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Subject: Prefiled Statement

June 8, 2005

To: Bob Amato
Jason Bentley
Richard Raff
Michael Burford

From: Tom FitzGerald

Re: Administrative Case 2005-00090

Thank you or the invitation to participate in the Technical Conference on June 14 in PSC Case No. 2005-00090. I have attached in word format my written prefiled statement, and look forward to the conference.

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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COMMISSION

In the Matter of:)
) ADMINISTRATIVE CASE
AN ASSESSMENT OF KENTUCKY'S) NO. 2005-00090
ELECTRIC GENERATION, TRANSMISSION)
AND GENERATION NEEDS)

PREFILED STATEMENT OF THOMAS J. FITZGERALD
DIRECTOR, KENTUCKY RESOURCES COUNCIL, INC.

This prefiled statement is submitted by Tom FitzGerald, Director of the Kentucky Resources Council, Inc. (KRC), on behalf of the Board and membership of the KRC. KRC is a non-profit membership-based environmental advocacy organization providing legal and technical assistance without charge to low-income individuals, to community groups and to local governments on a range of environmental quality and health issues.

KRC appreciates the invitation of the Public Service Commission to participate in this Technical Conference on Case No. 2005-00090. KRC appreciates also the recognition by the Governor Fletcher in Executive Order 2005-121 that a “comprehensive statewide assessment of Kentucky’s infrastructure – generation, transmission and distribution – which includes reasonable projections of future electricity requirements,” is an essential

to the intelligent crafting of a “strategic blueprint” for investment and policy-setting. My comments address what I believe are the top issues facing the electric power industry in Kentucky in the next 20 years: the need for full-cost accounting and the specific challenges of carbon and mercury control.¹

While the assessment will help illuminate the current infrastructure situation and the current projections for native load growth, as well as the considerations being evaluated by the utilities in determining how to meet that load growth, the assessment alone will *not* provide a strategic blueprint for our energy future. Rather, as we create a blueprint for regulatory policy and public and private investment, we must first consider the *goals* of the blueprint, and make transparent the assumptions we make and core values that animate the process and which we consider to be immutable.

I was asked to participate on this panel as one representative of environmental concerns. By way of "full disclosure," for twenty-five years I have represented low-income citizens, organizations and on occasion local governments in environmental matters in this Commonwealth - four as a

¹ The letter of invitation from the Commission chair asked also that witnesses comment on additional information or data needed to support development of the strategic blueprint. Many of the points and concerns raised in these comments suggest additional data requests – for example, what steps have been taken by the utilities to diversify their fuel mix, to encourage end-use energy efficiency, and to explore potential efficiencies in other models of generation and distribution of power? Additionally, what strategic planning have the individual utilities engaged in to anticipate and address carbon capture and reduction requirements?

legal aid attorney with the eastern Kentucky legal services corporation grantee Appalachian Research and Defense Fund of Kentucky, 21 as director of the Kentucky Resources Council, a non-profit provider of free legal and strategic assistance on environmental matters. My perspective has been forged by my experiences with the underside of the energy industries in this state. I have buried one client who was crushed to death in a slurry impoundment collapse because of poor design, poorer construction, and non-existent state and federal oversight. And I have watched the quality of life of many thousands of others suffer at the hands of coal and non-coal mining and oil and gas operations. KRC represents those who live downhill, downwind and downstream, and who have disproportionately borne the brunt of our failure to fully cost our energy choices and energy utilization to the triple bottom line.

At the outset, I note that the goals outlined in the Commission's Order – of promoting future investment in electricity infrastructure, protecting the low-cost advantage of the state, maintaining affordable rates, and preserving Kentucky's commitment to environmental protection, can be achieved only through policies that embrace full-cost accounting and which seek long-term, sustainable power generation and utilization and not minimum regulatory compliance as the goal.

We cannot “balance” energy development with environmental protection. The premise that protection of air, water and land resources must be moderated has undergirded our current failed energy policies – policies which have admittedly provided low direct costs for energy but have done so in part by shedding and avoiding ownership of environmental, health, and other costs. You cannot “balance” environmental and public health protection with energy development and hope to sustain a healthy economy, society and planet. Balancing assumes continued degradation that we can ill afford, with a 70% reduction in atmospheric carbon loading needed to stabilize climate, with mercury contamination from coal combustion so pervasive that consumption of fish by sensitive subpopulations becomes a health-threatening activity, and with peer-reviewed public health literature daily underscoring the direct link between elevated fine particulate levels and a range of adverse health consequences disproportionately falling on those least capable of protecting themselves.

