

# UTILITY RATEMAKING: The Kentucky PSC Process

Duke Energy Kentucky – Case 2017-00321

February 2018

**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**
- **Limited intervenors – cross-examination only**

# 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 cost adjustment (above or below base fuel cost)
- Environmental compliance cost – separate by state law
- Demand-side management surcharge (energy efficiency programs) – separate by state law
- Low-income assistance program fee
- 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
  - 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 –
  - 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

# The PSC ratemaking process

## Rate design

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

- Residential
- Commercial
- Large industrial
- Miscellaneous – lighting, pole attachments, etc.

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 a 1-megaWatt load than 1,000 1-kiloWatt loads

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 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?

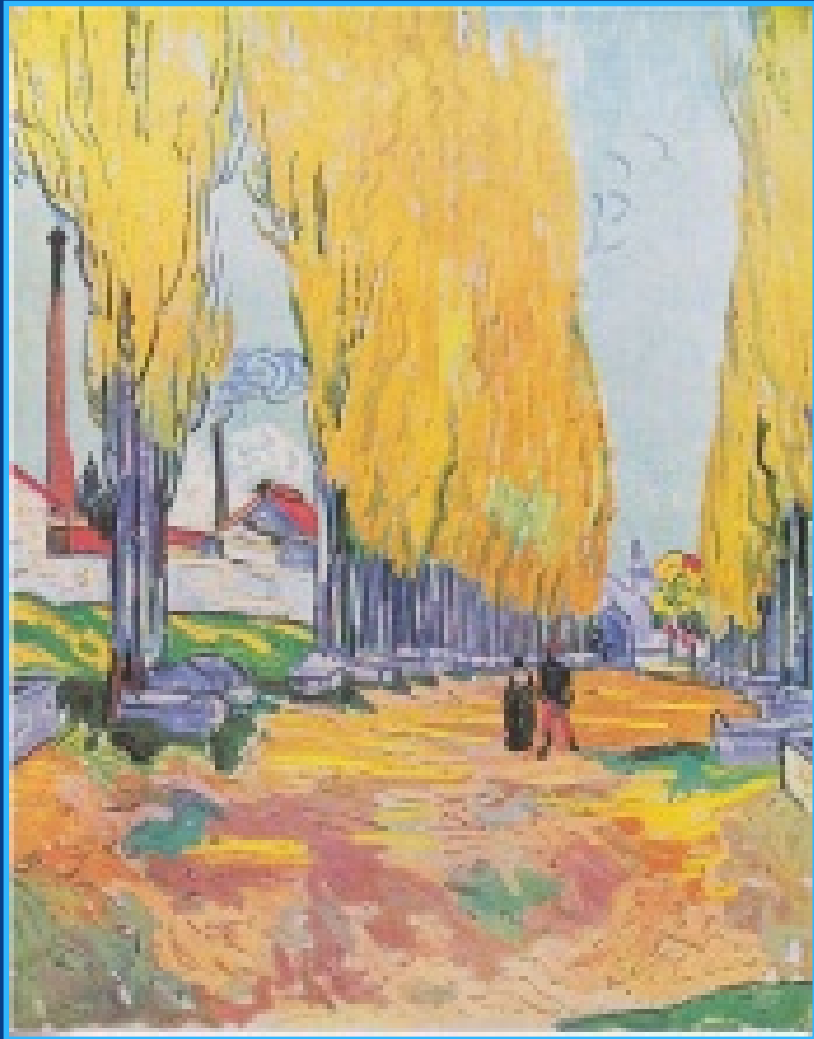
- Balancing act
  - Fair to investors
  - Sufficient to support safe and reliable service
  - Not unduly burdensome on ratepayers
- Rates cannot be confiscatory
- PSC has discretion, but only within the legal limits

