COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC INVESTIGATION OF THE FUEL ADJUSTMENT CLAUSE REGULATION 807 KAR 5:056, PURCHASED POWER COSTS, AND RELATED COST RECOVERY MECHANISMS	**)** **)** **)** **)**	**CASE NO. 2022-00190**

COMMENTS ON BEHALF OF EAST KENTUCKY POWER COOPERATIVE INC. AND ITS SIXTEEN OWNER-MEMBERS

Pursuant to the Kentucky Public Service Commission's ("Commission") November 2, 2022 Order ("Order") East Kentucky Power Cooperative, Inc. ("EKPC") submits the following comments on behalf of EKPC and its sixteen owner-members distribution cooperatives.

EKPC appreciates the Kentucky Public Service Commission ("Commission") opening up an administrative case to address one of the issues raised in Senate Resolution 316 from the 2022 Regular Session of the Kentucky General Assembly. The purchase of fuels and wholesale power is generally the single greatest expense for a utility and the Fuel Adjustment Clause ("FAC") regulation (807 KAR 5:056) therefore plays a pivotal role in assuring that utilities are able to provide service to customers at fair, just and reasonable rates. The issues raised in the Commission's November 2, 2022 Order are weighty and cannot be reasonably or practically resolved through the simple filing of comments and replies over a forty-five (45) day period. The critical nature of some issues will likely take months to fully review, analyze, and contextualize.

Fortunately, the solutions offered by EKPC herein are accomplishable by the Commission without resort to any formal legislative action. EKPC respectfully requests the Commission to authorize deferral authority for jurisdictional utilities as a means to combat anticipated volatility in the fuel market during the upcoming winter heating season and to authorize the recovery of reasonable financial natural gas hedging expenses for future winter heating seasons.[1] Both of these actions will help reduce volatility within the FAC context.

In structuring its comments, EKPC and its sixteen owner-member distribution cooperatives will provide general comments on the Commission's Order; propose and support Commission action on the two adjustments mentioned above; and provide detailed responses to each of the specific questions posed in the Order. EKPC desires to be a constructive contributor to assuring that the FAC continues to provide stability for utilities and consumers alike, while also remaining consistent with the evolving nature of fuel and energy markets. Though EKPC believes its comments offered herein are a good starting point for this discussion, due to the complexity and importance of the FAC, it and its owner-members reserve the right to amend these comments, make further comments and to participate in this case to the maximum permitted extent.

GENERAL COMMENTS ON THE NOVEMBER 2, 2022 ORDER

Changes in Circumstances – Creation of Wholesale Power Markets – Issues to Consider

"Membership in an RTO has also presented some issues in the functioning and review of a utility's FAC and what costs may be recovered. For example, members of PJM either receive revenue for or must pay for multiple services, some of which may be recovered through the FAC, while other utilities may not. Due to PJM's billing system, a utility may not know the final costs of these services for several months, which may not be within the review period prescribed by 807 KAR 5:056, Section 3(3). This inhibits the Commission's review of the fuel-related costs during that

[1] In conjunction with its owner-members, EKPC is also studying a third proposal to adjust the FAC regulation to all for a twelve (12) month averaging of costs. This concept is still being studied and is not formally proposed for adoption at this time. However, it is discussed below at a conceptual level and EKPC reserves the right to make a formal proposal subsequently in this proceeding or thereafter.

review period. There is also debate regarding what other RTO-related service costs a utility may recover through its FAC, or from customers, or at all. Finally, the Commission seeks comments regarding similar FAC mechanisms employed by other jurisdictions that may better serve the Commonwealth, or which mechanisms or characteristics of mechanisms to which commenters would be opposed."

Concerning these "Issues to Consider":

- Members of PJM either receive revenue for or must pay for multiple services, some of which may be recovered through the FAC, while other utilities may not. EKPC notes that footnote 15 that accompanied this observation referenced a 2-year FAC review case for EKPC where extensive testimony was provided and EKPC responded to the Commission's examination of the issue of RTO billing codes and the appropriateness of their inclusion in the FAC calculation for those utilities that are RTO members. Ordering Paragraphs 3 and 4 of the Commission's August 11, 2015 Order in Case No. 2014-00451 stated:

> The PJM Billing Codes included by East Kentucky in its FAC calculation are approved as modified herein, subject to the limitation of power purchase recovery to East Kentucky's highest-cost generation unit available to be dispatched during the expense month. East Kentucky shall make no change to the PJM Billing Codes included in the calculation of its FAC without Commission authorization.[2]

EKPC has consistently followed the Commission's decision concerning the PJM billing codes that are included in its FAC calculation. Each utility that is a member of an RTO has been required to demonstrate to the Commission's satisfaction that the costs for certain RTO-related services are reasonable to include in the FAC calculations. The fact that the listings of the applicable billing codes may be different reflects the decision by the utility of whether to

[2] *In the Matter of An Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 2012 through October 31, 2014*, Case No. 2014-00451, p. 11 (Ky. P.S.C., Aug. 11, 2015).

recover the billing code through base rates or the FAC and not a systemic failure to consider which cost codes are eligible for FAC recovery.

