UTILITY RATEMAKING: The Kentucky PSC Process

September 2016

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 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

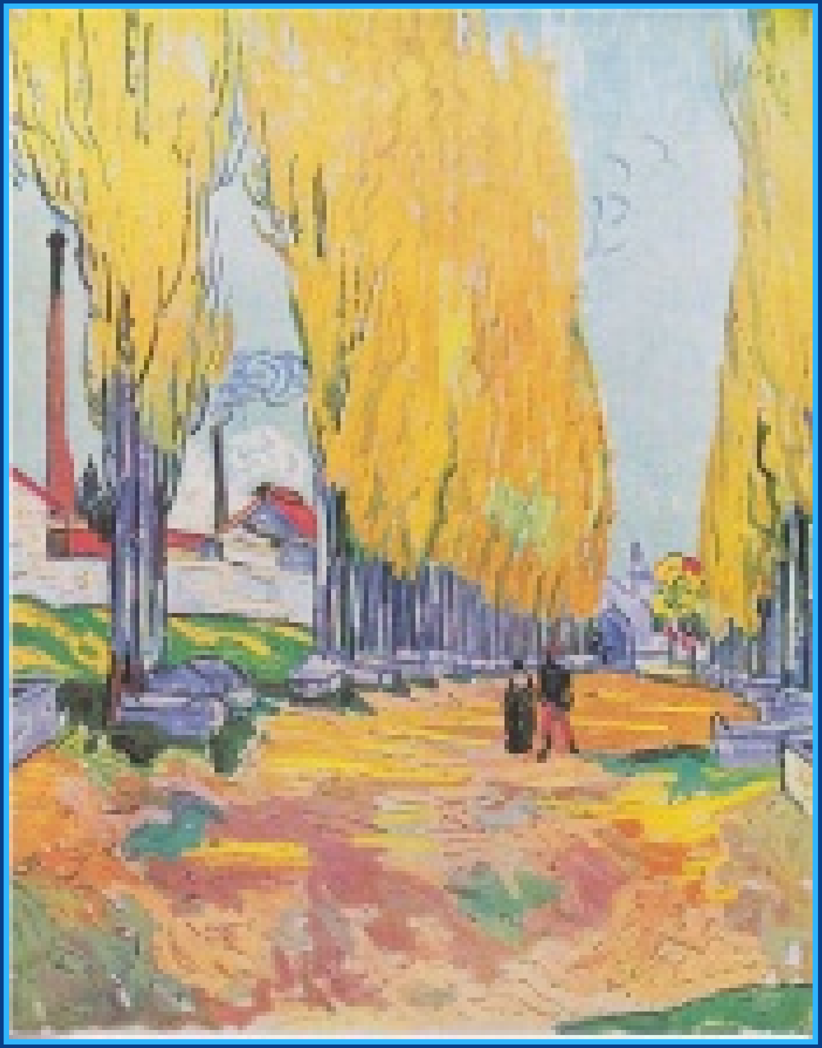
  - Is a higher fixed rate component unduly burdensome on lower-income customers?

