



KENTUCKY PUBLIC
SERVICE COMMISSION

UTILITY RATEMAKING: The Kentucky PSC Process

Duke Energy Kentucky – Case 2019-00271

February 2020

Kentucky Public Service Commission



Meeting agenda

- 1. Presentation – PSC staff**
- 2. Q&A – PSC staff**
- 3. 6:30 pm – Public comments – PSC Commissioners**



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)

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

- **Full settlement** – all parties agree on all issues
- **Partial settlements** – all parties agree on some issues, or some parties agree on all issues
- **The PSC analyzes and reviews the settlement’s proposed rates and other terms as carefully as it would in a fully litigated case**
- **Rates resulting from a settlement must still meet the “fair, just and reasonable” test**



The PSC ratemaking process

What is NOT in base rates:

- Fuel costs for electric generation – dollar-for-dollar pass-through of amounts above (surcharge) or below (credit) a baseline amount
- Environmental compliance costs for coal combustion – under Kentucky law, these are recovered separately
- Demand-side management surcharge (energy efficiency programs) – separate by state law
- Low-income assistance program fees
- Franchise fees
- Local taxes



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
 - borrowing costs



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
 - fines
 - 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, for example:
 - Storms costs
 - Asset sales
 - Amortized and recovered through rates
- Final revenue requirement = allowable expenses and the opportunity to earn a reasonable rate of return on equity



The PSC ratemaking process

Revenue requirement – base rates

- Calculating return on equity (for investor-owned utilities only) –
 - 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
- Allowance in ROE for taxes – when taxes decline, so does the revenue requirement



The PSC ratemaking process

Revenue requirement – base rates

- Return on equity is not used in rate calculations for not-for-profit utilities (water districts, electric cooperatives, etc)
- A margin above operating costs is calculated to reflect requirements of lending agencies, as well as a reasonable cushion for contingencies



The PSC ratemaking process

Rate design

The purpose is to allocate costs and revenue appropriately over various rate classes

- Residential
- Commercial
- Large industrial
- Lighting

Each large rate class may be divided into several categories of service



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 one very large customer than hundreds of smaller customers with the same total consumption

Among the major customer classes, cost of service is highest for residential class



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 in detail how much it costs to serve each rate class; also may examine fixed versus variable 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 – 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 mcf, per gallon, etc)
- Variable charge generally recovers a portion of fixed costs



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?



The PSC ratemaking process

The bottom line –

what is fair, just & reasonable?

- Things to consider
 - Fair to investors (if utility is investor-owned)
 - 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

