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**MEMORANDUM**

TO: Jeb Pinney, Acting General Counsel, Kentucky Public Service Commission

FROM: Emily Caudill, Regulations Compiler

RE: Proposed Amendment or New Regulation – 807 KAR 005:056

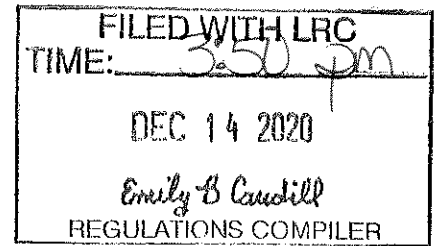
DATE: December 14, 2020

A copy of the administrative regulation listed above is enclosed for your files. This regulation is **tentatively** scheduled for review by the Administrative Regulation Review Subcommittee at its **March 2021** meeting. We will notify you of the date and time of this meeting once it has been scheduled.

Pursuant to KRS 13A.280, **if** comments are received during the public comment period, a Statement of Consideration or a one-month extension request for this regulation is due **by noon on March 15, 2021**. Please reference KRS 13A.270 and 13A.280 for other requirements relating to the public hearing and public comment period and Statements of Consideration.

If you have questions, please contact us at [RegsCompiler@LRC.ky.gov](mailto:RegsCompiler@LRC.ky.gov) or (502) 564-8100.

Enclosures



1 ENERGY AND ENVIRONMENT CABINET

2 Public Service Commission

3 (Amendment)

4 807 KAR 5:056. Fuel adjustment clause.

5 RELATES TO: KRS 61.870 - 61.884, 143.020, Chapter 278

6 STATUTORY AUTHORITY: KRS 278.030(1), (2), 278.040(3)

7 NECESSITY, FUNCTION, AND CONFORMITY: KRS 278.040(3) authorizes the Public Service  
8 Commission to promulgate administrative regulations to implement the provisions of KRS  
9 Chapter 278. KRS 278.030(1) authorizes utilities to demand, collect, and receive fair, just, and  
10 reasonable rates. KRS 278.030(2) requires every utility to furnish adequate, efficient, and  
11 reasonable service. This administrative regulation establishes the requirements with respect to the  
12 implementation of automatic fuel adjustment clauses by which electric utilities may immediately  
13 recover increases in fuel costs subjected to later scrutiny by the Public Service Commission.

14 Section 1. Fuel Adjustment Clause. Fuel adjustment clauses that are not in conformity with the  
15 requirements established in subsections (1) through (6) of this section are not in the public interest  
16 and may result in suspension of those parts of the rate schedules based on severity of the  
17 nonconformity and any history of nonconformity:

18 (1) The fuel adjustment clause shall provide for periodic adjustment per Kilowatt Hour (KWH)  
19 of sales equal to the difference between the fuel costs per KWH sale in the base period and in the  
20 current period according to the following formula:

$$\text{Adjustment Factor} = \frac{F(m) F(b)}{S(m) S(b)}$$

Where F(b) is the cost of fuel in the base period, F(m) is the cost of fuel in the current period, S(b) is sales in the base period, and S(m) is sales in the current period, all as defined below.

(2) F(b)/S(b) shall be determined so that on the effective date of the commission's approval of the utility's application of the formula, the resultant adjustment shall be equal to zero.

(3) Fuel costs (F) shall be the most recent actual monthly cost, based on weighted average inventory costing, of:

(a) Fossil fuel consumed in the utility's own plants, and the utility's share of fossil and nuclear fuel consumed in jointly owned or leased plants, plus the cost of fuel that would have been used in plants suffering forced generation or transmission outages, but less the cost of fuel related to substitute generation; plus

(b) The actual identifiable fossil and nuclear fuel costs associated with energy purchased for reasons other than as established in paragraph (c) of this subsection, but excluding the cost of fuel related to purchases to substitute for the forced outages; plus

(c) The net energy cost of energy purchases, exclusive of capacity or demand charges irrespective of the designation assigned to the transaction, if the energy is purchased on an economic dispatch basis. Costs, such as the charges for economy energy purchases, the charges as a result of scheduled outage, and other charges for energy being purchased by the buyer to substitute for the buyer's own higher cost energy, may be included; and less

(d) The cost of fossil fuel recovered through intersystem sales, including the fuel costs related to economy energy sales and other energy sold on an economic dispatch basis.

