COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF DUKE ENERGY KENTUCKY, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET FOR THE LIABILITIES ASSOCIATED WITH THE PJM EXPENSES RELATED TO THE GREENHAT ENERGY, LLC DEFAULT	)))))))	CASE NO. 2020-00031

O R D E R

On February 14, 2020, Duke Energy Kentucky, Inc. (Duke Kentucky) filed an application, pursuant to KRS 278.030(1), KRS 278.040(2), and KRS 278.220, seeking authorization to establish a regulatory asset to defer expenses that arise from the GreenHat Energy, LLC, (GreenHat) default in PJM Interconnection, LLC (PJM), including carrying charges.

By Order dated February 27, 2020, the Commission established a procedural schedule for the processing of this matter. The procedural schedule provided for a deadline for intervention requests and two rounds of discovery upon Duke Kentucky. There were no parties requesting intervenor status to this proceeding. On May 18, 2020, Duke Kentucky requested that the Commission take this matter under submission without a hearing. Because there are no intervenors in this case and a hearing is not necessary in the public interest, the Commission will adjudicate this case based on the evidence of record.

BACKGROUND

The Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation, which was codified as Accounting Standards Codification (ASC) 980, Regulated Operations, provides the criteria for recognition of a regulatory asset.[1] Supplemental to the requirements of ASC 980, Commission precedent obligates Duke Kentucky to obtain approval prior to establishing a regulatory asset.[2] The Commission has historically approved regulatory assets where a utility has incurred: (1) an extraordinary, nonrecurring expense, which could not have reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or administrative directive; (3) an

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[1] ASC 980-340-25-1 provides, in full, as follows:

> **25-1** Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
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> a. It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
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> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.
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> A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date.

[2] Case No. 2001-00092, *Adjustment of Gas Rates of the Union Light, Heat and Power Company* (Ky. PSC Jan. 31, 2002), Order at 14.

expense in relation to an industry sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[3]

GreenHat was a PJM member that participated in the Financial Transmission Rights (FTR) market. In June 2018, PJM notified GreenHat that its failure to satisfy a $1.2 million invoice placed it in default for nonpayment and initiated liquidation of its remaining FTR portfolio.[4] As an FTR market participant, Duke Kentucky was allocated GreenHat default charges through PJM's billing line item 1999 (BLI 1999) beginning in July 2018 and expects the last charge in June 2021.[5] Duke Kentucky included the BLI 1999 expenses in its Fuel Adjustment Clause (FAC) from July 2018 to August 2019.[6] The Commission denied recovery of the GreenHat default charges through Duke Kentucky's FAC in its most recent FAC two-year and six-month review cases on the basis that the PJM BLI 1999 is not included in the Commission-approved enumerated BLIs listed in Duke Kentucky's FAC tariff.[7]

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[3] Case No. 2008-00436, *The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages* (Ky. PSC Dec. 23, 2008), Order at 4.

[4] Application at 2.

[5] Application at 7 and Duke Kentucky's Responses to Commission Staff's First Request for Information (Responses to First Requests) (filed Apr. 3, 2020), Item 4.

[6]Responses to First Request, Item 4(a) and Duke Kentucky's Responses to Commission Staff's Second Request for Information (Response to Second Requests) (filed Apr. 27, 2020), Item 3(a).

[7] 2019-00006, *Electronic Examination of the Application of the Fuel Adjustment Clause of Duke Energy Kentucky, Inc. from November 1, 2016 through October 31, 2018* (Ky. PSC Dec. 26, 2019) and Case No. 2019-00230, *An Electronic Examination of the Application of the Fuel Adjustment Clause of Duke Energy Kentucky, Inc. from November 1, 2018 through April 30, 2019* (Ky. PSC Feb. 4, 2020).

