

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

ELECTRONIC INVESTIGATION OF THE FUEL)	
ADJUSTMENT CLAUSE REGULATION)	Case No. 2022-00190
807 KAR 5:056, PURCHASED POWER)	
COSTS, AND RELATED COST)	
RECOVERY MECHANISMS)	

ATTORNEY GENERAL'S COMMENTS

The Attorney General provides these Comments in response to the Kentucky Public Service Commission’s (“Commission”) investigation of the Fuel Adjustment Clause (“Fuel Adjustment Clause” or “FAC”) and related matters.

In the 2022 Regular Legislative Session, the Kentucky State Senate adopted Senate Resolution 316, which “urge[d] the Kentucky Public Service Commission to open one or more administrative cases to examine the issues of volatility of electric and natural gas fuel prices, the procurement practices of regulated utilities under its jurisdiction, and the use of securitization of utility costs as a strategy for easing the burden of utility costs on ratepayers.”¹ The Commission opened this docket, “[g]iven the request of the Senate and based on its own concerns[.]”²

Fuel prices are high and volatile chiefly because the Biden administration is adopting policies that increase the costs associated with the production and use of fossil fuels at a time when utilities must continue to rely on them to provide reliable,

¹ 2022 KY S.R. 316, 2022 Regular Session.

² Order of November 2, 2022 at 1.

dispatchable power. The Attorney General recognizes that the Commission has little ability to influence either federal energy policy or other national and international forces that are causing the volatile energy market. However, the Commission can take steps to mitigate some harms being experienced by ratepayers.

First, the Commission can take actions that support a common sense, all-of-the-above energy policy for the Commonwealth, in contrast to the extreme anti-fossil fuel energy policy of the Biden administration. Additionally, the Commission can and should take steps to ensure that the FAC is employed narrowly and conservatively to ensure that utilities do not use it as a substitute for prudent investment in their own reliable generation capacities.

- I. The Biden administration is erecting barriers to the production and use of fossil fuels, while utilities must rely on them to provide necessary dispatchable power.**
 - a. The Biden administration is making natural gas production and usage more difficult and expensive.**

President Biden campaigned on a platform of “end[ing] fossil fuel.”³ It comes as no surprise then that, as soon as he was sworn into office, he immediately took executive action to fulfill that promise. Just last month, he declared that there would be “no more drilling.”⁴ “Simply put, the regulatory and legislative agenda of the Biden administration has pushed to restrict and, where possible, eliminate drilling for oil and natural gas in the

³ *In intimate moment, Biden vows to ‘end fossil fuel’*, <https://apnews.com/article/9dfb1e4c381043bab6fd0fa6dece3974> (accessed November 10, 2022).

⁴ *Biden Promises ‘No More Drilling’ Just Days After Demanding More Drilling*, <https://www.forbes.com/sites/davidblackmon/2022/11/07/biden-promises-no-more-drilling-just-days-after-demanding-more-drilling/?sh=20d5f42e78e7> (accessed November 30, 2022).

United States.”⁵ Despite attempts by the EPA under the Obama administration, the President cannot dictate the disuse of fossil fuels directly.⁶ So, instead, President Biden is attempting to “end fossil fuel” in other ways. First, he pulled all available executive policy levers to restrict the production of fossil fuels directly. Further, the production he could not directly restrict, he sought to heavily regulate, and thereby increase the price in order to make alternative “renewable” energy sources appear more attractive.

Take direct restrictions. President Biden is directly restricting oil and gas production. Almost immediately, President Biden halted new oil and gas leases on federal land and water.⁷ Despite federal laws that require leases to be conducted quarterly,⁸ the administration failed to auction a single lease for the first year and half of his presidency. Then, in June of 2022, after his “pause” on federal leasing was invalidated in the federal courts, Biden tepidly resumed the sale of leases.⁹ But even then, the leases

⁵ *Id.*

⁶ *Supreme Court Rules EPA Cannot Require Existing Fossil Fuel Power Facilities to Shift to Lower CO2 Emitting Sources of Electricity*, <https://www.whitecase.com/insight-alert/supreme-court-rules-epa-cannot-require-existing-fossil-fuel-power-facilities-shift>, (accessed November 10, 2022). “On June 30, 2022, the Supreme Court ruled that the US Environmental Protection Agency (EPA) cannot use the Clean Air Act to require fossil fuel power facilities to implement a measure known as “generation shifting” without express authorization from Congress. Generation shifting was a measure EPA proposed that would have required a shift in electricity production from certain fossil fuel power generation sources, primarily fired by coal and natural gas, to other sources that emit less carbon dioxide.”

