

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

REPLY COMMENTS OF DUKE ENERGY KENTUCKY, INC.

I. INTRODUCTION

Please accept these reply comments submitted on behalf of Duke Energy Kentucky, Inc., (Duke Energy Kentucky or Company) in response to the Kentucky Public Service Commission’s (Commission’s) request for comments from interested utilities in order to develop a record that the Commission can draw upon as it conducts its investigation into the fuel adjustment clause regulation 807 KAR 5:056, purchased power costs, and related cost recovery mechanisms.¹

II. BACKGROUND

On November 2, 2022, the Commission initiated this proceeding to investigate the fuel adjustment clause (FAC) regulation 807 KAR 5:056, purchased power costs, and related cost recovery mechanisms. In its November 2, 2022 Order (Order), the Commission directed jurisdictional electric utilities to respond to fifteen questions and to “identify and explain the provisions in their tariffs that allow the recovery of fuel costs, purchased power

¹ *In the Matter of an Electronic Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056, Purchased Power Costs, and Related Cost Recovery Mechanisms*, Case No. 2022-00190, Order (November 2, 2022).

costs, and related expenses that occur outside of the FAC.”² On December 2, 2022, Duke Energy Kentucky provided its responses to those Questions in the form of Initial Comments.³ On December 2 and December 5, additional utilities and other parties filed initial comments as well.⁴ In Paragraph 4 of the Order, the Commission allowed reply comments within 15 days following the deadline for initial comments.

In accordance with the Order, Duke Energy Kentucky submits its reply comments herein, addressing certain initial comments made by other parties.⁵

III. DISCUSSION⁶

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

Duke Energy Kentucky appreciates the supportive comments of the Attorney General regarding the twelve-month rolling average method as an option for reducing volatility.⁷ However, the Attorney General’s concerns about gamesmanship by utilities is

² *In the Matter of an Electronic Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056, Purchased Power Costs, and Related Cost Recovery Mechanisms*, Case No. 2022-00190, Order, Paragraph 5 (November 2, 2022).

³ *Id.*, Duke Energy Kentucky, Inc.’s Initial Comments (December 2, 2022) (Duke Energy Kentucky Comments).

⁴ *Id.*, Comments from the Kentucky Office of Energy Policy (November 30, 2022) (KOEP Comments); Attorney General’s Comments (December 1, 2022) (Attorney General Comments); Kentucky Solar Industries Association, Inc. Written Comments (December 2, 2022) (KYSEIA Comments); Comments of Kentucky Industrial Utility Customers, Inc. (December 2, 2022) (KIUC Comments); Initial Comments of Kentucky Power Company (December 2, 2022) (Kentucky Power Comments); Response of Kentucky Utilities Company and Louisville Gas and Electric Company to the Commission’s Order of November 2, 2022 (December 2, 2022) (KU/LG&E Comments); Comments of Joint Movants for Joint Intervention Kentuckians for the Commonwealth, Mountain Association, Metropolitan Housing Coalition, and Earth Tools, Inc. (December 2, 2022) (Joint Intervenor Comments); Joint Comments of Big Rivers Electric Corporation, Jackson Purchase Energy Corporation, Kenergy Corp, and Meade County Rural Electric Cooperative Corporation (December 5, 2022) (Big Rivers Comments); Comments on Behalf of East Kentucky Power Cooperative Inc. and Its Sixteen Owner-Members (December 5, 2022) (East Kentucky Power Comments); Comments on Behalf of Jackson Energy Cooperative Corporation (December 5, 2022) (Jackson Energy Comments).

⁵ Where these reply comments do not address a matter discussed in initial comments, agreement should not be inferred.

⁶ The Commission’s Questions are reproduced *verbatim* below for ease of reference. Only those for which the Company has reply comments are included. Such reproduction does not mean that the Company agrees with all premises or statements in the Questions.