1 (4) Forced outages shall include [~~are~~] all nonscheduled losses of generation or transmission that  
2 require substitute power for a continuous period in excess of six (6) hours. If forced outages are  
3 not the result of faulty equipment, faulty manufacture, faulty design, faulty installations, faulty  
4 operation, or faulty maintenance, but are Acts of God, riot, insurrection, or acts of the public  
5 enemy, then the utility may, upon proper showing, with the approval of the commission, include  
6 the fuel cost of substitute energy in the adjustment. In making the calculations of fuel cost (F) in  
7 subsection (3)(a) and (b) of this section, the forced outage costs to be subtracted shall be no less  
8 than the fuel cost related to the lost generation until approval is obtained.

9 (5) Sales (S) shall be all KWH's sold, excluding intersystem sales. Utility used energy shall not  
10 be excluded in the determination of sales (S). If, for any reason, billed system sales cannot be  
11 coordinated with fuel costs for the billing period, sales may be equated to:

- 12 (a) Generation; plus
- 13 (b) Purchases; plus
- 14 (c) Interchange-in; less
- 15 (d) Energy associated with pumped storage operations; less
- 16 (e) Intersystem sales referred to in subsection (3)(d) above; less
- 17 (f) Total system losses.

18 (6) The cost of fossil fuel shall only include the cost of the fuel itself and necessary charges for  
19 transportation of the fuel from the point of acquisition to the unloading point, as listed in Account  
20 151 of FERC Uniform System of Accounts for Public Utilities and Licensees, less any cash or  
21 other discounts.

22 Section 2. Filing Requirements. (1) If a utility initially proposes a fuel adjustment clause, the  
23 utility shall submit copies of each fossil fuel purchase contract not otherwise on file with the

1 commission and all other agreements, options, amendments, modifications, and similar documents  
2 related to the procurement of fuel supply or purchased power.

3 (2) Any changes in the contracts or other documents filed pursuant to subsection (1) of this  
4 section, including price escalations, and any new agreements entered into after the initial  
5 submission, shall be submitted at the time they are entered into.

6 (3) If fuel is purchased from utility-owned or controlled sources, or the contract contains a price  
7 escalation clause, those facts shall be noted, and the utility shall explain and justify them in writing.

8 (4) The monthly fuel adjustment shall be filed with the commission no later than ten (10) days  
9 before it is scheduled to go into effect, along with all the necessary supporting data to justify the  
10 amount of the adjustment.

11 (5) Copies of all documents required to be filed with the commission under this administrative  
12 regulation shall be open and made available for public inspection at the office of the Public Service  
13 Commission pursuant to the provisions of KRS 61.870 [tø] through 61.884.

14 Section 3. Review of Fuel Adjustment Clauses. (1) Fuel charges that are unreasonable shall be  
15 disallowed and may result in the suspension of the fuel adjustment clause based on the severity of  
16 the utility's unreasonable fuel charges and any history of unreasonable fuel charges.

17 (2) The commission on its own motion may investigate any aspect of fuel purchasing activities  
18 covered by this administrative regulation.

19 (3) (a) At six (6) month intervals, the commission shall conduct a formal review and may  
20 conduct public hearings on a utility's past fuel adjustments.

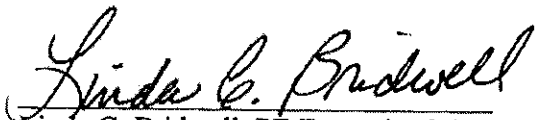
21 (b) The commission shall order a utility to charge off and amortize, by means of a temporary  
22 decrease of rates, any adjustments the commission finds unjustified due to improper calculation or  
23 application of the charge or improper fuel procurement practices.

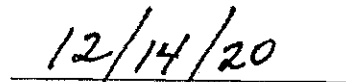
1 (4) (a) Every two (2) years following the initial effective date of each utility's fuel clause, the  
2 commission shall conduct a formal review and evaluate past operations of the clause, disallow  
3 improper expenses and, to the extent appropriate, reestablish the fuel clause charge in accordance  
4 with Section 1 (2) of this administrative regulation.


5 (b) The commission may conduct a public hearing if the commission finds that a hearing is  
6 necessary for the protection of a substantial interest or is in the public interest.