⁷ *Executive Order on Tackling the Climate Crisis at Home and Abroad*, <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/27/executive-order-on-tackling-the-climate-crisis-at-home-and-abroad/> (accessed November 10, 2022).

⁸ 30 USCA Sec. 226.

⁹ *Biden administration to hold its first oil drilling lease sales on federal lands*, <https://thehill.com/policy/energy-environment/3538914-biden-administration-to-hold-its-first-oil-drilling-lease-sales-on-federal-lands/> (accessed November 10, 2022); *Biden administration plans to resume plans for federal oil and gas development*, <https://www.reuters.com/business/energy/biden-administration-says-will-resume-plans-federal-oil-gas-development-2022-03-18/> (accessed November 10, 2022); *Federal Court Issues Permanent Injunction on Federal Oil and Gas Leasing “Pause,”* <https://www.foley.com/en/insights/publications/2022/09/federal-court-permanent-injunction-federal-oil-gas#:~:text=On%20August%2018%2C%202022%2C%20a,so%2Dcalled%20%E2%80%9Cpause%E2%80%9D> (accessed November 10, 2022).

were only offered on a much smaller scale with more restrictive terms. The June 2022 auction included, “a major reduction in the number of acres offered and an increase in the royalties companies must pay to drill.”¹⁰ These are just a few of the actions President Biden is pursuing to restrict oil and gas production.

Other direct restrictions target the use of fossil fuels after they have been produced. The Biden Administration is proposing a stringent new “Good Neighbor” regulation under the Clean Air Act, which would require significant emissions reductions for fossil fuel fired power plants and industries who utilize fossil-fuels in their processes.¹¹ These regulations are unnecessary to achieve the national ambient air quality standards (“NAAQS”) in effect.¹² This proposal is simply another means to restrict the use of fossil fuels.

Now take pricing policies. Though presidents have always sought to lower energy prices for Americans, President Biden is deliberately pursuing other policies that have increased and will continue to increase the price of fossil fuels. One example is the Biden administration’s increased regulation of methane emissions on gas production,¹³ a policy sure to increase the cost of extraction and therefore the price to the public. The

¹⁰ *Biden administration to resume leasing for oil and gas drilling on federal lands*, <https://www.cnbc.com/2022/04/15/biden-administration-to-resume-leasing-for-oil-and-gas-drilling-on-federal-lands.html> (accessed November 10, 2022).

¹¹ *Federal Implementation Plan Addressing Regional Ozone Transport for the 2015 Ozone National Ambient Air Quality Standard*, 87 Fed. Reg. 20036 (2022).

¹² *Attorney General’s Comment on Federal Implementation Plan Addressing Regional Ozone Transport for the 2015 Ozone National Ambient Air Quality Standard*, [https://www.ag.ky.gov/Press%20Release%20Attachments/KY%20AG%20Transport%20Rule%20Comment%20Letter%20\(final%20w%20signatures\).pdf](https://www.ag.ky.gov/Press%20Release%20Attachments/KY%20AG%20Transport%20Rule%20Comment%20Letter%20(final%20w%20signatures).pdf) (accessed December 1, 2022).

¹³ *EPA Proposes New Source Performance Standards Updates, Emissions Guidelines to Reduce Methane and Other Harmful Pollution from the Oil and Natural Gas Industry*, <https://www.epa.gov/controlling-air-pollution-oil-and-natural-gas-industry/epa-proposes-new-source-performance>, (accessed November 10, 2022).

administration has also implemented a “social cost of carbon” policy that would make major natural gas projects “impossible to permit,”¹⁴ and it has championed the inaptly named Inflation Reduction Act, which ironically will have the effect of increasing taxes on natural gas production.¹⁵ Those taxes will be passed on to ratepayers through higher prices. These are just a few of the many misguided actions President Biden has taken in his all-fronts crusade against fossil fuels.

In a vacuum, these policy choices would have been disastrous for ratepayers across the country, who rely on utilities powered by fossil fuels. But geopolitical events have exacerbated the impact of the Biden energy agenda on natural gas prices. Europe’s reliance on Russian natural gas supplies was tested when Russia invaded Ukraine, causing a decrease in Russian natural gas flows to Europe.¹⁶ U.S. suppliers have attempted to fill that void by increasing shipments of liquefied natural gas to Europe.¹⁷ The effect has been upward pressure on natural gas prices for U.S. consumers from whom

¹⁴ *Potential Carbon Cost Hike Spurs Fears of Energy Project Delays*, <https://news.bloomberglaw.com/environment-and-energy/potential-carbon-cost-hike-spurs-fears-of-energy-project-delays> (accessed November 10, 2022).

