



COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
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May 8, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Dingell:

We appreciate the opportunity to respond to your questions regarding the restructuring of the electric utility. We hope our responses to your questions are helpful and informative. As our responses indicate, the Kentucky Public Service Commission is concerned about the impact on Kentucky consumers of the deregulation of the electric generation sector and the restructuring of the distribution and transmission sectors. Kentuckians have always enjoyed low electric rates. As legislators and regulators begin deliberating on changes to the current electric utility industry, special consideration must be given to the overall impact such changes will have on Kentucky's citizens and businesses.

If you have any further questions regarding these responses or the restructuring of the electric utility industry in general, please do not hesitate to contact me at (502) 564-3940.

Sincerely,

A handwritten signature in cursive script that reads "Linda K. Breathitt".

Linda K. Breathitt
Chairman

Enclosure

KENTUCKY PUBLIC SERVICE COMMISSION

Response to the Survey on Electric Retail Wheeling The Honorable John Dingell, Ranking Member of the House of Representatives Commerce Committee

1. **Question** - Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?

Answer - Both the Kentucky Public Service Commission and the Kentucky Legislature have retail competition under consideration. The Kentucky Public Service Commission is finishing a series of workshops with various stakeholder groups and is meeting on a regular basis with the Legislature. As expected, the PSC has made this issue our top priority, is studying all federal and state legislative action and proposals, all papers, studies, articles and other material available on electric retail wheeling and other markets which have been deregulated. Our focus is broad and thorough.

2. **Question** - Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?

Answer - No, Kentucky has not asked Congress to enact legislation on retail wheeling. We strongly believe that a federal mandate is not in the public interest. Wholesale competition is in effect and high cost states are receiving the benefits of low-cost generation reserves in states which have opened the retail wheeling market. This will continue and expand as high cost states who have not enacted retail choice do so. Low cost states may or may not benefit by retail competition. Kentucky is in the latter

category. We do not believe Congressional action is necessary for us to adopt retail competition if and when we decide it is in Kentucky's best interest. We are studying the issue and, in the meantime, encouraging wholesale competition. We believe it would greatly impede the states' efforts and knowledge of their markets for Congress to enact national legislation and to impose a "one-size-fits-all" set of policies in a market as diverse and complex as electricity. We have not requested any type of Congressional action relating to electric restructuring.

3. **Question** - Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?

Answer - The only statute that our Legislature has to impede any retail competition issue is designated service territories for electric companies. Otherwise, the Commission is not bound by statute from resolving any stranded cost issue or other competitive issues. And, as we earlier stated, the Legislature is working with us and all stakeholders to advance Kentucky's public interest in this area. We believe the Commission and the Kentucky Legislature have sufficient authority and knowledge to resolve the stranded cost issue if Congress does or does not enact federal legislation.

4. **Question** - Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating

competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978 (PURPA)?

Answer - With regard to PUHCA, no. We believe the Kentucky Commission and the Kentucky Legislature have sufficient authority to enact appropriate policies to address the issues PUHCA now considers. If PUHCA is repealed, we have sufficient statutory authority to mandate appropriate policies under our Financing and Transfer statutes. We have, in fact, already worked through and entered Orders permitting the merger of Cincinnati Gas and Electric (who previously owned The Union Light, Heat and Power Company, the Kentucky affiliate) with PSI Energy, Inc. This merger was several years ago, and our requirements have been met. We have dealt with numerous other smaller mergers.

Moreover, two of our larger electric companies formed holding companies in the late '80's. In both instances we established accounting and operating guidelines that the companies follow. Financings, asset or stock sales or changes of control and other activities involving any PUHCA issues that come to mind are all routinely handled by this Commission.

With regard to PURPA, Kentucky has not formulated a position regarding the repeal or modification of PURPA or the handling of existing PURPA contracts. This particular section required the Federal Energy Regulatory Commission (FERC) to adopt rules to encourage cogeneration and small power production by requiring electric utilities to sell electricity to qualifying cogeneration and small power production facilities and to

purchase electricity from such facilities. Section 210(f) of PURPA required the Kentucky PSC and the utility regulatory authority in all other states to implement the FERC rules. As a result of this section, the PSC promulgated its regulation 807 KAR 5:054 in April 1982.

