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January 4, 2022

PSC STAFF OPINION 2022-001

Hon. David S. Samford
Goss Samford, PLLC
david@gosssamfordlaw.com

Re: Request for a Staff Opinion – Regarding Ability to Use a Regulatory Asset

Dear Mr. Samford:

Commission Staff acknowledges receipt on December 22, 2021, of your letter in which you request an opinion on behalf of East Kentucky Power Cooperative, Inc. (EKPC) regarding whether EKPC may use a regulatory asset to account for deferred recovery of extraordinary and non-recurring Fuel Adjustment Clause (FAC) expenses.

Your letter presents the following facts: four of EKPC's units (Spurlock 2 (510 MWs), Spurlock 4 (268 MWs), Cooper 1 (116 MWs) and Cooper 2 (225 MWs)) were taken offline during the fall of 2021 for planned and necessary maintenance; EKPC, during the maintenance outages, procured replacement power through PJM Interconnection, LLC (PJM); PJM's energy market during this period of time was unusually volatile and energy prices were generally higher (although EKPC maintains these would be economic energy purchases); and the energy purchases totaled $16.78 million in incremental replacement costs during the FAC's November expense month, which translate into a charge of $17.60 per MWh for recovery through the FAC in January 2022. You state that several of EKPC's Owner-Members have expressed concern that the November expense month, when applied to January bills, will have an adverse effect on their customers. You state that EKPC is willing to defer recovery of the unusually high FAC expense, however EKPC understands that the Commission would need to authorize the establishment of a regulatory asset to be able to defer the charges.

You note that under the FAC, power purchased due to a scheduled outage is eligible for recovery pursuant to 807 KAR 5:056, Section 1(3). You state that, "EKPC understands that it is not possible to absorb a portion of its November 2021 fuel expense through margins. Indeed, the Commission has characterized the FAC as a rigid process for accounting for and reporting fuel costs . . ."

However, you state that, "[w]hile prior Commission Orders speak to the rigidity of the process for accounting for and reporting fuel expenses, 807 KAR 5:056 appears to leave open the door for delayed recovery of FAC expenses." You note that the Commission, during the 2014 Polar Vortex, allowed EKPC to delay recovery of FAC expenses by deferring and spreading the costs out over several months. You state that, "unlike with the Polar Vortex, the costs in this situation will be incurred in one calendar year and recovered on a deferred basis in a separate calendar year. Accordingly, EKPC understands that a regulatory asset would be necessary to assure that the deferral is properly accounted for and amortized."

You cite to a Commission order in which the Commission identified the four circumstances in which the Commission authorizes regulatory assets. The relevant portion of the order provides:

> The authority for establishing regulatory assets arises under the Commission's plenary authority to regulate utilities under KRS 278.040 and the Commission's authority to establish a system of accounts under KRS 278.220. Historically, the Commission has exercised its discretion to approve regulatory assets where a utility has incurred: (1) an extraordinary, nonrecurring expense which could not have 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.[1]

You state that EKPC is aware that the Commission recently rejected a similar request[2] from Duke Energy Kentucky, Inc. (Duke Kentucky) to establish a regulatory asset to defer costs of power purchases, and that EKPC "reluctantly" accepts the Commission's decision with regard to Duke Kentucky. However, you state that EKPC is seeking guidance from Commission Staff about whether the four factors in Case No. 2008-00436 are the exclusive factors the Commission will consider in establishing a regulatory asset. You point to another portion of the order in Case No. 2008-00436 in which the Commission stated that:

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[1] Case No. 2008-00436, *The 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 4.

[2] Case No. 2021-00459, *Electronic Application of Duke Energy Kentucky, Inc. for Proposed Accounting and Fuel Adjustment Clause Treatment and for Declaratory Ruling* (Ky. PSC Dec 17, 2021).

> However, in exercising discretion to allow the creation of a regulatory asset, the Commission's overarching consideration is the context in which the regulatory asset is sought to be established and not necessarily the specific nature of the costs incurred.[3]

You state that EKPC can afford to defer recovery of the purchased power only if the Commission authorizes a regulatory asset. You also state that EKPC will gain nothing from deferring the power purchase expenses, and would be better suited to recover the expenses in the January 2022 billing period. You state that it would be beneficial to the retail customers of EKPC's Member-Owners if EKPC could defer the power purchase expenses, especially because EKPC forecasts lower power costs in the remaining heating months of 2022.

You request an advisory opinion from Commission Staff as to whether Commission precedent precludes the establishment of an FAC-specific regulatory asset that will benefit ratepayers and not harm the utility. You present the request as, "whether a fifth category of regulatory asset – one which benefits customers by smoothing out volatility in extraordinarily high FAC expenses – would be permissible under Commission precedent."

EKPC, by requesting that Commission Staff consider a "fifth category" of regulatory asset, appears to concede that the power purchase expenses do not meet any of the other four categories of a regulatory asset put forth in Case No. 2008-00436. Commission Staff agrees that the purchase power expenses do not meet any of the four categories for a regulatory asset.

Commission Staff, however, cannot opine as to the whether the Commission would approve a "fifth category" of regulatory asset, as that request goes beyond interpretation of an existing Commission order, regulation, or statute and its application to the facts you have presented. Only the Commission, through a written order, could create or modify the categories for regulatory assets.

Commission Staff notes that when EKPC deferred recovery of power purchases due to the Polar Vortex, no regulatory asset was approved and the deferral was in a response to a once-in-a-century weather phenomenon. To the extent that the Commission has addressed a FAC-specific regulatory asset, Commission Staff points you to the Commission's recent decision in Case 2021-00459 in which the Commission denied Duke Kentucky's request, which is similar to EKPC's request. In Case No. 2021-00459 the Commission also informed Duke Kentucky that, although no

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[3] Case No. 2008-00436, *The 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 5.

regulatory asset would be approved, Duke Kentucky could still spread out recovery of the power purchases over subsequent months through the FAC.

Commission Staff also notes that the primary purpose of regulatory accounting is not to smooth out peaks in expenses, while that could be one of the benefits. The Commission has rejected requests for regulatory assets that did not meet any of the four categories for establishment of a regulatory asset and were proposed to prevent financial statement volatility and smooth out peaks in expenses.[4] Given that EKPC's purpose in deferring the FAC charges is "smoothing out volatility in extraordinarily high FAC expenses," and does not otherwise meet the criteria for a regulatory asset, such a request is not proper for a regulatory asset.

This letter represents Commission Staff's interpretation of the law as applied to the facts presented. This opinion is advisory in nature and not binding on the Commission should the issues herein be formally presented for Commission resolution. Questions concerning this opinion should be directed to me at (502) 782-2587 or jeb.pinney@ky.gov.

Sincerely,

J.E.B. Pinney

J.E.B. Pinney
Executive Advisor

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[4] See, Case No. 2019-00146, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment Of Regulatory Assets for Present and Future Maintenance Expenses* (Ky. PSC Dec 20, 2019).