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**

<u>JOINT COMMENTS OF BIG RIVERS ELECTRIC CORPORATION, JACKSON PURCHASE ENERGY CORPORATION, KENERGY CORP., AND MEADE COUNTY RURAL ELECTRIC COOPERATIVE CORPORATION</u>

Big Rivers Electric Corporation ("*Big Rivers*"), by counsel, and on behalf of itself and its three member distribution cooperatives, Jackson Purchase Energy Corporation ("*Jackson Purchase*"), Kenergy Corp. ("*Kenergy*"), and Meade County Rural Electric Cooperative Corporation ("*Meade County RECC*") (collectively, the "*Members*"), respectfully submits these joint comments in response to the Public Service Commission's (the "*Commission*") Order dated November 2, 2022 ("*November 2nd Order*"), which directs each jurisdictional electric utility to file comments on certain issues, including fifteen questions enumerated in the Order.[1]

I. INTRODUCTION

The Commission established this proceeding "to investigate the fuel adjustment clause, purchased power recovery, current and future fuel and power

[1] November 2nd Order at p. 11.

price volatility, and related recovery mechanisms."[2] In its Order opening this case, the Commission noted several issues that have arisen and changes in circumstances that have occurred since the Commission's last significant investigation into the FAC in 1986, including the rise in natural gas generation in proportion to coal-fired generation and its effect on fuel costs and power market prices; the development of regional transmission organizations ("*RTOs*") and how a utility's membership in an RTO affects the FAC; the recovery through non-FAC mechanisms of purchased power costs that are not recoverable through the FAC, and the effect that those mechanisms have on incentives for utilities to employ reasonable fuel procurement and operational and maintenance practices; and the burden of proof in FAC reviews.[3]

While we have recently seen increases in FAC charges, these increases are primarily due to market forces outside of a utility's control. But this is not a flaw of the FAC; it is the FAC operating as intended. The Commission has historically recognized that fuel costs are one of a utility's largest single expenses,[4] as are purchased power costs. The Commission has also historically recognized how volatile these costs can be, and that the FAC is an efficient mechanism for recovery

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[2] *Id.* at p. 1.

[3] *Id.* at pp. 3-10.

[4] *See, e.g., id.* at p. 3.

of these costs from the cost-causer because it avoids frequent and costly base rate proceedings.[5]

Because market forces are outside the control of individual utilities, utilities have a limited ability to completely avoid higher fuel and power market costs that have arisen over the past year. However, Big Rivers has been able to mitigate some of our exposure to these outside forces. For example, owning enough generation to serve native load and anticipated load growth has enabled Big Rivers to reduce our exposure to wholesale power market prices, with Big Rivers hedging the little exposure that does exist. Maintaining coal-fired generation and entering into long-term coal contracts reduces our exposure to the natural gas market and that market's influence on power prices. And increasing the diversity of our generation and entering into long-term power purchase and sales agreements mitigates our exposure to the volatility in the wholesale power market. Big Rivers, like our Members, is an electric cooperative that is owned by the customers we serve. Because of this, Big Rivers and its Members are incentivized, with or without a FAC, to provide safe and reliable power to our customer-owners *at the lowest reasonable cost*, and Big Rivers would take the above actions with or without a FAC.

However, the assurance of the timely recovery of prudently-incurred costs through mechanisms such as the FAC provides many benefits. The credit rating

[5] *See In the Matter of: An Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056*, P.S.C. Administrative Case No. 309, Order (Sept. 21, 1988) at p. 10 ("If the FAC is eliminated, then there would be abrupt changes in costs to consumers resulting in longer time lags and causing less equitable charges of cost to the cost-causer").

agencies have cited the FAC as a factor that positively impacts Big Rivers' credit rating, which helps Big Rivers secure low-cost funding for needed projects. The FAC also helps to ensure that Big Rivers and its Members have the cash available for operating and maintenance needs. While Big Rivers and its Members recognize the challenges that FAC volatility can present to retail customers, we believe the advantages of the FAC far outweigh its disadvantages. Moreover, there already are processes in place that would allow the utility to alleviate high FAC charge months by spreading some of the expense that would otherwise be billed in those months over time.[6] As such, Big Rivers and its Members do not believe any changes to the Commission's existing regulations are warranted at this time. If other parties propose changes to the existing regulation, Big Rivers and its Members recommend that the Commission implement a collaborative process similar to the process utilized in Administrative Case No. 2008-00169[7] to address the parties' proposals.

II. TARIFF PROVISIONS

Ordering Paragraph 5 of the November 2nd Order requires that "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."[8]

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[6] *See* the response to Question 1, below.

[7] *In the Matter of: Development of Guidelines for Interconnection and Net Metering for Certain Generators with Capacity Up to Thirty Kilowatts*, P.S.C. Administrative Case No. 2008-00169.

