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John E. B. Pinney  
Acting General Counsel  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, KY 40601

RE: *Duke Energy Kentucky, Inc.'s Comments on the Commission's Proposed  
Amendment to 807 KAR 5:056 Fuel Adjustment Clause*

Dear Mr. Pinney:

Please accept these comments submitted on behalf of Duke Energy Kentucky, Inc., (Duke Energy Kentucky or Company) regarding the Commission's proposed Amendments to 807 KAR 5:056 Fuel Adjustment Clause.

#### **I. Background**

The Kentucky Public Service Commission (Commission) has published its proposed amendments to its long-standing Fuel Adjustment Clause (FAC) Regulation, 807 KAR 5:056 (FAC Regulation). These amendments are intended to do the following: i) clarify potentially ambiguous language; ii) remove superfluous language; and iii) bring the language of the regulation in conformity with the drafting requirements of KRS 13A.222. More specifically, these changes remove the current requirement that the Commission must conduct a public hearing at six-month and two-year intervals, and instead make such hearing discretionary for the Commission. Additionally, and perhaps more significantly, the proposed amendment would allow the Commission to essentially ignore any impacts of the Kentucky coal severance tax required under KRS 143.020 (Kentucky Coal Tax) as part of the Commission's evaluation of the reasonableness of the utility's cost of fuel.

While Duke Energy Kentucky is generally supportive of the Commission's desire to streamline the administrative process of the fuel adjustment clause proceedings, the Company is concerned with the unintended consequences of the Commission's attempt to dissect the impact of the Kentucky Coal Tax from the utility's cost of fuel. Absent clarification, as written, this proposed revision raises several concerns as it relates to: i) how utilities conduct coal solicitations; ii) evaluate responsive bids for both Kentucky-sourced coal and coal from other states that have similar such taxes; and iii) how the Commission will consider the reasonableness of fuel costs going forward if it is able to ignore the Kentucky Coal Tax, but not any other state that imposes a similar such assessment. Duke Energy Kentucky respectfully recommends that the Commission reconsider this amendment or provide clarification such that any state that has a similar such tax on coal be equally excluded and that the tax itself is per-se reasonable for recovery under the FAC.

## **II. Discussion**

### **Discretionary Evidentiary Hearing**

Duke Energy Kentucky is supportive of the Commission's desire to make the six-month FAC hearing discretionary. Duke Energy Kentucky's experience is that the Commission's Staff is well informed and engaged in the review of the utility's periodic FAC filings. Further, these six-month hearings are somewhat routine and often times there are no issues, making the evidentiary hearing a formality. In order to appear at a hearing, the Company must publish notice, and appear before the Commission with multiple witnesses to answer few if any questions. The publication of a notice of the hearing and travel expense can be significant. This is particularly true for witnesses that must travel distances that cannot be reasonably accomplished in the morning of the evidentiary hearing.

The Commission's proposed revision would not change the fact that the Commission will conduct its investigation in six-month increments, nor would it eliminate the utility's requirement to respond to Staff's inquiries. The only change would be to allow the Commission to determine whether or not a hearing is actually necessary. The Company would support such a change, especially if it also allows the Company to avoid the expense of having to publish notice if such a hearing is not determined to be necessary.

#### Exclusion of KRS 143.020

The Commission is further suggesting that a new provision to FAC Regulation be added so to allow the Commission to evaluate the reasonableness of a utility's fuel costs in contracts and competing bids based on the cost of the fuel "less any tax collected under KRS 143.020." This suggested amendment to the FAC Regulation raises several concerns. At a minimum, the Commission should clarify that such an evaluation in no way results in any pre-determination that the Kentucky Coal Tax is *per-se* unreasonable and thus unrecoverable through the FAC.

KRS 143.020 sets forth a tax on the severing and/or processing of coal within Commonwealth of Kentucky, providing as follows:

For the privilege of severing or processing coal, in addition to all other taxes imposed by law, a tax is hereby levied on every taxpayer engaged in severing and/or processing coal within this Commonwealth at the rate of four and one-half percent (4.5%) of the gross value of all coal severed and/or processed during the reporting period; except that the minimum tax for a reporting period shall be an amount determined by applying a rate of fifty cents (\$0.50) per ton to the total number of tons severed during the reporting period. The minimum tax shall not apply to a taxpayer who only processes coal.

Because the Kentucky Coal Tax is required by Kentucky law, to the extent the tax is included in the utility's delivered price of coal, it should be *per-se* recoverable through the FAC. If the Commission's proposed regulation change is adopted, it should be clarified that associated taxes are recoverable.

While the proposed language to allow the Commission to exclude any impacts of the Kentucky Coal Tax when evaluating the reasonableness of a utility's cost of fuel is seemingly benign, this subtle addition will change the way Duke Energy Kentucky, and likely all jurisdictional electric utilities owning coal-fired generation, procure and evaluates the price of coal sources to use in its resource mix.

Presently, Duke Energy Kentucky solicits and receives bids from its solicitation that include a total delivered cost of coal per ton. The impact, if any, of the Kentucky Coal Tax from any Kentucky supplier is not an identified line item in the responsive bids that are currently received. In other words, although the Company suspects the Kentucky Coal Tax is embedded in the bids it receives from Kentucky suppliers, Duke Energy Kentucky does not actually know whether the coal suppliers are including this cost in their bid solicitations. In order to acquire this information and provide it to the Commission, Duke Energy Kentucky would have to request that this information be included as part of any future solicitation if this requirement is adopted.