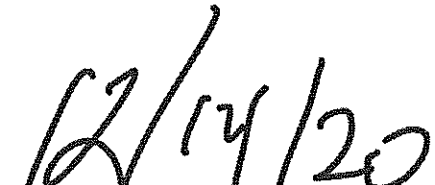
7 ~~[(5) For any contracts entered into on or after December 1, 2019, the commission shall, in~~  
8 ~~determining the reasonableness of fuel costs in procurement contracts and fuel procurement~~  
9 ~~practices, evaluate the reasonableness of fuel costs in contracts and competing bids based on the~~  
10 ~~cost of the fuel less any coal severance tax imposed by any jurisdiction.]~~

This is to certify that the Public Service Commission approved promulgation of this administrative regulation, pursuant to KRS 278.040(3), on December 14, 2020.

  
Linda C. Bridwell, PE Executive Director  
Public Service Commission

  
Date

  
Michael J. Schmitt, Chairman  
Public Service Commission

  
Date

**PUBLIC HEARING AND PUBLIC COMMENT PERIOD:** A virtual public hearing on this administrative regulation shall be held on February 25, 2021, at 9:00 a.m. Eastern Standard Time at the Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601. Individuals interested in being heard at this hearing shall notify this agency in writing, by five workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing is received by that date, the hearing may be canceled. This hearing is open to the public and instructions on how to attend and participate virtually will be published on the Commission's website at [psc.ky.gov](http://psc.ky.gov). Any person who wishes to be heard will be given an opportunity to comment on the proposed administrative regulation. A transcript of the public hearing will not be made unless a written request for a transcript is made. The Commission, however, will post a video recording of the hearing on its website. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments shall be accepted through February 28, 2021. Written notification of intent to be heard at the public hearing and written comments on the proposed amendment should be sent or delivered to the contact person listed below.

Contact person: John E.B. Pinney, Acting General Counsel, Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601, phone (502) 782-2587, mobile (502) 545-6180, fax (502) 564-7279, email [Jeb.Pinney@ky.gov](mailto:Jeb.Pinney@ky.gov).



## REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

807 KAR 5:056

Contact Person: John E.B. Pinney, phone 502-782-2587, mobile 502-545-6180, email [Jeb.Pinney@ky.gov](mailto:Jeb.Pinney@ky.gov)

(1) Provide a brief summary of:

(a) What this administrative regulation does: This regulation prescribes the requirements with respect to the implementation of automatic fuel adjustment clauses by which electric utilities may immediately recover increases in fuel costs subject to later scrutiny by the Kentucky Public Service Commission.

(b) The necessity of this administrative regulation: This regulation promotes reliable electric service at reasonable rates by creating a mechanism by which fluctuations in fuel costs, which are a significant and volatile cost in electric generation, may be reflected in customer bills in a timely manner, subject to commission oversight, without a more burdensome general rate adjustment proceeding.

(c) How this administrative regulation conforms to the content of the authorizing statutes: KRS 278.040(3) provides that the commission may promulgate administrative regulations to implement the provisions of KRS Chapter 278. KRS 278.030(1) provides that all rates received by an electric utility subject to the jurisdiction of the commission shall be fair, just and reasonable. KRS 278.030(2) provides that every utility shall furnish adequate, efficient and reasonable service. Administrative regulation number, 807 KAR 5:056, limits regulatory lag by prescribing a mechanism by which fluctuations in fuel prices, which are a significant and volatile cost in electric generation, may be reflected in customer bills in a timely manner, subject to commission oversight, without a more burdensome general rate adjustment proceeding.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: This regulation limits regulatory lag by prescribing a mechanism by which fluctuations in fuel prices, which are a significant and volatile cost in electric generation, may be reflected in customer bills in a timely manner, subject to commission oversight, without a more burdensome general rate adjustment proceeding.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: The proposed amendment deletes Section 3(5), so that the Commission is no longer required to subtract any severance taxes when evaluating the reasonableness of fuel costs in contracts and competing bids

(b) The necessity of the amendment to this administrative regulation: (1) a federal legal challenge has been brought alleging that 807 KAR 5:056 Section 3(5) is unconstitutional because it violates the Dormant Commerce Clause of the United States Constitution; (2) in the event that a federal court finds that Section 3(5) is unconstitutional, Section 3(5) will be enjoined and the Commonwealth may have to pay significant attorneys' fees to the prevailing party; and (3) removing Section 3(5) reduces regulatory uncertainty for regulated electricity generators whose reporting requirements to the commission may change suddenly based upon the legal challenge.