⁷ Attorney General Comments, pg. 14.

misplaced. The example given, of a utility filing a request to spread costs “to keep rates artificially and unreasonably low for ratepayers, while a large regulatory asset unnecessarily accrues,”⁸ is not realistic. It would not be financially responsible for the Company to grow an unreasonably large regulatory asset. The costs being recorded to that regulatory asset represent a cash outlay by the Company. In the meantime, the regulatory asset would not be accruing any carrying costs. It is in the best interest of the Company to balance the interest of customers and shareholders to try to keep rates as smooth as possible and not make significant cash outlays that are not being recovered in rates.

Additionally, the Company disagrees with the Attorney General’s implication that the Commission needs to be more “aggressive” in overseeing procurement and purchasing practices due to utilities “attempt[ing] to manipulate the fuel adjustment system.”⁹ As explained in the Company’s Initial Comments, oversight of fuel procurement and purchasing is already quite extensive, with a robust existing discovery process¹⁰ The Attorney General does not cite to any instances where utilities have attempted to manipulate the fuel adjustment system. As noted in the Company’s Initial Comments, the fuel adjustment clause is a means to collect costs at no mark-up to the Company. Nothing more, nothing less. The Commission’s current review cycle, every six months, followed by a two-year comprehensive review, is sufficient and essentially provides the Commission multiple opportunities to examine the reasonableness of fuel expense.

⁸ *Id.*

⁹ *Id.*, at pg. 15.

¹⁰ *See* Duke Energy Kentucky Comments, pg. 6-7, 11-12.

Question 2: What changes to the FAC regulations, if any, could reduce exposure of the FAC to volatility in the wholesale power market?

KIUC suggests that the Commission could reduce volatility of FAC charges by adopting its definition of “economy” and “non-economy” purchase and by “expressly considering the adequacy of a utility’s plant maintenance and operations practices as a factor when setting the return on equity in base rates.”¹¹ Both suggestions are misguided. KIUC’s proposed definition of an “economy purchase” should be rejected on its merits, as explained in the Company’s reply to Question 14 below. As for the suggestion to consider maintenance and operations practices in base rate cases, the Commission already conducts a thorough review of rate case applications for prudence and reasonableness of costs and an appropriate rate of return, based upon the relative risk of the utility, that is necessary to attract investment capital. This proceeding is not the proper forum to modify that review process. Furthermore, utilities are motivated to operate reliably and efficiently for a host of reasons, as amply discussed in comments.¹² Thus, both of KIUC’s suggestions on this point should be rejected.

Question 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?

KIUC offers no explanation of how “[g]reater scrutiny” of non-economy expenses would “incentivize utilities to be more diligent” in fuel procurement and purchased power

¹¹ KIUC Comments, pg. 1-2; the same suggestion is repeated in response to Question 3.b. on pg. 4.

¹² See KU/LG&E Comments, pg. 11; East Kentucky Power Comments, pg. 16-17.

acquisition.¹³ As discussed above, under Question 1, the existing discovery process is quite robust and thorough. Ambiguous and undefined changes to the existing practices are not necessary.

Question 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?

It is simply false that, as KYSEIA writes, a utility “has no incentive to invest in technologies or facilities that use low amounts of fuel or no fuel” under the current FAC.¹⁴ As explained in the Company’s Initial Comments, utilities are motivated to maintain competitive fuel rates, given that competitive rates foster economic development and regional growth in a utility’s service territory.¹⁵

While utilities are not “indifferent” to the relative price stability of solar power,¹⁶ they must also consider their responsibility to provide reliable electric service to customers at all hours and under all weather conditions. Although utilities have and will continue to invest in solar generation assets in Kentucky,¹⁷ the current state of technological development is such that considerable reliance on fuel is necessary to assure sufficient generating capacity to deliver reliable service. Solar energy, wind energy, storage technologies and energy efficiency, whose adoption Joint Intervenors propound, are all areas with potential for growth and development, but any consideration of their “avoidance

¹³ KIUC Comments, pg. 4.