¹⁵ *Inflation Reduction Act Methane Emissions Charge: In Brief*, <https://crsreports.congress.gov/product/pdf/R/R47206> (accessed November 10, 2022).

¹⁶ *The role of natural gas in the Russia-Ukraine conflict*, <https://www.cnn.com/2022/04/08/the-role-of-natural-gas-in-the-russia-ukraine-conflict.html>, (accessed November 10, 2022); *EU struggles with how to cut off reliance on Russian natural gas*, <https://www.pbs.org/newshour/world/eu-struggles-with-how-to-cut-off-reliance-on-russian-natural-gas>, (accessed November 10, 2022); *Russian gas flows to Europe slide further in October, fall below 2 Bcm*, <https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/natural-gas/110222-russian-gas-flows-to-europe-slide-further-in-october-fall-below-2-bcm#:~:text=Russia%20gradually%20choked%20its%20gas,extent%20of%20Russian%20supply%20curtailments>, (accessed November 10, 2022).

¹⁷ *The U.S. Will Increase Natural Gas Exports to Europe to Replace Russian Fuel*, <https://www.scientificamerican.com/article/the-u-s-will-increase-natural-gas-exports-to-europe-to-replace-russian-fuel/>, (accessed November 10, 2022).

those natural flows have been diverted to meet European demand.¹⁸

b. Utilities increasingly rely on natural gas to provide necessary dispatchable power, a characteristic not offered by renewable generation.

President Biden's actions to "end fossil fuels" would lead one to believe fossil fuels are not a critical part of America's energy portfolio. To the contrary, those actions come at a time when our country increasingly relies on natural gas for reliable, dispatchable electricity generation.

Utilities in Kentucky, like those in most areas across the nation, remain reliant on fossil fuels, and natural gas in particular. That reliance will continue for years to come. Largely due to federal policies that disincentivized coal-based electric generation, Kentucky's energy generation mix is shifting from coal to natural gas. Since the 1970's, approximately 20% of Kentucky's generation has shifted from coal to other sources, predominantly natural gas.¹⁹ In 2021, 71% of electric generation in Kentucky was coal-

¹⁸ *The U.S. Is Exporting Natural Gas and Importing High Prices*, <https://www.barrons.com/articles/exporting-natural-gas-and-importing-high-prices-us-russia-europe-51661974541> (accessed November 10, 2022); see also *Public Citizen: Natural Gas Exports Driving up US Gas, Power Prices*, https://www.rtoinsider.com/articles/31151-public-citizen-natural-gas-exports-driving-up-prices?utm_source=ActiveCampaign&utm_medium=email&utm_content=Today+%40+RTO+Insider&utm_campaign=Daily+News+for+Paid+++Trial+Subscribers%3A+11%2F18%2F2022, (accessed November 18, 2022). "A surge this year in U.S. LNG exports – some with long-term contracts to Asia – is driving up domestic natural gas prices and contributing to uncertainty about the reliability of the electric grid as winter begins, according to consumer watchdog Public Citizen."

¹⁹ Order at 3-4. "In 1977, 95 percent of electricity production in Kentucky came from coal and 1.9 percent from natural gas. According to the Kentucky Office of Energy Policy, in 2020, 75.2 percent of generation in Kentucky came from coal, 17.3 percent from natural gas, and 7.4 percent from renewable energy." Further, the Commission went on to correctly identify that natural gas prices, even during times of relative stability, are more volatile than coal prices because coal is generally purchased through long-term contracts, while natural gas is purchased on a daily market. Order at 4. "Coal used for generation is generally secured via long-term contracts that remain in place for several years, securing a fixed price. Natural gas purchases, however, are generally made as daily spot purchases based upon a generator's immediate need."

based and 21% came from natural gas.²⁰ “The rest of Kentucky's electricity generation, less than one-tenth, came mostly from hydroelectric power plants, along with small contributions from biomass, solar energy, and petroleum-fired generation.”²¹

Aside from nuclear power, fossil fuel-based generation is the only source of generation that is readily dispatchable and reliable based on current, scalable technology. Kentucky’s climate does not provide adequate wind and solar capacity to make large-scale, rapid adoption of renewable resources cost-effective for utility ratepayers. Even if it did, the inherently intermittent nature of renewable resources carries unavoidable reliability risks requiring dispatchable backup power. Indeed, the nation is already experiencing major reliability problems in those regions where major shifts to renewable resources have occurred, and which lack adequate dispatchable resources to complement renewable resources.²² The Northwest and Southwest face growing risks as renewables continue to replace flexible coal and natural gas plants that can be dispatched when the sun goes down and winds are calm.²³ Meaningful, cost-effective battery capacity for

²⁰ *Kentucky State Profile and Energy Estimates*, U.S. Energy Information Administration, <https://www.eia.gov/state/analysis.php?sid=KY> (accessed November 15, 2022).