- Due to PJM's billing system, a utility may not know the final costs of these services for several months, which may not be within the review period prescribed by 807 KAR 5:056, Section 3(3). This inhibits the Commission's review of the fuel-related costs during that review period. EKPC respectfully disagrees with this conclusion, especially the contention that adjustments to PJM billing codes occurring in a different time period inhibits the Commission's review. Adjustments to the PJM billing codes are applicable in the time period the adjustment is posted, not the period of the original transaction. As the adjustment is posted in a current period, the Commission has the opportunity to review that adjustment transaction within the review period prescribed in 807 KAR 5:056, Section 3(3). As always, EKPC is ready to meet its burden of proof and provide all details concerning any adjustment to a PJM billing code that was included in EKPC's FAC expenses.
- There is also debate regarding what other RTO-related service costs a utility may recover through its FAC, or from customers, or at all. EKPC notes that this statement references footnote 16, which referenced FAC review cases for Duke Energy Kentucky ("Duke") and Kentucky Power Company ("Kentucky Power"). Both cases reference a default in the PJM Financial Transmission Rights auction market by GreenHat Energy, LLC. Due to the size of the impact from the default, PJM began a liquidation protocol allocating costs associated with the default to its stakeholders. It was determined that Duke had been including these charges in its FAC calculations. Kentucky Power had not included the charges, but argued that its FAC tariff allowed for the charges to be passed through its monthly FAC rate

because it falls under a fuel-related cost and because the phrase "including but not limited to" is included in the tariff and it was related to allowable PJM billing codes. In both cases, the Commission found that the PJM billing code used to allocate the liquidation costs was not previously approved for recovery under the FAC tariffs for either Duke or Kentucky Power. Duke was ordered to refund to the customer the costs it had included in its FAC calculations and Kentucky Power was directed to not include the costs in its FAC calculations. Neither utility appealed the decision. EKPC was subject to the same liquidation protocol. When questioned during its FAC review case EKPC stated that it did not plan on passing these costs through its monthly FAC rate filing, as the PJM billing code for the default was not one of the billing codes approved for pass through of the FAC by the Commission.[3] Thus, there does not really appear to be any debate on the subject of the recovery of RTO-related service costs. It is clear that the recovery of costs contained in certain PJM billing codes through the FAC must be previously approved by the Commission. This limitation is well understood and, to the extent a question arises in the future, the ability for any affected party to request either a staff advisory opinion or file an application for a declaratory ruling (807 KAR 5:001, Section 19) already affords an appropriate mechanism for resolving a dispute.

- Finally, the Commission seeks comments regarding similar FAC mechanisms employed by other jurisdictions that may better serve the Commonwealth, or which mechanisms or characteristics of mechanisms to which commenters would be opposed. EKPC has not reviewed or examined other FAC mechanisms approved in other jurisdictions and cannot

[3] *See In the Matter of Electronic Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 2016 through October 31, 2018*, Case No. 2019-00003, p. 3-4 (Ky. P.S.C., Dec. 26, 2019).

comment on the reasonableness of those mechanisms for utilities in the Commonwealth. EKPC would only suggest that if the Commission considers adopting provisions of other jurisdictions' FAC mechanisms that it carefully study those mechanisms before proposing them for adoption in Kentucky.

Changes in Circumstances – Incurrence and Recovery of Wholesale Power Costs – Issues to Consider. "*If a generator is essentially guaranteed to recover the costs related to non-economy purchases or forced outages, it raises the question of whether utilities will pursue the lowest cost and most efficient fuel procurement, or whether they will employ reasonable operational and maintenance practices. If a generator can recover these costs across different areas such as base rates and riders regardless of their reasonable actions, these recovery mechanisms could create a perverse incentive for a utility to not pursue prudent activities. A generator may postpone maintenance (and its related expense) on a generating unit if recovery of the cost of replacement power is guaranteed. A generator cannot immediately recover incremental operations and maintenance expense but can recover the costs of replacement power. If a utility can automatically recover through base rates non-economy purchases, there may be little incentive to make economic purchases.*

Traditionally, the burden of proof for charges recovered through the FAC lies with the utility . . . Because non-FAC expenses appear to largely evade Commission review, it raises the question of whether non-FAC expenses that are traditionally excluded from the FAC should be reviewed for reasonableness in FAC review proceedings before they could be recovered through base rates or tariff riders because, pursuant to KRS 278.190(3), the burden of proof to prove the reasonableness of those charges lies with the utility. Contemporaneous and consolidated review of these costs could make it more efficient for the Commission to review such expenses, ensuring that such review is not overlooked. Therefore, in addition to review of the FAC regulation, the Commission could also review electric utilities' riders and other costs recovery mechanisms in their tariffs that are designed to recover costs related to fuel and power purchases outside of the utility's FAC. Electric utilities would then be required to identify and explain the provisions in their tariffs that allow the recovery of fuel costs, purchased power costs, and related expenses that occur outside of the FAC. The Commission would look for information and evidence from interested stakeholders on this proposal.

In addition to review of non-FAC expenses, the Commission questions the working expectation that FAC charges are presumed reasonable absent evidence to the contrary in the record. Under KRS 278.190(3), the burden of proof falls upon the utility to prove the reasonableness of any proposed rate, and the Commission wonders why the same burden should not apply to FAC charges. The presumption that FAC charges are reasonable removes the burden of proof off the utility and places the onerous burden upon the Commission and its resources in reviewing FAC charges, reviewing thousands of pages of information every six months, and without any information or evidence on the operation or status of relevant generation units. The Commission will seek comment on whether utilities should be required to file additional evidence relating to the reasonableness of their FAC charges and purchased power expense. This evidence could include, but not be limited to, economic dispatch practices; RTO bidding practices and decisions; power plant maintenance; and comparing fuel and power purchase costs to area averages".

Concerning these "Issues to Consider":

- If a generator is essentially guaranteed to recover the costs related to non-economy purchases or forced outages, it raises the question of whether utilities will pursue the lowest cost and most efficient fuel procurement, or whether they will employ reasonable operational and maintenance practices. EKPC respectfully disagrees with the premise that generators are "essentially guaranteed to recover the costs related to non-economy purchases or forced outages." Rather, EKPC has perceived the Commission's traditional and long-standing approach to these costs to be in line with the quote from Case No. 2000-00496-B, that such expenses, if reasonably incurred, would be eligible for recovery through base rates.[4] The Commission's oft-repeated direction to seek recovery of non-FAC expenses through base rates is far from a "guarantee" of cost recovery. Further, EKPC has an obligation to its owner-members to pursue the lowest cost and most efficient fuel procurement and employ reasonable operational and maintenance practices. The possible cost recovery of non-economy purchases or forced outages is not a factor in EKPC's decision making when pursuing those obligations.
- Contemporaneous and consolidated review of these [non-FAC] costs could make it more efficient for the Commission to review such expenses, ensuring that such review is not overlooked. Therefore, in addition to review of the FAC regulation, the Commission could also review electric utilities' riders and other cost recovery mechanisms in their tariffs that are designed to recover costs related to fuel and power purchases outside of the utility's

[4] *See In the Matter of An Examination of the Application of the Fuel Adjustment Clause for Duke Energy Kentucky, Inc. from November 1, 2013 through April 30, 2014*, Case No. 2014-00229, p. 6 (Ky. P.S.C., Jan. 30, 2015) and *In the Matter of An Examination of the Application of the Fuel Adjustment Clause of Kentucky Power Company from November 1, 2013 through April 30, 2014*, Case No. 2014-00225, p. 2-3 (Ky. P.S.C., Jan. 22, 2015).

