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**Via E-Mail and Overnight Mail**

June 7, 2019

John E.B. Pinney, Acting General Counsel
Office of General Counsel
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602-0615

**RE: Comments of Kentucky Industrial Utility Customers, Inc., on Proposed Changes to Commission Regulation 807 KAR 5:056**

Dear Mr. Pinney:

Attached please find the Comments of Kentucky Industrial Utility Customers, Inc., (KIUC) on the Proposed Changes to Commission Regulation 807 KAR 5:056.

Very truly yours,

K. Boehm


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KJBkew
Enclosure

cc: Kent A. Chandler, Asst. Attorney General, Office of Kentucky Attorney General
Robert M. Conroy, Vice President, State Regulation and Rates, LG&E and KU Energy LLC
Kendrick R. Riggs, Esq., Counsel for KU and LG&E

**COMMONWEALTH OF KENTUCKY**
**BEFORE THE PUBLIC SERVICE COMMISSION**

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**COMMENTS OF**
**KENTUCKY INDUSTRIAL UTILITIES CUSTOMERS, INC.**
**ON PROPOSED CHANGES TO COMMISSION REGULATION 807 KAR 5:056**

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## I. INTRODUCTION

On April 15, 2019, the Kentucky Public Service Commission filed proposed revisions of Kentucky's Fuel Adjustment Clause ("FAC") Regulation, 807 KAR 5:056, with the Kentucky Legislative Research Commission pursuant to KRS 278.040(3). Kentucky Industrial Utilities Customers, Inc. ("KIUC") submits the below Comments concerning 807 KAR 5:056. As explained below:

1. KIUC does not object to the Commission's proposed revisions to the FAC Regulation;
2. KIUC proposes a new, revenue neutral, revision to the FAC Regulation that would protect energy-intensive manufacturing customers from business disruptions caused by month-to-month FAC volatility; and
3. KIUC supports the inclusion of a "deviation provision" to the FAC Regulation.

## II. COMMENTS

### 1. KIUC Does Not Object To The Commission's Proposed Revisions To The FAC Regulation.

#### a. KIUC Does Not Object To The Commission's Proposal That Kentucky Coal Severance Taxes Not Be Considered When Evaluating The Reasonableness Of A Fuel Procurement Contract.

Per KRS 143.020, coal mined in Kentucky is subject to a coal severance tax of 4.5 percent of the gross value of coal severed, processed or both; with a minimum tax of 50 cents per ton of severed coal. While this severance tax is an important source of revenue for the Kentucky General Fund, the Local Government Economic Assistance Fund, and the Local Government Economic Development Fund the severance tax can put Kentucky coal at a disadvantage in the Commission's fuel procurement contract evaluation process relative to other fuel sources. The Commission's proposed revision to the FAC Regulation addresses this problem by providing that in reviewing the reasonableness of the cost of fuel in a procurement contract the Commission will look at the cost of fuel in the contracts and competing bids based on the cost of the fuel less any severance tax collected under KRS 143.020.

This amendment would put Kentucky coal on equal footing with out of state coal that originates from states that do not apply coal severance taxes. Currently, Illinois and Indiana do not have coal severance taxes.

This amendment may result in slightly higher FAC costs. However, it is also possible that some of these costs will be offset by an increase in mining activities in Kentucky. More power usage by Kentucky mines would have an offsetting effect on electric prices. The potential harm to customers is low and is possibly outweighed by the potential benefits created by not penalizing Kentucky coal in the fuel procurement evaluation process for paying a Kentucky tax. Therefore, KIUC does not object to this proposed revision to the FAC Regulation.

KIUC has reviewed the Comments filed by Kentucky Utilities Company ("KU") and Louisville Gas & Electric Company ("LG&E") on May 22, 2019 opposing this proposed revision for a variety of legal and operational reasons. KIUC does not take a position on the issues raised by KU and LG&E.

### b. KIUC Does Not Object To Giving The Commission The Discretion to Waive Public Hearings On FAC Review Cases.

807 KAR 5:056(11) requires the Commission to conduct public hearings on a utility's past fuel adjustments at six-month intervals. The Commission proposes a change to the FAC Regulation that would make conducting a public hearing on each FAC review discretionary. While some FAC review cases involve contested issues that require a formal hearing, many FAC review cases, are not contested and do not require a public hearing. As long as intervenors are granted a public hearing on a utility's FAC when substantive issues are identified by Staff or intervening parties KIUC does not object to a revision of the FAC Regulation that allows the Commission to waive public hearing on uncontested FAC review cases. A revision to the FAC Regulation that makes a public hearing discretionary will promote administrative efficiency.