[8] November 2nd Order at Ordering Paragraph 5.

Big Rivers' tariff includes a purchased power adjustment rider: the Non-Smelter Non-FAC PPA (the "*Non-FAC PPA*"), a copy of which is attached hereto as Exhibit No. 1. The Commission approved Big Rivers' Non-FAC PPA in Case No. 2011-00036.[9] This rider allows Big Rivers to recover certain purchased power costs that are not recoverable through the FAC. Under this rider, Big Rivers defers in regulatory accounts the monthly difference between the Non-FAC PPA purchased power expense included in base rates and the amount Big Rivers actually incurs. The balance of the regulatory accounts as of June 30 each year is amortized and billed to Big Rivers' Members over a 12-month period beginning in September.[10]

The purchased power costs that are recoverable through the Non-FAC PPA are those costs expensed to Account 555, Purchased Power, attributable to the Members and not otherwise recovered through Big Rivers' FAC, and further excluding certain purchased power costs, such as backup power services for Domtar Paper Company, LLC (which are billed directly to Domtar under Domtar's special contract with Kenergy), power purchases attributable to non-Member sales, *etc*.[11] An over- or under-recovery is calculated using actual amounts and is included in the regulatory account balance, as are adjustments to purchased power expense in previous months.

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[9] *In the Matter of: Application of Big Rivers Electric Corporation for a General Adjustment in Rates,* P.S.C. Case No. 2011-00036, Order (Nov. 17, 2011).

[10] *See* Big Rivers' Non-Smelter Non-FAC PPA tariff schedule, attached hereto as Exhibit 1.

[11] *See id.; In the Matter of: Application of Big Rivers Electric Corporation for a General Adjustment in* Rates, P.S.C. Case No. 2011-00036, Application Exhibit 55 (Direct Testimony of Mark A. Hite), at p. 14, lines 9-17 (filed Mar. 1, 2011).

Each Member's tariff also includes a purchased power adjustment rider to pass through wholesale charges or credits resulting from Big Rivers' Non-FAC PPA. The Commission approved Jackson Purchase's "Schedule PPA – Non-Smelter Non-FAC Purchase Power Adjustment" on November 17, 2011, in Case No. 2011-00057.[12] The Commission approved Kenergy's "Schedule 30 – Non-FAC Purchased Power Adjustment (PPA) Rider" on the same day in Case No. 2011-00035.[13] The Commission approved Meade County RECC's "Schedule 25 - Non-FAC Purchased Power Adjustment Clause" on August 20, 2013, in Case No. 2013-00033.[14] The Member's Non-FAC PPA tariffs are attached hereto as Exhibit Nos. 2-4.

III. RESPONSES TO THE COMMISSION'S QUESTIONS

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

Big Rivers and its Members understand that monthly volatility of the FAC impacts retail customer-members and that spreading the costs out over a longer period of time, such as with a rolling twelve-month average basis, may reduce the volatility. However, because fuel and purchase power costs are such a significant portion of Big Rivers' and its Members' total costs, deferring the recovery of these

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[12] *See In the Matter of: Application of Jackson Purchase Energy Corporation for Approval of Flow Through Rates Pursuant to KRS 278.455*, P.S.C. Case No. 2011-00057 (Nov. 17, 2011).

[13] *See In the Matter of: Application of Kenergy Corp. for Approval of Flow Through Rates Pursuant to KRS 278.455*, P.S.C. Case No. 2011-00035, Order (Nov. 17-2011).

[14] *See In the Matter of: Application of Meade County Rural Electric Cooperative Corporation for a General Adjustment of Rates and a Flow-Through of Big Rivers' Rate Increase*, P.S.C. Case No. 2013-00033, Order (Aug. 20, 2013).

costs could have serious negative short-term impacts to Big Rivers' or its Members' available cash positions. As such, Big Rivers and its Members recommend that the Commission not require any specific volatility reduction mechanism and instead continue with measures that allow flexibility that takes into account each utility's specific circumstances, such as when the Commission allows utilities to recover less than the full amount of FAC expenses they would be entitled to recover in a high bill month and to recover the remainder in other months.[15]

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

See the response to Question 1. Big Rivers and its Members oppose any changes to the FAC regulation that would limit the recovery of prudently-incurred costs that are currently recoverable through the FAC because not being able to timely recover such costs could result in serious negative short-term impacts to Big Rivers' and its Members' available cash positions.

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***

[15] *See, e.g., In the Matter of: Electronic Application of Kentucky Power Company to Defer a Portion of Fuel Adjustment Clause Charges for Later Collection without Establishing a Regulatory Asset,* P.S.C. Case No. 2022-00125, at pp. 2-4.

there other incentives or changes that could be made that would provide further incentive for increased reliability and efficiency?