DUKE KENTUCKY'S PROPOSAL

Duke Kentucky expects that it will be allocated $462,205 of GreenHat default expense for July 2018 through June 2021.[8] Duke Kentucky contends that the GreenHat default charges are reasonable and prudent and should therefore be recoverable as a necessary cost of providing service to Duke Kentucky's customers.[9] Additionally, Duke Kentucky claims that the GreenHat default charges constitute "an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning."[10] Duke Kentucky also contends that the GreenHat default charges result from a statutory or administrative directive because they were charged to Duke Kentucky pursuant to the Federal Energy Regulatory Commission's orders and tariffs.[11] Therefore, Duke Kentucky requests authority to establish a regulatory asset for the GreenHat default charges.[12] Duke Kentucky proposes that this treatment be granted for the GreenHat default charges from 2018 and 2019 and any future GreenHat Default charges, expected to end in June 2021.[13]

Duke Kentucky asserts that FTR are hedges to day ahead energy prices in the PJM market and that the Commission has ruled that the GreenHat default charges are

[8] Application at 8. *See also* Response to First Requests, Item 4. Duke Kentucky recorded GreenHat default charges of $158,131 in 2018 and $167,086 in 2019 and expects to record $128,963 in 2020 and $8,024 in 2021.

[9] Application at 5.

[10] *Id.*

[11] Response to Second Requests, Item 2.

[12] Application at 8.

[13] *Id.* and Response to First Requests, Item 1.

fuel related.[14] Duke Kentucky argues that its request will simply enable it to recover all of its FTR expenses, the remainder of which flow through its FAC.[15] Duke Kentucky states that the GreenHat portfolio likely affected the FTR auction results that have been recovered through its FAC and the GreenHat default charges are another cost of the FTR hedge.[16] Duke Kentucky further asserts that it could not predict the GreenHat default and therefore had no ability to mitigate the default charges or include these expenses in its planning.[17] Duke Kentucky further asserts that the timing of the denial of recovery of the GreenHat default charges through its FAC prevented it from including these expenses in its base rates in Case No. 2019-00271.[18]

Duke Kentucky also requests authority to include carrying charges in the requested regulatory asset of its long-term debt rate to "recognize that the time value of money is a cost to [Duke Kentucky], resulting from the inability to recover net fuel related costs in a timely manner."[19] Using the long-term debt rate approved in Case No. 2019-00271[20] of 4.03 percent would result in annual carrying costs of approximately $18,600.[21]

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[14] Application at 5–6 and Response to Second Requests, Item 2.

[15] Application at 6.

[16] *Id.*

[17] Application at 5.

[18] Application at 7.

[19] Application at 8 and Response to First Request, Item 6.

[20] Case No. 2019-00271, *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* (Ky. PSC Apr. 27, 2020), Order at 38.

[21] $462,205 x 4.03% = $18,627.

DISCUSSION

As described above, Duke Kentucky argues that the GreenHat default expenses should be treated as a regulatory asset because they are 1) extraordinary or nonrecurring expenses which could not have reasonably been anticipated or included in the utility's planning; or 2) expenses resulting from a statutory or administrative directive. Duke Kentucky also argues that the GreenHat default charges are fuel related and that the magnitude of the GreenHat default charges is not a reasonable basis for disallowance.[22] Duke Kentucky's total allocated default charges, which span 36 months, are estimated to be $462,205. Duke Kentucky's 2018 and 2019 fuel expenses were $59.2 million and $69.5 million, respectively, of which Duke Kentucky's total GreenHat default charges equate to less than 1.0 percent.[23] Duke Kentucky's rate base for forecasted test-years ended March 31, 2019, and 2021 were $741.4 million and $881.0 million, respectively, of which the total GreenHat default charges equate to less than 0.1 percent.[24]

The Commission has historically not allowed a utility to establish a regulatory asset after a cost has been recorded as an expense and the utility has closed its books for the relevant fiscal year.[25] The Commission has also historically denied regulatory asset

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[22] Response to Second Requests, Item 2.

[23] Duke Kentucky's 2018 Annual Report at 89 and Duke Kentucky's 2019 Annual Report at 91.