## 2. The FAC Regulation Should Allow The Commission To Require Levelized FAC Billing On An Individual Customer Basis.

### a. The Month-to-Month Volatility Of FAC Charges Creates Significant Problems For Energy Intensive Customers.

The Commission's proposed revisions to the FAC Regulation do not address levelized FAC billing; an issue of great concern for some of KIUC's members. KIUC would like to take this opportunity to propose a revenue neutral enhancement to the FAC Regulation that will benefit energy-intensive power users and put these customers on an equal footing with energy-intensive customers in neighboring states that already enjoy the benefits of rate certainty in their fuel cost recovery mechanisms. KIUC's proposed enhancement will not harm Kentucky utilities or their customers.

The FAC Regulation requires each utility to charge or credit customers the difference between the actual cost of fuel and the baseline fuel cost that is incorporated in base rates. The FAC factor changes monthly to reflect the fuel costs incurred two months earlier. In some months the FAC is a charge and in other months it is a credit. Kentucky's monthly-adjusted FAC is different than the more levelized fuel recovery methods used by neighboring states such as West Virginia and Virginia. West Virginia's Expanded Net Energy Cost, and Virginia's fuel factor[1] are typically adjusted and "trued-up" annually so that customers will receive the same fuel charge on their bill for a 12-month period.

There are pros and cons to making month-to-month adjustments to the FAC. As the Commission describes in its Regulatory Impact Analysis, the benefits of a monthly variable FAC are that it limits regulatory lag by prescribing a mechanism by which fluctuations in fuel prices, which are a significant and volatile cost in electric generation, may be reflected in customer bills in a timely manner, subject to Commission oversight, without a more burdensome general rate adjustment proceeding.

The drawback of a monthly-adjusted FAC is that customers are not safeguarded from the disruptive volatility of fuel costs. This is particularly problematic for energy-intensive manufacturers for whom power costs are a very large expense. For energy-intensive manufacturers, electricity costs are among the most expensive cost items in their budget. So large, unpredictable fluctuations in power costs can cause difficult budgeting and cash-flow problems that are not experienced by manufacturers in states, like West Virginia and Virginia, that make less frequent adjustments to their fuel recovery mechanisms.

Perhaps the biggest problem created by Kentucky's FAC structure is its unpredictability. There is no consistency to the cost or credit from month-to-month and no way for a customer to predict its next FAC charge. The 60-day delay in the time that fuel costs are incurred by the utility and FAC charges are levied on customers

