, new lines
  - equipment purchases
  - operations: maintenance, billings, customer service, etc.
  - personnel costs: salaries & benefits
  - major construction – some costs recoverable in progress, but most are not until project is in service
  - depreciation
  - borrowing costs

The PSC ratemaking process

Revenue requirement – base rates

- Calculating return on equity –
  - Capital structure – debt & common equity
  - Cost of debt – long-term & short-term
  - Examine risk factors
  - Compare to similar utilities
- Return on equity has to balance the ability to attract capital at reasonable rates against impact on ratepayers

The PSC ratemaking process

Revenue requirement – base rates

- Expenses not allowed –

  - promotional advertising (for example: customer information education/information expense is recoverable through rates, sports sponsorships are not recoverable)
  - executive bonuses
  - charitable donations
  - club memberships
  - any expense deemed unreasonable

The PSC ratemaking process

Revenue requirement – base rates

- Unusual or one-time costs or revenue are excluded from test year and accounted for separately as regulatory assets or liabilities, for example:
  - Storms costs
  - Asset sales

- Final revenue requirement = allowable expenses and the additional revenue needed for an opportunity to earn a fair rate of return on equity or, for non-profit utilities, to meet lender requirements and maintain financial stability

The PSC ratemaking process

The bottom line –
what is fair, just & reasonable?

- Balancing act
  - Fair to investors
  - Sufficient to support safe and reliable service
  - Not unduly burdensome on ratepayers
- Rates cannot be confiscatory
- PSC has discretion, but only within the legal limits

The PSC ratemaking process

Rate design

The purpose is to allocates costs and revenue proportionately over various rate classes

- Residential
- Commercial
- Large industrial
- Miscellaneous – fire service, hydrants, etc.

Each large rate class may be divided into several categories of service

The PSC ratemaking process

Rate design –cost of service studies

As part of a rate application, utilities must submit a “cost of service” study that determines how much it costs to serve each rate class and also may examine fixed versus variable costs

The PSC ratemaking process

Rate design – customer classes

Basic premise – customers receiving same type of service should pay the same rate

In general, larger customers have lower cost of service, due to economies of scale – it costs less to serve a 1-megaWatt load than 1,000 1-kiloWatt loads

Among the major customer classes, cost of service is highest for residential class

The PSC ratemaking process

Rate design – fixed vs. variable costs

Fixed costs – independent of consumption

- Basis for monthly service charge
- Monthly service charges historically have not fully recovered fixed costs

Variable costs – based on consumption

- Variable charge (per kWh, per gallon, etc)
- Variable charge generally recovers a portion of fixed costs

The PSC ratemaking process

Rate design

PSC uses cost of service study as a guideline, but rates are not set to strictly reflect costs

- Industrial customers may pay higher rates than cost of service study would indicate
- Residential rates, while higher than industrial, may not fully cover cost of service
- Fixed and variable costs are not allocated on a strictly proportional basis to fixed and variable charges

The PSC ratemaking process

Rate design

- Some rebalancing of costs and rates typically occurs in every rate case
- PSC has adopted gradual approach to attaining fully balanced rates
- This gradual approach applies both across rate classes and with respect to fixed vs. variable costs

The PSC ratemaking process

Rate design - issues

- Cross-subsidization across rate classes – how much is fair or acceptable?
- Fixed vs. variable cost allocation

  - Is a higher fixed rate component unduly burdensome on lower-income customers?

  - Does a higher fixed rate component discourage efficient usage and is it unfair to customers who take steps to reduce consumption?

Louisville Gas & Electric Co.

Case 2014-00372

Overview

PROCEDURAL SUMMARY

Filed in late 2014

Suspension period ends June 30, 2015

Evidentiary hearing

- Tuesday, April 21, 2015 – 10 a.m. EDT
- May last two or three days
- Open to public
- Streamed live at psc.ky.gov

PROCEDURAL SUMMARY

Intervenors

- Attorney General
- Kentucky Industrial Utility Customers
- Kentucky Cable Television Association
- Kentucky School Boards Association
- Wal-Mart/Sam's
- Kroger Co.
- Association of Community Ministries
- Metropolitan Housing Coalition
- Sierra Club
- US Dept. of Defense and other federal agencies

THE CASE – ELECTRIC SERVICE

Annual revenue increase of $30 million (2.7%)

Requested return on equity – 10.5%

Reasons for increase

- New 640 MW, $563 million gas-fired generating facility at Cane Run – 22% owned by LG&E
- Purchased power agreement with gas-fired plant in Oldham County
- Increase hydroelectric capacity at McAlpine
- Decreased revenue from off-system sales
- Higher operating costs

THE CASE - ELECTRIC
Residential rate changes

Monthly service charge
- current - $10.75
- proposed - $18

Consumption charge
- current – 8.076 ₵ per kilowatt-hour
- proposed – 7.618 ₵ per kilowatt-hour

THE CASE - ELECTRIC
Residential customer impact

Based on average usage for all residential customers averaged over 12-month period

984 kilowatt-hours/month

Current - $101.85
Proposed - $104.60
Increase - $2.75 (2.7%)

THE CASE – NATURAL GAS SERVICE

Annual revenue increase of $14 million (4.2%)

Requested return on equity – 10.5%

Reasons for increase

- Higher operating costs
- Infrastructure improvements
- Safety compliance

THE CASE – NATURAL GAS
Residential rate changes

Monthly service charge

current - $13.50

proposed - $19

Delivery charge

current – $2.64 per 1,000 cubic feet

proposed – $2.13 per 1,000 cubic feet

THE CASE – NATURAL GAS
Residential customer impact

Based on 5,700 cubic feet of consumption, the average customer bill, exclusive of commodity cost, would change as follows:

Current - $28.55
Proposed - $31.15
Increase - $2.60

Thank you

Questions?

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