²¹ *Id.*

²² See, e.g., *Ensuring Electricity Reliability Must Be Job Number One For FERC*, July 29, 2021: <https://www.utilitydive.com/news/ensuring-electricity-reliability-must-be-job-number-one-for-ferc/604034/>

(accessed April 20, 2022); and *Renewable Energy Boom Risks More Blackouts Without Adequate Investment In Grid Reliability*, <https://www.forbes.com/sites/michaelshellenberger/2021/04/20/why-renewables-cause-blackouts-and-increase-vulnerability-to-extreme-weather/?sh=3ef335174e75> (accessed April 20, 2022).

²³ *Natural gas a critical 'reliability fuel' as renewables grow, NERC says*, S&P Global Market Intelligence, December 17, 2021: <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/natural-gas-a-critical-reliability-fuel-as-renewables-grow-nerc-says-68130328> (last accessed April 20, 2022).

wind and solar generation does not exist today.²⁴ As a recent PJM report notes, “[t]he proliferation of intermittent resources will also increase the need for controllable resources such as gas-fired combustion turbines and combined-cycle plants that can ramp and/or start up quickly.”²⁵

Therefore, given that federal environmental policy strongly favors new natural gas generation over coal-based generation—and in the absence of any realistic alternatives on the foreseeable horizon—utilities have no choice but to continue to invest in generation based on natural gas if they are to provide reliable service to their ratepayers. Unfortunately, this necessary reliance on natural gas comes at a time when radical environmental activists and their allied policymakers are actively engaged in a quixotic effort to “end fossil fuel.” The results are entirely predictable.

- c. The Biden administration’s efforts to disincentivize fossil fuels combined with current necessity to rely on natural gas to provide reliable electric service will continue to have the entirely predictable effect of increasing price for ratepayers and decreasing the reliability of electric service.**

The Biden administration and other ideologically driven policymakers have rushed headlong into an effort to subsidize renewables and disincentivize fossil fuel generation. Their failure to grapple with the technological limitations of their unrealistic policy goals is having the direct effect of increasing electric rates and reducing the reliability of service.

²⁴ *Wind and Solar Energy Don’t Work*, Powerline, February 10, 2021: <https://www.powerlineblog.com/archives/2021/02/wind-and-solar-energy-dont-work.php> (accessed April 20, 2022).

²⁵ *Reliability in PJM: Today and Tomorrow*, PJM Interconnection, March 11, 2021, at 25.

The Biden administration's efforts to drive natural gas out of use through regulation will not bring about its disuse but will only serve to increase its price. This is simply a function of supply and demand. President Biden's policies are limiting the supply of natural gas while demand for it increases. That is what ratepayers are already experiencing. Make no mistake, the high energy prices currently being experienced by Kentucky ratepayers are a direct result of the policy choices of President Biden and other like-minded policy-makers in Washington, D.C.

Further, disincentivizing the use of natural gas poses a reliability risk for utilities. Just last week, FERC Commissioner Christie stated that nuclear, natural gas and coal generators are shutting down "at an unsafe pace" to keep up with the transition to wind and solar, and, as soon as this winter, New England could see the large increases in utility bills and the potential for electricity shortfalls.²⁶ "The red lights are flashing everywhere."²⁷ "We're not going to have sufficient power supply."²⁸

Kentucky is not immune from these effects. In their Comments on the administration's proposed Good Neighbor regulation, LG&E and KU stated that their:

...primary concern with the Proposed Rule is the impact to reliability to the customers [LG&E and KU] serve[.]. As further discussed below, the dramatic contraction of emission allowances may lead to a potentially unbridgeable gap in resources... This loss of capacity would drop [LG&E and KU] below our target reserve margin range to reliably meet the needs of our service territory as set forth in our Integrated Resource Plan on file with the Kentucky Public Service Commission.

²⁶ *High Costs, Low Reliability Imperil US Grid, Regulator Warns*, <https://www.bloomberg.com/news/articles/2022-11-21/high-costs-low-reliability-imperil-us-grids-regulator-warns?sref=ZCWlnS6F&leadSource=uverify%20wall> (accessed November 22, 2022).