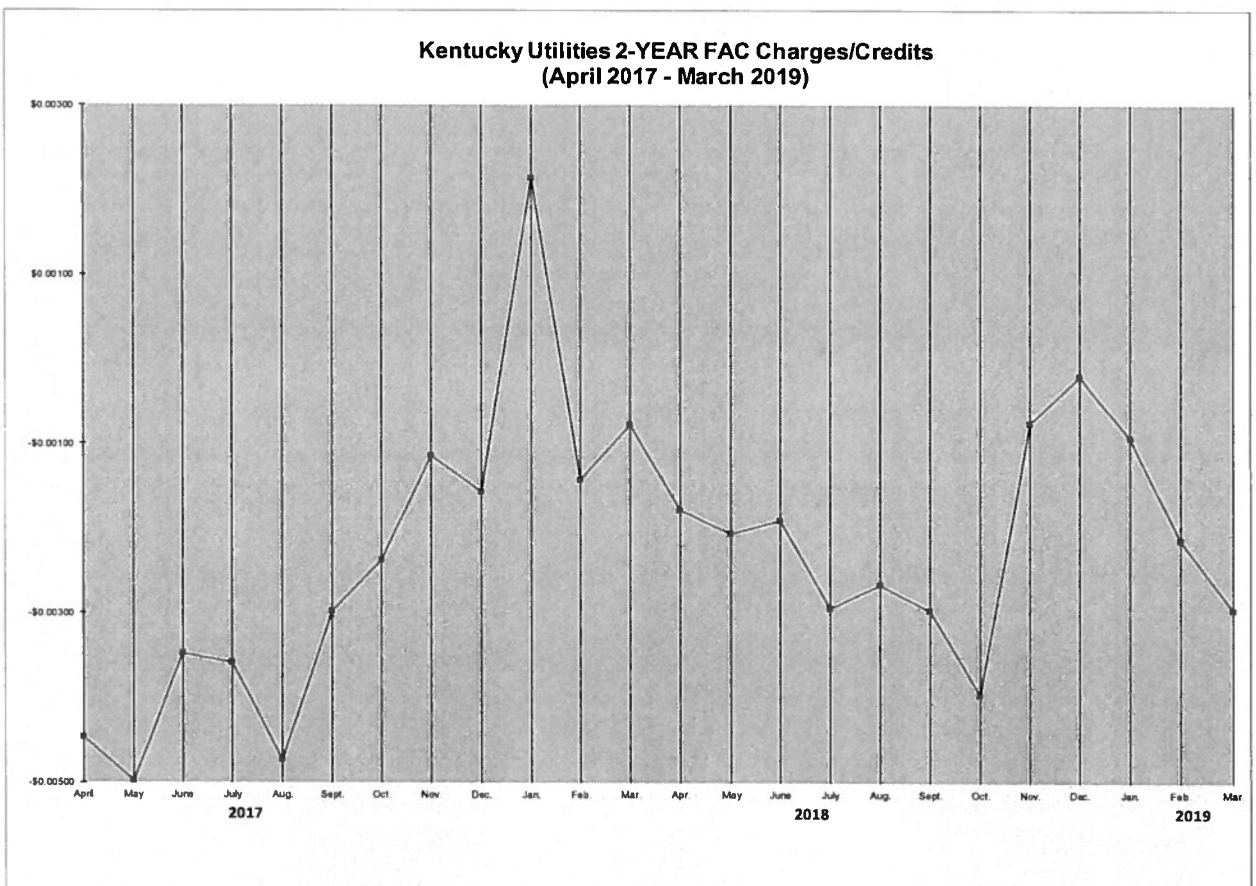
[1] Virginia Code § 56-249.6

prevents customers from attributing fuel costs to production realities. This makes it difficult to analyze power usage in a meaningful way because there is no matching of production usage with FAC costs. As a result, energy-intensive manufactures need to keep cash on hand that may or may not be necessary to pay electric bills. This is an inefficient use of capital. The Commission should promote a policy that will allow large manufacturers to budget more accurately in order to invest their capital into maintaining and growing their businesses rather than keeping cash in reserve.