Big Rivers and its Members do not believe that the current structure of the FAC regulation affects the efficiency or reliability of Big Rivers' power plants. Big Rivers and its Members are electric cooperatives, and are owned by the customers they serve. As cooperatives, our purpose is to provide safe and reliable power to our customer-owners at the lowest reasonable price. As a cooperative, we have no profit motive and we are regulated by our elected Board of Directors as well as the Public Service Commission. As such, with or without a FAC, Big Rivers is already incentivized to pursue cost-effective measures to maximize the efficiency and reliability of its generating units.

a. No, for the reasons stated above, the current FAC regulation does not incentivize Big Rivers to imprudently delay or forego necessary maintenance.

b. No other incentives or changes are needed in the FAC regulation to incentive Big Rivers to prudently maintain its generating fleet. As a cooperative, we have no profit motive and we are regulated by our elected Board of Directors as well as the Public Service Commission. As such, with or without a FAC, Big Rivers is already incentivized to pursue cost-effective measures to maximize the efficiency and reliability of its generating units.

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?

The only current disincentive to the efficient and prudent procurement of fuel is the statutory requirement that coal severance taxes be excluded from the determination of the reasonableness of fuel purchases.[16] This requirement can force utilities to purchase more expensive coal than they otherwise would.

Otherwise, no changes are necessary to promote prudent fuel procurement practices. Big Rivers' mission is to safely deliver competitive and reliable wholesale power and cost-effective shared services desired by its Member-Owners. The Members in turn provide safe, reliable, and affordable power to their member-owners. Regardless of the FAC regulation's incentives, efficient and prudent fuel procurement practices are vital to sustain and fulfill this mission. Additionally, the elected Boards of Directors of the cooperatives expect and demand that we operate our business in the most efficient manner possible.

Question 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.

Neither Big Rivers nor its Members have affiliates that operate in other jurisdictions and that purchase fuel or power.

[16] *See* KRS 278.277.

Question 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?

Big Rivers and its Members are not economically indifferent to the cost and recovery of fuel and purchased power costs. As cooperatives, Big Rivers and its Members strive to provide safe and reliable power at the lowest reasonable costs. As cooperatives, we have no profit motive. Thus, whether in the context of purchases of fuel or power, or when evaluating generation needs (whether in a case seeking a certificate of public convenience and necessity or financing for a proposed generation project, or in an integrated resource plan), the cost and recovery of fuel and purchased power are significant considerations. The assurance of the timely recovery of prudently-incurred fuel and purchased power expenses allows Big Rivers to effectively plan the operation and maintenance of its facilities. As such, no changes to the FAC regulation are needed at this time.

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?

Yes, the FAC "provides for a straight pass-through of fuel costs, with no allowance for profit to the utility."[17] The Commission has previously considered changing the FAC to incorporate less than a 100% pass through of recoverable FAC expenses, but the Commission has ultimately rejected alternative mechanisms because the disadvantages that would result from such a change outweigh any potential benefits.[18] In the case of Big Rivers, the assurance that we will fully and timely recover our prudently-incurred fuel and purchased power costs is vital to maintaining our ability to access the low-cost financing that is necessary to maintaining operations. Any increased risk of non-recovery of prudently-incurred costs could lead to a higher cost of capital or even the inability to find capital to access.

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[17] November 2nd Order at 2.

[18] *See In the Matter of: An Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056*, P.S.C. Administrative Case No. 309, Order (Sept. 3, 1986), at p. 3.

Question 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?

Big Rivers and its Members recognize the challenges in regulating diverse utilities uniformly. However, Big Rivers and its Members believe that the FAC regulation has worked well since its adoption and should not be changed.

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?

FAC review proceedings should be limited to expenses that are recoverable through the FAC. Other mechanisms exist for the Commission to review non-FAC expenses. For example, non-FAC expenses included in base rates are subject to review by the Commission in the case establishing those base rates. Further, the Commission already has the authority to order a review of base rates if the Commission believes the level of non-FAC expenses included in base rates is no longer reasonable.[19] Likewise, the Commission already has the authority to review other tariff riders, and if the Commission were to determine that a utility is passing unreasonable costs through a non-FAC rider, the Commission could order a change

[19] KRS 278.180(1); KRS 278.260(2); KRS 278.270.

or discontinuance of that rider.[20] The Commission also has the authority to investigate the condition of a utility, and to conduct management or operations audits "to investigate all or any portion of the management and operating procedures or any other internal workings of the utility."[21]

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

In Administrative Case No. 309, the Commission found that the FAC provides the information necessary to adequately monitor fuel costs, and such monitoring can lead to in-depth investigations of fuel costs and fuel-related issues.[22] Big Rivers and its Members believe current FAC reviews continue to provide the information necessary for the Commission to adequately monitor FAC charges and expenses.