Second, any requirement to list by line-item any state assessments on coal presents additional complications insofar as how the Company evaluates coal bids, particularly as it relates to other states that have similar taxes or assessments on coal. For example, West Virginia has a similar coal severance tax,<sup>1</sup> WVC § 11-13A-6,<sup>2</sup> and recently took action to reduce its rate.<sup>3</sup>

If the Commission is presuming that the Kentucky Coal Tax is an expense included in the bids, and then considers the reasonableness of a utility's fuel procurement exclusive of such tax, this now places all other coal from other jurisdictions that also include similar taxes and assessments at a competitive disadvantage. Duke Energy Kentucky must now reconsider how it

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<sup>1</sup> <https://tax.wv.gov/Documents/TSD/tsd210.pdf> Last viewed May 16, 2019.

<sup>2</sup> <http://code.wvlegislature.gov/11-13A-6/>

<sup>3</sup> <http://wvmetronews.com/2019/03/27/justice-signs-bill-lowering-coal-severance-tax/> Last viewed May 16, 2019.

evaluates competing bids. In order to compare these solicitations on an “apples to apples” basis, either all such assessments must be considered as a delivered price per ton (as currently occurs) or all such assessments must be excluded. Otherwise, the true reasonableness of the cost of coal is being determined in an arbitrary and intentionally one-sided manner, which may result in customers paying a higher cost. For example, assuming that the Kentucky Coal Tax were to equate to an approximately \$2.00 per ton “add-on” to the price per ton, and the Company is offered non-Kentucky coal at \$49 per delivered ton and Kentucky coal at \$50 per delivered ton, under the Commission’s proposed change, the Kentucky coal appears arbitrarily more reasonable because it looks like it only costs \$48 per ton when one ignores the Kentucky Coal Tax impact suggesting that the utility should select the Kentucky coal option. However, because the true or “all in” cost of the Kentucky coal is actually \$50 per delivered ton, customers would end up paying more for fuel than if the Company had purchased the lower cost alternative. This raises numerous questions and puts the utility in the untenable position of having to act contrary to the best interests of its customers by purchasing more expensive coal or else be questioned on the reasonableness of its fuel procurement practices.

Additionally, the exclusion of the Kentucky Coal Tax from the Commission’s consideration of the reasonableness of the fuel costs in contracts may have the extra-territorial impact of placing Kentucky-sourced coal on an unequal and more advantageous level than coal sourced from other states that also have a similar assessment or tax. Such a policy raises potential constitutional concerns under the Dormant Commerce Clause of the U.S. Constitution and makes the regulation’s enforceability questionable. The Dormant Commerce Clause is the principle that state and local laws are unconstitutional if they discriminate against or unduly burden interstate

commerce.<sup>4</sup> For example, in *Ky Power Co. v. Huelsmann*, the United States District Court for the Eastern District of Kentucky determined that KRS 278.214, which provided Kentucky retail electric customers a priority in terms of emergency curtailment to the exclusion of non-Kentucky customers was a violation of the Dormant Commerce Clause of the U.S. Constitution.<sup>5</sup> Likewise, the Commission's proposed regulation, to the extent it favors Kentucky-sourced coal by excluding the impact of the Kentucky Coal Tax from the Commission's evaluation of reasonableness while making no such concession for non-Kentucky sourced coal that may have a similar state-imposed tax or assessment would likely suffer the same constitutional deficiency.

Even if the proposal to exclude the Kentucky Coal Tax from its review of the reasonableness of the utility fuel procurement passes constitutional challenges, the Commission's proposal may still create unintended extra-jurisdictional consequences. Other states may then create similar such regulatory provisions to enhance the desirability of in-state sourced coal, and making the marketability and exportability of Kentucky-sourced coal outside the Commonwealth constrained. Such practices should not be encouraged.

### Recommendations

In order to alleviate the concerns raised above, and to avoid the potential constitutional debate of a policy to ignore the line-item of the Kentucky Coal Tax from the consideration of the reasonableness of the utility's fuel procurement practice, the Commission should simply maintain the status quo and consider the total delivered price of coal. However, if the Commission desires to have the information regarding the impact of the Kentucky Coal Tax, and all other similar such

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<sup>4</sup> See *Ky. Power Co. v. Huelsmann*, 352 F. Supp. 2d 777 (E.D. Ky. 2005).

<sup>5</sup> *Id.*; "As a result of the curtailment procedure in *KRS 278.214*, retail and wholesale customers in other states will have their service curtailed during transmission system emergencies while similarly situated customers in Kentucky will be unaffected. The *Dormant Commerce Clause* simply does not permit this result." *Id.* pg. 787.

taxes and assessments that exist in other jurisdictions where coal is procured, the Commission should include the flexibility such that the Commission *may* consider the reasonableness of the price of coal exclusive of *any* taxes or assessments by *any* state. Further, the Commission should also clarify that such an exclusion from its reasonableness consideration should in no way be considered a determination that such assessments are per-se unreasonable or unrecoverable by the utility through its FAC.

### **III. Conclusion**

Duke Energy Kentucky appreciates the opportunity to offer its comments to the Commission's proposed revision to the FAC Regulation. The Company is supportive of the Commission's intention increase its efficiency as it relates to the FAC as well as, its consideration of opportunities to examine and encourage the use of Kentucky sourced coal as a fuel. Nonetheless, such an endeavor must not come at the expense of constitutional protections or create unreasonable and complicated new processes for the utilities to change their coal procurement strategies.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read 'Rocco O. D'Ascenzo', is written over a horizontal line.

Rocco O. D'Ascenzo (92796)  
Deputy General Counsel  
Duke Energy Kentucky, Inc.  
139 East Fourth Street, 1303-Main  
Cincinnati, OH 45202  
(513) 287-4320  
(513) 287-4385 (f)  
Rocco.D'ascenzo@duke-energy.com  
*Counsel for Duke Energy Kentucky, Inc.*