FAC. Electric utilities would then be required to identify and explain the provisions in their tariffs that allow the recovery of fuel costs, purchased power costs, and related expenses that occur outside of the FAC. EKPC is concerned that the approach outlined is essentially single issue ratemaking. The Commission can examine a non-FAC expense within the parameters of the proceeding allowing for the possible non-FAC expense recovery. If a rider mechanism is involved, then the Commission's approval of that rider should include its own interim review mechanism. While this could be done simultaneously with an FAC review, it should not be "part of" the FAC review since two different categories of costs are in question. For non-FAC expense embedded in base rates, the Commission gives up the right to have the interim reviews by forcing those costs into base rates. EKPC has not sought or been approved for riders or other cost recovery mechanisms for non-FAC costs. EKPC has followed the Commission's directives to propose an adjustment during its base rate cases to include a provision for non-economy purchases and forced outage costs based on a five-year average of those costs. This approach helps manage the impact these non-FAC costs have on EKPC's margins, and it does not constitute a dollar-for-dollar recovery of those costs. In the 2021 base rate case, EKPC proposed an adjustment for these non-FAC costs of approximately $3.4 million, which represented approximately 0.75% of the total cost of electric service.

- In addition to review of non-FAC expenses, the Commission questions the working expectation that FAC charges are presumed reasonable absent evidence to the contrary in the record. . . . The Commission will seek comment on whether utilities should be required to file additional evidence relating to the reasonableness of their FAC charges and purchased power expense. EKPC respectfully disagrees that there is a working expectation

that FAC charges are presumed reasonable absent evidence to the contrary. The applicant always has the burden of proof to establish the reasonableness of the costs it has submitted for recovery through the FAC mechanism. EKPC believes it has met that burden in past FAC review cases by responding to numerous information requests to the best of its ability. EKPC will continue to satisfy its burden of proof when responding to information requests by the Commission or intervening parties in future cases. However, EKPC strongly disagrees with utilizing comparisons of fuel and power purchase costs to area averages to determine the reasonableness of its costs. The Commission has a long history of not utilizing "benchmarks" and EKPC believes that the Commission has been well served by that approach.

COMMENTS ON PARTICULAR QUESTIONS IN THE NOVEMBER 2, 2022 ORDER

Questions on which comments may be filed:

1. *What changes to the FAC regulation, if any, could reduce the monthly volatility of the FAC?*

EKPC has identified actions that could give utilities more tools to combat volatile fuel costs. EKPC proposes consideration of two measures: (1) opening the FAC regulation to allow for financial hedging of natural gas purchases; and (2) increasing the use of regulatory assets to mitigate rate volatility in general and in the context of the fuel expense in particular. Neither of these actions would impose any additional burden upon regulated utilities, but they would provide jurisdictional electric utilities with enhanced options for responding to volatility in fuel expenses. Likewise, neither of the proposed actions would impose additional costs, personnel expenses or workload on the Commission.

Financial Hedging. Kentucky electric consumers would see less volatility in the FAC portion of their electric bill if electric utilities were permitted to enter into financial

hedges for natural gas purchases. Electric utilities purchase coal and natural gas to fire boilers and turbines to produce electricity for ultimate consumption by retail consumers. The cost of fuel is the single largest expense an electric utility faces.

In the coal context, EKPC and other regulated utilities have policies in place to limit supply risk and price volatility. These hedging strategies assure that the utility has access to coal in the future while also limiting the volatility of coal pricing over a future period. While the details will vary from one utility to another, all Kentucky utilities generally seek to have contracts in place such that most, if not all, of their anticipated coal supply needs are contractually secured a year or more in advance. For future years, utilities add new coal supply contracts so that delivery years closest in time have the most supply secured and delivery years that are farther away have fewer contracts in place. These types of hedges are known as physical hedges because they involve contracts for the physical delivery of coal. The advantage of physically hedging coal supply is that it blends the pricing for coal over a period of several years, thereby minimizing the rate impact of the normal peaks and valleys of the coal market. By hedging coal purchases, price volatility is reduced and utilities and customers alike have greater predictability as to future energy costs. Physical hedging of coal is made possible because coal-fired electric generating units all have coal yards in which to stockpile coal for future consumption.

Natural gas is different. Natural gas used to generate electricity is generally delivered directly from an interstate pipeline at the time it is to be consumed. As a result, utilities must either purchase natural gas on a firm basis (similar to how coal is purchased) with contractually required delivery times or they must purchase gas when it is needed on the spot market. Purchasing natural gas on a firm basis works well if a utility can accurately

predict exactly when its natural gas-fired generation assets will be called upon to produce electricity.[5] Unfortunately, this is rarely the case for electric utilities. Firm natural gas purchases are not well-suited to serving natural gas units that primarily serve as peaking units to meet electric load during the periods of highest demand. This means that natural gas is most often purchased on the spot market to run turbines when electricity is needed instantaneously. The spot market is much more volatile, however, and can lead to significant swings in pricing from one day to the next. Since the cost of natural gas is one of the most significant drivers of electricity prices, the volatility in the natural gas spot market contributes directly to price volatility experienced by retail electric consumers.