¹⁴ KYSEIA Comments, pg. 5.

¹⁵ Duke Energy Kentucky Comments, pg. 8.

¹⁶ KYSEIA Comments, pg. 8.

¹⁷ See generally, e.g., *Electronic Joint Application of Ky. Utils. Co. & Louisville Gas & Elec. Co. for Certificates of Public Convenience & Necessity & Site Compatibility Certificates & Approval of a Demand Side Management Plan*, Application, pg. 1-2 (December 15, 2022); *Electronic Application of Duke Energy Kentucky, Inc. for an Order Declaring the Construction of Solar Facilities Is an Ordinary Extension of Existing Systems in the Usual Course of Business*, Case No. 2020-385, Order (March 1, 2021).

of fuel cost volatility,”¹⁸ needs to be balanced with consideration of their reliability and availability, as well as any other relevant factors. In the meantime, utilities should be able to continue to recover fuel costs, subject to the existing FAC review.

Question 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?

The existing FAC, contrary to arguments by KYSEIA, remains necessary as long as electric generation requires significant amounts of fuel. Utilities do not earn any profit off FAC charges, but merely recover the prudently incurred actual cost of fuel. While utilities have some control over their fuel procurement practices and over their power purchasing practices, they do not have ultimate control over fuel prices or wholesale power prices. The existence of mechanisms to manage other types of risk and volatility, such as environmental compliance costs, or weather normalization,¹⁹ is a *non-sequitur* that does not address the cost of fuel. Likewise, the existence of the IRP planning process, wholesale power markets (where prices are heavily impacted by the cost of fuel), and distributed generation do not fundamentally alter a utility’s need to be able to recover fuel costs prudently incurred to provide service to customers.

Insofar as certain intervenors appear to express interest in cost-sharing mechanisms,²⁰ the Company reiterates its position that any type of shared-savings or other profit-sharing approach would be more appropriately implemented through a separate rate mechanism.²¹

¹⁸ Joint Intervenor Comments, pg. 8.

¹⁹ See KYSEIA Comments, pg. 2.

²⁰ See Joint Intervenor Comments, pg. 10-11.

²¹ See Duke Energy Kentucky Comments, pg. 6.

The Joint Intervenors argue that “While utilities do not profit from their fuel costs, they are guaranteed to recover 100% of their fuel costs unless the Commission finds during a backward-looking review that the PSC undertakes every six months and two years that specific costs were imprudent and unreasonable.”²² This statement is contradictory in and of itself. The mere fact that the PSC reviews “every six months and two years [whether] specific costs were imprudent and unreasonable” or prudent and reasonable clearly demonstrates that utilities are *not* guaranteed 100% recovery of their fuel costs.

Question 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?

The Attorney General proposes two arbitrary exclusions from base rates, both of which should be rejected. The Attorney General proposes that non-economy purchases “should not be allowed in base rate recovery unless the utility can demonstrate clearly that the purchases were absolutely necessary for reliability, capacity, or demand purposes,” and that forced outage purchase power should be categorically excluded from base rates.²³ First, procedurally, this is not an appropriate proceeding to suggest changes to base rate case procedures. Second, base rates are not recovered “automatically,”²⁴ as the Attorney General states. The review of a rate case application is extensive and rigorous, and the Attorney General cites no reason why the ordinary prudent and reasonable standard should be abandoned for his proposed “absolutely necessary” threshold. These proposals should be rejected out of hand.

²² Joint Intervenor Comments, pg. 2.

²³ Attorney General Comments, pg. 18-19.

²⁴ *Id.*, pg. 18.

