



KENTUCKY PUBLIC  
SERVICE COMMISSION

# UTILITY RATEMAKING: The Kentucky PSC Process

Duke Energy Kentucky – Case 2018-00261  
Northern Kentucky Water District – Case 2018-00291

**January 2019**

**Kentucky Public Service Commission**



# Meeting agenda

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

- Commodity cost of natural gas – dollar-for-dollar pass-through
- Purchased water costs – reflected in volumetric rate, but passed through dollar-for-dollar
- 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
  - 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
- Transportation-only service (for large-volume gas customers)

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



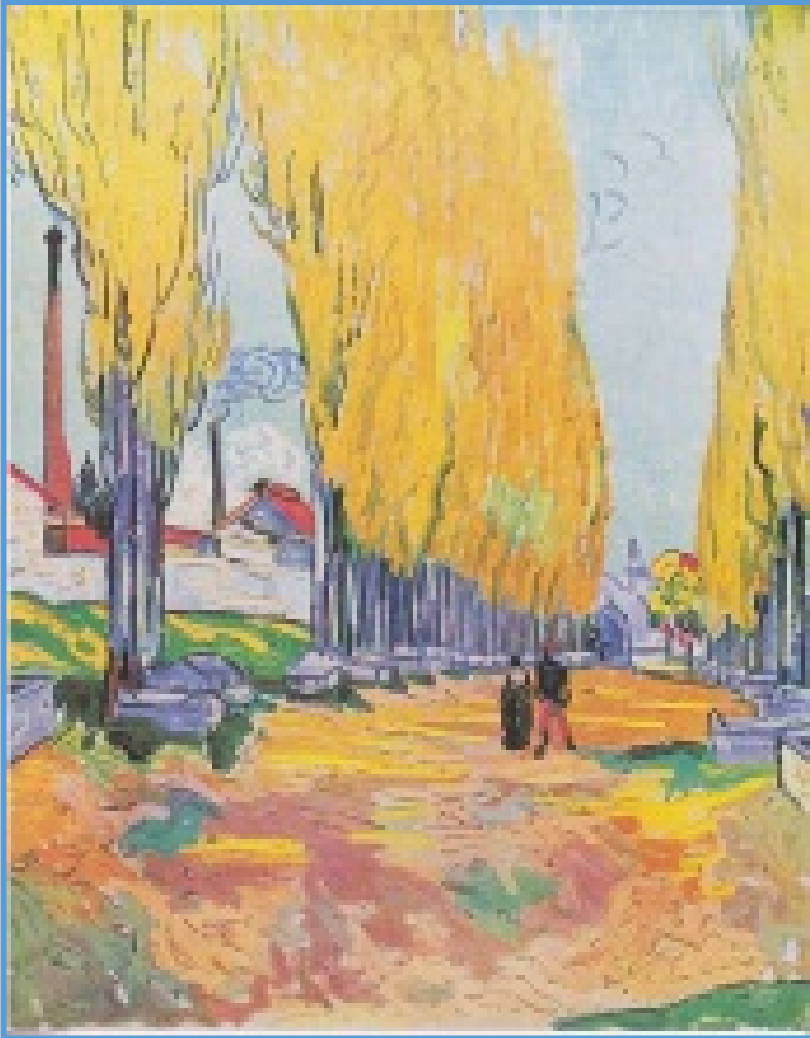


# RATEMAKING IS ALSO ABOUT PERSPECTIVE

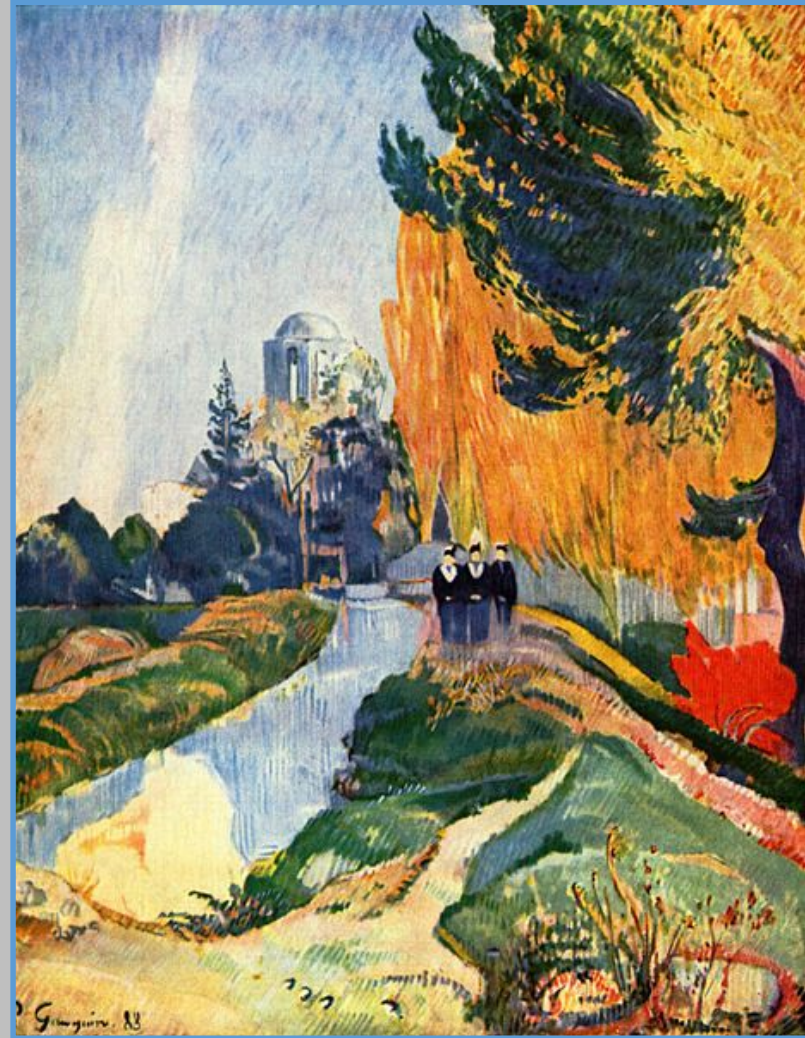
- Low rates vs. adequate service
- Low rates vs. financial stability
- Low rates vs. shareholder return
  - Small vs. large customers



# KENTUCKY PUBLIC SERVICE COMMISSION



Van Gogh



Gauguin



# KENTUCKY PUBLIC SERVICE COMMISSION



Reality: les Alyscamps, Arles, France





**Case 2018-00261**

**Duke Energy Kentucky**



## Most recent increase – December 2009 (effective January 2010) (settlement – Attorney General)

- *Requested about \$17.5 million annual increase*
- *Received \$13 million annual increase*
- *Average residential base rate bill increased about \$11.35/month*
- *Duke Kentucky had sought to increase residential bill by \$13.30*
