COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION FOR ADJUSTMENT OF ELECTRIC RATES OF KENTUCKY POWER COMPANY	)	CASE NO. 91-066

O R D E R

On October 28, 1991, the Commission approved a unanimous Settlement Agreement, entered into by Kentucky Power Company ("Kentucky Power") and all the intervenors, that resolved all but one of the issues pending in this proceeding. The sole remaining issue is the Low Income Residential Assistance Rate ("Low Income Rate") proposed by the Low Income Residential Customers ("Low Income Customers"). A hearing on this issue was held on September 6, 1991 and briefs were filed by Kentucky Power, Low Income Customers, Kentucky Industrial Utility Customers ("KIUC"), and the Attorney General's Utility and Rate Intervention Division ("AG").

Low Income Customers propose that Kentucky Power be required to adopt the Low Income Rate on a pilot or test basis for a period of one year. The pilot would be limited to 1,000 residential customers who are participating in the Low Income Home Energy Assistance Program ("LIHEAP"), a federally funded, state-administered program. A separate classification would be established for these customers with a rate set at approximately 70 percent of the Residential Service rate. This new rate would be designed to cover Kentucky Power's variable costs and make a

contribution toward fixed costs. Under the Low Income Rate, the existing arrearages of these customers would be placed in a suspend account and, after one year of timely payments under the Low Income Rate, written off by Kentucky Power. Low Income Customers proposed that any costs or revenue shortfalls experienced by Kentucky Power should, in future rate proceedings, be allocated to all other customer classes.

The intent of the Low Income Rate, as explained by the Low Income Customers, is twofold: (1) to make energy bills more affordable for low-income customers; and (2) to increase the net revenues Kentucky Power collects from these customers. This latter intent reflects the Low Income Customers' belief that with lower bills, customers will pay those bills with greater frequency and consistency and that improved payment patterns from low-income customers will reduce Kentucky Power's collection costs. Under Low Income Customers' proposal, eligibility for the Low Income Rate would be tied to participation in LIHEAP. Thus, the determination of eligibility would not be Kentucky Power's responsibility.

Low Income Customers argue that the Low Income Rate is comparable to rates and rate designs the Commission has approved for other utilities. It cites approvals of flexible gas transportation rates for Columbia Gas of Kentucky, Inc.[1] and

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[1] Case No. 10201, An Adjustment of Rates of Columbia Gas of Kentucky, Inc., Order dated October 21, 1988.

Western Kentucky Gas Company[2] as instances where the Commission found that lowering a rate as an inducement to retain customers did not result in unreasonable discrimination under KRS 278.170. Low Income Customers also cite the Commission's approval of Big Rivers' variable electric rate for aluminum smelters as another instance of reasonable discrimination as allowed under KRS 278.170.[3] The variable rate for aluminum smelters, which ties the price of electricity to the market price of aluminum, is characterized by Low Income Customers as "a product which could have resulted in a permanent rate reduction <u>due to the companies income</u>." (emphasis in original)

Low Income Customers contend that under the Low Income Rate all customers will cover variable costs and make a contribution to fixed costs and that net revenues from these customers will be increased to the benefit of Kentucky Power and its remaining customers. Given this result and the implied comparability to other approved rates, Low Income Customers opine that the Commission would be guilty of discrimination if it did not approve a pilot Low Income Rate.

Kentucky Power opposes the Low Income Rate. It argues that the such a rate would not improve its economic performance, that

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2 Case No. 89-354, Alternative Fuel Flex Tariff of Western Kentucky Gas Company, Order dated September 18, 1990.

3 <u>National-Southwire Aluminum Co. v. Big Rivers Electric Corp.</u>, Ky.App. 785 S.W.2d 503, (1990).

the proposal is merely a subsidy program designed to give preferential treatment to certain customers based solely on their income status, and that rates cannot be set based on customers' incomes. Kentucky Power contends that the economic problem of low-income customers is a societal problem which should be addressed by societal means, not utility means. Kentucky Power opines that it could not fairly implement and administer such a program and that government, rather than a private company, should administer such a program.