KIUC reviewed the FAC charges for each investor-owned utility in Kentucky over the past 24 months to quantify the impact of FAC volatility for energy-intensive customers. We found that for large power users, the FAC factor can fluctuate by tens of thousands or even hundreds of thousands of dollars from month-to-month. Below is a brief discussion of the volatility and rate impacts for every Kentucky electric generation utility:

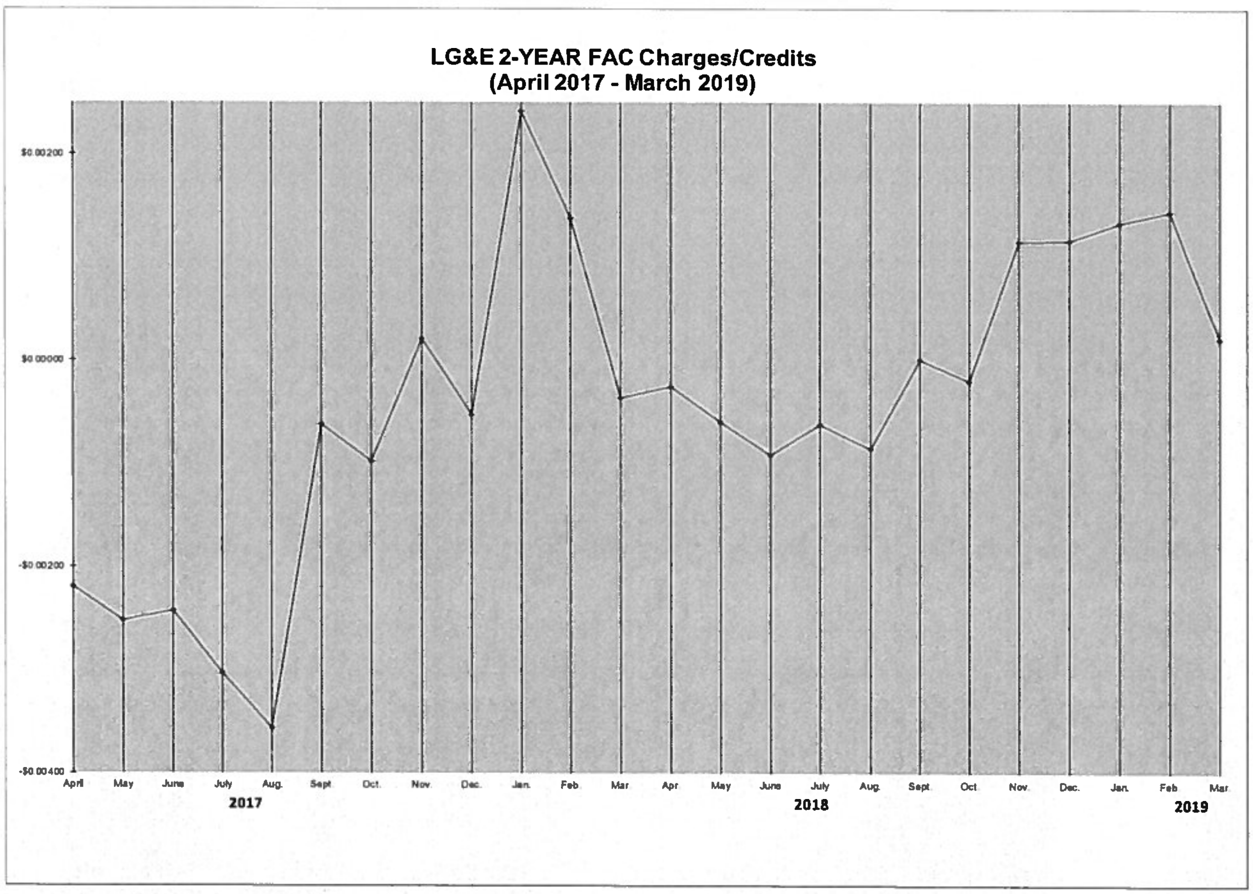
## Kentucky Utilities Company and Louisville Gas & Electric Company