²⁷ *Id.*

²⁸ *Id.*

LG&E and KU went on to conclude that, “[b]y 2026,” “[t]his low level of reserve margin is likely to lead to periodic Energy Emergency Alert notices per the National Electric Reliability Corporation and ultimately rolling blackouts in the communities we serve.”²⁹

In Kentucky, utilities are required to provide reliable service to their ratepayers.³⁰ Reasonable utilities traditionally meet this requirement by ensuring they have the physical capacity to generate the energy their ratepayers need. But the policies of the Biden administration limit the ability of utilities to generate the electricity needed to provide reliable service to their ratepayers.

Some utilities may attempt to avoid the challenges presented by the Biden administration’s assault on fossil fuel by generating less electricity directly, and, instead, relying on variable and potentially volatile open market purchases of electricity to meet the energy needs of their ratepayers. But in time, if an increasing number of utilities choose to rely on market purchases and fail to engage in realistic, long-term resource planning and generation investment, the free rider problem will catch up with those unprepared utilities. In such a scenario, increasingly volatile and expensive market purchases will yield increasingly unaffordable rates for ratepayers, if energy is available to be purchased at all.

²⁹ See *Comment submitted by LG&E and KU Energy LLC*, June 21, 2022 in Docket ID No. EPA-HQ-OAR-2020-0272.

³⁰ 807 KAR 5:058(8)(1). “The plan shall include the utility's resource assessment and acquisition plan for providing an adequate and reliable supply of electricity to meet forecasted electricity requirements at the lowest possible cost.”

d. The financial damage of the Biden energy agenda is not limited to one's electric bill or trip to the gas station.

When energy prices increase, all prices increase. It is easy to see changes in energy prices at the gas pump, or when people open their utility bills. But what is not always readily apparent is the ripple effect energy prices and misguided energy policy have through the larger economy. A substantial portion of the price that we pay for groceries and consumable goods is driven by the energy needed to produce and transport those goods.³¹ So, when one visits the grocery store to buy food and sees that grocery prices are up 13.5% from this time last year, the highest rate since 1979,³² energy costs are a primary driver of that inflation.³³ Inflation is at a 40-year high and because energy is needed for everything that is fabricated, grown, operated or moved, the cost of energy is one of the biggest, if not the biggest, contributor to inflation.

In conclusion, natural gas prices are high and volatile due to policy choices in Washington, D.C. designed to subsidize renewable energy and disincentivize fossil fuel use and production. Rather than pursuing a balanced, all-of-the-above energy strategy that seeks to draw on all affordable energy solutions to power America, the Biden administration is dogmatically set on pursuing a renewables-only approach, irrespective of the affordability and reliability challenges that brings. Biden administration officials

³¹ *Food Prices Could Stay High. Energy Costs Are to Blame*, <https://www.barrons.com/articles/food-prices-could-stay-high-due-to-surg-ing-energy-costs-51660843083> (accessed November 14, 2022).

³² *Grocery store prices aren't coming down anytime soon*, <https://www.cnn.com/2022/09/30/business-food/grocery-store-prices-food> (accessed April 20, 2022).

³³ *How the energy crisis is exacerbating the food crisis*, <https://www.iea.org/commentaries/how-the-energy-crisis-is-exacerbating-the-food-crisis> (accessed April 20, 2022). "The surge in food prices since mid-2020 has been driven by factors such as ... rapidly soaring input costs, notably energy and fertilisers."

might consider coming to Kentucky, where electricity prices are increasing rapidly for some of the poorest communities, to see the results of their policy choices. Instead, clear-eyed policymakers should accept the reality that fossil-fuel based generation will continue to be an important factor in the modern industrial economy for the foreseeable future. The only thing that can truly be done to meaningfully reduce energy prices today, and therefore reduce electric bills, is to remove barriers to the use of fossil fuels. The Biden administration continues to do the opposite.

The Commission cannot increase the supply of natural gas available to Kentucky utilities (though it can, and should, continue to support its necessary use). However, the Commission can take some steps to mitigate the impact of high and volatile fuel prices.

II. The Fuel Adjustment Clause serves an important purpose, but changes can be made to mitigate some of the volatility experienced by ratepayers.

a. The Fuel Adjustment Clause serves a valuable purpose.

In general, regular, periodic adjustment of rates to account for changing fuel prices serves a purpose. If utilities did not recover fuel costs in such a fashion, requests to adjust base rates would be more frequent. Ratepayers pay for the expenses associated with rate cases. Worse still, failure to periodically adjust rates to account for changed fuel prices could result in unreasonable rates for ratepayers if fuel prices fall. In such a scenario, the utility would receive a windfall profit and would have no incentive to file a rate case. Thus, for these reasons among others, regular, periodic adjustment of rates to account for changing fuel prices is a good practice.