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

The Attorney General's suggested modifications to the current review process should be rejected as baseless and unnecessarily burdensome. First, the Attorney General lists over thirty items of information, without any discussion of which are already provided or how each item would aid review. As Duke Energy Kentucky described in its Initial Comments, the existing review is thorough and the Commission Staff have discretion to seek additional information when they have cause.²⁵ Second, the Attorney General recommends that the Commission require uniform presentation of FAC data and supporting documentation by the utilities.²⁶ This would be unnecessarily awkward and burdensome, as the utilities have different characteristics that impact which data are relevant to their reviews (*e.g.*, RTO member vs. non-member, etc.), how that data may be obtained, and how the data is best presented for maximum comprehension of the factors weighing on each utility's decision-making at the time of each decision. Duke Energy Kentucky recommends that both of these proposed changes to the current review process be rejected. As was discussed in the initial Company comments to Question #12, Duke Energy did recommend that some additional information for entities in RTO's could be appropriate for inclusion in the FAC, such as generating unit (1) Day Ahead Awards; (2) Day Ahead Cleared MW; (3) Day Ahead Energy Offers; (4) Unit Parameters (includes unit min/max load); and (5) Day Ahead LMP prices. However, the information supplied would be a listing of hourly information and appropriate to gain a better understanding of the

²⁵ See Duke Energy Kentucky Comments, pg. 6-7, 11-12.

²⁶ Attorney General Comments, pg. 21.

Company's generating offer practices, not a detailed analysis as recommended by the Attorney General.

The additional information that KIUC recommends providing is either already provided or irrelevant. KIUC recommends that utilities be required to provide "economic dispatch practices, RTO bidding practices and decisions, power plant maintenance, and comparing fuel and power purchase costs to area averages," as well as a comparison of the utility's actual O&M costs and the O&M amounts included in the utility's most recent base rate case.²⁷ As was discussed above, some of the type of additional information recommended could be appropriate for inclusion in the FAC, such as generating unit (1) Day Ahead Awards; (2) Day Ahead Cleared MW; (3) Day Ahead Energy Offers; (4) Unit Parameters (includes unit min/max load); and (5) Day Ahead LMP prices. However, the Company believes that examination of O&M costs or maintenance records would not lead to beneficial results in a FAC proceeding. "Maintenance practices" is extremely broad and could lead to literally examination of thousands of records without a clear understanding of exactly what would constitute an improper maintenance practice. Additionally, O&M expenses vary, with some months higher and some lower due to timing of maintenance outages. Additionally, comparing the utility's O&M costs to base rates undermines the entire purpose of a base rate case. Unlike FAC costs, which are volatile and beyond the utility's control, O&M costs are typically accounted for in base rates and there is no basis for changing that in this proceeding.

²⁷ KIUC Comments, pg. 5-6.

Question 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?

The Attorney General’s contention that utilities “favor market purchase over generation” because they want to avoid “regulatory and environmental compliance” or meet net-zero emissions goals²⁸ does not stand up to scrutiny in light of the cost-only pass-through nature of the FAC. Regulated utilities earn no return on FAC costs; and recoverability of those costs is subject to a prudence review of reasonableness. There is no incentive to “function[] as a middleman” when there is no markup. Utilities do not profit from the FAC. They do, however, earn a return on capital investments, such as power plants which generate energy. Thus, there is no incentive to favor energy purchases over utility-owned generation.

The Commission should reject KIUC’s proposed methodology for determining an economy purchase vs. a non-economy purchase.²⁹ As the Company explained in its Initial Comments, comparing energy purchase costs to the highest cost unit available during the hour of the energy purchase—as KIUC advocates, with some modification—is not appropriate for a utility that is member of an RTO. Rather, if the Commission wishes to assess the reasonableness of purchase power costs, there is additional information that can potentially support the prudence of a utility’s bidding strategy, as discussed in the Company’s Initial Comments.³⁰ Accordingly, KIUC’s proposed methodology should be rejected.

²⁸ Attorney General Comments, pg. 17-18.

²⁹ See KIUC Comments, pg. 2-4.

³⁰ Duke Energy Kentucky Comments, pg. 12-13.

