

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENTUCKY)	
POWER COMPANY FOR AN ORDER)	
APPROVING ACCOUNTING PRACTICES TO)	
ESTABLISH A REGULATORY ASSET RELATED)	CASE NO.
TO THE EXTRAORDINARY FUEL CHARGES)	2023-00145
INCURRED BY KENTUCKY POWER COMPANY)	
IN CONNECTION WITH WINTER STORM)	
ELLIOTT IN DECEMBER 2022)	

ORDER

On May 3, 2023, Kentucky Power Company (Kentucky Power) filed an application pursuant to KRS 278.030, KRS 278.040, and KRS 278.220, requesting authorization to establish a regulatory asset for Kentucky Power's non-Fuel Adjustment Clause (FAC) eligible fuel costs totaling approximately \$11,519,695 related to Winter Storm Elliott in December 2022. Kentucky Power requests that the Commission enter an order on or before June 5, 2023, that will permit Kentucky Power sufficient time to pursue securitization of the storm-related costs that otherwise Kentucky Power would request to recover in base rates.

The Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (Attorney General) and Kentucky Industrial Utility Customers, Inc. (KIUC) are intervenors in this proceeding.

The Attorney General and KIUC filed a joint protest on May 9, 2023, arguing that Kentucky Power's regulatory asset request is contrary to Commission precedent and the legal standard that must be satisfied for approving a regulatory asset, and would

improperly approve recovery of certain non-FAC eligible costs that are the subject of cases pending before the Commission.¹ On May 16, 2023, Kentucky Power filed a memorandum in opposition to the Attorney General and KIUC's joint protest, arguing that the joint protest contained arguments not supported by law or fact, and thus should be disregarded by the Commission. On May 18, 2023, the Attorney General and KIUC filed a response reiterating that the regulatory asset requested by Kentucky Power does not satisfy the legal standards evaluated by the Commission for approving a regulatory asset. This case stands submitted for a decision based on the written record.

LEGAL STANDARD

KRS 278.220 sets out that the Commission may establish a uniform system of accounts (USoA) for utilities and in Kentucky Power's case, that the system of accounts shall conform as nearly as practicable to the system adopted or approved by the Federal Energy Regulatory Commission (FERC). The FERC USoA provides for regulatory assets, or the capitalization of costs that would otherwise be expensed but for the actions of a rate regulator. It must be probable that the utility will recover approximately equal revenue through the inclusion of these costs for ratemaking purposes, with the intent to recover the previously incurred cost not a similar future cost.

The Commission has established parameters for expenses that qualify for regulatory asset treatment; the Commission has approved regulatory assets when a utility has incurred: (1) an extraordinary, nonrecurring expense which could not have

¹ See Case No. 2022-00263, *An Electronic Examination of the Application of the Fuel Adjustment Clause of Kentucky Power Company from November 1, 2021 Through April 30, 2022* (Ky. PSC Sept. 13, 2022); and Case No. 2022-00190, *Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056, Purchased Power Costs, and Related Cost Recovery Mechanisms* (Ky. PSC Nov. 2, 2022).

reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or administrative directive; (3) an expense in relation to an industry sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.² Additionally, the Commission has established a requirement that utilities seek Commission approval before recording regulatory assets,³ and requirements regarding the timing for applications seeking such approval.⁴

KRS 278.030(2) requires every utility to furnish adequate, efficient and reasonable service to its customers.

KRS 278.010(14) provides the definition of "adequate service" as follows:

"Adequate service" means having sufficient capacity to meet the maximum estimated requirements of the customer to be served during the year following the commencement of permanent service and to meet the maximum estimated requirements of other actual customers to be supplied from the same lines or facilities during such year and to assure such customers of reasonable continuity of service.

REQUEST FOR REGULATORY ASSET

In support of the request to establish a regulatory asset for the non-FAC eligible purchased power costs⁵ related to Winter Storm Elliott, Kentucky Power asserted that it

² Case No. 2008-00436, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages* (Ky. PSC Dec. 23, 2008), Order at 3–4.

³ Case No. 2016-00180, *Application of Kentucky Power Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to the Extraordinary Expenses Incurred by Kentucky Power Company in Connection with the Two 2015 Major Storm Events* (Ky. PSC Nov. 3, 2016), Order at 9.

⁴ Case No. 2016-00180, Dec. 12, 2016 Order at 5.