# **RATEMAKING IS ALSO AN ART**

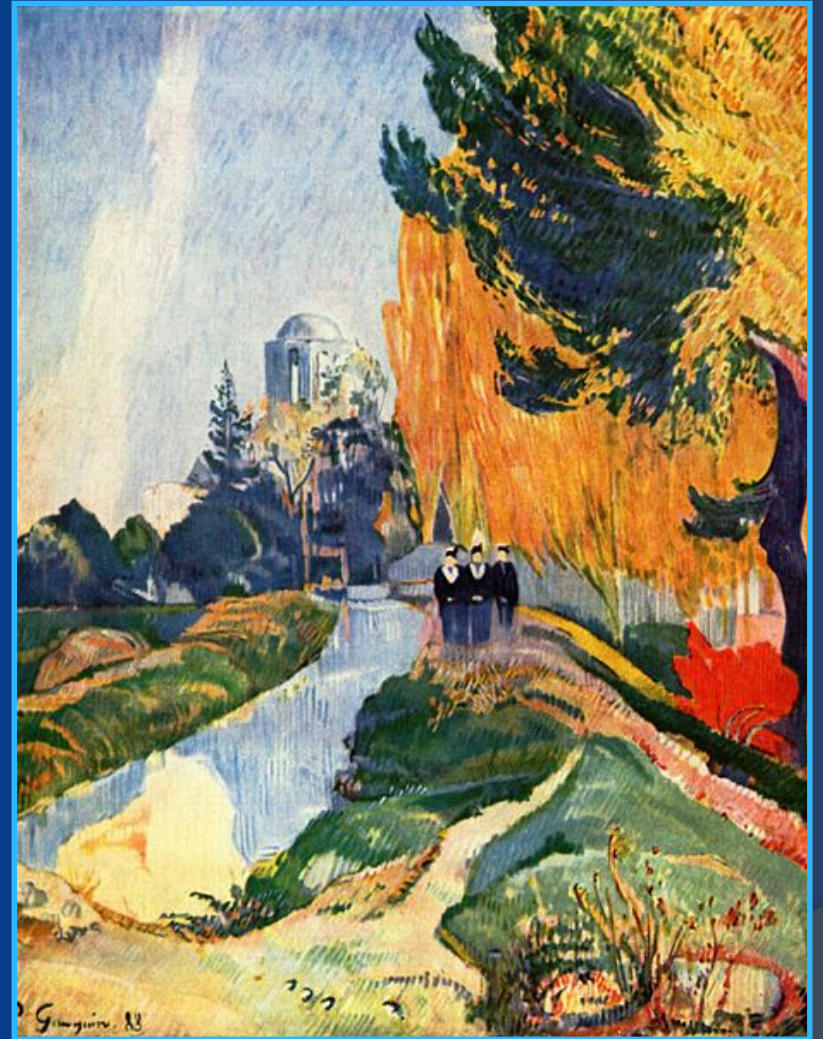
**A balancing act**

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





Van Gogh



Gauguin



Reality: les Alyscamps, Arles, France

**Case 2017-00321**

**Duke Energy**

**Kentucky**

## ◎ Most recent increase – December 2006

(settlement – Attorney General, Kroger,  
St. Elizabeth Hospital System)

- *Requested about \$66.5 million annual increase*
- *Received \$49 million annual increase*
- *Average residential base rate bill increased about \$8.61/month (11.8 %)*
- *Duke Kentucky had sought to increase residential bill by \$17.57 (24 %)*
- *Prior rate increase was 14 years earlier*

# What this case is NOT about

- Natural gas 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 2017-00321

Duke KY is seeking to increase annual base revenue by \$48.6 million (15.7 %)

Seeking 9.9-10.7 % rate of return on equity

## Reasons for requested increase

- ⦿ Increased operating costs since 2007
- ⦿ Recover costs related to East Bend purchase
- ⦿ Recover cost of advanced meters
- ⦿ Recover 2008 storm restoration costs
- ⦿ Maintain reasonable rate of return

# Case 2017-00321

## Significant elements:

- ⦿ Forecasted test year
- ⦿ Increase monthly residential charge
- ⦿ Increase per kwh usage charge
- ⦿ Establish environmental surcharge – East Bend compliance costs
  - Operations and maintenance of environmental controls
  - New ash landfill/wastewater systems
  - Closure of old ash pond
  - By law, PSC reviews surcharge every six months
- ⦿ Establish rider to track and recover transmission costs set by the Federal Energy Regulatory Commission (FERC) – would be a dollar-for-dollar pass-through of costs for using transmission systems not owned by Duke Energy Kentucky

# Case 2017-00321

## Significant elements:

- ⦿ Distribution Capital Investment (DCI) rider
  - Proposed as a way to fund investment in distribution integrity and reliability
  - Similar to Advanced Main Replacement Program (AMRP) for natural gas
  - Funded by surcharge
  - Annual PSC review and true-up
  - Would include “targeted undergrounding” for above-ground lines that are subject to frequent weather-related outages
- ⦿ Federal corporate income tax rate adjustments
  - Not in original case, but will be addressed
  - Likely will adjust for current taxes
  - More complex issues such as deferrals will be addressed in separate case



# Case 2017-00321

## Rate impact (as proposed)

- ⦿ Duke KY estimate based on average monthly residential use of 1,000 kilowatt-hours (kWh)
- ⦿ Monthly charge: \$4.50 → \$11.22
- ⦿ Charge per kWh: 7.546 ¢ → 8.308¢
- ⦿ Total (not including surcharges/riders) :  
\$79.96 → \$94.30 ( + \$14.34 or 17.9 %)

# Case 2017-00321

## Intervenors:

- ⦿ Kentucky Attorney General – Office of Rate Intervention
- ⦿ Kentucky School Boards Association
- ⦿ Kentucky Industrial Utility Customers
- ⦿ Kroger Co.
- ⦿ Northern Kentucky University

# Case 2017-00321

## What has happened so far:

- ⦿ September 15, 2017 – Duke Energy Kentucky's application for rate adjustment is accepted for filing
- ⦿ September 27, 2017 – PSC suspended proposed rates through April 14, 2018
- ⦿ PSC has ruled on all intervention requests
- ⦿ Public meeting

# Case 2017-00179

## What's next:

- ⦿ Formal evidentiary hearing
  - March 6, 7 & 8 – 9 a.m. EST
  - PSC offices – 211 Sower Blvd., Frankfort
- ⦿ Open to public
- ⦿ Streamed live at [psc.ky.gov](http://psc.ky.gov)
- ⦿ Suspension period ends April 14, 2018
- ⦿ PSC must issue decision by July 13, 2018

# Public Comments

## Public Comments

E-mail to [psc.info@ky.gov](mailto:psc.info@ky.gov)

Put the case number (2017-00321) 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:

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