

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION)	
OF THE FUEL ADJUSTMENT CLAUSE OF EAST)	CASE NO.
KENTUCKY POWER COOPERATIVE, INC. FROM)	2017-00002
NOVEMBER 1, 2014 THROUGH OCTOBER 31, 2016)	

ORDER

Pursuant to 807 KAR 5:056, the Commission, on February 6, 2017, established this case to review and evaluate the operation of the fuel adjustment clause ("FAC") of East Kentucky Power Cooperative, Inc. ("EKPC") for period from November 1, 2014, through October 31, 2016, and to determine the amount of fuel costs that should be included in its base rates.

In establishing this review, the Commission ordered EKPC to submit certain information concerning its fuel procurement, fuel usage, and the operation of its FAC. EKPC submitted this information on February 20, 2017, and filed responses to Commission Staff's second and third data requests on March 20, 2017, and April 7, 2017, respectively. A public hearing was held on April 18, 2017. On April 28, 2017, EKPC filed responses to questions asked at the hearing and filed a brief on May 9, 2017. Informal conferences ("IC") were held in this matter on May 23, 2017, and June 22, 2017. There are no intervenors in this proceeding.

Base Fuel Cost

807 KAR 5:056 Section 1(12) 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.

807 KAR 5:056 Section 1(2) states:

FB/SB shall be so determined that on the effective date of the commission's approval of the utility's application of the formula, the resultant adjustment will be equal to zero.

EKPC proposes that no change be made to its current base fuel rate of \$.03014 per kWh.¹ According to EKPC, it is not necessary or appropriate to reestablish its base fuel rate at this time.² EKPC argues that, although coal and natural gas costs and market prices have been low during the last 12 months of the review period, increases are anticipated during the next two years.³ EKPC asserts that a change is not necessary because it would not produce a change in total fuel costs billed to customers and therefore would have no effect on the total bill. EKPC also asserts that its member cooperatives do not favor a change in the base fuel rate. EKPC states that its member cooperatives have concerns about how a reestablishment of the base fuel rate would be received and understood by their customers.⁴ EKPC also states that the use of the phrase "to the extent appropriate" in the regulation indicates that the base fuel charge need not be re-established in the course of every two-year review and that the Commission has declined

¹ EKPC last made a change to the fuel costs included in base rates in Case No. 2010-00491, *An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 2008 through October 31, 2010* (Ky. PSC May 31, 2011).

² EKPC's response to the Commission's February 6, 2017 Request for Information ("February 6, 2017 Request"), Item 1.

³ *Id.*

⁴ EKPC's response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 4.a.

to reestablish a base environmental cost component in the context of the environmental surcharge statute, KRS 278.183.⁵ Finally, EKPC states that it and its member cooperatives have identified an issue related to the effective date for new base rates that would need to be addressed if the base fuel rate is reestablished.⁶ However, EKPC proposes that, if the Commission were to order a change to the base fuel rates, the Commission use May 2015 as the base period, with a fuel cost of \$.02776 per kilowatt-hour (“kWh”).

When determining a representative month, EKPC reviewed the 24 months of the review period and eliminated any month that included adjustments not reflective of normal operations.⁷ The average total fuel cost of the remaining months was calculated to be \$.02603 per kWh.⁸ Given its expectation that the cost of coal, natural gas and market purchases will increase, EKPC eliminated from consideration months in which the fuel cost was below \$.02603 per kWh. EKPC compared the estimated average fuel costs for 2017 and 2018 to the actual fuel costs experienced during the two-year review period to quantify the expected increase in fuel costs.⁹ Based upon its review, EKPC concluded that the May 2015 fuel cost represents the level of fuel costs going forward.¹⁰

In establishing the appropriate level of base fuel cost to be included in EKPC's rates, the Commission must determine whether the proposed base period cost per kWh

⁵ Brief of EKPC at 4 and 6.

⁶ EKPC's response to the February 6, 2017 Request, Item 1, page 2.

⁷ *Id.* at 3.

⁸ *Id.* at 4.

⁹ *Id.* at 5.