The recognition that responsible energy policy must factor in environmental and public health protection as an integral driver of energy investment and regulatory policy, is an important first step towards a rational energy policy.

The role of the PSC could not be more pivotal in helping to create the transparency and accountability needed to better choose a rational energy future. While there are a number of forces at play that can only be dimly perceived or predicted, the extent to which traditional issues of necessity and convenience and reasonableness of rates, are reframed to include the full gamut of policy choices and implications of choices, will have a significant impact on whether the transition to more sustainable energy generation and use is relatively seamless and efficient in this state or chaotic and at a dear cost.

Kentucky has lagged behind many parts of the nation in development of potential renewable resources, and in end-use energy conservation. We are one of 22 or so states laboring under the powerful and harmful myth that environmental quality and economic progress are in conflict and that too much emphasis on accountability for pollution is bad for business. We have enshrined in all of our major environmental laws the edict that we will be “no more stringent than” the federal minimum standard, so that the federal floor has become our ceiling. We have not tended to lead in policy areas, which in the case of restructuring was a blessing since the legislature and past administrations understood that the vast majority of Kentuckians would lose in a deregulated marketplace. We have heavily subsidized our

extractive industries, both with direct financial subsidies, and with indirect subsidies in the form of burdens disproportionately inflicted on residents of the regions from which the natural resources are extracted, through which they are transported and in which they are burned and their wastes dumped.

The Kentucky Public Service Commission has performed well the traditional functions of demanding reliability and nondiscrimination in service, and moderating the pricing of energy services for investor-owned and co-op utilities. But it is no longer enough. Our challenge, as a state whose economic fortunes have been tied to extractive industries and to industries attracted by the lowest combined electric rates in the nation, is to come to terms, culturally, politically, legislatively, economically, with the inevitable trends that are obligating us to include and account for the costs that have been shifted off-budget for so long and at such dear cost to a relative few – the impacts of rock-bottom environmental policies from coal and other fossil fuel producers on air, land and water resources; the impacts of combustion of coal on public health from particulate, ozone-forming and air toxic releases; the pollution from disposal of wastes generated by fossil fuel beneficiation and combustion.

We have a public that increasingly expects and demands the opportunity to participate in decisions concerning the siting of facilities and transmission

lines, and which is very resistant to accepting the centralized risk of hosting a new generation of merchant plants while bearing the burden of pollution from the aging fleet of existing units that are not equipped with the full range of pollution controls. We expect cheap, reliable power and are more than happy to let someone else pick up the tab for those parts of the costs that we don't pay. As the Chinese call each year by a symbolic name – the year of the horse, or the dragon, this year promises to be for Kentucky the “Year of The Transmission Line” as we grapple with the impacts to landowners and the environment of constructing new lines across the state to support regulated and merchant units.

The new mercury standards; the NOx SIP call; the recent call for significant reductions in the fine particulates air quality standard and the adoption of the new final CARB ozone standard – these and more will continue to drive up the costs of generation of electricity from certain plants, and will in turn make the costs of deployment of a new generation of plants more cost-competitive and attractive to investors. To the extent that proper planning anticipates and responds to new mandates, the utility company investors will not suffer since the costs are passed through via direct cost recovery mechanisms and through rate adjustments.

But the impacts of rising heating and cooling costs will spur increasing pressure on the PSC to demand more accountability of another historic “externality,” which is the assurance of affordability of basic service for fixed and low-income residents. The prospect of sharply rising prices for essential service create a very real crisis that has profound moral overtones for any state and nation that calls itself civilized. Already an issue fraught with conflict and once historically considered by the commission as being outside of the scope of the ratesetting process, the increasing costs of power and the profligate waste of energy in heating and cooling that has accompanied artificially low pricing of energy, presents both a challenge, and an opportunity to moderate use and costs by substantially increasing investment in end use efficiency.

If we are to craft a more rational energy policy, it must fully cost and fairly price energy by accounting for the ecological, health and safety impacts of the production and utilization of energy. The consumer cost of energy has not historically incorporated environmental and public health costs associated with combustion of fossil fuels, and instead those costs have been paid in public and occupational injury and health impacts, environmental degradation, water and air pollution, and loss of economic opportunity.

