

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE)	ADMINISTRATIVE
FUEL ADJUSTMENT CLAUSE)	CASE NO. 309
REGULATION 807 KAR 5:056)	

O R D E R

On August 25, 1977, the Public Service Commission initiated proceedings in Case No. 6877, The Examination of the Fuel Adjustment Tariff Provisions of Kentucky Power Company, East Kentucky Power Cooperative, Inc., Louisville Gas and Electric Company, Kentucky Utilities Company, Big Rivers Electric Corporation and Union Light, Heat and Power Company, to examine the fuel adjustment tariff clauses being used by electric generating utilities in Kentucky. The stated purpose of the case was to determine whether or not any modification of such clauses was warranted, or whether fuel adjustment clauses should be eliminated entirely. The result was the standardized Fuel Adjustment Clause regulation, 807 KAR 5:056 effective June 7, 1978. After 8 years experience with this fuel adjustment clause and considering changing economic conditions, the Commission has determined that an examination of the standardized fuel adjustment clause should be conducted. The purpose of this proceeding is to determine whether, due to changing circumstances, the fuel adjustment clause should be modified or eliminated and to develop a proposed regulation if changes are needed.

Fuel adjustment clauses have been in tariffs filed with the Commission since the 1950's. With rapidly rising coal prices in the 1970's, these clauses attracted a great deal of attention. In 1976 the five generating electric utilities under the Commission's jurisdiction collected approximately \$115 million through the application of their fuel adjustment clauses, almost 20 percent of their total revenue.¹ Concern about rapidly increasing fuel prices and the operation of fuel adjustment clauses led to the establishment of Case No. 6877. As a result of that case, previously heterogeneous clauses were replaced by a standard fuel adjustment clause. This clause was intended to meet the major objectives of the Commission's review at that time: first, to bring fuel charges under appropriate Commission regulatory processes; second, to standardize the fuel clause for all jurisdictional electric utilities; third, to insert fuel charges into base rates on a systematic basis; fourth, to introduce incentives for management to hold down fuel costs; and fifth, to represent a responsible, workable regulatory procedure for handling fuel clause matters in Kentucky.² An important issue in the current case is whether these objectives have been met. Another issue is whether other objectives and standards should be adopted.

¹ Soder, "Fuel Adjustment Clause: Kentucky Electric Utilities," Case No. 6877, September 20, 1977, page 1.

² Case No. 6877, Order dated December 15, 1977, pages 14-15.

Fuel expenses are the largest single cost for electric utilities in Kentucky, approximately one-half of total operating expenses. Establishing the appropriate framework for regulating rates that result from fuel expenses is crucial to electric utility regulation. The regulatory framework for fuel expenses should (1) provide incentives for efficient management of fuel procurement and power-plant performance, (2) provide information that permits the Commission to adequately monitor fuel costs to protect ratepayers, (3) be consistent for all jurisdictional utilities, (4) be fair in billing costs to the cost-causer, (5) be administratively workable and efficient, and (6) provide for fair regulation of both distribution and generation utilities. The primary purpose for including a fuel adjustment clause in the regulatory framework is to provide a procedure whereby in times of rapid changes in the price of fuel, a utility's rates can be adjusted more quickly than would be possible through a protracted rate-making proceeding. This protects utility shareholders from the risk of fuel price increases by allocating the risk of price increases to ratepayers. Fuel adjustment clauses have a number of advantages and disadvantages. They may reduce incentives for efficient management of fuel procurement and use. They may also promote ratepayer participation in fuel price decreases, reduce regulatory expenses and reduce utility cost of capital due to the lower investor risk. The decision to adopt a fuel adjustment clause depends in part on the extent of control or influence that utilities have over fuel costs, the percentage of fuel costs to total utility operating costs, and the variability of fuel prices.

The rapid fuel price increases of the 1970's were central to the reasoning supporting the adoption of the current fuel adjustment clause. This case will review the fuel adjustment clause under current conditions.

In initiating this investigation, the Commission is seeking comments from all interested parties. To aid in the determination of specific alternatives and areas of concerns within the general issues of this case, the Commission finds that all jurisdictional electric utilities and other interested persons should file comments on the following questions within 60 days of the date of this Order. Electric utilities that do not operate generating facilities need only answer questions 2(B) and 5.

1. Incentives included in the current fuel adjustment clause include:

- Lags in recovery due to use of historical data and 10-day prefiling.
- Limitation on recovery of fuel expense due to forced outages.
- Limitation on recovery of energy purchases expense (exclusive of capacity or demand charge).
- Limitation on recovery of fuel-related expenses not includable (for example, excise taxes, brokerage commissions, fuel unloading and hauling expenses).

How effective has each of these incentives been in promoting efficient fuels management? How could the fuel adjustment clause be modified to improve these incentives?

2. How would elimination of the fuel adjustment clause with no other change in Commission regulations, affect incentives for efficient management of the following?