Among other provisions, the PSC's regulation requires electric utilities to file avoided cost data, capacity expansion plans, and estimated capacity costs with the PSC every two years. The regulation also requires electric utilities to sell electricity to qualifying facilities at just and reasonable rates and to purchase electricity from qualifying facilities at rates based on utility avoided costs.

Given the extremely low avoided costs of electric utilities in Kentucky, qualifying cogeneration and small power production facilities have, for the most part, been unwilling or unable to locate in the state. As a result, Kentucky's utilities have not been involved with a substantial sale of electricity to or the purchase of electricity from qualifying facilities. Therefore, PURPA is unlikely to have a direct or immediate affect on Kentucky.

5. **Question** - Would any constitutional issues be raised by federal legislation:
 - a. mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?

- b. requiring states to conduct a proceeding on retail competition, reserving to the state discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?

Answer - a.) We believe the 10th Amendment to the Constitution could possibly be at issue in federal legislation requiring states to take certain actions regarding matters traditionally within their sovereign powers.

b.) The impact of the 10th amendment would be reduced if states are permitted the discretion to act in their consumers' best interests.

6. **Question -** From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?

Answer - For Congress to mandate retail competition assumes that "one-size-fits-all" is applicable in the electricity industry. Kentucky's opinion is that states have more exact and complete knowledge of their own markets, generation, stranded costs, customer needs and other factors that would enable states to make informed decisions on retail competition. For Congress to fail to grandfather state legislation would ignore the carefully crafted work the states have performed knowledgeably and diligently in order to protect the public interest of the state. We believe that states have the expertise to adequately address the myriad of issues that must be addressed individually by state but which will further the collective good of the nation. From a practical standpoint, we believe that to not grandfather state legislation could detrimentally disturb

the financial markets, disrupt industrial economic development plans, cause significant residential customer confusion, and at the very least require states, utilities, and consumer groups to expend significant time and resources redoing and undoing the work they have already done.

7. **Question** - In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.

- a. Are you aware of any study or analysis relevant to your State that supports this conclusion?
- b. Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.

Answer - There are no studies in Kentucky that support the conclusion that large industrial customers are reaping any benefits that are not also enjoyed by the residential classes. We do have one provision that allows industrial customers to gain a temporary rate reduction if they provide a specified level of new jobs or investment in the state. Overall, this provision helps the economy and the residential consumer.

Historically, Kentucky has used the industrial class to subsidize the residential class. In the late '80's we adopted cost of service as a goal. However, we simultaneously adopted the concept of gradualism (meaning slowly removing the subsidies). Since that time, we have had very few rate cases and, therefore, few opportunities to shift the subsidized costs. Industrial rates have remained virtually in the same proportion to residential rates as they were prior to our cost-of-service goal.

Finally, there have been few filings and even fewer approvals of special contract rates for industrial customers. Kentucky has virtually the lowest industrial and residential rates in the nation, and we do not favor one class over another. The trend has not altered as you can see from our rate comparisons in Attachment 1. We trust this answers both parts of the question.

8. **Question** - Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.

Answer - Please see Attachment 1. In summary, Kentucky's rates have remained stable or dropped since 1990 through 1995. As you review Attachment 1, keep in mind that we did this analysis based on revenue per class; therefore, significant changes in the average costs are primarily due to changes in volume and usage patterns affecting demand charges. We do not have 1996 information readily available at this time, but if you wish to review this information later, please contact us. We need to add

that we do not regulate municipal electric systems nor do we regulate TVA distribution cooperatives located in Kentucky.

We have an automatic adjustment clause for fuel. The rates have recently dropped as a result of our efforts and the utilities' efforts to procure coal at lower prices. Otherwise, we have had no major construction, have had considerable job downsizing and few rate cases since 1990. We have not altered the revenue allocation in any of the customer classes. See answer to number 7.

9. **Question** - Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility shareholders or the highest bidder?

Answer - Kentucky does not favor Congressional action on retail competition. Having reiterated this position, we will attempt to answer this question .

- We believe at this time that ratepayers in Kentucky may see an increase in rates if federal legislation is passed. This, of course, will depend on how the legislation is constructed, but if high cost states are the recipients of our native load at low cost prices, our ratepayers may have to buy power from higher cost generating units. Under this scenario, it would follow that stockholders would benefit. On the other hand, if Kentucky utilities with excess reserves sell only the reserve margins

outside the state, and keep the native load requirements, it would appear that both stockholders and ratepayers may benefit.