Financial hedging instruments provide a means to mitigate the risk of price volatility for natural gas purchases by allowing a utility to purchase rights relating to the purchase and delivery of natural gas without the transaction being tied to a specific delivery of natural gas to a particular generating station. They, in essence, allow the utility to diversify its portfolio and spread risk over multiple types of natural gas transactions. Financial hedging is a procurement tool that compliments a utility's ability to enter into

[5] Regulated natural gas utilities are better able to procure needed gas supplies based upon a predictable demand for natural gas as a commodity to heat homes and run appliances. Thus, the Commission generally permitted natural gas utilities to physically hedge natural gas purchases from 2001 – 2014. However, the Commission's appetite for such activities waned and the utilities' hedging programs were discontinued based upon the Commission's belief that:

> …[C]ontinued low and stable gas prices could obviate the need for hedging. … While there is no guarantee that higher levels of gas prices and volatility will not recur, current projections from the United States Energy Information Administration's 2014 Annual Energy Outlook indicate prices are not expected to exceed $8.00 per Mcf through 2040 using the reference case and are not expected to exceed $8.15 per Mcf using the High Growth scenario. More importantly with regard to volatility, the trend in price increases is projected to be gradual and steady in the long run.

In the Matter of the Application of Duke Energy Kentucky, Inc. to Implement a Hedging Program to Mitigate Price Volatility in the Procurement of Natural Gas, Order, Case No. 2015-00025, p. 4 (Ky. P.S.C. Mar. 27, 2015); *see also In the Matter of the Application of Columbia Gas of Kentucky, Inc. to Extend Its Gas Price Hedging Plan*, Order, No. 2013-00354 (Ky. P.S.C. Sept. 17, 2014); *In the Matter of the Application of Atmos Energy Corporation for Continuation of Its Hedging Program*, Order, Case No. 2013-00421 (Ky. P.S.C. Sept. 18, 2014).

spot market transactions to purchase natural gas. Thus, financial hedges extend some of the same market volatility protections available in the coal market through physical hedging to natural gas purchasing done through the spot market. Financial hedging is not a guarantee that a utility will always purchase natural gas at the lowest possible price, but it does assure that the overall volatility of fuel prices will be diminished over time. This leads to more predictable energy bills.

Unfortunately, the FAC regulation does not permit the recovery of financial hedges of natural gas. By limiting fuel cost recovery to natural gas that is "consumed" by the utility's electric generating units or specifically attributable to power purchases, recovering the cost of financial hedges associated with reducing natural gas price volatility is prohibited. While well-intentioned, the FAC regulation prevents utilities from having the ability to use financial hedges as a tool to mitigate price volatility in the natural gas market. In periods where the natural gas market is stable over time, the absence of this tool is inconsequential. However, in periods where natural gas prices are highly volatile, the inability to use financial hedges as a tool to mitigate price volatility is much more acute. Expanding the FAC to include the ability to include financial hedges as a cost of fuel is an important tool that would greatly benefit utilities in reducing volatility in fuel costs on consumer bills.

Regulatory Assets. Faced with higher than anticipated fuel expenses a year ago, EKPC requested a Staff Advisory Opinion from the Commission on December 22, 2021. EKPC sought guidance as to whether it could establish a regulatory asset to permit the deferred recovery of extraordinary and non-recurring FAC expenses arising from power

purchases from prolonged maintenance outages.[6] While prior Commission Orders speak to the rigidity of the process for accounting for and reporting fuel expenses, the FAC regulation leaves open the door for delayed recovery of FAC expenses. EKPC did this very thing during the 2014 Polar Vortex when power purchase expenses were extraordinarily high.[7] However, unlike with the Polar Vortex, where the costs were incurred early in the calendar year, the purchased power costs EKPC incurred in November 2021 would have to be recovered in a separate calendar year if deferred. Accordingly, a regulatory asset would be necessary to assure that the deferral was properly accounted for and amortized.

In late 2021, EKPC was considering deferring recovery of the extraordinary FAC expense from the November expense month, but could do so only if it could carry the deferral as a regulatory asset for the full length of the deferral period.[8] EKPC had nothing to gain from deferring cost recovery because it would not impose a carrying charge on the regulatory asset's balance. In fact, EKPC was better-suited financially to fully recover its costs in the timeframe set forth in its FAC tariff and 807 KAR 5:056. However, recognizing that it would certainly be beneficial for the retail customers who are members of EKPC's owner-member to see a lower FAC expense in January, EKPC was willing to accommodate deferred cost recovery if the Commission would recognize fuel volatility as an additional basis for granting a regulatory asset.

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[6] Power purchases resulting from scheduled outages are eligible for recovery under the FAC. *See* 807 KAR 5:056, Section 1(3).

[7] *See In the Matter of an Examination of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 2021 through October 31, 2014*, Order, Case No. 2014-00451, p. 3 (Ky. P.S.C. Aug. 11, 2015).

[8] As set forth in Case No. 2004-00430, fuel expense cannot be absorbed into margins.

EKPC sought Staff's guidance as to whether the four factors identified in Case No. 2008-00436 are the *exclusive* factors which could support Commission authorization to establish a regulatory asset. This request was based upon subsequent language in the Order in Case No. 2008-00436 which made it clear that the four articulated criteria are not to be viewed as an exhaustive and comprehensive list of circumstances for which a regulatory asset may be approved. The Order in Case No. 2008-00436 goes on to state:

> 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.[9]

Unfortunately, the Advisory Opinion was negative:

> 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.
> …
> 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.
> …
> 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. Given that EKPC's purpose in deferring the FAC charges is "smoothing out volatility in extraordinarily high FAC expenses,"

[9] *See* Order, Case No. 2008-00436 (emphasis added).