¹⁰ *Id.* at 6.

is representative of the level of fuel cost currently being experienced by EKPC. An analysis of EKPC's monthly fuel clause filings showed that the fuel cost billed for the two-year review period ranged from a low of \$.02282 per kWh to a high of \$.02934 per kWh, with an average cost billed for the period of \$.02588 per kWh. Consequently, EKPC's fuel costs recovered through base rates fell outside of the range of actual fuel costs during the entirety of the review period, resulting in an FAC credit on bills each month. Furthermore, EKPC has estimated the average fuel cost for 2017 to be \$.02723 per kWh and for 2018 to be \$.02834 per kWh, well below the \$.03014 embedded in base rates.¹¹

EKPC points out that the Commission has previously declined to reestablish a base environmental cost component in environmental surcharge mechanism review proceedings and maintains that the Commission should be consistent and similarly decline to reestablish the base fuel rate in this proceeding. The Commission finds EKPC's arguments to be unpersuasive. The environmental surcharge mechanism has capital cost components that affect demand charges. Although the Commission has stated in prior environmental surcharge mechanism review proceedings that it was more appropriate to reestablish base rates in a base rate proceeding due to the filing of a cost-of-service study,¹² the FAC mechanism has no capital cost components that would compel the Commission to make a similar decision in this proceeding.

Based upon its review, the Commission finds that EKPC's base fuel rate should be adjusted and that the proposed May 2015 base period fuel cost of \$.02776 per kWh should be approved.

¹¹ EKPC's response to Staff's Second Request, Item 4.b.

¹² A cost of service study provides guidance in making a reasonable allocation of demand and energy costs.

Lag Issue

EKPC states that the time or “lag” between the period in which the fuel cost is incurred and when the FAC factor for that period is billed to its member cooperatives is two months. EKPC further states that the time between when the member cooperatives bill that particular factor to their respective retail customers can be up to an additional two months.¹³ In previous two-year review proceedings, the Commission has approved new base rates reflecting the base rate change to be effective on the same date for both EKPC and its member cooperatives. The Commission has also approved the use of the new base fuel rate in the calculation of EKPC’s FAC factor for the same service month. For example, in Case No. 2010-00491, the Commission approved new base rates for both EKPC and its member cooperatives for service rendered on and after June 1, 2011. The Commission also stated that, for service rendered on and after June 1, 2011, EKPC should use an FAC rate based upon the new base fuel rate. EKPC contends that those directives caused its member cooperatives to experience a mismatch between the energy rates the member cooperatives charged their customers and the FAC factor that was included on customers’ bills. EKPC recommends that, if the base fuel rate is reestablished in this proceeding, the Commission delay the effective date of any change in the member cooperatives energy rates for two months.¹⁴

Following the hearing in this matter, Commission Staff (“Staff”) held two ICs with EKPC to discuss the lag issue. At the first IC, Staff suggested that the issue may not be a result of the Commission approving a simultaneous change in base rates for EKPC and

¹³ Direct Testimony of Isaac Scott at 4.

¹⁴ Id. at 7.

its member cooperatives but a result of the language that has been included in the EKPC final orders when a change is made to the base fuel rate. For example, when EKPC billed its member cooperatives in July 2011 for June 2011 service, it was billing for the May 2011 expense month FAC factor. Staff suggested at the IC that, since the previous base rates were in effect during May 2011, if the former base fuel rate had been used in the calculation of the FAC factor for the May 2011 expense month, the timing issue might have been avoided. Staff noted that since the May 31, 2011 Order approved a change in base rates effective for June 2011 service, it would have been appropriate to use the new base fuel rate to calculate the FAC factor for the June 2011 expense. Staff suggested that, since the FAC factor for the June 2011 expense month was billed by EKPC to its member cooperatives for July 2011 service in August 2011, its proposed change to the order language would continue the two-month lag currently in existence.

EKPC responded to both IC memoranda and disagreed with Staff's suggested language change. In its responses, EKPC stated that both the energy rate and the FAC amount must reflect the same base fuel cost and that Staff's suggested change to the ordering language would not accomplish this match.¹⁵ EKPC contends that Staff's alternate language would relieve only a portion of the lag issue for the member cooperatives, making it a one-month lag rather than two months. EKPC further argues that Staff's alternate language would create a one-month lag issue for EKPC.¹⁶ According to EKPC, "[e]ach would experience a billing month where the applicable energy rates were based on new base fuel cost and the FAC rate would be based on the old base fuel

¹⁵ EKPC's response to Informal Conference Memorandum filed June 2, 2017 at 2.

¹⁶ *Id.* at 3.

cost.”¹⁷ EKPC reiterated its belief that no change to EKPC’s base fuel rate is necessary or required but that if a change is directed by the Commission, the effective date for the new base rates should be delayed for the member cooperatives by two months, as described in the Direct Testimony of Isaac Scott filed in this proceeding.¹⁸