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

Please see the response to Question No. 10, above.

Question 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?

Kentucky is very unique because some of the utilities are in PJM, some in MISO and some are not in an RTO. MISO and PJM business practices are different

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[20] KRS 278.180(1); KRS 278.260(2); KRS 278.270.

[21] KRS 278.250; KRS 278.255(2).

[22] *In the Matter of: An Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056*, P.S.C. Administrative Case No. 309, Order (Dec. 18, 1989), at p. 10.

in many cases, so one bidding strategy will not fit all. In an RTO, the utility sells all of its generation in the market and purchases all of its load from the market. There are times where a specific generator price may be different from the load price, which could cause a generator to not be dispatched when its generating cost is lower than the load cost. For an example, during Winter Storm Uri, congestion issues caused the Wilson generator price to be negative but the load price was not. The negative price signal from MISO is the way an RTO gets a utility to take a unit offline. In this case, the cost to purchase power was higher than the cost to generate from the Wilson generator; however, when you include the negative price at the generator node, it was more economical to purchase the load. These are examples that demonstrate the RTO markets are too complex for the Commission to dictate a one-size-that-fits-all bidding strategy.

Please see the response to Question No. 10, above. Current FAC reviews are efficient and effective. Subjecting every utility management decision that could affect FAC charges to review will result in FAC reviews becoming as costly and time consuming as full blown rate cases.

Likewise, changing the burden of proof in FAC review proceedings would have the same effect. In the November 2nd Order, the Commission "questions the working expectation that FAC charges are presumed reasonable absent evidence to the contrary in the record."[23] The Commission has already approved Big Rivers' and its Members' FAC tariffs. The FAC is essentially a formula rate, which means that the

[23] November 2nd Order at p. 10.

approved rate is the formula. The use of formula rates is widespread at the state and federal levels. All formula rates operate on the fundamental premise that the inputs to the formula will yield a just and reasonable rate. While the inputs to a formula rate are typically subject to a certain degree of review, they are universally considered reasonable absent evidence to the contrary. Since the FAC rates have been approved as reasonable, Big Rivers and its Members no longer bear the burden of proof. Denying cost recovery for an otherwise recoverable FAC expense is a change from the approved rate, and as such, it is appropriate to require evidence that an expense is unreasonable prior to requiring the utility to provide additional evidence supporting the expense. It would be an unreasonable burden to require utilities to approach every FAC review like a full blown rate proceeding.

Question 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?

Please see the response to Question No. 12, above.

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?

Calculating the assumed or actual cost of units at a specific hour for purposes of the FAC would have little impact on the charges to Big Rivers' Members and would add an unnecessary burden.

Question 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?

Prior to joining MISO, Big Rivers operated as its own balancing authority, purchasing power when enough owned generation was unavailable to meet our Members' needs. Thus, there was a direct correlation between fuel cost and replacement power as contemplated by the FAC regulation. Today, as a Market Participant in MISO, Big Rivers offers in all of its available generation into the MISO Day-Ahead or Real-Time markets and purchases all of its Members' energy needs. Under this new regime, Big Rivers would not be explicitly aware whether MISO's commitment or dispatch of a unit was due to transmission reliability issues rather than economics, except if MISO commits to a unit at below cost and supplements the generator with make whole payments.[24]

IV. CONCLUSION

The FAC was created to address fluctuating fuel prices through an automatic rate adjustment without the necessity of a costly and time-consuming full rate proceeding.[25] The current FAC regulation allows utilities to effectively manage the

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[24] *See In the Matter of: Electronic 2020 Integrated Resource Plan of Big Rivers Electric Corporation*, P.S.C. Case No. 2020-00299, Big Rivers' Response to Item No. 42 of the Commission Staff's First Request for Information.

[25] *Kentucky Power Company*, P.S.C. Case No. 6877, Order (Dec. 15, 1977) at p. 2 (describing the FAC as "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 profit to the utility").

volatility in expenses that are outside of the control of the utility, such as fuel and purchased power costs. Further, despite changes to the fuel and power markets, as the Commission found in 1989, the current FAC regulation still "provides information necessary to **adequately monitor fuel costs** and such monitoring can lead to in-depth investigations of fuel costs and fuel-related issues"[26] (emphasis added).

Again, should any other party recommend changes in the existing FAC, Big Rivers and its Members encourage the Commission to implement a collaborative process to address the parties' proposals so as to maintain the benefits of the existing regulation.

Filed this 5th day of December, 2022.

Respectfully submitted,

BIG RIVERS ELECTRIC CORPORATION

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[26] *In the Matter of: An Investigation of the Fuel Adjustment Clause Regulation 807 KAR 5:056*, P.S.C. Administrative Case No. 309, Order (Dec. 18, 1989) at p. 10.