

UTILITY RATEMAKING: The Kentucky PSC Process

Kentucky-American Water Co. – Case 2012-00520

May 2013

Kentucky Public Service Commission



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)

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**
- **Limited intervenors – cross-examination only**

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

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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

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
 - borrowing costs

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, for example:
 - Storms costs
 - Asset sales
- Final revenue requirement = allowable expenses and the opportunity to earn a reasonable rate of return on equity (investor-owned) or to meet TIER requirement (coops)

The PSC ratemaking process

What is NOT in base rates:

- Fuel cost adjustment (above or below base fuel cost)
- Commodity cost of natural gas
- Environmental compliance cost – separate by state law
- Demand-side management surcharge (energy efficiency programs) – separate by state law
- Low-income assistance program fee
- Franchise fees
- Local taxes

The PSC ratemaking process

Rate design

- Allocates costs and revenue over various rate classes – residential, commercial, industrial, etc.
- As part of rate application, utilities must submit a “cost of service” study that determines how much it costs to serve each rate class
- In general, larger customers have lower cost of service; among the major customer classes, cost of service is highest for residential class
- Fixed vs. variable cost allocation

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
- Some rebalancing of costs and rates typically occurs in every rate case
- PSC has adopted gradual approach to attaining fully balanced rates

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Base rate case

- Filed December 28, 2012
- Suspension period ends July 26, 2013
KAWC could put proposed rates into effect subject to refund
- Decision due by October 27, 2013

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Base rate increase:

- Additional annual revenue - \$12.3 million
- Increase annual revenue by 14.6 percent

Residential rate impact (KAWC estimate):

- Typical user = 4,500 gallons/month
- Current monthly bill: \$32.75/month
- If approved: \$38.5/month
- Increase: \$5.76 (17.6 percent)

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Proposed rate riders:

- Infrastructure improvement surcharge
 - Would fund distribution system upgrades
 - Calculated annually, with annual true-up
 - Capped at 10% of base revenue
- Energy/chemical surcharge/credit
 - Intended to capture cost fluctuations above or below base level
 - Adjusted annually, with true-up

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Proposed rate riders:

- KAWC position: rate riders could reduce frequency of base rate adjustments
- Less extensive PSC review than in base rate cases
- Concept is similar to adjustments used in other utility sectors in Kentucky (natural gas & electric)
- First such request by a water utility in Kentucky - other states have similar riders

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Intervenors:

- Kentucky Attorney General – Office of Rate Intervention
- Lexington-Fayette Urban County Government
- Community Action Council for Lexington-Fayette, Bourbon, Harrison, and Nicholas Counties, Inc.

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Evidentiary hearing

- 10 a.m. EDT, Tuesday, June 4
- At PSC offices in Frankfort
- Open to the public
- Public comments will be taken
- Webcast at psc.ky.gov

Public Comments

Public Comments

E-mail to psc.info@ky.gov

Put the case number in the subject line

Written comments to PSC

Kentucky Public Service Commission

211 Sower Boulevard

Frankfort, KY 40601

(include case number if possible)

Fax to 502-564-9625

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