Nonetheless, the Commission should take steps to limit the volatility associated

with the FAC and to ensure utilities do not manipulate the fuel adjustment construct to benefit shareholders to the detriment of ratepayers.

b. Volatility of the fuel adjustment clause can be limited by allowing utilities to spread fuel costs over longer periods.

The Commission should allow utilities flexibility to “smooth” fuel price volatility by allowing utilities to spread collection of extraordinary fuel costs over longer periods.

Currently, the Fuel Adjustment Clause requires fuel costs to be passed along monthly.³⁴ If the Commission were inclined to change the regulation, consideration should be given to allowing for greater flexibility for utilities to recover extraordinary fuel costs over periods greater than a single month when circumstances warrant. At times, utilities have requested the flexibility to do just this.³⁵ The ability for a utility to spread extraordinarily large fuel costs over a greater period may be a valuable tool for the Commission. While flexibility to do so would not necessarily be to the advantage of every ratepayer (*e.g.*, smoothing could advantage or disadvantage specific ratepayers with volatile usage patterns), it might provide relief to ratepayers generally if appropriate safeguards are observed.

Allowing for such flexibility would not be without risk. Care should be taken to ensure that the Commission exercises appropriate oversight over such requests to ensure

³⁴ 807 KAR 5:056(3). “Fuel costs (F) shall be the most recent actual monthly cost...”; *See also* Case No. 2022-00125, *In the Matter of: Electronic Application of Kentucky Power Company to Defer a Portion of Fuel Adjustment Clause Charges for Later Collection without Establishing a Regulatory Asset*. “The monthly FAC factor is calculated pursuant to 807 KAR 5:056 and Kentucky Power’s tariff based upon fuel and power costs of Kentucky Power and is thus considered the filed rate that Kentucky Power must charge.”

³⁵ *For example, see* Case No. 2022-00125, *In the Matter of: Electronic Application of Kentucky Power Company to Defer a Portion of Fuel Adjustment Clause Charges for Later Collection without Establishing a Regulatory Asset*.

that that this flexibility is not abused. For example, a utility might file such a request in order to keep rates artificially and unreasonably low for ratepayers, while a large regulatory asset unnecessarily accrues. Thus, such flexibility should be employed only when it is reasonable to believe that fuel adjustment decreases sought by a utility can reasonably be offset in the near term. Concerns related to this type of gamesmanship might also be addressed by allowing “smoothing” to operate on an ongoing basis, such as the twelve-month rolling average method proposed by Duke Energy Kentucky, Inc. in Case No. 2019-00271.³⁶ Of course, if the Commission believes that allowing for the flexibility described here creates substantive or procedural impracticalities that cannot be overcome and would result in abuse, it should disallow such flexibility. However, if a system can be put in place that allows for smoothing to occur but limits the potential for gamesmanship and manipulation, the Commission would be right to pursue such a change, as it could result in less volatile rates for ratepayers.

c. Volatility of the fuel adjustment clause can be limited by ensuring that only a narrow set of specific costs are allowed to pass through that mechanism.

The Commission can and should ensure that utilities do not manipulate the fuel adjustment mechanism to benefit shareholders at the expense of ratepayers by passing

³⁶ See Order of April 27, 2022 in Case No. 2019-00271, *Electronic Application of Duke Energy Kentucky, Inc. for 1) and Adjustment of the Electric Rates; 2) Approval of New Tariffs; 3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 4) all other required approvals and relief*. “Duke Kentucky proposes a revision to its Fuel Adjustment Clause Rider (FAC) changing the FAC rate calculation from a monthly basis to a rolling twelve-month average. Duke Kentucky states that the change to a rolling twelve-month average will help to mitigate volatility in the FAC rate for its ratepayers. 807 KAR 5:056, Section 1, states that the monthly FAC rate will be based upon the most recent actual monthly cost and sales and does not have a deviation clause. Therefore, the Commission denies Duke Kentucky proposed revisions to the FAC rate calculation.”

improper costs through the FAC.

The Commission has the authority, during its six-month review, to order a utility to “charge off” any adjustments it deems “unjustified due to improper calculation or application of the charge or improper fuel procurement practices.”³⁷ Further, the Commission has the authority to “disallow improper expenses” during its two-year review of each utility’s Fuel Adjustment Clause.³⁸ The Commission should aggressively exercise this authority to ensure that utilities engage in appropriate procurement and purchasing practices, do not attempt to pass ancillary non-fuel costs through the FAC, and generally do not attempt to manipulate the fuel adjustment system for the benefit of shareholders at the expense of ratepayers.