- Congress should consider all factors relating to the issue. For instance, even if a state has high cost electricity, its wage thresholds have probably factored in the high cost of electricity and vice versa with low cost states. Kentucky's wage scales are far less than, for example, New York's wage scales due to cost of living differentials.

Congress should also consider the depletion of states' resources and future state costs and environmental shifts and losses as resources are depleted. Moreover, Congress has other avenues to incent low-cost power generation through tax credits, low-cost loans or even through negative approaches. These issues should be explored. Retail wheeling is a serious issue, one that should be viewed in totality. Although telecommunications, trucking, banking and airline industries have been deregulated, the consequences for the individual were not as severe. A lack of electricity even for a day in freezing weather conditions would be life threatening. This industry is the lifeblood of the nation and must be given the care and consideration as such. A prudent review and enactment by each state should precede federal involvement. Congress can intervene if state efforts are not successful. Federally mandated retail competition assumes that states cannot address the issue.

- The benefits of low cost resources should be shared. Moreover, at no time should the highest bidder be the total recipient of low cost resources without a full

sharing of all benefits. If Congress enacts legislation, it must consider the needs of the most vulnerable segments of society, i.e. low-income consumers, the elderly, low income healthcare facilities, etc.

10. **Question** - Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity", (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interest does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?

Answer - Kentucky has not adopted retail competition and has not taken a position on this issue.

11. **Question** - If Congress were to require "unbundling" of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?

Answer - Many problems may arise if Congress enacts legislation unbundling local distribution services. Primarily, the pricing of these individual services will require significant scrutiny, especially if the generation owners are also the owners of the distribution company. Cross subsidy analysis will be intense. Customer confusion will be heightened, just as we've seen in the telecommunications industry but probably at an even greater degree. Depending on the legislative mandate, we may have problems

with supplier of last resort and obligation to serve. Depending on the issues involved in the legislation, there are other complications that could arise.

12. **Question** - Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?

Answer - The word connection complicates this question. If physical connection is the emphasis of the query, the answer is no. If the emphasis is on problems we foresee with public or federal power, we are concerned that federally funded power generators have a significant market advantage over investor-owned utilities. True competition could not be achieved if these advantages are allowed to continue.

13. **Question** - How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?

Answer - The Kentucky Commission has not calculated the loss of funding but we expect it could be serious. We are funded through assessments on the gross receipts of utilities and competition could shift the assessment level to the other regulated industries; however, this seems quite unfair. Competition moves in stages. Incumbent utilities generally enjoy a dominant market power position for some time until other generation utilities gain customer recognition and all classes of consumers understand the process. We also expect that aggregators and marketers will need some oversight with at least a minimum code of conduct or minimum service requirements.

If the Commission is required to make and/or enforce these requirements, to be fair the assessments should come from these sources.

14. **Question** - Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?

Answer - Kentucky has not adopted legislation. We will, however, add that we have little stranded cost exposure. The issue is of importance but not to the degree in many other states.

15. **Question** - There is a wide divergence of opinion as to whether or not **PUHCA** should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.

- a. Do you believe PUHCA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?
- b. Do you believe Congress should modify or repeal PUHCA? If so, why, and under what, if any, conditions?
- c. Should Congress enact legislation to modify the holding in Ohio Power Co. V. FERC, 954 F. 2d 779 (D.C. Cir. 1992)?

Answer - Kentucky has not formulated a position regarding the repeal or modification of PUCHA. However, it appears that PUCHA is somewhat cumbersome and creates an unlevel playing field for those companies covered by the Act. On the other hand, PUCHA discourages inappropriate and unfair business practices which could accelerate given the level of merger activity, as you mentioned. As Kentucky has three of the nation's 14 utility holding companies regulated under PUCHA, any reform to PUCHA is very important to Kentucky and must be done carefully. The Commission is concerned about the allocation of costs by utilities between regulated and unregulated subsidiaries and, of course, any violations or abuse of market power involving antitrust practices. These concerns may heighten given the level of merger activity. Any reform of PUCHA must continue to provide states access to the books of electric service providers and their affiliates. If utilities are required to unbundle services and certain aspects of utility operations become unregulated, especially in large merged utilities, the PSC will have difficulty in protecting Kentucky consumers against the misallocation of costs between regulated and unregulated business activities, as well as market power abuses.