(A) For Generating Utilities:

(1) fuel procurement

(a) fuel requirements planning

(b) fuel source selection practices

(c) mix of long-term contracts, short-term
contracts and spot-market purchases

(d) contract negotiations

(e) enforcement of contract terms and conditions

(2) generation

(a) heat rate efficiency

(b) power plant availability

(c) economic dispatch

(3) economy purchases of energy

(4) other energy purchases

(5) earnings stability of the utility

(6) flow of information necessary for the public and
for commission oversight

(B) For distribution utilities:

(1) energy purchases

(2) earnings stability of the utility

(3) flow of information necessary for the public and
for Commission oversight

3. How would elimination/modification of the fuel adjustment clause affect regulatory costs and benefits for the Commission, utilities and intervenors?

4. Does the current fuel adjustment clause provide the Commission with adequate information for the necessary regulatory review of fuels expenses? What changes would improve the quality or availability of information?

5. If the fuel adjustment clause were eliminated, what changes in Commission regulations and practices would be necessary to provide the Commission with adequate information for the review of fuels expenses?

6. How has the variability of fuels expenses changed during the last 10 years? Generating utilities should provide supporting data based on their own purchases.

7. What changes in the variability and level of fuels expenses do you project for the next 5 years? Include assumptions and factors considered.

8. How would elimination of the fuel adjustment clause affect efficient pricing of electric services, that is, charging costs to cost-causers? How could the fuel adjustment clause be changed to improve efficient pricing of electric services?

9. If the current fuel adjustment clause were eliminated, could a standby fuel adjustment clause be made available for use during periods of rapid fuel price changes? What would be the advantages and disadvantages of a standby fuel adjustment clause? What criteria should be specified as triggering the operation of a standby fuel adjustment clause?

10. Possible reporting and procedural requirements for a fuel adjustment clause include:

- Requiring utilities to document fuels requirements planning, fuel source search and selection practices, and fuel contract negotiations,
- Requiring utilities to certify both the quality and quantity of delivered fuel and the enforcement of fuel contract terms and conditions,
- Comparing utility fuel costs to area averages,
- Monitoring economic dispatching practices,
- Monitoring power plant maintenance, heat rate efficiency and plant availability,
- Auditing fuel costs and practices,
- Performing management audits of fuel procurement, fuel handling, and power plant performance, and
- Holding periodic, formal evidentiary hearings on the fuel adjustment clause.

What would be the advantages and disadvantages of each of these requirements? If the fuel adjustment clause is eliminated, should the Commission impose any of these reporting and procedural requirements outside of the rate case setting?

11. Incentives that could be included in a fuel adjustment clause (in addition to those in question 1) include:

- Partial pass-through of differences between actual fuel costs and fuel costs included in base rates,
- Exclusion of all line losses,

-Use of a fixed heat-rate, and

-Use of power plant availability incentives.

(A) What would be advantages and disadvantages of including each of these in a modified fuel adjustment clause?

(B) What other incentives could be built into a fuel adjustment clause? What would be advantages and disadvantages of including these incentives?

12. One criticism of fuel adjustment clauses is that they may distort the input mix, encouraging utilities to substitute fuel for labor or capital. This has implications for efficient use of resources, as well as conservation. To what extent has the current FAC biased utility decisions in favor of using more fuel? How would elimination or modification of the fuel adjustment clause change this?

IT IS THEREFORE ORDERED that:

(1) An investigation of the fuel adjustment clause be and is hereby instituted. All electric utilities shall be parties to this proceeding. Other interested parties may intervene and participate; however, intervention is not required to file comments.

(2) The Commission shall publish notice of the hearing in this proceeding in the following newspapers: The Courier-Journal and Louisville Times, Lexington Herald-Leader, The Independent (Ashland), Kentucky Post, Paducah Sun and Messenger-Inquirer (Owensboro). Each electric utility shall publish a one-time

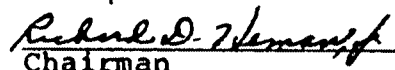
notice of the hearing in a newspaper of general circulation in its service area. The notice shall be in substantially the same form and content as set out in attached Appendix A.

(3) All electric utilities shall comply with the requirements of this Order. An original and 10 copies of written responses shall be filed within 60 days of the date of this Order. Each party shall make copies of its comments available on request.

(4) Hearings shall be held in the Commission's offices in Frankfort, Kentucky, beginning at 9:00 a.m., Eastern Standard Time, December 10, 1986, for the purpose of receiving comments and cross-examination from all parties and other interested persons. Parties with similar interests may consider combining comments and representation.

Done at Frankfort, Kentucky, this 3rd day of September, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

--- NOTICE ---

The Kentucky Public Service Commission is reviewing the fuel adjustment clause now being used by electric generating utilities in Kentucky. In this review, the Commission will determine if changing circumstances merit modifying or eliminating the fuel adjustment clause. To receive comments from interested parties, the Commission will hold a public hearing on December 10, 1986, beginning at 9:00 a.m., Eastern Standard Time, at the Commission's office, 730 Schenkel Lane, Frankfort, Kentucky.