Areas where utilities have discretion invite opportunities for savings, but also opportunities for abuse. For example, utilities are not allowed to recover costs for non-economic purchases.

The FAC allows utilities to recover, “[t]he 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.”³⁹ The Commission has determined economy purchases are, “recoverable through an electric utility's FAC as purchases that an electric utility makes to serve native load, that displace its higher cost of generation, and that have an energy cost less than the avoided variable generation cost of the utility's highest cost generating unit available to serve native load

³⁷ 807 KAR 5:056(3)(3)(b).

³⁸ 807 KAR 5:056(3)(4)(a).

³⁹ 807 KAR 5:056(3)(3)(c).

during that FAC expense month.”⁴⁰ The Commission defined non-economic purchases as, “energy purchases made to serve native load that have an energy cost greater than the avoided variable cost of the utility's highest cost generating unit available to serve native load during that FAC expense month.”⁴¹ The Commission has, “interpret[ed] Administrative Regulation 807 KAR 5:056 as permitting an electric utility to recover through its FAC only the lower of the actual energy cost of the non-economy purchased energy or the fuel cost of its highest cost generating unit available to be dispatched to serve native load during the reporting expense month.”⁴² Thus, whether the cost of an energy purchase is recoverable turns on the cost at which the utility could have generated the energy through its own means of generation. But calculating what the utility would have spent to generate the energy but for the market purchase is sometimes difficult in practice. As we have seen lately, this is an area rife for disagreement.⁴³

Nevertheless, the calculation of the fuel cost for a utility’s highest cost generating unit is a calculation a utility must get right if the fuel adjustment mechanism is to have its intended effect. Unfortunately, utilities are not incentivized to reach the correct calculation. Instead, utilities are incentivized to characterize the maximum amount of cost possible as “economic,” and therefore, recoverable. If a utility can justify a market purchase instead of running its own plant, it can lessen operation and maintenance

⁴⁰ Case No. 2000-00496-B, *An Examination by the Public Service Commission of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from May 1, 2001 to October 31, 2001* (Ky. PSC May 2, 2002), Order at 4.

⁴¹ *Id.*

⁴² *Id.*

⁴³ See Case No. 2022-00036, *An Electronic Examination of the Application of the Fuel Adjustment Clause of Kentucky Power Company from May 1, 2021 through October 31, 2021*.

expense, benefitting its own bottom line by saving some of the associated costs. The result is wasteful duplication. Ratepayers pay the market rate for energy, pay base rates that include operation and maintenance costs not incurred because the plant did not run, and the plant they invested in is in worse shape for future use. Thus, ratepayers are worse off.

One should ask why, if it had the means to generate the energy, a utility would risk making market purchases, knowing that it would be required to charge off disallowed costs deemed to be uneconomic. Generally, utilities can minimize the risk of costs being disallowed by structuring their FAC in such a way that allows them to predictably define the opportunity cost to their advantage. But, even if the FAC was a straight pass-through and utilities were unable to benefit their bottom line through strategic market purchases, there could still be a reason for a utility to favor market purchase over generation.

Increasingly, utilities are incentivized to favor market purchases over generation of energy based simply on risk. Generation involves regulatory and environmental compliance. These risks are minimized when energy is purchased on the market. If one can simply buy the product (the energy) and pass it along to the ratepayer, functioning as a middleman, the utility, and its shareholders, are better off than if the utility had generated the energy, because it has minimized risk. And sometimes the risk being avoided is not regulatory or environmental risk imposed by the government; the avoided risk can be self-imposed. For utilities with parent companies that have self-imposed net-zero emissions goals, those utilities can likely make progress toward those goals faster by

purchasing energy on the market rather than generating energy and having to account for the associated emissions.

It has been observed, “[t]he more complex the factors prescribed to trigger rate adjustments, the more complex becomes the task of regulatory surveillance.”⁴⁴ Thus, “[a]djustment clauses are generally reserved for expenses that are outside the control of the utility or are required by law or rule.”⁴⁵

Allowing a utility to benefit from a purchasing decision completely within its control could operate to the detriment of ratepayers; this is not the appropriate place for the FAC to operate. However, allowing utilities flexibility to make market purchases when the costs associated with those purchases are truly below the utility’s higher generation cost is a valuable interest worth protecting. In order to provide clarity, one area the Commission should focus on is how Kentucky utilities define economic and non-economic purchases, such that utilities do not receive unreasonable compensation for market purchases.