Kentucky Power argues that the Low Income Rate would result in unreasonable discrimination in violation of KRS 278.170. Kentucky Power contends that a 30 percent rate reduction for LIHEAP participants is unreasonable and that it is improper to grant this reduced rate to the low-income customers participating in LIHEAP while not offering it to those low-income customers not participating in LIHEAP. Kentucky Power maintains the Low Income Rate proposal would create two rate classes of residential customers, although there would be no difference in the character of service provided to both classes, thereby violating the statute.

Kentucky Power further opines that the Low Income Rate would not increase its net revenues, but rather, would cause its financial condition to worsen. Kentucky Power argues that the revenue reduction it would experience under the Low Income Rate, together with the arrearages it would be required to write off as bad debt for 1,000 customers, would nearly equal its $450,000 total bad-debt expense for the 1990 test year. Extending the

program to all 3,200 of its LIHEAP customers would, Kentucky Power contends, increase the cost to over two and one-half times its bad-debt expense. Kentucky Power also contends that with 29,000 customers per month being in a delinquency status, a reduction of 1,000 customers would not significantly reduce its collection costs.

KIUC argues that Kentucky has no significant collection problem involving low-income customers that might be corrected by the Low Income Rate. KIUC maintains that the Low Income Customers have not shown that Kentucky Power would be better off under the Low Income Rate.

The AG argues that the Low Income Rate is similar to flexible gas transportation rates that have been approved by the Commission in that it will retain load and generate more revenues than if that load were lost. The AG concludes that the Low Income Rate will result in reducing the overall cost of service and, as such, should be approved.

The Commission well recognizes the problems facing low-income utility customers; nevertheless, given our statutory mandate to set fair, just, and reasonable rates, we must reject the proposed Low Income Rate. This rejection is based on the Commission's rate-making obligations as set out in KRS Chapter 278 and the Commission's judgment of what constitutes reasonable consideration and unreasonable discrimination.

KRS 278.030(3) allows reasonable classifications for service, patrons, and rates by considering "the nature of the use, the quality used, the quantity used, the time when used, the purpose

for which used, and any other reasonable consideration." Under KRS 278.170(1), no utility shall "give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference . . . . between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions."

The Low Income Rate would be available only to a new classification of residential customers based on their income and their participation in a federally-sponsored energy assistance program (LIHEAP). This new classification is to have a rate that is 30 percent below the residential rate and will provide for the cancellation of all arrearages after 12 months. Such a classification scheme does not comport with the specific criteria listed in KRS 278.030(3) and could be approved only if found to be within the general criteria of "other reasonable consideration." Customers eligible for the Low Income Rate would clearly receive a preference and advantage over the remaining residential customers while both groups would be provided a like and contemporaneous service under the same or substantially the same conditions. If this preference and advantage is found to be unreasonable, the Low Income Rate would violate KRS 278.170.

The issues before the Commission are (1) whether customers' incomes and their participation in an energy assistance program constitutes a reasonable consideration for establishing a customer class, and (2) whether a 30 percent rate discount for these customers, compared to the rates for other customers receiving a

like and contemporaneous service under the same or substantially the same conditions, constitutes an unreasonable preference or advantage.

In deciding similar issues of classifications and discrimination, the Commission has considered whether the new classification is likely to benefit the utility and its other ratepayers or is it likely to produce additional costs for the utility and its other ratepayers. If the new classification is found to produce a net cost, the result is subsidization by other ratepayers and thus an unreasonable preference. This type of analysis has been the primary focus of past Commission decisions to approve flexible gas transportation rates and economic development rates. In those instances, the Commission judged that the utility and all its customers would receive a benefit from the establishment of those types of classifications and rate designs. In this instance, our judgment is that Kentucky Power and all its customers would be better served by maintaining one residential rate rather than by establishing a new classification to offer the Low Income Rate.