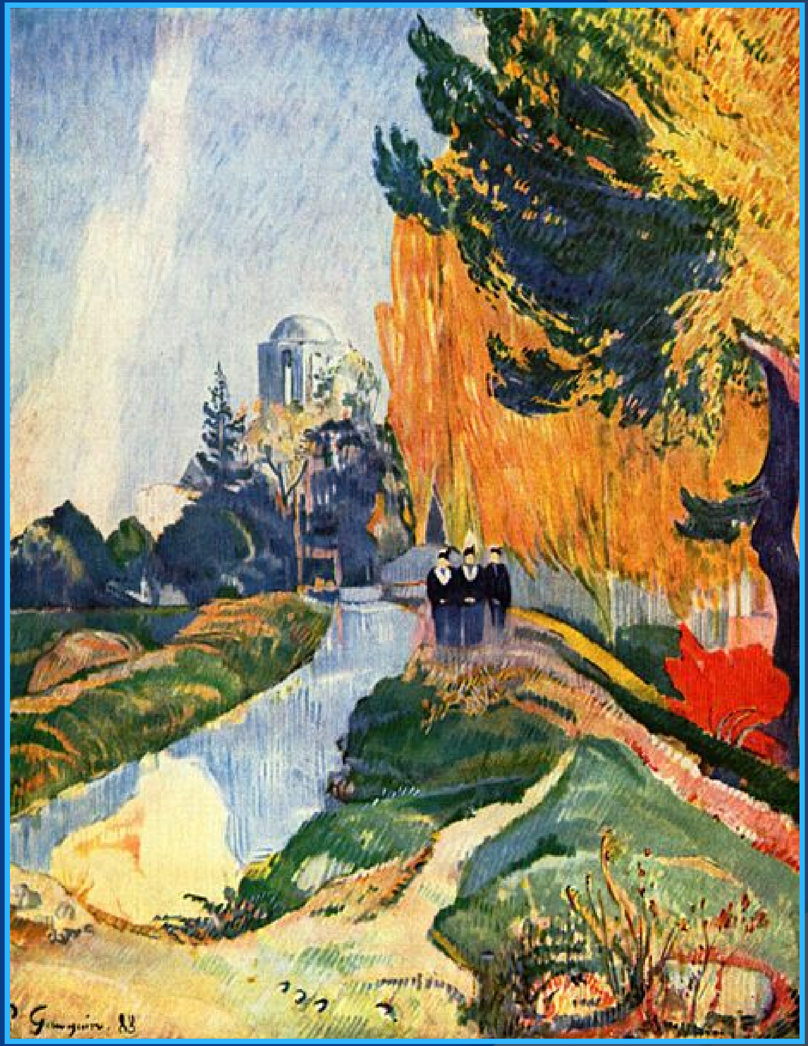
  - Does a higher fixed rate component discourage efficient usage and is it unfair to customers who take steps to reduce consumption?

RATEMAKING IS ALSO AN ART

A balancing act

- Low rates vs. adequate service
- Low rates vs. financial stability
- Low rates vs. shareholder return
- Small vs. large customers





Van Gogh

Gauguin

Reality: les Alyscamps, Arles, France

Case 2016-00162

Columbia Gas of Kentucky

Case 2016-00162

- Columbia Gas seeking to increase annual revenue by $25.4 million (27.4%)
- Proposing to increase both customer and delivery charge
- Total revenue sought: $118 million
- Most recent increase – December 2013
  - *Requested $16.6 million annual increase*
  - Settled for $7.66 million annual increase (8%)
  - Average monthly residential bills increased about $3.12
  - Fixed charge and delivery charge both increased

Case 2016-00162

Reasons for requested increase

- Replacement of old and potentially unsafe gas mains
- Increased operating costs

The proposed changes

- Monthly charge: $17.25 (includes $2.25 AMRP surcharge) increases to $19.75 (AMRP reset to 0)
- Charge per 1,000 cubic feet: from $2.3402 to $3.9404

  (includes two surcharges totaling $0.0736 per mcf that remain unchanged)
- $0.69/month demand-side management charge is unchanged

Case 2016-00162

Rate impact – average use

- Columbia Gas estimate based on average monthly residential use of 5,500 cubic feet
- Monthly charge: $17.25 (includes $2.25 AMRP surcharge) → $19.75 (AMRP reset to 0)
- Charge per 1,000 cubic feet: $2.3402 → $3.9404

  $12.87 → $21.67
- Total: $30.12 → $41.42 **+$11.30 (37.5%)**
- Current gas cost : $4.5034/mcf = $24.77
- Total bill impact: $55.58 → $66.88 **+$11.30 (20.3%)**