In the production sector, pricing of electricity and other energy must more fully account for the costs of responsibly producing, transporting and converting those fuels. Our economic fortunes – such as they have been in a state where abject poverty is still the norm for many and third-world living conditions are still all too prevalent, has been tied to our artificially low energy costs. There are a number of forces at play that will cause a greater internalization of those costs of extracting and combusting fossil fuels for power. How we become and remain prosperous and healthy depends on our ability to understand and our willingness to accept change, and our wisdom to craft paths towards success out of chaos.

Coal-fired electricity will continue to make up a significant percentage of the national and regional profile in electricity supply, and a very significant percentage of Kentucky's supply. Where and how it is produced and used will depend on decisions within the coal and utility industries, and state legislative and administrative agency policy directions.

Within the coal sector, the industry has been living on the edge environmentally for many years, and the bill has come due. The industry has been rocked by judicial decisions that have challenged its waste disposal and mining practices, and it must reconfigure extraction and spoil management

approaches to respond to regulatory and judicial decisions. Formerly accepted practices, such as construction of fills in watersheds; mining under homes; hauling overweight on small rural roads; mining near and in streams without adequate protection of stream health; dumping coal mine wastes in slurry impoundments; have all come under new scrutiny and opposition. Coal combustion in utility plants is increasingly identified as a significant cause of failure to maintain healthy air quality in areas of the state, and in disruption of the use of public lands for recreational purposes. These issues will affect which reserves are economically and technologically accessible, how they can be mined, and the waste products managed for disposal.

The role of research, applied technology, and creative engineering in addressing these challenges has never been more important. The question is not only whether the industry can adjust technologically, but whether the political and cultural environment within the industry has enough wisdom and commitment to allow the profession to address these challenges.

I am not particularly sanguine about the near-term. We are so used to being a cheap date – a state whose attractiveness to industry has been a combination of rock-bottom environmental standards and cheap power -- that we have a hard time envisioning ourselves otherwise. The tension

between the new economy and the old, between the desire for clean and cheap power and the desire to advance the interests of the Kentucky coal industry, have surfaced in several issues, such as allocation of NOx credits and tax breaks for combusting Kentucky coal under the auspices of clean coal tax credits. There is as yet no apparent consensus on the goal or the strategies to achieve it. As part of the blueprint development, a clear-eyed review of the subsidies for extraction and combustion of fossil fuels for the generation of electricity, and the positive and negative impacts of those subsidies, is appropriate.

The coal industry has never been long on introspection. Throughout the thirty years that I have worked on environmental issues related to the coal industry, the industry I have observed has been incapable of recognizing that extracting coal and upending the earth to do so; handling and disposing of wastes; moving the product from mine-site to market; combusting the coal in power plants not designed with Best Available Control Technologies; and disposal of combustion wastes; cause harm to the public's resources and the legitimate rights of others. The full costs have not been accounted for, prevented and minimized. Instead, it is always someone else's fault – environmentalists, Washington, the jealous Northeastern states, the UN, God. The self-image the industry sees is a bunch of good apples with maybe

one or two rotten ones, beleaguered and set upon by ignorant citizens fueled by misinformation and a vengeful press.

The truth is that the industry, through its bottom-line, skating-on-the-edge approach to mining, to worker safety, and to social responsibility, has brought its woes on itself, and that the viability of the eastern coal industry in the short-term will rest on the industry's ability to understand and resolve, not avoid and ignore, several core issues relating to mining. The propensity of the industry to ride the margin, profiting while the market is high and bankrupting companies when the inevitable bust follows the boom, adversely affects confidence in the companies and is a direct cause of the difficulties that the industry faces in obtaining bonding and insurance coverage. The failure of the coal industry to come to terms with the need for reform in areas such as hauling overweight, excessive and improper blasting practices, end-dumped fills, and damage to water supplies, reflects an industry still in denial. Anyone with passing familiarity of the lay of the land in the coalfields would have to note the resurgence of vocal communities and coalfield citizens groups, fueled by anger at the scale of abusive practices, including massive end- and side-dumped fills, overweight haulage on secondary rural roads, as perhaps the most significant trend in recent

years in the area of coal mining. It is not going to end until the practices are reformed.