(c) How the amendment conforms to the content of the authorizing statutes: Administrative regulation number, 807 KAR 5:056, continues to limit regulatory lag by prescribing a mechanism by which fluctuations in fuel prices, whether up or down, may be reflected in customer bills in a timely manner, subject to commission oversight, without a more burdensome general rate adjustment proceeding. The amendment clarifies the application of the regulation by removing regulatory uncertainty related to the legal challenge to Section 3(5). The proposed amendment is consistent with the content of the authorizing statutes.

(d) How the amendment will assist in the effective administration of the statutes: The proposed amendment further clarifies the application of 807 KAR 5:056 by removing regulatory uncertainty related to the legal challenge to Section 3(5), and ensures customers continue to receive adequate, efficient and reasonable service through the utilities' timely recovery of volatile costs for fuel from diverse sources.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: The regulation will affect regulated electric generation and distribution utilities in the Commonwealth of which there are approximately 25.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

- (a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment: The amendment of the regulation will remove regulatory uncertainty related to the legal challenge to Section 3(5) and allow the regulated entities certainty in their fuel procurement practices. The commission does not anticipate the regulated entities having to take additional actions to comply with the amendments.
- (b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): Zero Dollars; no fiscal impact.
- (c) As a result of compliance, what benefits will accrue to the entities identified in question (3): The amendment resolves regulatory uncertainty, and thereby should ease compliance, which should ease the burden on the regulated entities while allowing the commission to maintain its oversight of fuel adjustment clauses.
- (5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:
- (a) Initially: Zero Dollars; no fiscal impact.
- (b) On a continuing basis: Zero Dollars; no fiscal impact.
- (6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: The commission does not anticipate this amendment increasing its enforcement cost. The commission currently funds enforcement of this regulation through its general operating budget funded through annual assessments paid by regulated utilities pursuant to KRS 278.130, *et. seq.*, and this amendment has no effect on that funding.
- (7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment: No fiscal impact.
- (8) State whether or not this administrative regulation established any fees or directly or indirectly increased any fees: No new fees are established and existing fees will not be affected.
- (9) TIERING: Is tiering applied? Tiering is not applied to this regulation, because it would not be appropriate. This regulation simply creates a mechanism by which fluctuations in fuel costs

incurred by each utility may be passed through to customer bills in a timely manner. Although the utilities to which this regulation applies vary in size and location, they function in a similar manner. Moreover, the amounts that are flowed through the fuel adjustment clauses, whether they result in increases or decreases in customer bills, will vary based on the size of the utility. The commission's review of the fuel adjustment clauses of smaller utilities will be less burdensome by virtue of the fact that there is less to review. However, while the total amounts flowed through the fuel adjustment clauses vary based on the size of the utility, the fuel costs will make up approximately the same percentage of the utilities expense and their customer bills regardless of the size of the utility, so there would be no basis for reviewing the amounts passed through fuel adjustment clauses more or less frequently based on the size of the utility.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

807 KAR 5:056

Contact Person: John E.B. Pinney, phone 502-782-2587, mobile 502-545-6180, email [Jeb.Pinney@ky.gov](mailto:Jeb.Pinney@ky.gov)

(1) What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? No impact.

(2) Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 278.040

(3) Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect. Zero Dollars; no fiscal impact.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? Zero Dollars; no fiscal impact.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? Zero Dollars; no fiscal impact.

(c) How much will it cost to administer this program for the first year? Zero Dollars; no fiscal impact.

(d) How much will it cost to administer this program for subsequent years? Zero Dollars; no fiscal impact.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

Revenues (+/-):

Expenditures (+/-):

Other Explanation:

## FEDERAL MANDATE ANALYSIS COMPARISON

807 KAR 5:056

Contact Person: John E.B. Pinney, phone 502-782-2587, mobile 502-545-6180, email [Jeb.Pinney@ky.gov](mailto:Jeb.Pinney@ky.gov)

- (1) Federal statute or regulation constituting the federal mandate: None.
- (2) State compliance standards: N/A
- (3) Minimum or uniform standards contained in the federal mandate: N/A
- (4) Will this administrative regulation impose stricter requirements, or additional or different responsibilities or requirements, than those required by the federal mandate? N/A
- (5) Justification for the imposition of the stricter standard, or additional or different responsibilities or requirements. N/A