> and does not otherwise meet the criteria for a regulatory asset, such a request is not proper for a regulatory asset.[10]

Based upon this Advisory Opinion, EKPC could not defer its FAC expense well into the next calendar year and the costs of the November 2021 power purchases were recovered from customers in the ordinary course of business. However, given the purpose and nature of this investigation into the FAC, EKPC believes the Commission should reconsider its previous position on the use of regulatory assets to mitigate rate volatility in fuel expenses.

2. *What changes to the FAC regulation, if any, could reduce exposure of the FAC to volatility in the wholesale power market?*

Please see EKPC's response to Item #1.

3. *How does the current structure of the FAC regulation affect the efficiency and reliability of power plants, if at all?*
a. Does the current FAC regulation provide incentives to imprudently delay or forego necessary maintenance?
b. Does the current FAC regulation provide sufficient incentives for promoting the efficiency and reliability of power plants, and are there other incentives or changes that could be made that would provide further incentive for increased reliability and efficiency?

As set forth in prior Commission Orders, the purpose of the FAC is to provide:

> ... a means for [an electric] utility to recover from its customers its current fuel expense through an automatic rate adjustment without the necessity for a full regulatory rate proceeding. This rate may increase or decrease from one billing cycle to the next depending on whether the utility's cost of fuel increased or decreased in the same period. The rate provides for a straight pass-through of fuel costs, with no allowance for a profit to the utility.[11]

[10] *See* Ky. P.S.C. Staff Advisory Opinion 2022-0001 (citation omitted).

[11] *In the Matter of East Kentucky Power Cooperative 's Request for a Declaratory Ruling on the Application of Administrative Regulation 807 KAR 5:056 to its Proposed Treatment of Non-Economy Energy Purchases,* Order, Case No. 2004-00430 (Ky. P.S.C. Feb. 7, 2005) quoting *In the Matter of Kentucky Power Company,* Order, Case No. 6877, p. 2 (Ky. P.S.C. Dec. 15, 1977).

Consequently, the current FAC regulation was not designed or intended to affect the efficiency and reliability of power plants. Therefore, the recovery of FAC expense should not be a factor in the efficiency and reliability of a utility's power plants.

a. The FAC regulation was not designed or intended to provide incentives to electric utilities; rather it is a means of current fuel expense recovery without a full regulatory rate proceeding. The FAC saves money for utilities and keeps rates lower for consumers by avoiding the need to have more frequent and costly base rate proceedings. The decision to delay or forego necessary maintenance of power plants is based upon numerous factors, but the possibility of recovering the cost of replacement purchased power through the FAC is not one of those factors for EKPC.

b. EKPC does not view the current FAC regulation as providing incentives to promote the efficiency and reliability of power plants. It is a financial cost recovery mechanism. EKPC believes the focus of the FAC regulation should continue to be on the recovery of current fuel and purchased power expense without a full regulatory rate proceeding. EKPC is unaware of any instances where the FAC has been used to incentivize power plant efficiency or reliability.

EKPC is a member-owned cooperative and the incentive to maintain plants in a reliable and efficient manner resides with EKPC's Mission Statement, which is "EKPC exists to serve its member-owned cooperatives by safely delivering reliable, affordable and sustainable energy and related services." Power plant reliability and efficiency efforts are evaluated on an integrated basis and not on an impact to the FAC basis. Potential maintenance needs are planned based on the overall impact to EKPC's costs and reliability

and evaluated based on total cost and reliability impacts, not simply the potential FAC impacts. Additional costs for purchased power are included in the evaluation process and considered when reviewing the project alternatives. The long-term plan for maintenance and efficiency projects are provided in the Integrated Resource Plan that is filed every three years at the Commission. The Commission and its staff have an opportunity to fully review and investigate those plans at that time.

4. *Does the current FAC regulation provide sufficient incentives to ensure efficient and prudent fuel procurement practices? If not, what changes could be made to better promote efficient and prudent fuel procurement practices?*

Yes. Fuel procurement practices are appropriately reviewed. However, in assuring that the procurement of fuel is least cost, it becomes impossible to mitigate FAC volatility. As a result of the limitation of the regulation, utilities cannot enter into financial hedges that would limit volatility and give rise to greater FAC predictability for consumers. In other words, the consequence of the FAC is to require utilities to strictly pay market prices for fuel even if the market is highly volatile. This tradeoff works extremely well in periods where energy markets are flat, but is difficult for customers when energy markets are highly volatile and lead to significant fluctuations in the FAC.

Except for the changes related to financial hedging and deferral authority noted above, EKPC does not advocate for changes to the current FAC regulation at this time. While it may be advisable to review the mechanism that permits jurisdictional utilities to regularly adjust the price of electricity to reflect fluctuations in the cost of fuel or purchased power used to supply that electricity, the current FAC regulation requires full transparency through the filing requirement and review process. The current FAC mechanism sufficiently ensures that rates are fair, just, and reasonable. In regard to the timing of rates

going up or down, it is notable that pricing in long-term coal supply contracts may not correspond to the current spot coal market, which is subject to more volatility. EKPC does not earn a profit with the FAC, as monthly cost are reflected on a dollar-for-dollar basis through the strict mechanism. Through a well-established procedure, the monthly FAC filings are reviewed by the Commission for accuracy. A more detailed review is conducted by the Commission every six months. A final review occurs at two-year intervals. The public has access to FAC information and FAC reviews are conducted as cases with hearings that are open to the public.

EKPC's fuel procurement objectives are to ensure an adequate supply of fuel of proper quality, purchased at competitive prices, and in accordance with the requirements of lending and regulatory agencies; to ensure ethical, fair, and sound business practices are followed; and to avoid any conflict of interest or appearance of any such conflict of interest. Fuel procurement techniques follow approved corporate policy, strategy, and procedures. In addition to the timely monthly filings of analysis of fuel purchases and in the interest of documenting efficient and prudent fuel procurement practices, EKPC openly responds to Commission Data Requests and provides information that includes, but is not limited to, the following: contract and spot coal tons purchased, list of purchases under a long-term contract (details include contract number, supplier name, production facility, delivery method, actual quantity received for the specific period, and current price), state of physical coal inventory, list of written and oral Request For Proposals (details include information about the RFP and bid tabulation sheet), any changes to hedging activities, verification that all fuel contracts related to commodity and transportation have been filed, list of "new" coal contracts to evaluate reasonableness of fuel costs in contract and competing bids,

inform if currently involved in any litigation, state any changes to EKPC's written policies and procedures regarding fuel procurement, and whether if EKPC is aware of any violations of its policies and procedures.

