

THE FUEL ADJUSTMENT CLAUSE: FREQUENTLY ASKED QUESTIONS

What is the Fuel Adjustment Clause?

The Fuel Adjustment Clause (FAC) is a mechanism that permits jurisdictional utilities to regularly adjust the price of electricity to reflect fluctuations in the cost of fuel, or purchased power, used to supply that electricity.

Why is the FAC necessary?

Fuel costs make up a significant portion of the cost of generating electricity. Fuel prices, including the price of coal (used to generate 95% of Kentucky's electricity) can fluctuate widely over relatively short periods, as can the price of purchased power. The FAC allows utilities to reflect those fluctuations in their electric rates without having to request changes in their base rates. Without the FAC, utilities would likely be required to file for more frequent adjustments in their base rates, and the changes in base rates would be greater.

Do utilities earn a profit on the FAC?

No. The FAC serves strictly as a mechanism for reflecting the costs of fuel and purchased power on a dollar-for-dollar basis.

How is the FAC amount determined?

The FAC is set against a baseline fuel cost that is incorporated within the consumption-based (per kilowatt-hour) portion of a utility's base rates. If the utility's fuel costs in a given month are above the baseline, the FAC appears as a per-kilowatt-hour surcharge. If fuel costs fall below the baseline, the FAC appears as a per-kilowatt-hour credit.

How often does the FAC change?

The FAC changes monthly to reflect the fuel costs incurred two months earlier.

Why doesn't the FAC drop right away when cost of coal declines?

In order to maintain adequate reserves, utilities typically purchase coal months before it is used and maintain an inventory that is generally equal to a one or two month supply. Thus the price of coal being burned to generate power in any given month is unlikely to correspond directly to the current market price of coal. Furthermore, in order to be assured of a reliable source of supply, utilities purchase much of their coal under contract. The contract prices may not correspond to the current market price. Thus, it usually takes several months for changes in coal (and other fuel prices) to be reflected in the FAC. But, because the FAC is used to pass through prices on a dollar-for-dollar basis, those changes will eventually be reflected in utility bills as either credits or, if prices increase, as surcharges.

Does the Kentucky Public Service Commission (PSC) review the FAC amounts for each utility?

Yes. The monthly FAC filings are reviewed for accuracy. A more detailed review is conducted every six months, at which time the PSC may disallow earlier charges because of factors such as improper calculations or improper fuel procurement practices, and order rate decreases accordingly. A final review occurs at two-year intervals and results in a resetting of the baseline fuel cost if necessary.

How does the PSC know if the FAC accurately reflects fuel costs for a utility?

Utilities are required to fully document all of their fuel costs. This includes submitting fuel purchase contracts and other materials to the PSC. The PSC may, on the basis of that information, determine whether or not a utility has done everything it reasonably can do to keep fuel costs as low as possible, while maintaining a reliable fuel supply.

Can the public access FAC information?

Yes. Most of the documents provided to the PSC become public records. The utilities' monthly FAC reports can be viewed on the PSC Web site. The six-month and two-year FAC reviews are conducted as cases before the PSC, with hearings that are open to the public. As with any other case before the PSC, members of the public may submit comments on the FAC cases.

What is the legal authority for the FAC?

The FAC process is set forth in detail in PSC regulation 807 KAR 5:056. The statutory foundations for the regulation are KRS 278.040, which gives the Commission exclusive jurisdiction over the regulation of rates and services of utilities, and KRS 278.030(1), which grants the PSC the authority to set rates that are fair, just and reasonable.