Duke Energy Kentucky believes the current energy purchase comparison to the highest cost unit available during an FAC month is not appropriate for utilities operating in an RTO because a comparison of an energy purchase from an RTO is different than comparison of an energy purchase by a utility that is not part of an RTO. However, if the Commission is going to keep or modify this comparison, the Company offers the following for consideration:

- As was explained in the Companies response to question #13 in the initial comments, differences in LMP between the price at the Company's load purchase and generating unit(s) nodal point must be incorporated for this calculation to be accurate. These differences are the Congestion and Loss component of the respective LMP's.
- As was explained in the Companies response to question #15 in the initial comments, the avoided unit's startup cost, both the fuel component and the O&M component, must be incorporated into the comparison of generator cost and purchase power for the calculation to be accurate. However, the amount of startup cost included would be amortized over the appropriate commitment period.³¹
- The physical parameters of a generating unit, namely the unit's start-up time, needs to be incorporated in order to have an accurate calculation. For example, the Company's Woodsdale combustion turbines can come on-line within 20 minutes. However, LMP's can change every 5 minutes. If the Company were

³¹ Note that currently, when Duke Energy Kentucky does this comparison, start-up costs are not included.

purchase energy from PJM while the 5-minute LMP changed from \$20/MWh to \$500/MWh, as can happen with price volatility, the Woodsdale unit isn't even physically capable of coming on-line to capture this LMP value due to the length of time it takes to start the unit. Nonetheless, the utility could be subject to scrutiny as part of a hindsight back lookback.

- Monthly vs. hourly benchmark:
 - As previously explained, comparing energy purchase costs to the highest cost unit available during the hour of the energy purchase is not appropriate for a utility that is member of an RTO.
 - Hourly energy LMP spot prices are volatile in nature and an hourly examination of purchase prices would require more extensive research and analysis and does not lend itself to the nature of an FAC proceeding.
 - The purpose of the benchmark is set a general level of reasonability of purchase power expenditures and using a monthly average levelizes these inevitable price spikes.
 - Changing to an hourly benchmark would magnify some after-the-fact lookback and create unreasonable situations where a utility is subject to non-recovery through no fault of their own. For example, suppose the Day-Ahead market is \$20/MWh and East Bend is a \$30/MWh unit and therefore the East Bend unit was de-committed for that day. If somewhere in PJM a unit(s) were lost unexpectedly and LMP for the next few days came in at \$50/MWh, the Company would have more purchase cost subject to this new calculation through no fault of its own.

Finally, depending on how or if the Commission were to change the benchmark comparison calculation, consideration needs to be given to its impact to ensure that utilities aren't forced to change generating unit offer practices to in order to comply, which may result in unintended consequences that aren't in the customers' long-term best interest. Utilities operating in structured wholesale markets, like PJM, balance the short-term and long-term interests of customers with respect to until dispatch commitment to avoid volatility to the greatest extent possible. The Commission should not establish such a strict benchmark comparison such that the utility can no longer consider longer term consequences of unit commitment. As discussed in the Company's initial comment response to question 12, all of this does not mean that the Commission should not review RTO participants purchase power costs for prudence, but only that the formulaic approach of a benchmark comparison does not make sense in an RTO. The Company suggest that other offer parameters such as (1) Day Ahead Awards; (2) Day Ahead Cleared MW; (3) Day Ahead Energy Offers; (4) Unit Parameters (includes unit min/max load); and (5) Day Ahead LMP prices are more appropriate.

IV. CONCLUSION

Duke Energy Kentucky appreciates the opportunity to offer its reply comments in the Commission's investigation into the FAC regulation 807 KAR 5:056, purchased power costs, and related cost recovery mechanisms.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that the foregoing electronic filing is a true and accurate copy of the document being filed in paper medium; that the electronic filing was transmitted to the Commission on December 19th, 2022; and there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

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