Furthermore, EKPC has provided the Fuel & Emissions Department Procurement's Manual and its exhibits. This Procurement Manual includes, but is not limited to the following: applicable Board and Administrative Policies, Procurement Procedures, Fuel Strategy, Coal Bidders List, Transportation Bidders List, Coal Proposal Form, Coal Specifications, Fuel Cost Evaluation Variables, Fuel Evaluation System Manual, Supplier Scorecard, Fuel Transaction Checklists, Coal RFP Template, Fuel Evaluation Data Entry Verification Form, and a Coal Approval Memorandum. On July 27, 2020 EKPC's Fuel & Emissions staff went through EKPC's Fuel Evaluation Model with the Commission in an Informal Conference to demonstrate how the least cost option is determined on an evaluated basis. EKPC believes that it operates in compliance with the current FAC regulation and that the current FAC regulations appropriately regulates fuel procurement practices.

5. *If you have affiliates that operate in other jurisdictions, explain how those jurisdictions permit the recovery of actual or anticipated fuel and purchased power expenses.*

EKPC does not have affiliates in other jurisdictions.

6. *The current FAC makes utilities economically indifferent to the cost and recovery of fuel. Should the Commission leave the FAC as is, and take this fact into account when reviewing applications for certificates of public convenience and necessity and financing and integrated resource plans, or should it amend the current FAC to provide for less economic indifference by the utility to the cost and recovery of fuel and purchased power?*

EKPC does not believe the current FAC makes it economically indifferent to the cost and recovery of fuel expense. As a cooperative, EKPC is very sensitive to the impact the cost of fuel and purchased power will have on its owner-members. EKPC is also not

indifferent when it comes to the recovery of prudently incurred fuel and purchased power costs, but has to deal with the ramifications of the Commission's decisions when such expenditures and purchases are declared "non-economic."

Fuel cost and energy need is considered during the Certificate of Public Convenience and Necessity ("CPCN") process. The evaluation must consider the type of resource needed to serve the need, the expected amount of energy needed from the resource on an economic and reliability basis, and the total cost to best serve the defined need. The energy expense is an integral portion of this analysis, both the amount and cost. In general, the higher the initial capital investment then the lower the average energy cost. Likewise, the lower the capital investment then the higher the average energy cost. All of EKPC's generation investments have been evaluated on this basis when requesting a CPCN. Once the CPCN is granted, the capital investment cannot be subjectively changed due to volatile markets and associated consumables that contribute to the energy cost. The potential volatility of the fuel and other consumable markets must be considered when evaluating the capital project during the CPCN process. The FAC is then a secondary process once the capital plan is approved to ensure that continued fuel purchases to utilize the approved project are prudent and well defined.

7. *Does the current FAC appropriately balance the risk accompanying the incurrence and recovery of fuel and purchased power costs between customers and the utility? If so, why? If not, why not?*

Yes The FAC appropriately allows utilities to cover their actual costs (no profits) of fuel and economy energy purchases. This removes any arbitrary allocation of price risk from customers.

8. *The current FAC regulation is uniformly applicable to all utilities. If changes to the FAC regulation are made, should the FAC regulation continue to be uniformly applicable? If not uniformly applicable, should the FAC regulation prescribe different FACs from which a utility may choose?*

From a very technical and literal standpoint, the current FAC regulation requires only that individual utilities' FAC tariffs be consistent with the regulation. The various tariffs employed for the FAC calculations are not uniformly identical. Each of the six generating utilities have some unique feature that is applicable to that utility only, whether it be utilizing estimated amounts that are trued up to actual in the subsequent month, the treatment of transactions between affiliated utilities, proxy calculations for establishing economic purchases for a utility that lacks a peaking resource, or FAC appropriate costs from membership in RTOs. The current FAC regulation provisions have been consistently applied to the generating utilities and that feature should continue. While it might be tempting to have a FAC regulation that would prescribe different FACs that a utility could choose, EKPC believes that approach could result in a situation that would be administratively difficult to oversee and could lead to inequitable results that give one utility a competitive advantage over others. Rather than amending the FAC regulation to prescribe different FAC methods that a utility could choose, EKPC believes the better approach would be to amend the current FAC regulation to allow for deviations to the regulation "upon good cause shown." This change would maintain the overall consistency of the regulation but allow for flexibility to address specific situations that is currently lacking.

9. *Should the FAC be the only mechanism to review non-FAC expenses for reasonableness as a predicate for recovery through base rates or tariff riders?*

Please see EKPC's previous comments at page 5 referencing concerns about single issue ratemaking and mixing the focus of a FAC expense and non-FAC expense review.

10. *What additional information should be required to support the reasonableness of FAC charges and expenses?*

As stated previously, concerning what additional information needs to be provided to support the reasonableness of FAC charges and expenses, EKPC believes the Commission needs to make that determination. However, EKPC strongly disagrees with utilizing comparisons of fuel and power purchase costs to area averages to determine the reasonableness of its costs. The Commission has a long history of not utilizing "benchmarks" and it has been well served by that approach.

11. *What additional information should be required to support the prudence of the utilities' fuel procurement actions?*

EKPC understands a prudence review of any action or activity by a utility is a very serious matter and is usually associated with an investigation that questions the reasonableness of the action or activity. Key to this investigation is the concept that the action or activity must be evaluated in light of the information that was available to the utility at the time the action or activity was undertaken. While the Commission should determine what information it needs to evaluate the reasonableness of the action or activity, supporting documentation such as utility fuel procurement policies, fuel solicitations, competitive bid evaluation forms, and internal evaluations of fuel supplier contract compliance may be part of the documentation needs. This information is already routinely supplied to the Commission as part of semi-annual review proceedings.