The graph below shows KU's per kWh FAC charge or credit for the most recent 24-month period.



While the change in FAC charges or credits for KU was relatively smooth in some months (i.e. April-2017 through June-2017), the difference between FAC charges in other months was extreme. This month-to-month volatility is reflected in customer bill impacts. For example, an average RTS customer, consuming 5.1 million kWh per month,[2] would have received a $8,000 FAC credit on its December 2017 bill and a roughly $11,000 FAC charge the next month (January-2018). Obviously, the magnitude of this monthly variation is increased for larger customers. For just its FLS account, KU's largest customer consumes an average of 52.4 million kWh per month.[3] This customer would have received a FAC credit of $82,000 in December of 2017 and a $112,000 charge the next month. This swing of nearly $194,000 on just one account creates budgeting and cash-flow issues for even very large Kentucky businesses.

The graph below shows LG&E's per kWh FAC charge or credit for the most recent 24-month period.

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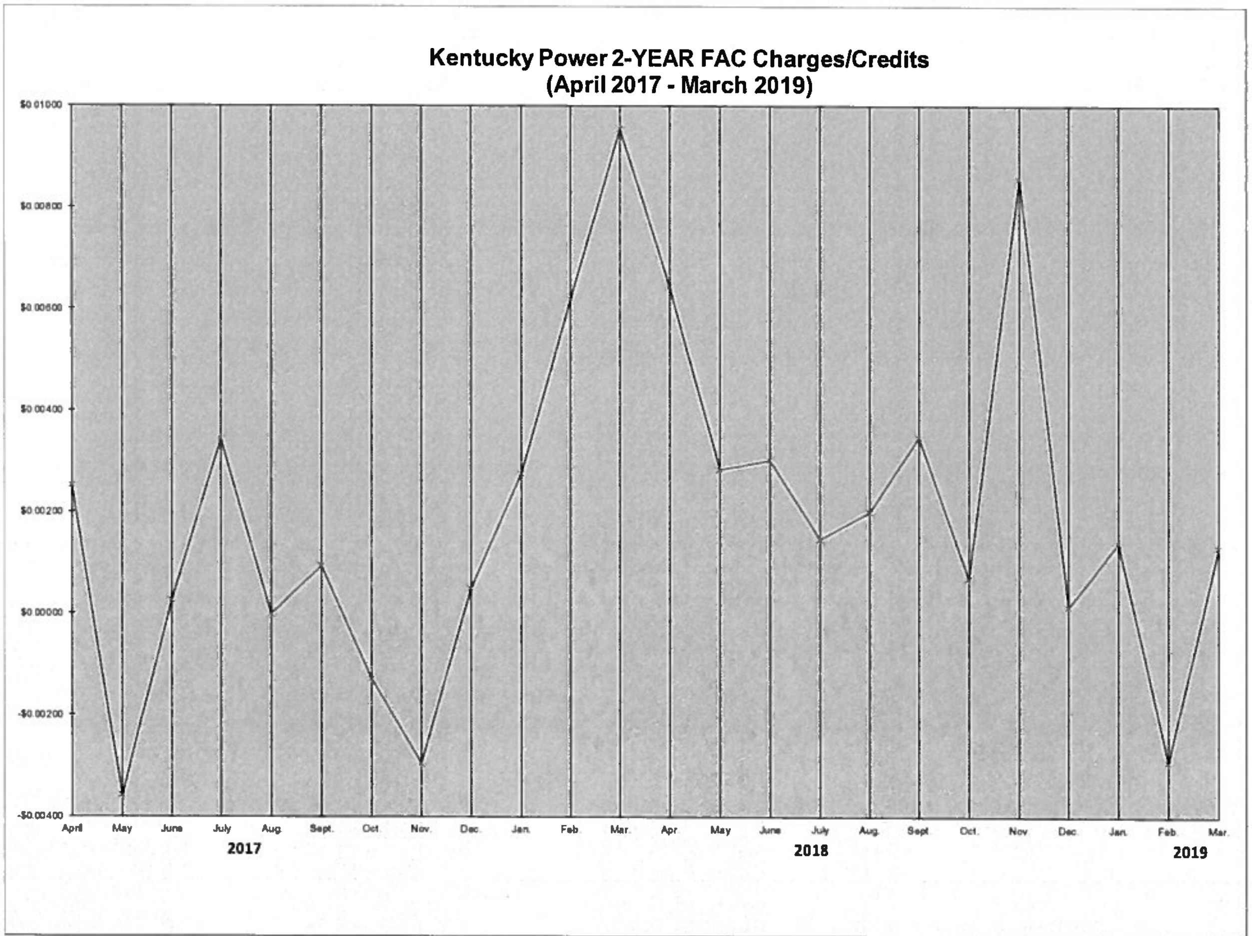
[2] See KU's FERC Form 1 2018 Q/4, p. 304, line 9.
[3] See KU's FERC Form 1 2018 Q/4, p. 304, line 10.