Coal will continue to be the fuel of choice for electric generation in Kentucky and surrounding states in the near term, though the extent to which western US coal will continue to displace eastern coal will depend on a number of factors. In the short and mid-term, eastern coal generally and Kentucky coal specifically, will continue to gradually lose market share, as companies who produce in this region maximize their profit from their western holdings, and utilities continue to purchase lowest-cost fuel. Barring mandates to install flue gas desulfurization controls on all utility plants, western Kentucky coal fortunes will not dramatically improve. The short-term question is whether, in an effort to lower costs to maintain market share, the industry will continue to cut corners on mine safety, reclamation and protection of the public off-site. The future is always less than clear, but in order to create a more sustainable role for Kentucky coal as a bridge fuel, creative engineering and technology application, and a regulatory framework intolerant of shoddy mine planning and execution, will be needed to find better approaches to key questions such as spoil and processing waste disposal, transfer from mine-site to market to minimize disruption to

communities and relieve stress on minor roads, and protection of water supplies.

The goal for state and federal agencies regulating coal extraction, combustion and disposal should be conservative design, not minimum compliance. For thirty years my job has been to demand that accountability from the industry. It will fall to the research and educational institutions to show the state and industry the way to use better design, better planning, and better engineering to meet the triple bottom line if they have the wisdom to take the high road instead of continuing to haul, overweight, on the low road.

For the PSC, how to account for, and cost for, the impacts of coal extraction, transportation, utilization and disposal in the pricing of the electricity generated by coal-fired plants will be key. If we are to encourage excellence in mining and conversion of the fuel, we must reward those values rather than sales of more power from the lowest-cost units.

For the natural gas industry, the sustained increases in prices have spurred new interest in exploration and production from both traditional and non-traditional sources. A number of challenges face an industry that increasingly is in conflict with local governments and landowners over

resource conflicts. It must assure that production of oil, gas, coalbed methane, and other fossil fuels occurs under a regulatory framework that is protective of the rights of surface landowners and requires protection of groundwater and surface water resources.

In the area of incentives, Kentucky has numerous incentives in law for use of fossil fuels – but where are comparable incentives for energy efficiency and diversification of the utility portfolios? Are we not doing a disservice to ratepayers by failing to meaningfully anticipate the need to diversify the fuel mix and to evaluate alternatives to the centralized generation and delivery model of supply?

End-use conservation measures and renewables are available today, at prices that are competitive but being ignored by utilities. For example, right here on the Ohio River, there are three new hydroelectric plants, FERC licensed and ready to be built. But even though the costs of this power is competitive or even lower cost than coal, each utility in this region has developed a creative excuse as to why they don't want this power. These plants offer 240 MW of clean power, but no one wants it in an environment where tax credits are available to build coal plants and burn coal. The incentivizing of electricity generation through a tax and rate policy that

favors lowest cost power but defines “cost” in a manner that skews and fails to require capture and accounting for the full range of costs, is indefensible, and will dig deeper the hole out of which we must climb when carbon restrictions are imposed.

Many states now have renewable energy portfolios. There is a move in Washington for a national renewable portfolio, in order to get all the states on the same page. This same trend is beginning to happen with respect to CO2 emissions, and will have a significant impact on Kentucky that should be part of the regulatory planning equation now.

Efficiency in terms of conversion of fuels and utilization, represents an area of significant potential for this state. The artificially low cost of electricity and natural gas has historically dampened conservation measures and investment in efficiency. Investing in available energy conservation technologies that if deployed can create value, cut precursor emissions, and address the central consideration in our energy usage – the tremendous benefit of investment in energy conservation and efficiency in curbing pollution loading and controlling the rate of growth in energy consumption.

The state should utilize tax policy and its role as a “consumer” to affect the development and deployment of alternative fuels and of responsibly-produced power.

The development of a sound energy policy requires a clear separation of function and mission between the regulatory agencies and those agencies whose mission is to promote development of particular energy sectors. That separation of function must be clearly understood and respected.

The budgetary and systems management situation within the regulatory agencies must be addressed. In order to assure that energy development, transportation, conversion and waste disposal are properly managed to minimize impacts, agencies must have the resources necessary to fully implement and administer environmental and workplace safety and health programs, and systems for managing compliance, permitting and enforcement information must be such that they facilitate rather than hinder effective delivery of the investigative, licensure and enforcement functions of those agencies.