- *Monthly charge rose to \$16 from \$12 (Duke had requested \$30)*
- *Delivery charge from \$2.67 to \$3.72 per 1,000 cubic feet (Duke proposed \$2)*
- *Prior rate increase was in 2005*



## What this case is NOT about

- Electric rates
- The commodity cost of natural gas
- 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 2018-00261

Duke KY is seeking to increase annual base revenue by \$10.5 million (10 %)

Seeking 7.18 % rate of return on equity

### Reasons for requested increase

- ⦿ Eroding rate of return – currently 4.66%
- ⦿ Increased operating costs
- ⦿ Declining per-customer consumption



## Case 2018-00261

### Significant elements:

- Forecasted test year
- Increase monthly residential charge
- Increase in delivery charge per 1,000 cubic feet (mcf)
- Reduction of revenue requirement to reflect federal corporate income tax reduction
- Weather normalization adjustment
- Completion of service line replacement program – discontinuation of surcharge





## Case 2018-00261

### Rate impact (as proposed)

- ❖ Duke KY estimate based on average monthly residential use of 5,300 cubic feet (5.3 mcf)
- ❖ Monthly charge: \$16.00 → \$17.50
- ❖ Delivery charge per mcf: \$3.72 → \$4.87
- ❖ Total (not including surcharges/riders) : \$35.72 → \$ 43.31 +\$7.59
- ❖ Offset in part by end of service line replacement surcharge  
\$ 7.59 - \$1.80 = \$5.79 (at time of application)  
\$ 7.59 - \$3.22 = \$4.37 (current)