12. *If applicable, what additional information should be required to support the prudence of utilities' bidding strategy governing the potential selection of a unit for economic dispatch?*

As noted in EKPC's response to Item No. 11, a prudence review of any action or activity by a utility is a very serious matter and is usually associated with an investigation that questions the reasonableness of the action or activity. A review of the prudence of the utility's bidding strategy governing the potential selection of a unit for economic dispatch would likely involve an examination of any policies and procedures adopted by a RTO concerning bidding strategy and operational rules and strategies followed for economic dispatch. EKPC must offer its units in compliance with the PJM tariff which is defined as a rule set within the Operating Manuals. This tariff is regulated by Federal Energy Regulatory Commission ("FERC"). PJM and the Internal Market Monitor ("IMM") provide oversight of ensuring that EKPC is offering its resources within those rules. If an infraction is suspected, the IMM will open an investigation and determine if rules have been violated.

13. *If applicable, what additional information should be required to support the prudence of utilities' power purchases in instances when units are not selected for economic dispatch?*

As noted in EKPC's response to Item No. 11, a prudence review of any action or activity by a utility is a very serious matter and is usually associated with an investigation that questions the reasonableness of the action or activity. As noted in EKPC's response to Item #No. 12, a review of the RTO's operational rules and strategies followed for economic dispatch likely would be included. Much more information than just the utility's generation offers will be needed to fully vet the validity of the RTO's dispatch order. PJM is obligated to operate its system in a reliability constrained economic dispatch manner. Its tariff defines these obligations, as reviewed and approved by FERC. Evaluating EKPC's unit dispatch in isolation may not reveal the constraints within the PJM system that defined the dispatch order for the EKPC units. In general, the dispatch logic is readily transparent

and easily followed. However, there are times when constraints in areas of PJM that are not readily apparent to EKPC that can cause dispatch or non-dispatch of local units. The overall benefit to the EKPC system of being dispatched within the larger RTO footprint have been well defined within the annual reports provided to the Commission and are substantial. Many millions of dollars have been saved when compared to EKPC operating on its own, as shown within the trade benefits on the annual reports. These trade benefits are directly reflected within the FAC and therefore are immediately provided to the end use consumer.

14. *When determining whether an energy purchase is an economy energy purchase, should energy purchases be compared to the highest cost unit available during an FAC expense month or the highest cost unit available during the hour the energy purchase is made?*

Dispatch is an extremely complicated activity. A Balancing Authority has to dispatch generation within the boundaries of NERC standards BAL-001-2 and BAL-002-34, while also achieving the most economic outcome for end use customers. This is generally referred to as security-constrained economic dispatch. The question, as stated, is flawed in its presumption. Should the Commission determine that a granular second-by-second analysis of the dispatch be the measure of prudency, the cost that purchase should be compared to may be a unit that is running, but most likely will be a unit that has to be started as opposed to being ramped up. To determine which is the correct comparison, one would need to evaluate all the generation on line at every given second and determine which unit, given the transmission topography at the time, would move up to serve the load instead of the purchase. If the size of the purchase being made was such that the online resources did not have adequate head room to fill the need, then one would need to compare the purchase to the cost of bringing a unit online. The startup cost of bringing on additional

generation varies dramatically depending on the technology of the units. Each technology has a start cost and the start cost of a combustion turbine is small (when compared to the cost of a base load coal unit) but still costs thousands of dollars. A base load coal unit cost tens of thousands of dollars to start.

Decisions to start units are not made based on the second-by-second dispatch of the generation fleet. They cannot be. Instead, dispatchers assure that adequate generation is available (operating reserves) to be able to move the system up or down to meet the requirements of NERC BAL standards. Each day the load is modeled for the next day and units and purchases are scheduled to serve the forecasted load. The units are ordered based on economics and then the economic dispatch is modeled to determine if it can be accommodated by the transmission system. Frequently, the economic dispatch must be modified to resolve transmission overloads. This is called the security-constrained dispatch. Prior to joining PJM, this is what EKPC did on a daily basis. Since June 1 of 2013, EKPC has participated in the PJM wholesale market.

When EKPC integrated into the PJM market, the Commission approved EKPC participating in the Reliability Pricing Model ("RPM") rule set. Under the RPM rule set, once a generator is committed into the Base Residual Auction it has a "must offer" requirement into the energy market. Conversely, EKPC has to purchase capacity and energy from PJM markets. The proceeds from capacity and energy sales offset the costs of capacity and energy purchases from PJM. Participation in a wholesale energy market introduces additional complications to the accounting for fuel and purchased power. However, the process by which EKPC accounts for these purchases in the FAC has been described above. The benefits that accrue to EKPC's end use customers have

greatly exceeded the original estimates and have largely been derived from purchasing energy cheaper than EKPC's dispatch cost. The benefits from purchasing below EKPC's dispatch cost has an immediate benefit to the retail members because the benefits flow through the FAC. When EKPC joined PJM, EKPC met with the Commission and Staff and walked through the PJM billing codes that flow through the FAC and which do not. PJM performs a day ahead dispatch and adjusts that dispatch in real time to accommodate load forecast error, forced outages, transmission outages and other divergences from the day ahead plan.

Dispatch decisions are primarily influenced by reliability and economics, but frequently there are additional factors that influence how plants are dispatched or offered into the market. Some of these factors are the fuel inventory, inventory of consumable chemicals for environmental controls, impending weather, delivery chain risk, supplier risks, plant readiness, environmental operating constraints, operating reserves. Determining whether a power purchase was a prudent decision would need to consider many more factors than a simple comparison between the highest cost unit during any given hour of a power purchase.