Finally, and perhaps most significantly, carbon emissions are the 800-pound gorilla in the living room that no one wants to acknowledge about in the hope that denying its existence will cause it to disappear. Our state will

inexorably be drawn into better control of precursors of global warming, for while some remain skeptical, the overwhelming weight of scientific thought underscores the very real and very disruptive impacts of global warming on the health and welfare of nations and their economies.

The United States is responsible for some 22% of the world's CO₂ emissions, with power plants, mainly coal-fired, responsible for 1/3 of US emissions. Stated alternatively, power plants in the US, mainly coal plants, and mainly in the Southeast, are thus responsible for over 7% of all the CO₂ emissions in the world.

And as a state that is overwhelmingly dependent on coal combustion to supply our electricity, and one where coal mining remains an important industry, we are more vulnerable than perhaps any other state to the adverse economic effects of a failure to plan for regulatory and tax policy shifts to address carbon emissions.

Increasingly, regulated utilities are seeking a higher degree of regulatory certainty in their choice of technology. While in part this desire for certainty is motivated by a natural desire to avoid risk by securing certification that the investment now in a high-end technology will continue to be thought of as prudent down the road, there is little doubt that the greater concern is that the decisions made now to deploy the new generation of coal-fired plants

will be determined imprudent in the coming decades for failing to anticipate and respond to the global crisis in carbon emissions.

Kentucky will be asked to grapple with this desire for certainty in the 2006 legislative session and beyond. It is certainly not unreasonable for consumers to insist that any certification process incorporate greater transparency and public input in the review and selection of generation technologies, that the process include as a key consideration the ability of the plant to capture and mitigate carbon and mercury releases, and that there be periodic benchmarking to review the prudence of continued development of certain technologies against other supply options, and including end-use conservation and renewables. As much as the utilities seek certainty through some certification of prudence to minimize the possibility that later disallowance will interfere with the ability to recover investment, the public will be seeking assurances that the investment in next generation coal plants is anticipating carbon avoidance as well as reductions, and is coupled with a greater commitment to diversifying the utility portfolios, increasing efficiency in energy generation and use, and in helping to predict and adjust to the effects of a higher-cost power. Certainty is neither needed nor warranted when the choice is merely among accepted technologies meeting minimum standards, but may be appropriate where the proposal is to exceed

current standards by using lowest-cost compliance technology, and instead to meaningfully respond to carbon and mercury pollution.

The impact of the national strategies for carbon reduction on the combustion of fossil fuels will dramatically affect a state producing significant tonnage of coal and a region relying on coal for most of its electrical output. A new power plant built today will be in service for the next fifty years, and within that time frame, regulatory restrictions and potentially carbon taxes will certainly be in place. From a climate change perspective, coal is the dirtiest fuel. For us as participants in this process, and for the PSC as regulators to ignore this when crafting a strategic blueprint, and when new coal fired plants are proposed and alternatives are considered, would be the height of irresponsibility, and will potentially lead to the state being uncompetitive in the future and being saddled with significant costs of compliance. As the PSC establishes and enforces utility regulatory policy and through those policies helps to shape the face of the utility industry as the new generation of facilities are developed, we do a great disservice to the ratepayers and the industry if we fail to define carbon sequestration and reduction as a central benchmark in the choice of technologies for electricity generation. Putting our heads in the sand doesn't

make the problem go away, and leaves us all the more vulnerable to significant unanticipated costs.

Within the utility industry and in our regulatory framework for the utility and fossil fuel industries, we need a new definition of the “bottom line.” Former Governor Patton framed a challenge in the presentation of his environmental agenda to the 2002 General Assembly which I think appropriate to considering the long-term interests of this region – a responsibility that falls to you since the utilities, particularly the investor-owned utilities, are more focused on quarterly dividends than on crafting equitable, sustainable long-term energy policy:

“Those things we hold dear about our state - the unique beauty of our landscapes, prime farmland, wildlife, recreational opportunities- have become even more important. As have our small towns and large cities, which offer citizens a sense of community and a high quality of life.

These qualities will determine our ability to compete for quality jobs in the new economy of the 21st century, where technology allows companies to locate virtually anywhere. Those areas that offer a high concentration of skilled workers and are attractive, clean and have a high quality of life will be the most successful.”

KRC appreciates this opportunity to be a small part of this important mission.

Tom FitzGerald