[24] Case No. 2017-00321, *Electronic Application of Duke Energy Kentucky, Inc. for: 1) An Adjustment of the Electric Rates; 2) Approval of an Environmental Compliance Plan and Surcharge Mechanism; 3) Approval of New Tariffs; 4) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 5) All Other Required Approvals and Relief* (Ky. PSC Oct. 2, 2018), rehearing Order at 12 and Case No. 2019-00271, *Duke Energy Kentucky, Inc.* (Ky. PSC Apr. 27, 2020), Order at 36.

[25] Case No. 2010-00523, *Application of Duke Energy Kentucky, Inc. for an Order Approving the Establishment of a Regulatory Asset Related to Voluntary Opportunity and Other Post-Retirement Expenses* (Ky. PSC July 14, 2011).

treatment for expenses deemed immaterial.[26] Furthermore, an expense resulting from a statutory or administrative directive is incurred in pursuit of complying with those directives. If a tariff that governs the recovery of a particular cost were a statutory or administrative directive that justified the treatment of that expense as a regulatory asset, then any of Duke Kentucky's PJM expenses could fit within that standard, which would be unreasonable.

The Commission finds that Duke Kentucky has failed to establish that the expenses at issue are material to Duke Kentucky's financial position and therefore warrant deferral accounting. Regarding Duke Kentucky's contention that the GreenHat default could not have been anticipated and that it had no ability to mitigate the default charges, the Commission notes that the Report of the Independent Consultants on the GreenHat Default identified a participant default in PJM's FTR market 12 years earlier that had similarities to the GreenHat default.[27] The Commission also notes that as a Load Serving Entity and a Transmission Owner within PJM, FTRs and their related policies are central to Duke Kentucky's on-going participation in PJM. Duke Kentucky's membership in PJM requires diligent participation, including ensuring adequate and appropriate market and credit rules. Duke Kentucky and other members failed to fulfill these requirements in the case of the rules that led to the GreenHat default. Given that Duke Kentucky's ratepayers bear the costs of Duke Kentucky's membership and participation

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[26] Case No. 2000-00120, *Application of Kentucky-American Water Company to Increase Its Rates* (Ky. PSC Nov. 27, 2000), final Order at 20-22 and Case No. 2008-00440, *Request of Kentucky-American Water Company for Approval to Defer Certain Expenses as Regulatory Assets* (Ky. PSC Aug. 26, 2009).

[27] Report of the Independent Consultants on the GreenHat Default at 15. This report can be accessed via the following link: https://www.pjm.com/-/media/library/reports-notices/special-reports/2019/report-of-the-independent-consultants-on-the-greenhat-default.pdf (Last viewed Aug. 24, 2020)

in PJM, the Commission expects Duke Kentucky to vigorously work through the PJM stakeholder process to protect its customers' interests.[28] Since Duke Kentucky's customers effectively pay the cost of PJM membership and participation, they should not also bear the burden of ensuring PJM rules, and in this case credit rules, are adequate. That is the job of Duke Kentucky as the PJM member.

The Commission also finds that Duke Kentucky has not established that the expenses at issue fit within a category of expense for which regulatory asset treatment is appropriate and therefore, Duke Kentucky's request to establish a regulatory asset for GreenHat default charges should be denied. Duke Kentucky has recorded the $270,497 erroneously recovered though the FAC in Account No. 242890 Deferred Rev Pay – Fuel and credited it back to customers through the FAC.

CONCLUSION

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that Duke Kentucky's request to establish a regulatory asset should be denied.

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's request for authorization to establish a regulatory asset for the deferral of GreenHat default charges is denied.

2. This case is closed and removed from the Commission's docket.

[28] Case No. 2017-00179, *Electronic Application of Kentucky Power Company for (1) A General Adjustment of Its Rates for Electric Service; (2) An Order Approving Its 2017 Environmental Compliance Plan; (3) An Order Approving its Tariffs and Riders; (4) An Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities; and (5) An Order Granting All Other Required Approvals and Relief* (Ky. PSC Jan. 18, 2018), final Order at 54.

By the Commission

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