⁵ See Kentucky Power response to Staff DR 1-1, wherein the Company confirmed references in its Application to "non-FAC eligible fuel costs" should be read to mean "non-FAC eligible purchased power costs."

incurred extraordinary purchased power costs from PJM Interconnection, LLC (PJM) between December 23 and 25, 2022, because PJM had to dispatch high-cost generators to satisfy load related to the event and the cost of that purchased power exceeded the level of purchased power expense that is eligible for recovery through Kentucky Power's FAC tariff. Kentucky Power explained that due to a weather event that resulted in a 29 degree drop in temperature over a 12-hour span on December 23, 2022, PJM experienced a spike in load and had approximately 43,000 MW of forced, or non-planned, generation outages. Kentucky Power further explained that the demand continued through December 24, 2022, and that the low point in demand was greater than any other peak for that date in a decade.

Kentucky Power stated that, due to the demand spike and forced outages, PJM issued a call for conservation for the entire PJM footprint. Kentucky Power further stated that PJM requested and received approval from the U.S. Department of Energy to require all electric generating units in the PJM footprint to operate up to their maximum generation output levels. Kentucky Power asserted that the additional dispatch of resources required by PJM resulted in the dispatch of high-cost generators that resulted in extraordinary fuel costs to Kentucky Power. Kentucky Power owns two generating units, Big Sandy Unit 1 and Mitchell. Kentucky Power stated that the two Mitchell units were operating at capacity factors of 80.3 percent and 74.1 percent, due to operational issues largely unrelated to the extreme weather conditions, and Big Sandy 1 was offline for scheduled maintenance that was unexpectedly extended due to additional emergent generator repairs.⁶

⁶ Kentucky Power's Response to Commission Staff's First Request for Information (Staff's First Request), Item 6.

Additionally, Kentucky Power argued that “capacity resources are planned on a long-term basis and informed by forecasts including weather-normalized projected capacity requirements. Energy requirements related to possible extreme weather events during the planning horizon, beyond those covered by the projected capacity margins, are not a basis for long-term planning of capacity resources.”⁷

Kentucky Power maintained that the real-time load-weighted-average hourly locational marginal pricing (LMP) during Winter Storm Elliott was extremely high, with a peak LMP exceeding \$3,500/MWh.⁸ Kentucky Power further maintained that during the period of required maximum generation dispatch, the real-time load-weighted-average hourly LMP exceeded \$4,500/MWh.⁹

Kentucky Power explained that its FAC tariff establishes a calculation that limits the amount of purchased power costs that can be recovered through the FAC surcharge. Kentucky Power further explained that the calculation compares the cost for actual purchased power on an hourly basis to the cost of Kentucky Power’s highest-cost unit, or theoretical peaking equivalent (PUE),¹⁰ then caps the amount recovered in the FAC surcharge at the cost of the highest generating unit or PUE.

Kentucky Power stated that in December 2022, gas prices were elevated due to Winter Storm Elliott, with gas prices over \$50/MMBtu in the eastern region of PJM and approximately \$6/MMBtu in the western region of PJM. Kentucky Power asserted that

⁷ Kentucky Power’s Response to Staff’s First Request, Item 7.

⁸ Application at 6.

⁹ Application at 6.

¹⁰ The PUE is a proxy because Kentucky Power does not own peaking units.

the difference resulted in Kentucky Power's actual purchased power costs exceeding the amount that could be recovered through the FAC surcharge. Kentucky Power further asserted that purchased power costs that exceed the amount eligible for recovery through the FAC surcharge are recoverable in base rates. Kentucky Power provided the PUE monthly calculation for December 2022 to demonstrate the difference between actual purchase power costs and the PUE.

Kentucky Power asserted that the \$11,519,695 of non-FAC eligible purchased costs it incurred in December 2022 were directly related to Winter Storm Elliott. Kentucky Power further asserted that the non-FAC eligible purchased power costs were prudently incurred. Kentucky Power stated that it intended to request to amortize the regulatory asset in an upcoming base rate case. Given the recent enactment of a law that authorizes securitization of certain extraordinary expenses, Kentucky Power stated that it now plans to pursue recovery of the non-FAC eligible purchased power costs through a securitization application. Kentucky Power explained that, under the securitization law, regulatory assets existing on June 30, 2023, are eligible for recovery through securitization. Kentucky Power asserted that recovering non-FAC eligible purchased power costs through securitization would result in a lower interest rate than would be recovered in base rates, and thus would result in lower rates than if the costs were recovered through base rates.