15. *What details should be taken into account in considering a change in the definition of an economy energy purchase, including its recovery through the fuel adjustment clause?*

EKPC has not identified any details that should be taken into account when considering a change in the definition of an economy energy purchase other than those which have previously been articulated in Commission Orders. It is also not aware of any reasons that would support a change in the definition at the present time. EKPC strongly believes the cost of economy energy purchases should be fully recoverable through the FAC.

Ordering Paragraph 5

5. *As part of the comments in response to ordering paragraph 3, electric utilities shall identify and explain the provisions in their tariffs that allow the recovery of fuel costs, purchased power costs, and related expenses that occur outside of the FAC.*

The only EKPC tariff provision that allows for the recovery of fuel costs, purchased power costs, and related expenses is the Fuel Adjustment tariff, P.S.C. No. 35, Third Revised Sheet No. 17. EKPC has not sought Commission approval for a tariff to recover fuel costs, purchased power costs, and related expenses that occur outside of the FAC.

FAC Issues Unique to Distribution Cooperatives

Unlike a vertically integrated utility (functions of generation, transmission, and distribution are consolidated), a cooperative model presents a unique application of the FAC in that fuel costs are incurred by the G&T cooperative (EKPC) and then passed along to its sixteen owner-members, who then pass the costs along to their retail consumers. This multi-step cost recovery process is inherently more prolonged than that for investor-owned utilities and results in delayed recovery of costs by owner-members. Because energy consumption changes over this period, distribution cooperatives are more likely to experience greater over- or under-recoveries, which can exaggerate the volatility within the FAC. These comments begin with the acknowledgement that they only reflect discussions between EKPC and its sixteen owner-members.

EKPC and its owner-members discussed issues the owner-members have been having with the FAC mechanism. The first such issue deals with the regulatory lag between the time the fuel costs are incurred by EKPC and when each owner-member's share of those costs appear on the bill to the final retail customer. The second issue is the volatility that results from month to month due to true-up adjustments and periods where the FAC has continually been increasing (or declining).

Since 807 KAR 5:056 was designed for fully integrated investor owned electric utilities and wholesale G&T cooperatives, the regulation does not address in any way a mechanism for distribution cooperatives to recover fuel costs billed by the distribution cooperative's wholesale power supplier from its retail customers. The Commission developed the current approach many decades ago and has not been inclined to consider modifications, even though the approach was established by Commission Order rather than regulation or statute.

Under the current approach, for example, EKPC will file its September fuel cost expenses and other applicable data with the Commission by October 20th. The resulting FAC is then billed for October service on bills rendered in November. The process then starts all over with the owner-members and goes through at least another two-month process and, in some cases, three months. 807 KAR 5:056, Section (1)(3) clearly states that fuel costs shall be the most ***recent actual*** monthly cost. Costs that are four to five months old due to the process being followed certainly cannot be considered "recent."

A related issue for the owner-members is the lack of full recovery for the FAC they are billed by EKPC. The long expressed theory has been that the owner-members will be made whole over time. That may have been the case when the mechanism was established by Commission Order and there was not the volatility currently experienced. The steady rise in the FAC since last fall and little improvement expected in 2023 will make it even more difficult to the balancing theory to prove out. Consequently, the owner-members carry the over- or under-recovery for many months on their books, which makes it a cash issue in the immediate term. This also jeopardized their ability to achieve required financial metrics.

In the first question posed by the Commission in the November 2, 2022 Order opening this investigation, the Commission asked what changes to the FAC regulation, if any could reduce the

monthly volatility of the FAC and cited in footnote 24 the recent Duke electric rate case, where Duke proposed calculating the monthly FAC factor by using a rolling 12-month average basis. While offering the proposal as an example of how the FAC regulation might be changed, the Commission's finding in the Duke case was quite direct and offered no hope for the proposal to be adopted:

> Rider FAC, Fuel Adjustment Clause. Duke Kentucky proposes a revision to its Fuel Adjustment Clause Rider (FAC) changing the FAC rate calculation from a monthly basis to a rolling twelve-month average. Duke Kentucky states that the change to a rolling twelve-month average will help to mitigate volatility in the FAC rate for its ratepayers. 807 KAR 5:056, Section 1, states that the monthly FAC rate will be based upon the most recent actual monthly cost and sales and does not have a deviation clause. Therefore, the Commission denies Duke Kentucky's proposed revisions to the FAC rate calculation.[12]

EKPC and its owner-members believe with this investigation it certainly is the time to consider other options and alternatives to deal with the owner-members' fuel cost recovery. EKPC and the owner-members have begun preliminary calculations utilizing a 12-month averaging approach for both EKPC and the owner-members to determine whether such a method would be useful and beneficial. The analysis is not yet complete as such a change could have other implications that need to be carefully modeled and understood. EKPC and its owner-members hope the Commission will be willing to think out of the box to address these needs and be willing to consider other approaches as they are identified.

[12] *See in the Matter of Electronic Application of Duke Energy Kentucky, Inc. for 1) an Adjustment of the Electric Rates; 2) Approval of New Tariffs; 3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 4) All Other Required Approvals and Relief*, Case No. 2019-00271, p. 63 (KY. P.S.C. Apr. 27, 2020).

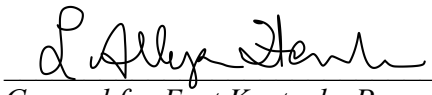
Respectfully submitted,

L. Allyson Honaker
Brittany Hayes Koenig
HONAKER LAW OFFICE PLLC
1795 Alysheba Way, Suite 6202
Lexington, KY 40509
(859) 368-8803
allyson@hloky.com
brittany@hloky.com

Counsel for East Kentucky Power Cooperative, Inc.

CERTIFICATE OF SERVICE

This is to certify that the foregoing electronic filing was transmitted to the Commission on December 5, 2022 and that there are currently no parties that the Commission has excused from electronic participation. Pursuant to prior Commission Orders, no paper copies of this filing will be made.



Counsel for East Kentucky Power Cooperative, Inc.