An LG&E customer would experience a monthly swing in its FAC charge similar to a KU customer. An average LG&E RTS customer, using 11.6 million kWh per month,[4] would have received a $6,000 FAC credit on its December 2017 bill and a $28,000 FAC charge the next month (January-2018); a net $34,000 month-to-month swing.

**Kentucky Power Company**

The graph below shows Kentucky Power's per kWh FAC charge or credit for the most recent 24-month period.




As shown above, Kentucky Power's FAC charges have been extremely volatile over the past 24 months fluctuating between smaller charges or credits in one month to very large charges the next month. An average Kentucky Power TOD-PA customer, using 8.5 million kWh per month,[5] would have received a $6,000 FAC charge

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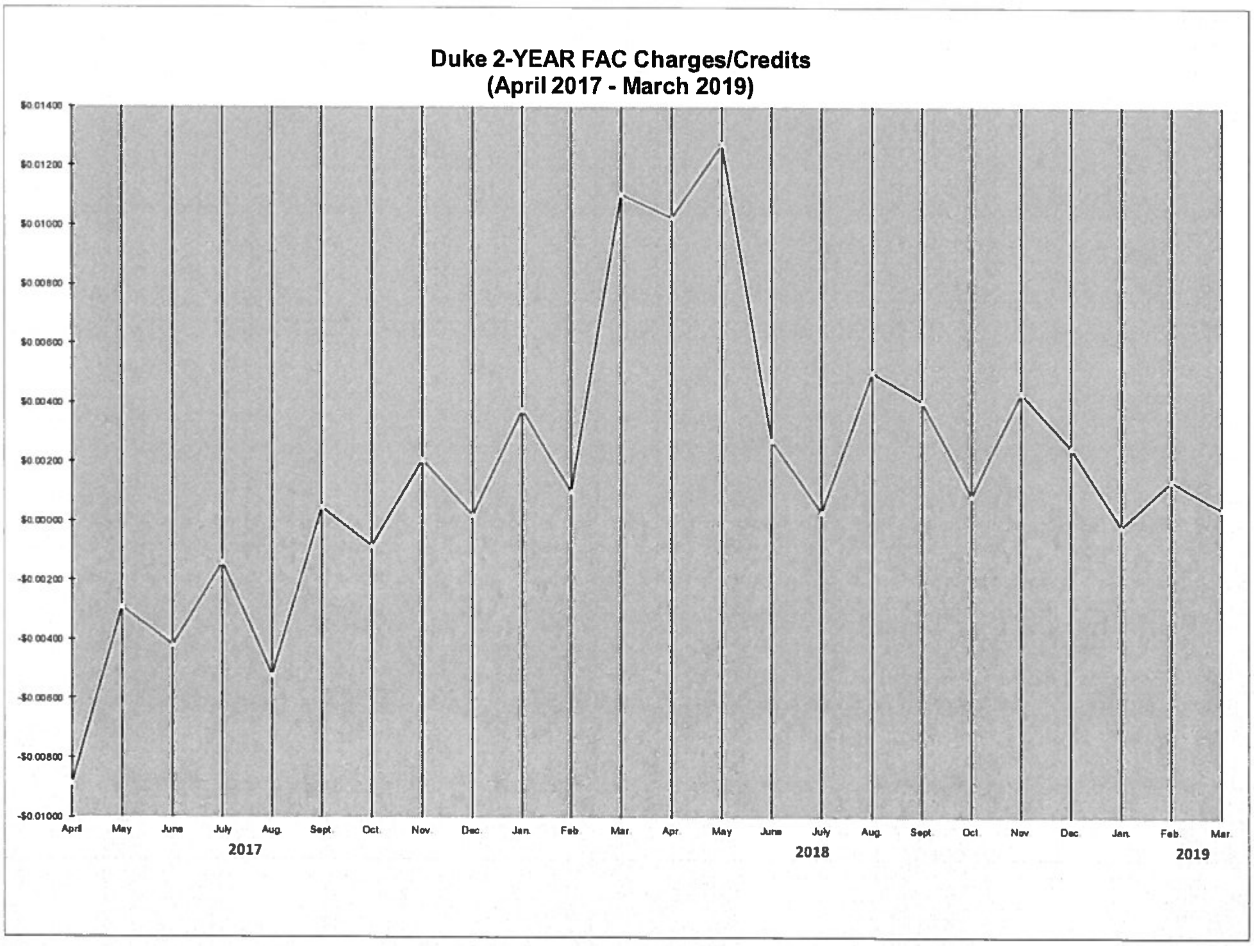
[4] See LG&E's FERC Form 1 2018 Q/4, p. 304, line 8.
[5] See Kentucky Power's FERC Form 1 2018 Q/4, p. 304, line 31.

on its October 2018 bill, a $73,000 FAC charge the next month (November-2018) then a small $1,200 charge the next month (December-2018). Again, a customer does not know if they will receive a large charge or a credit for the FAC portion of their bill until the bill arrives. A typical Kentucky Power TOD-PA customer would have had to keep nearly one hundred thousand dollars in reserve to pay the FAC portion of its bill.

## Duke-Kentucky

The graph below shows Duke-Kentucky's per kWh FAC charge or credit for the most recent 24-month period.