DISCUSSION

The Commission recognizes that there is a two-month lag inherent in EKPC’s and all of the jurisdictional generators’ FAC mechanisms. EKPC bills the FAC factor for a particular expense month two months after that expense month. For example, the FAC factor for the expense month of May is billed to its member cooperatives in July. Therefore, in July, EKPC is made whole for the May expense month by charging or crediting the difference between the base fuel rate billed to customers for May usage and actual fuel costs incurred in May. In the event that a change in the base fuel rate is directed by the Commission, EKPC’s proposal to implement a base rate change for its member distribution cooperatives two months after the effective date of new base rates for EKPC is not appropriate and should not be approved. EKPC attempted to illustrate its position in Comments Following the June 22, 2017 IC (“IC Comments”). On page 3 of the IC Comments, EKPC included a table to illustrate Staff’s suggested language assuming a reestablishment of the base fuel rate at \$.02776 for service rendered on and after May 1, 2017. EKPC attempts to show that, under that scenario, it would under-recover \$2,185,326 of fuel costs because the FAC factor for the June billing would be based on the old base fuel rate of \$.03014. However, what EKPC fails to acknowledge

¹⁷ *Id.*

¹⁸ EKPC’s Comments Following June 22, 2017 Informal Conference at 3–4.

is that, while the base fuel cost of \$25,489,346 shown on line 5 in the table represents the amount billed for May fuel costs, the FAC factor amount shown on line 6 is to true-up April fuel costs billed to customers in the previous month through base rates when the old base rates were in effect. As customers were billed the old base rates for April usage, the FAC factor applicable to the April expense month should be calculated using the old base fuel rate. Therefore, line 6 shows the appropriate amount to be credited to customers for April. EKPC's proposal is an attempt to eliminate the lag. However, the lag exists, is inherent in the mechanism, and cannot be eliminated.

Although this lag cannot be eliminated, it can and should be managed by keeping the same two-month lag when the base fuel rate changes. With this Order, the Commission is directing a base fuel rate change for EKPC for service rendered on and after September 1, 2017. In order to maintain the two-month lag, the Commission will require that the new base fuel rate be used when calculating the FAC factor beginning with the expense month of September 2017, which will be billed by EKPC to its member cooperatives in November 2017.

The Commission believes that the existence of a two-month lag in the FAC mechanism underscores the importance of having the base fuel rate as close as possible to actual fuel costs and undeniably supports the change in EKPC's base fuel rate that is directed by this Order.

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that:

1. During the period under review, EKPC has complied with the provisions of 807 KAR 5:056.

2. The month of May 2015 should be used as EKPC's base period.

3. A base period fuel cost of \$.02776 per kWh should be approved.

4. The establishment of a base fuel cost of \$.02776 per kWh requires a reduction of \$.00238 per kWh to EKPC's base energy rates.

5. The rates in the Appendix to this Order are designed to reflect the reduction of \$.00238 per kWh to base energy rates, which is the differential between the old base fuel cost of \$.03014 per kWh and the new base fuel cost of \$.02776 per kWh.

6. The rates in the Appendix to this Order are fair, just, and reasonable and should be approved effective with service rendered on and after September 1, 2017.

7. Beginning with the expense month for September 2017, EKPC should use an FAC rate based upon a base fuel cost of \$.02776 per kWh.

IT IS THEREFORE ORDERED that:

1. The charges and credits applied by EKPC through the FAC for the period from November 1, 2014, through October 31, 2016 are approved.

2. A base fuel cost of \$.02776 per kWh is approved

3. EKPC shall reduce its base energy rates by \$.00238 per kWh to reflect the reestablishment of base fuel costs.

4. The rates in the Appendix to this Order are approved effective with service rendered on and after September 1, 2017.

5. Beginning with the expense month for September 2017, EKPC shall use an FAC rate based upon a base fuel cost of \$.02776 per kWh.

6. Within 20 days of the date of this Order, EKPC shall file, using the Commission's electronic Tariff Filing System, its revised tariff sheets with the Commission

setting out the rates approved herein and reflecting that they were approved pursuant to this Order.

By the Commission

ENTERED
AUG 07 2017
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Acting Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2017-00002 **AUG 07 2017**

The following rates and charges are prescribed for the customers in the area served by East Kentucky Power Cooperative, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

SCHEDULE A

Monthly Rate Per Load Center:

Energy Charge per kWh \$.040502

SCHEDULE B

Energy Charge per kWh \$.040502

SCHEDULE C

Energy Charge per kWh \$.040502

SCHEDULE E

Monthly Rate Per Load Center:

Energy Charge per kWh:
Option 1 On-Peak \$.042752
Option 1 Off-Peak \$.042174
Option 2 On-Peak \$.050899
Option 2 Off-Peak \$.042174

SCHEDULE G

Energy Charge per kWh \$.038467

SPECIAL CONTRACT - GALLATIN

On-Peak Energy \$.040425
Off-Peak Energy \$.036997

SPECIAL CONTRACT – INLAND STEAM

Energy Charge - MMBtu

\$ 4.318

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