Kentucky Power asserted that the \$11,519,695 non-FAC eligible purchased power costs were extraordinary and sufficiently significant to satisfy the standard to establish a regulatory asset. Kentucky Power argued that the Commission evaluates whether to authorize a regulatory asset for storm costs based upon the magnitude of the expense

as compared to storm-related costs in the utility's base rates and the effect on the utility's current year financial results if the regulatory asset was denied. Kentucky Power maintained that PUE expense in its base rates is \$176,883, as compared to \$11,519,695 non-FAC eligible purchased power costs.¹¹ Kentucky Power asserted that the non-FAC eligible purchased power costs would represent 24.16 percent of Kentucky Power's net income for the 12 months ending December 31, 2022. Kentucky Power stated that if its request is granted, it will record the regulatory asset by reducing 2023 fuel expense because, while the majority of the expenses were incurred in 2022, the books for 2022 are already closed.¹²

ATTORNEY GENERAL AND KIUC'S COMMENTS

In their joint motion, the Attorney General and KIUC (jointly, Attorney General/KIUC) argued that Kentucky Power's request is contrary to Commission precedent and the FAC regulation, and it would improperly predetermine the issues pending in the six-month FAC review in which Attorney General/KIUC are protesting calculation of the PUE¹³ and in the administrative case investigating the FAC.¹⁴ The Attorney General/KIUC also asserted that allowing the establishment of a regulatory asset would allow Kentucky Power to recover power costs it would otherwise not be able to recover through the FAC or base rates.

¹¹ Kentucky Power's Response to Staff's First Request, Item 4.

¹² Application, paragraph 17 at 9 and paragraph 28 at 14. See also Kentucky Power's Response to Staff's First Request, Item 4, Attachment 1.

¹³ Case No. 2022-00263, *An Electronic Examination of the Application of the Fuel Adjustment Clause of Kentucky Power Company from November 1, 2021 through April 30, 2022* (filed Sept. 13, 2022).

¹⁴ Case No. 2022-00190, *Electronic Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056, Purchased Power Costs, and Related Cost Recovery Mechanisms* (filed Nov. 2, 2022).

The Attorney General/KIUC asserted that a reasonable amount of purchased power costs not recovered in the FAC may be recovered in base rates, but only prospectively. The Attorney General/KIUC also asserted that the requested deferral would improperly result in the retroactive recovery of a specific amount of purchased power costs not recoverable in the FAC. The Attorney General/KIUC claimed that the proper method of seeking recovery is for Kentucky Power to pursue recovery in an upcoming base rate case. The Attorney General/KIUC also stated that the existence of the securitization mechanism should not change what the Commission historically has allowed to be established in a regulatory asset.

Kentucky Power filed a response to the Attorney General/KIUC joint protest, responding that Attorney General/KIUC provided no grounds to deny the regulatory asset and made unsupported arguments concerning the recoverability of the costs. Kentucky Power stated that in this proceeding it is not seeking to collect and amortize the costs nor is it seeking the Commission's prudence review of the costs. Kentucky Power argued that establishing the regulatory asset does not deprive the Commission of its ability to review the costs for reasonableness, which the Commission could do in a securitization proceeding. Finally, Kentucky Power stated that allowing the regulatory asset would have no effect on the two open cases about which Attorney General/KIUC were concerned.

The Attorney General/KIUC argued that under FASB rules, in order to approve a regulatory asset that will be amortized in base rates, future recovery must be "probable." The Attorney General/KIUC asserted that in this case the standard is even higher because when recovery will be through an automatic adjustment clause, such as the securitization surcharge, the Commission, when allowing the establishment of the

regulatory asset, must clearly state its intent to permit recovery of the costs. The Attorney General/KIUC claimed that this will be binding on the Commission if approved. Attorney General/KIUC also asserted that if their challenge to the PUE is successful, the PUE disallowance for December will be greater than the current \$11.5 million.

DISCUSSION AND FINDINGS

As an initial matter, the Commission notes that Kentucky Power was aware that the loss of the Rockport Unit Power Agreement (UPA) represented a reduction in generation that could serve customers at a defined price and thus act as a physical hedge to market prices.¹⁵ The Commission further notes that Kentucky Power took no action to address its capacity shortfall in regards to energy capabilities, including entering into agreements that could hedge against market power prices. The Commission concludes, as further explained below, that Kentucky Power has not met its burden in this matter, and therefore the request should be denied.

Furthermore, granting the requested deferral would excuse Kentucky Power's purposeful lack of action to address the known risk that being "capacity short" represented, and instead shift that risk to consumers. Importantly, between consumers and Kentucky Power, the utility is the only entity that can address the impact of being "capacity short," and the result of the utility's unwillingness to address that fact should not be foisted upon captive ratepayers. Allowing or incenting such behavior would not result in fair, just or reasonable rates.

¹⁵ Case No. 2019-00443, *Electronic 2019 Integrated Resource Planning Report of Kentucky Power Company* (Ky. PSC June 4, 2021), Dec. 10, 2020 Hearing Video Transcript (HVT) at 10:58:36–11:06:00.