If income alone were to be recognized as a reasonable consideration for establishing customer classifications and rates, not only low income, but also middle and high incomes would need to be recognized. If it is appropriate to provide utility service to low income customers at reduced rates, service to high income customers should be at premium rates. Similarly, commercial and industrial customers' rates would have to be set based on income

levels. As the United States Supreme Court stated in Gainesville Utilities v. Florida Power Corp., 402 U.S. 515, 528 (1971), "But focus on the willingness or ability of the purchaser to pay for a service is the concern of the monopolist, not of a governmental agency charged both with assuring the industry a fair return and with assuring the public reliable and efficient service, at a reasonable price."

Even assuming that income was a proper consideration for establishing customer classifications, the proposed Low Income Rate is not available to all low income residential customers. Rather, availability is restricted to only those low income customers who participate in the federally funded LIHEAP program.

Kentucky Power estimates that the lost revenues and bad debt write-offs attributable to 1,000 customers on the Low Income Rate would total $382,300. Even if this total is not infinitely precise, and recognizing that the levels of consumption and arrearage for the average Low Income Rate customer may differ from those of the average residential customer, it clearly appears that these costs would exceed any realistic reduction in Kentucky Power's collection costs. The likely, eventual result on total revenue would be a decrease, resulting in other customers being harmed, not benefitted, by the establishment of a Low Income Rate.

The Commission further finds that the proposed Low Income Rate differs in significant respects from the rates for gas transportation, economic development, and aluminum smelters cited by the Low Income Customers and the AG. First and foremost, none

of these other rates operate retroactively, as does the Low Income Rate, to eliminate past due charges for prior service rendered. This retroactive aspect of the Low Income Rate is in direct violation of KRS 278.160(2), which provides that,

> (2) No utility shall charge, demand, collect or receive from any person a greater or less compensation for any service rendered or to be rendered than that prescribed in its filed schedules, and no person shall receive any service from any utility for a compensation greater or less than that prescribed in such schedules.

An integral part of the Low Income Rate is to take all past due customer bills, which reflect charges at the tariffed rate, and eliminate the bills as if the tariffed rate had been zero. Such a retroactive bill adjustment would require Kentucky Power, which has already charged these customers the compensation prescribed in its filed schedules, to collect and receive less compensation than that prescribed in its filed schedules.

While the Low Income Customers argue that the practice of collecting less compensation than was charged is permissible under the legal theory of accord and satisfaction, this theory has no application to utility collections. To allow customers on the Low Income Rate to pay nothing on their prior bills and then, after 12 months, eliminate such bills would clearly result in an unreasonable rate preference in contravention of KRS 278.170(1).

The Commission has previously approved the establishment of flexible gas transportation rates for customers who have alternative fuel capabilities and who provide an affidavit, attesting that their alternative fuel supply is less costly than

gas. In these situations, the flexing of the gas transportation rate allows the customers to displace their alternate fuel with gas. Utilizing gas for this purpose is explicitly recognized as a proper basis for customer classification in KRS 278.030(3), which specifies "the nature of the use." Since alternate fuel capability is a proper basis for a classification, there is no discrimination.

In addition, Columbia's flex gas transportation tariff requires the customer to sign a one year contract and be subject to rate flexing both below and above the embedded transportation rate. Thus, depending upon economic and market conditions, a flexed transportation customer may pay more, less, or the same as non-flex transportation customers. The flex transportation tariff of Western Kentucky Gas similarly requires a one year contract, although it does not provide for flexing above the embedded rate. A review of our September 18, 1990 Order approving this tariff discloses no challenge to the non-upward flexing provision or any claim of discrimination by any party.

Contrary to the claim of the Low Income Customers, in neither the Columbia Gas nor Western Kentucky Gas cases was any decision made as to how the reduction in revenue will be allocated for rate-making purposes. Questions of the proper allocation of any revenue shortfall to shareholders, and among classes of ratepayers, were deferred to the respective utilities' next rate case. However, in this case the Low Income Customers have proposed the lost revenue be allocated to all rate classes, except

the Low Income Rate class, absent any persuasive evidence that these other rate classes will receive any benefits.