# Case 2018-00261

## Intervenors:

- ❖ Kentucky Attorney General – Office of Rate Intervention



## Case 2018-00261

### What has happened so far:

- ◎ August 31, 2018 – Duke Energy Kentucky’s application for rate adjustment is filed; accepted as filed
- ◎ September 17, 2018 – PSC suspends proposed rates through March 31, 2019
- ◎ PSC has ruled on all intervention requests
- ◎ Four rounds of written discovery



## Case 2018-00261

### What's next:

- Formal evidentiary hearing
  - February 5, 6, & 7 – 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 March 31, 2019
- PSC must issue decision by June 28, 2019



**Case 2018-00291**

**Northern Kentucky  
Water District**



## Most recent increase – January 2016

- Requested and received \$4.8 million annual increase
- Phased in - two equal increments – January 2016 and January 2017
- Average residential bill increased about \$4.16/month in total
- Both monthly charge and volumetric rates increased
- Prior rate increase was in 2012



## Case 2018-00291

NKWD is seeking to increase annual base revenue by \$6.2 million (11.6 %)

### Reasons for requested increase

- ⦿ Debt service on capital improvement projects
- ⦿ Distribution system infrastructure rehabilitation projects
- ⦿ Increased operating costs



# Case 2018-00291

## Significant elements:

- Historic test year
- Two equal phases – April 2019 and April 2020
- Increase in monthly residential charge
- Increase in water usage charge





## Case 2018-00291

# Rate impact (as proposed)

- ❖ Estimate based on average monthly residential use of 700 cubic feet (about 5,200 gallons)
- ❖ Monthly charge: \$16.40 → \$17.50 → \$18.50
- ❖ Water usage charge per 100 cf: \$4.53 → \$4.65 → \$4.77
- ❖ Total (for 700 cf) : \$48.11 → \$ 50.05 → \$51.89 +\$3.78 (+7.8%)



## Case 2018-00291

### What has happened so far:

- ⦿ September 28, 2018 – NKWD files application; PSC on October 5 notes deficiencies and rejects application
- ⦿ October 11, 2018 – PSC issues order accepting application after deficiencies corrected
- ⦿ September 17, 2018 – PSC suspends proposed rates through April 9, 2019
- ⦿ No intervention requested
- ⦿ Discovery ongoing



## Case 2018-00291

### What's next:

- Formal evidentiary hearing
  - February 27 – 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 9, 2019
- PSC must issue decision by August 9, 2019



# Public Comments

## Public Comments

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



# KENTUCKY PUBLIC SERVICE COMMISSION

## Contact information:

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***Thank you***

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***Questions?***



# KENTUCKY PUBLIC SERVICE COMMISSION

## Gas base rates for investor-owned utilities in Kentucky

Utility	Monthly charge	per mcf delivery charge	5.3 mcf/mo total – base rate
Duke (current)	\$16	\$3.72	\$35.72
Duke (proposed)	\$17.50	\$4.87	\$43.31
Atmos Energy	\$17.50	\$1.72	\$26.62
Columbia Gas	\$16	\$3.57	\$34.92
Delta Gas	\$20.90	\$4.31	\$43.74
LG&E	\$16.35	\$3.63	\$35.59



# KENTUCKY PUBLIC SERVICE COMMISSION

Last Duke Energy Kentucky rate increase – December 2009

Rate of inflation – December 2009 to December 2018 – 16.34 %  
(\$100 then had same buying power as \$116.34 now)

*Source: US Bureau of Labor Statistics Consumer Price Index*





# KENTUCKY PUBLIC SERVICE COMMISSION

Last Northern Kentucky Water District rate increase – January 2016

Rate of inflation – January 2016 to December 2018 – 6.04 %  
(\$100 then had same buying power as \$106.04 now)

*Source: US Bureau of Labor Statistics Consumer Price Index*