Additionally, it is not as if addressing the relatively small shortfall resulting from the UPA expiration would be time consuming or arduous. Previously, Kentucky Power said acquiring a purchase power agreement (PPA) for energy would be not only possible but would be “easy and quick.”¹⁶ Of course, no evidence in this matter indicates Kentucky Power has taken on that effort. As is discussed below, the evidence in this case raises the question of whether Kentucky Power is meeting its statutory obligation under KRS 278.030 to provide adequate service. The seriousness of this concern requires further entry of Orders in separate matters.¹⁷

Based on the record before the Commission, Kentucky Power failed to meet its burden to provide sufficient evidence to support a finding that these costs were incurred prudently. For one, Kentucky Power failed to provide adequate evidence as to the reasonableness of the generation unavailability at Mitchell and Big Sandy 1. Kentucky Power stated that it schedules maintenance outages for shoulder months so they can be available for peak winter times,¹⁸ but the units were not fully available during the event,

¹⁶ Case No. 2022-00283, Nov. 28, 2022 HVT at 10:37:10. See also Case No. 2019-00443 Dec. 10, 2020 HVT at 11:00:00-11:06:00. See also Case No. 2022-00098, *Electronic 2022 Integrated Resource Plan of East Kentucky Power Cooperative, Inc.* (filed Apr. 1, 2022), Dec. 13, 2022 HVT at 2:42:57-2:45:23. East Kentucky Power Cooperative, Inc., who is also a winter peaking member of PJM, has routinely contracted for a 100 MW call option to hedge risk for generator outages and market prices during its winter peak.

¹⁷ Case No. 2021-00370, *Electronic Investigation of the Service, Rates and Facilities of Kentucky Power Company* (Ky. PSC Sept. 15, 2021).

¹⁸ Case No. 2022-00036, *An Electronic Examination of the Application of the Fuel Adjustment Clause of Kentucky Power Company from May 1, 2021 through October 31, 2021* (filed Mar. 31, 2022), Kentucky Power’s response to Commission Staff’s Second Request for Information, Item 8 and Kentucky Power’s Post-Hearing Brief at 5–6. See also Kentucky Power’s Nov. 21, 2022 FAC filing, cover letter at 1-2. While Kentucky Power asserted that December is a shoulder month for its planning purposes, the Winter Storm Elliott event occurred at the very end of December and after Big Sandy 1 was originally scheduled to return to service.

when they were planned to be back online.¹⁹ Kentucky Power contended that Mitchell and Big Sandy 1 were down for maintenance in November 2022 so that the plants would be in “good working order” and operating to serve customers, with the added benefit of acting as a hedge against higher energy prices when energy prices spike.²⁰ Kentucky Power now requests that customers pay for the entire impact of unexpected extensions of the Big Sandy 1 outage due to additional repairs and the derate of Mitchell due to operational issues largely unrelated to the extreme weather conditions.²¹ Neither of these reasons for unavailability or derates was explained further, nor was evidence provided as to the efforts taken, or not taken, by Kentucky Power to ameliorate the issues. The Commission does not agree with the Attorney General/KIUC’s premise that securitization will be an automatic adjustment mechanism but does agree the applicable regulation requires that deferral may only occur if recovery is probable. Based on the record, the Commission not only lacks sufficient evidence to indicate the recovery of the regulatory asset will be probable, but instead, finds the evidence before it supports a conclusion that the expenses sought to be deferred were in fact not prudently incurred. Kentucky Power certainly incurred the expense, but the evidence before us shows no effort to mitigate, reduce or otherwise limit the cost of purchased power during the event. As Kentucky Power has the burden to meet the legal and regulatory standard, which includes that it may only defer expenses as a regulatory asset if the ultimate recovery is probable, the

¹⁹ Kentucky Power’s Response to Staff’s First Request, Item 6.

²⁰ Case No. 2022-00283, *Electronic Investigation of Kentucky Power Company Rockport Deferral Mechanism*, November 28, 2022 Hearing Video Testimony (Nov. 28, 2022 HVT) at 10:38:36.

²¹ Kentucky Power’s Response to Staff’s First Request, Item 6.

Commission finds it necessary to deny the application based on that fact that recovery is improbable.

Regarding the Attorney General/KIUC's comments, the 6-month and 2-year reviews of the FAC are retrospective, and they are not relevant or impacted by this case.