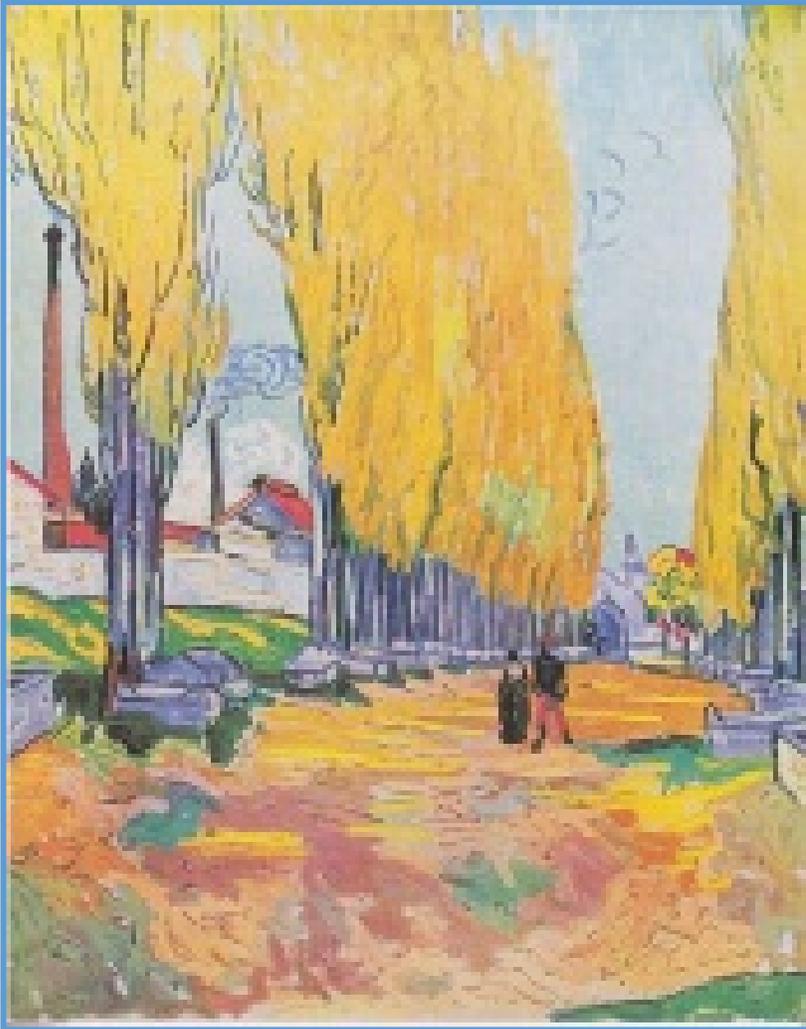


RATEMAKING IS ALSO ABOUT PERSPECTIVE

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



KENTUCKY PUBLIC SERVICE COMMISSION



Van Gogh



Gauguin



KENTUCKY PUBLIC SERVICE COMMISSION



Reality: les Alyscamps, Arles, France



Case 2019-00271

Duke Energy Kentucky



Most recent increase – April 2018

- *Requested about \$30 million annual increase*
- Received \$8.4 million annual increase
- Average residential base rate bill increased about \$2.56/month
- *Duke Kentucky had sought to increase residential bill by \$15.17*
- Monthly customer charge rose to \$11 from \$4.50 (*Duke had requested \$11.10*)
- Usage charge dropped from 7.546¢ to 7.152¢ per kilowatt-hour (*Duke proposed 8.308¢*)
- Prior rate increase was in 2007



What this case is NOT about

- Natural gas rates
- Net metering rates
- Advanced metering (“smart” meters)

PSC decision issued in May 2017 – approved settlement between Duke and Kentucky Office of Attorney General

Approved deployment

Set cost-based opt-out fees – no opt-out in Duke proposal; added as part of settlement with AG

Not part of this proceeding – other than net cost recovery



Case 2019-00271

Duke KY is seeking to increase annual base revenue by \$45.6 million (14.7 %) (subsequently amended to \$44.2 million)

Seeking 9.8 % rate of return on equity (amended to 9.7%)

Reasons for requested increase

- ⦿ Eroding rate of return – currently 3.1%
- ⦿ Increased capital operating costs
- ⦿ Recovery of 2018 storm restoration costs
- ⦿ Declining per-customer consumption



Case 2019-00271

Significant elements:

- Forecasted test year
- Increase in monthly residential charge
- Increase in delivery charge per kilowatt-hour (kWh)
 - 1 kWh = 100-watt incandescent bulb for 10 hours
 - 1 kWh = 13-watt (100W equivalent) LED bulb for 77 hours
- Remove charge for credit/debit card transactions; roll into base rates
- New customer service software
- Electric vehicle pilot program
- Voluntary renewable source tariff



Case 2019-00271

Rate impact (as proposed)

- ❖ Duke KY estimate based on average monthly residential use of 1,000 kWh
- ❖ Monthly customer charge: \$11.00 → \$14.00
- ❖ Energy charge per kWh: 7.165¢ → 8.4272¢
- ❖ Total (not including surcharges/riders) : \$82.65 → \$ 98.27
+\$15.62 (18.9%) - Duke estimates increase of 16.2% to total bill



Case 2019-00271

Intervenors:

- ❖ Kentucky Attorney General – Office of Rate Intervention
- ❖ Kroger Co.
- ❖ Northern Kentucky University



Case 2019-00271

What has happened so far:

- ◎ September 3, 2019 – Duke Energy Kentucky’s application for rate adjustment is filed; accepted as filed
- ◎ September 13, 2019 – PSC suspends proposed rates through April 2, 2020
- ◎ PSC has ruled on all intervention requests
- ◎ Four rounds of written discovery



Case 2019-00271

What's next:

- Formal evidentiary hearing
 - February 19, 20, & 21 – 8:30 a.m. EST
 - PSC offices – 211 Sower Blvd., Frankfort
- Open to public
- Streamed live at psc.ky.gov
- Suspension period ends April 2, 2020
- PSC must issue decision by July 2, 2020



Public Comments

Public Comments

E-mail to psc.info@ky.gov

Put the case number in the subject line

Written comments to PSC

Kentucky Public Service Commission

211 Sower Boulevard

Frankfort, KY 40601

(include case number)

Fax to 502-564-3460



Contact information:

Andrew Melnykovich

Communications Director

Kentucky Public Service Commission

211 Sower Boulevard, Frankfort KY 40602

502-782-2564

Psc.info@ky.gov



Thank you

Questions?