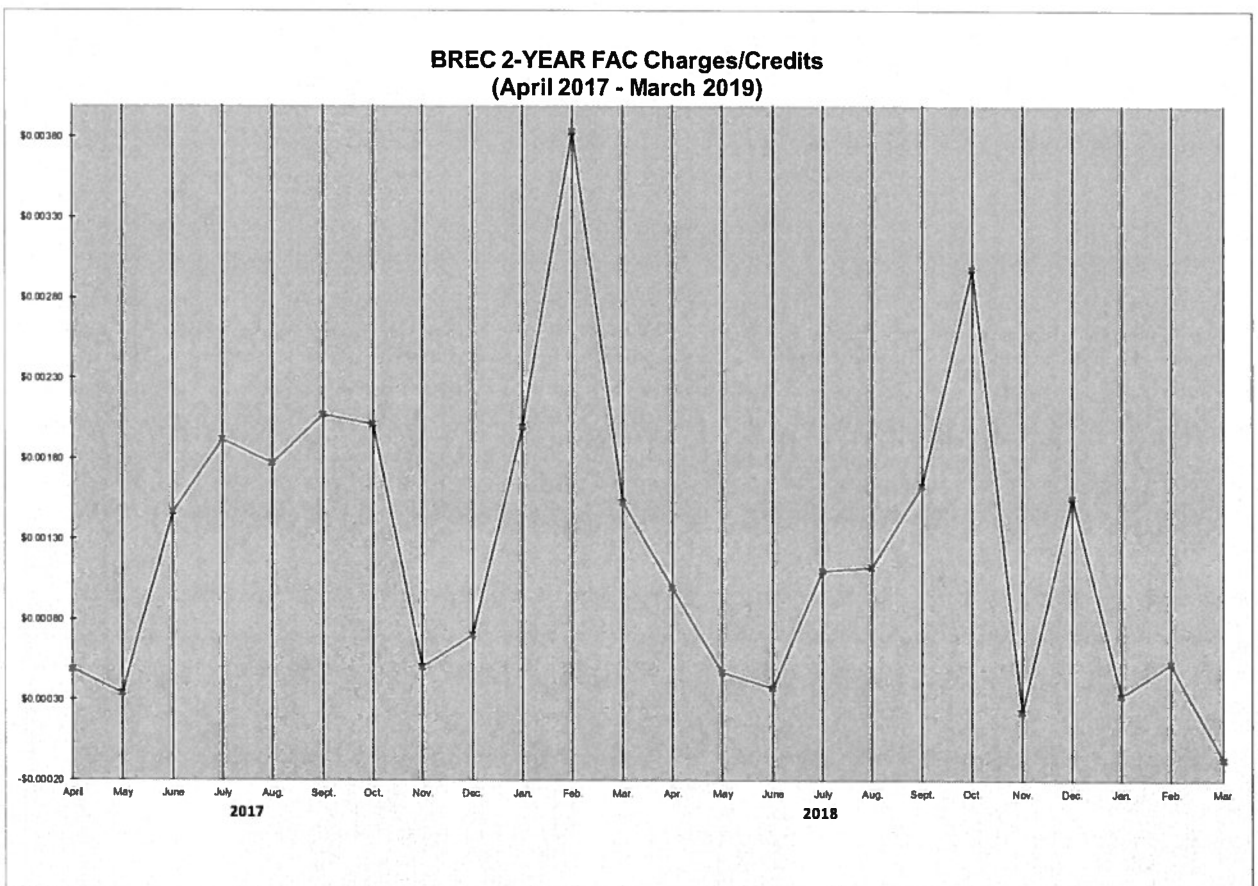

Duke-Kentucky has less large industrial load than the other Kentucky investor-owned utilities and its averaged-sized customer taking service on the large power rate uses less power (only about 2.8 million kWh per month)[6] than the typical industrial customer of the other investor-owned utilities. Despite relatively low usage, an

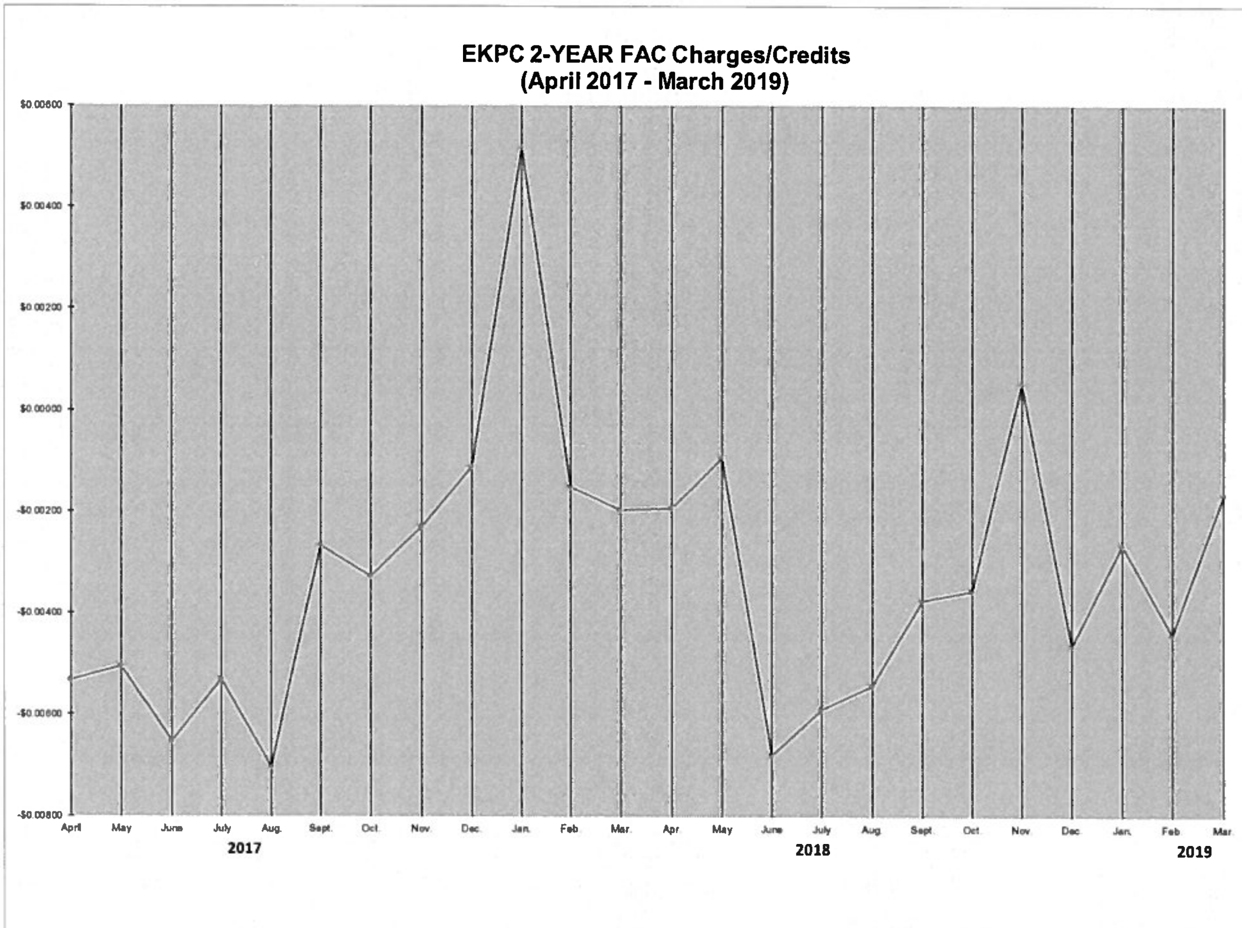
[6] Duke Kentucky's FERC Form 1 2018 Q/4, p. 304.1, line 21.

