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 OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

Kentucky Industrial Utility Customers, Inc. ("KIUC") hereby submits its Comments in the above-captioned proceeding in response to many of the questions posed by the Kentucky Public Service Commission ("Commission") in its November 2, 2022 Order.

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

One way to reduce the monthly volatility of FAC charges would be to provide the Commission authority to approve levelized FAC charges under 807 KAR 5:056. However, while levelization may help reduce rate volatility, customers will still ultimately remain responsible for the FAC costs, albeit at a later date. Levelization alone therefore does not ensure just and reasonable FAC rates for retail customers.

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

As mentioned above, allowing the Commission to approve levelization of FAC charges may help reduce volatility stemming from the wholesale power market. But another way to reduce retail customers' exposure to that volatility is to better incentivize Kentucky utilities to regularly maintain their own power plants and to utilize those plants when their cost of generation is lower than the market. The Commission could do so by establishing the correct threshold between *"economy"* and *"non-economy"* power purchases as discussed below, by more thoroughly reviewing the reasonableness of non-economy expenses as proposed in the Commission's November 2, 2022 Order opening this proceeding, 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.

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?**

The current application of the FAC regulation does not provide enough incentive for utilities to maintain efficient and reliable power plants. As detailed by KIUC in Case No. 2022-00036, at least one Kentucky utility has relied heavily on expensive purchased power rather than operating its own lower cost generating resources for extended periods of time. That utility had little incentive to maintain its own plants since it anticipated recovering the expensive purchased power costs under the current FAC regulation.

Establishing the correct threshold for purchased power recovery through the FAC may help with this problem. The Commission presently distinguishes between "*economy*" and *"non-economy"* power purchases when applying the FAC regulations.[1] "*Economy*" purchases save customers money because they are lower cost than what the utility would have otherwise generated. Such purchases are fully recoverable in an FAC. *"Non-economy"* purchases have an energy cost greater than the variable cost of the utility's highest cost generating unit available to serve native load during particular hours in the FAC expense month. Such purchases are not

[1] Order, Case No. 2022-190 at 6-7 (citing Order, Case No. 2000-00496-B (May 2, 2002) at 4).

fully recoverable in the FAC, but the amount not recoverable in the FAC may be recoverable in base rates if reasonable and prudent.[2]

For most Kentucky utilities, the threshold between *"economy"* and *"non-economy"* purchases should be set in the following manner, which is consistent with the *"economic dispatch"* approach described in current FAC regulation: The "*economy*" purchase price cap for all purchases in any hour should be set at the actual fuel cost of the utility's highest cost generating unit available to run in that hour. If the amount of purchased power acquired in that hour exceeds the MW size of that utility's highest cost unit, then the *"non-economy"* threshold for any remaining purchased power in that hour should be set at the utility's next highest cost unit available to run up to its MW size, and so on. This approach is outlined in the following chart, using 350 MW of power purchases in one hour, some of which were *"economy"* and some of which were *"non-economy,"* as an illustrative example.

Utility Generating Unit	**Size of Units Available to Run But Not Running**	**Unit Generating Cost (MWh)**	**Purchased Power Cost (350 MW)**	***"Non-Economy" Cap***	***Difference Between Cap & Unit Cost***	***"Non-Economy" Expenses***
1	200 MW	$90/MWh	$80/MWh	$90/MWh	($10/MWh)	$0
2	100 MW	$45/MWh	$80/MWh	$45/MWh	$35/MWh	$3,500
3	50 MW	$35/MWh	$80/MWh	$35/MWh	$45/MWh	$2,250

Using this methodology provides customers the benefit of the low energy cost of the high-capital cost base load generating units that they are paying for and incentivizes the utility to properly maintain and operate its base load power plants.

To the extent a Kentucky utility is permitted to use a hypothetical methodology to establish its *"economy/non-economy"* threshold, that calculation should include reasonable

[2] Order, Case No. 2004-00430 (Mar. 21, 2005) at 6.

assumptions. The hypothetical pricing should replicate a real-world generating unit as much as possible and should be specific with respect to the hypothetical unit's MW size.

The Commission's proposal to review the reasonableness of non-economy expenses in greater detail is also a good idea. Greater scrutiny of FAC costs will incentivize utilities to be more diligent with respect to both their fuel procurement and purchased power acquisition practices.

Additionally, the Commission should expressly consider whether a utility adequately maintained and operated its generation resources as a factor when setting the return on equity in base rates. In between base rate cases, there is reduced incentive for utilities to adequately maintain their plants since spending money to do so could undermine their earned returns. By expressly requiring utilities to prove within a base rate case that they adequately maintained and operated their plants in the period between rate cases, the Commission would provide a significant incentive for utilities to maintain efficient and reliable power plants.

4. 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?

As discussed above, KIUC supports greater scrutiny of utility fuel and purchased power costs.

5. 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?

As discussed above, the answer is "*yes*" if the *"economic dispatch"* provisions of the current FAC regulation are adequately enforced. The solutions discussed above with respect to the *"economy/non-economy"* threshold and greater scrutiny of fuel and purchased power costs would improve the current operation of the regulation.

6. 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?

Uniform application is reasonable and helps facilitate the Commission's comprehensive review of proposed FAC charges. If utilities could choose from a menu of potential FAC options, then the Commission's goal of greater scrutiny with respect to fuel and purchased power costs will be harder to achieve.

7. 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?

KIUC supports greater review of the reasonableness of non-economy expenses and welcomes additional review outside of the context of an FAC proceeding.

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

In its November 2, 2022 Order, the Commission questions whether utilities should be required to provide additional evidence to support their fuel and purchased power procurement practices including, but not limited to, economic dispatch practices, RTO bidding practices and decisions, power plant maintenance, and comparing fuel and power purchase costs to area averages. KIUC recommends that the utilities be required to provide such information. And with respect to power plant maintenance specifically, the Commission should require utilities to provide their actual operations & maintenance ("O&M") costs compared against the O&M costs included in their most recent base rate case.

9. 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?

As KIUC recommends above, utility energy purchases should be compared to the highest cost unit(s) available during the hour the energy purchase is made.

10. 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?

KIUC discussed its recommended approach to determining whether a purchase constitutes an *"economy"* or a *"non-economy"* purchase above.

Respectfully submitted,

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