Utilities are not entitled to carte blanche recovery of fuel and purchased power costs. The FAC of course has limitations.²² Further, mere incurrence of fuel or purchased power costs does not make the costs prudent, reasonable or recoverable.²³ For instance, relevant to issues at hand, the Commission has previously noted that limitations of the FAC regarding "non-economy energy purchases" were important "in order to incentivize utilities to keep outages to a minimum and to have sufficient capacity to meet load."²⁴

As described above, Kentucky Power argued that the non-FAC eligible purchased power costs related to Winter Storm Elliott should be approved for regulatory asset treatment because they are extraordinary, non-recurring costs which could not have reasonably been anticipated or included in its planning. The costs were neither extraordinary nor likely to be non-recurring in the context of whether the utility could have planned for them. Simply, as explained throughout this order, Kentucky Power has failed

²² Case No. 2014-00226, *An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 2013 through April 30, 2014* (Ky. PSC Jan. 30, 2015) stating that the FAC "was never meant to allow the utility to recover 100 percent of fuel costs incurred on a monthly basis."

²³ See Case No. 2014-00226, *An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 2013 through April 30, 2014* (Ky. PSC Jan. 30, 2015); Case No. 2014-00229, *An Examination of the Application of the Fuel Adjustment Clause of Duke Energy Kentucky from November 1, 2013 through April 30, 2014* (Ky. PSC Jan. 30, 2015); Case No. 2020-00031, *Electronic Application of Duke Energy Kentucky, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Liabilities Associated with the PJM Expenses Related to the GreenHat Energy, LLC Default* (Ky. PSC Nov. 9, 2020).

²⁴ Case No. 2014-00226, *An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 2013 through April 30, 2014* (Ky. PSC Jan. 30, 2015) at 8.

to have adequate capacity which can provide, even if available, sufficient energy to serve its customers in aggregate. Kentucky Power, by its own choosing, failed to buy, lease, or contract for sufficient capacity with accompanying energy, or otherwise enter into financial transactions that have the same benefit for customers, following the expiration of the Rockport UPA. Kentucky Power has an estimate of its customer's maximum energy requirements. In the lead up to and following the expiration of the Rockport UPA, having to buy energy from the market to meet Kentucky Power's aggregate demand should have been expected, anticipated and planned for. Kentucky Power's failure to plan for such an event, given its current capacity and energy position, does not make these expenses extraordinary. They could have, and should have, been planned for.

While Kentucky Power does recover non-FAC eligible fuel or purchased power costs in base rates, it is not on a deferral and amortization basis, so recovery is not retrospective. Kentucky Power's request would alter the recovery mechanism for non-FAC eligible purchased power costs and is not an appropriate use of deferral accounting. The existence of securitization legislation does not preempt the Commission's broad authority related to regulatory assets and is not sufficient justification to defer expenses. In fact, securitization is only available for expenses for which deferral accounting has *already* been approved by the Commission. Thus, it does not impact the Commission's decision on whether to grant deferrals.

The evidence of record demonstrates Kentucky Power's lack of action to address its generation shortfall available to serve customers following the end of the Rockport UPA, Kentucky Power's failure to provide sufficient evidence to support a finding that these costs were incurred prudently, and Kentucky Power's failure to provide sufficient

evidence as to the reasonableness of the generation unavailability at Mitchell and Big Sandy 1. For those reasons, the Commission, by separate Order entered in Case No. 2021-00370,²⁵ will require Kentucky Power to show cause why Kentucky Power should not be subject to the remedy for failure to provide adequate service in its service territory under KRS 278.018(3) and why it should not be subject to an assessment of civil penalties under KRS 278.990 for Kentucky Power's alleged violation of KRS 278.030, which requires a utility to provide adequate, efficient and reasonable service to the utility's customer.

Based on the foregoing, the Commission finds that Kentucky Power's request should be denied as it failed to meet its burden of proof that the expenses were extraordinary, non-recurring, and could not have reasonably been anticipated or included in the utility's planning, and that ultimate recovery is probable.

IT IS THEREFORE ORDERED that:

1. Kentucky Power's request for authorization to establish a regulatory asset for the non-FAC eligible purchased power costs related to Winter Storm Elliott in December 2022 is denied.
2. This case is closed and removed from the Commission's docket.

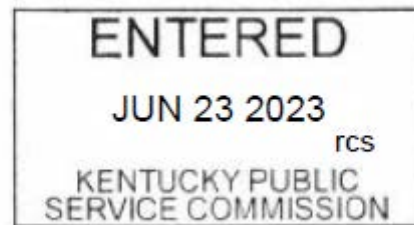
²⁵ Case No. 2021-00370, *Electronic Investigation of the Service, Rates and Facilities of Kentucky Power Company* (Ky. PSC Sept. 15, 2021).

PUBLIC SERVICE COMMISSION


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