average Duke TOD-Primary customer would have experienced a very large variation in its monthly FAC bills over the 24-month period that KIUC sampled. For example, an average Duke-Kentucky would have received a $2,800 FAC <u>charge</u> on its February 2018 bill, and a $31,000 FAC <u>charge</u> the next month (March-2018); a net $28,200 month-to-month swing. Later the same year, this customer would receive a $37,000 FAC charge in May of 2018 and a $8,000 charge the very next month. This is a large variation in costs for a customer that only uses an average of 2.8 million kWh per month.

<u>**Big Rivers Power Cooperative and East Kentucky Power Cooperative.**</u>

The FAC charges for Big Rivers and EKPC, Kentucky's generation-owning electric cooperatives are shown below. Like the investor-owned utilities, the FAC charges/credits levied by the cooperatives were extremely volatile and unpredictable over the past 24-months.






**b. KIUC Recommends That The FAC Regulation Be Amended To Allow The Commission To Require Levelized FAC Billing On An Individual Customer Basis.**

As stated above, unpredictable monthly variations in FAC charges create problems for energy-intensive businesses. One solution is to transition from a monthly variable FAC factor to an FAC factor that is set and trued up annually like West Virginia and Virginia. While this would certainly solve the problems created by volatile month-to-month billing, KIUC acknowledges that this would represent a major change to Kentucky regulation that would require extensive consideration and careful planning. We are not proposing that. A much simpler solution is for the Commission to support a revision to the FAC Regulations that would authorize the Commission to require levelized billing on an individual customer basis.

KIUC proposes that energy intensive customers be permitted to contract with their electric utility, or petition the Commission to require a utility, to provide a stable FAC factor that does not vary month-to-month. A levelized FAC factor would be based on the utility's projected FAC factor and could be adjusted periodically (every

12 months) to reflect actual costs. The levelized billing arrangement would be designed to be revenue neutral to the utility and other customers. A draft provision that could be added to the FAC Regulation is provided below:

**807 KAR 5:056, Section 1**

**(7) Individual industrial customers with energy-intensive processes can contract with their utility, or petition the Commission to require their utility, to provide a levelized fuel adjustment factor. The levelized fuel adjustment factor will be based on the utility's projection of the fuel adjustment factor. The levelized fuel adjustment factor will be adjusted every 12 months to update the utility's projected costs and to adjust for any over-recovery or under-recovery of fuel and purchased power costs previously incurred. The levelized fuel adjustment factor shall be revenue neutral to the utility and to other customers.**

KIUC respectfully requests that the Commission consider this, or a similar provision, to protect energy-intensive manufacturers from the business disruptions caused by FAC volatility.

### 3. KIUC Supports KU's and LG&E's Proposal To Include A Deviation Provision In The FAC Regulation.

On page 11 of their May 22, 2019 Comments, KU and LG&E recommend that the Commission consider the addition of a provision to the FAC Regulation that would permit the Commission to authorize deviations from the FAC Regulation for good cause. Similar provisions are found in most provisions of Title 807. KIUC agrees with KU and LG&E that the addition of a deviation provision would afford greater flexibility in addressing unusual or unique circumstances for good cause where the application of the regulation might otherwise produce unreasonable or uneconomic results.

Respectfully submitted,

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June 7, 2019