Case 2016-00162

Rate impact – low use case

- Based on residential use of 1,000 cubic feet
- Monthly charge: $17.25 (includes $2.25 AMRP surcharge) → $19.75 (AMRP reset to 0)
- Charge per 1,000 cubic feet: $2.3402 → $3.9404

  $2.34 → $3.94
- Total: $19.59 → $23.69 **+$4.10 (20.9%)**
- Current gas cost : $4.5034/mcf = $4.50
- Total bill impact: $24.78 → $28.88 **+$4.10 (16.1%)**

Case 2016-00162

Rate impact – high use case

- Based on residential use of 10,000 cubic feet
- Monthly charge: $17.25 (includes $2.25 AMRP surcharge) → $19.75 (AMRP reset to 0)
- Charge per 1,000 cubic feet: $2.3402 → $3.9404

  $23.40 → $39.40
- Total: $40.65 → $59.15 **+$18.50 (45.5%)**
- Current gas cost : $4.5034/mcf = $45.03
- Total bill impact: $85.37 → $104.87 **+$18.50 (21.7%)**

Case 2016-00162

Rate impact – very high use case

- Based on residential use of 20,000 cubic feet
- Monthly charge: $17.25 (includes $2.25 AMRP surcharge) → $19.75 (AMRP reset to 0)
- Charge per 1,000 cubic feet: $2.3402 → $3.9404

  $46.80 → $78.80
- Total: $64.05 → $98.55 **+$34.50 (53.9%)**
- Current gas cost : $4.5034/mcf = $90.07
- Total bill impact: $154.81 → $189.31 **+$34.50 (22.3%)**

Case 2016-00162 Summary of rate impacts

	Current	Proposed	Change
Low use			
Total without gas cost:	$19.59	$23.69	**+$4.10 (20.9%)**
Total bill impact:	$24.09	$28.19	**+$4.10 (17%)**
Average use			
Total without gas cost:	$30.12	$41.42	**+$11.30 (37.5%)**
Total bill impact:	$54.89	$66.19	**+$11.30 (20.6%)**
High use			
Total without gas cost:	$40.65	$59.15	**+$18.50 (45.5%)**
Total bill impact:	$85.68	$104.18	**+$18.50 (21.6%)**
Very high use			
Total without gas cost:	$64.05	$98.55	**+$34.50 (53.9%)**
Total bill impact:	$154.81	$189.31	**+34.50 (22.3%)**

Case 2016-00162

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.
- Kentucky Industrial Utility Customers, Inc.

Case 2016-00162

What’s next:

- Formal evidentiary hearing

  November 1 – 9 am EDT

  PSC offices – 211 Sower Blvd., Frankfort
- Open to public
- Streamed live at psc.ky.gov
- Suspension period ends December 26
- PSC must issue decision by March 27, 2017

Thank you

Questions?

Contact information:

Andrew Melnykovych
Communications Director
Kentucky Public Service Commission
211 Sower Boulevard, Frankfort KY 40602
502-782-2564
Psc.info@ky.gov

Prior to construction or acquisition of any major facility, such as a power plant, a utility must apply for a certificate of public convenience and necessity (CPCN)

The CPCN process:

Key points:

- Statute (KRS 278.020) is general – parameters of PSC decision have evolved over time through legal precedents
- Applicant must show a need for proposed facility – this includes demand forecasts
- Utility must show it has considered reasonable options, such as:
  - construction of various types of new facilities
  - long-term contracts to purchase water from a third party
  - demand-reduction measures

The CPCN process:

Key points:

- Wasteful duplication is not allowed – a utility may not overbuild or incur unnecessary costs
- "Least cost" principle flows from absence of wasteful duplication
  - Least cost not just construction or acquisition cost
  - Long-term costs also considered
  - PSC seeks least-cost reasonable option
- Grant of a CPCN leads to a presumption of future cost recovery

The CPCN process:

Procedure:

- No statutory time frame
- Intervention permitted
- Hearings/public comment meetings
  - Hearing webcasts at psc.ky.gov
- Public comments