Kentucky Power's existing residential time-of-day rate is similar to Columbia Gas's flex gas transportation rate in that the rate is variable. While the electric rate for off-peak time consumption is below the full embedded cost of residential service, the rate for on-peak consumption exceeds the full embedded cost. Whether a time-of-day customer pays more or less than embedded cost will depend on the time that the consumption occurs and cannot be determined with any certainty in advance. The Low Income Rate, on the other hand, is designed to recover only 70 percent of Kentucky Power's embedded cost, with the 30 percent shortfall to be tacked on the bills of all other customers.

The proposed Low Income Rate is dissimilar to Economic Development Rates which have been offered to a small number of industrial customers. To justify an Economic Development Rate, a utility must demonstrate, on a cost-of-service basis, that all other ratepayers are not adversely affected.[4] In addition, any customer requesting an Economic Development Rate must execute a service contract which is twice as long as the discount period, and which provides for the recovery of all customer-specific fixed

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4 Case No. 327, An Investigation Into The Implementation of Economic Development Rates by Electric and Gas Utilities, Order dated September 24, 1990.

costs over the term of the contract.[5] This is in stark contrast to the proposed Low Income Rate, where customers have no obligation to take service for any length of time and the full recovery of fixed costs is impossible.

The Low Income Rate also varies significantly from the variable aluminum smelter rate approved for Big Rivers Electric Corporation. The variable smelter rate, to be in effect for 10 years, was conceived specifically to recognize the projected changes in the market price of aluminum. Consequently, the variable rate was designed so that it was, "likely to produce, over time, the same amount of revenue that would be produced under a conventional, flat rate."[6] It was <u>not</u> designed to produce a permanent rate reduction for the smelters, as the Low Income Customers allege. The Low Income Rate, on the other hand, was specifically designed to produce 30 percent less revenue than the conventional rate paid by all other residential customers.

The Low Income Customers also cite the Commission's approval of late payment charges as an example of a non-cost based rate. While late payment charges may not be cost based, they are in part designed to be high enough to act as an incentive to encourage prompt payment by all affected customers. The Commission has never required all rates to be set exactly at the level necessary

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5 <u>Id</u>.

6 <u>National-Southwire Aluminum Co. v. Big Rivers Electric Corp.</u>, 785 S.W.2d 503, 509 (1990).

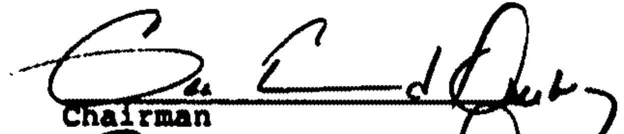
to recover full cost, no more or no less. If such a principle were adopted, the residential rates for Kentucky Power and almost every other utility would have to be increased. Setting rates equal to cost-of-service is the Commission's goal, but this goal must be tempered by the equally important principles of rate continuity and gradualism. Despite the proposed Low Income Rate being sufficient to cover Kentucky Power's variable cost of energy, plus make a contribution to fixed costs, the basic establishment of such a rate classification is improper. It results in an unreasonable advantage to those customers to be served by the Low Income Rate and an unreasonable disadvantage to all other customers.

Based on this analysis, the Commission concludes that customers' incomes and their participation in an energy payment assistance program are not reasonable considerations for establishing a customer class and that the rate preference and advantage given to Low Income Rate customers would be unreasonable. For these reasons, the Commission finds that the Low Income Rate would not result in fair, just, and reasonable rates, and, therefore, should be rejected.

IT IS THEREFORE ORDERED that the Low Income Customers' proposal that Kentucky Power adopt a Low Income Rate be and it hereby is denied.

Done at Frankfort, Kentucky, this 31st day of October, 1991.

PUBLIC SERVICE COMMISSION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