Relatedly, if the utility is not allowed to recover an improper cost through the FAC, it should not be allowed to recover this cost through another mechanism or through base rates automatically. For example, disallowed non-economy purchases should not be allowed in base rate recovery unless the utility can demonstrate clearly that the purchases were absolutely necessary for reliability, capacity, or demand purposes. If made for a

⁴⁴ *Developments in Regulation: Adjustment Clauses*, Denver Law Journal, 670 (1976).

⁴⁵ RRA Regulatory Focus: Adjustment Clauses,
<https://www.spglobal.com/marketintelligence/en/documents/adjustment-clauses-state-by-state-overview.pdf> (accessed November 14, 2022).

legitimate purpose to serve an actual ratepayer need, the utility should be compensated; otherwise, it should not. Also, ratepayers should not be charged in base rates for forced outage purchased power; ratepayers are already paying for equipment, labor, and maintenance. Utilities should be incentivized to ensure that those investments result in working power plants. The Commission should take great care to ensure that disallowed FAC costs are not collected from ratepayers through other means unless the utility makes a showing that those costs were necessary to serve ratepayers.

The Commission should be clear about which costs pass through an FAC, it should draw a bright line between economic and non-economic costs, and it should aggressively and continuously scrutinize fuel adjustment filings to ensure strict compliance on the part of the utilities.

d. In order to support a robust review of fuel adjustment filings and assist in the identification of improper charges or practices, the Commission should regularly collect detailed data from utilities in regular fuel adjustment filings.

In order to allow the Commission and stakeholders to effectively participate in the fuel adjustment review process, the Commission should require utilities to regularly disclose detailed information calculated at identifying whether charges passing through the FAC are proper or should be disallowed. The following information should be required to be disclosed, if applicable, for the period at issue:

- Amount of coal purchased during period, noting whether it was a spot or contract purchase;
- Current coal inventory and assessment of near-term coal supply;
- Details regarding each coal purchase, including price paid per ton;
- Details related to all coal solicitations undertaken;
- Details related to natural gas purchases including vendor, quantity, and whether

- it was a spot or contract purchase;
- Whether there were instances where natural gas units did not operate due to pipeline constraints or gas supply unavailability;
 - Changes to hedging activities;
 - Changes to fuel or transportation contracts;
 - Status of all litigation with fuel suppliers or vendors;
 - Changes to written fuel procurement policies;
 - Details regarding firm power commitments for purchases and sales;
 - Monthly billing summary for sales to all utilities;
 - List of scheduled and actual forced outage;
 - Monthly peaking unit equivalent calculations supporting the forced outage calculations;
 - Corresponding amount, if any, of forced outage purchased power collected through the purchase power adjustment tariff;
 - Monthly capacity factor for each unit operated;
 - Changes to maintenance and operation practices;
 - Specific generation efficiency improvements;
 - Violations of policies or procedures related to fuel procurement and relevant justifications;
 - Violations of FAC regulation and relevant justifications;
 - Details related to fuel contracts related to commodity and transportation, noting whether those contracts have been filed with the Commission;
 - RTO costs included in FAC, including amount and type;
 - Details regarding how purchase power costs are accounted for in the calculation of the FAC when the utility is not experiencing a generation outage but must purchase power in order to meet demand;
 - Details regarding amounts excluded from cost recovery as non-economy purchases with explanation of whether those costs are alternatively recovered from ratepayers;
 - Whether coal units are available, and if they are bid into energy markets as “must run”;
 - Information related to bids and bid status into markets and whether units cleared;
 - Whether, when the units are not on a planned, maintenance, or forced outage, the relevant RTO considers the units as being in available status;
 - Relevant demurrage charges;
 - Explanation of any relevant over or under recovery from ratepayers;
 - Whether utility was subjected to any RTO performance penalties;
 - Total amount of fuel related cost that occurred during a forced outage that was disallowed pursuant the FAC regulation or that the utility collects via any other means; and,
 - All other information the Commission deems necessary.

To the extent feasible, this information should be readily available to the public and should only be shielded from public review pursuant to the Commission's confidentiality procedures.⁴⁶

- e. The Commission should require FAC filings to be submitted in a standardized manner in order to allow for more efficient review by the Commission and stakeholders.**

Finally, to the extent the Commission allows utilities discretion in the manner of presenting FAC data and documentation to the Commission, that discretion should be significantly curtailed or eliminated to require utilities to file FAC data and supporting documentation in a consistent and uniform format. Currently, the filings made by utilities related to FAC compliance vary in presentation. This makes comparison between and among utilities more difficult. Consistency will aid the Commission and stakeholders in efforts to review these filings.

III. Conclusion

Electric rates are high and volatile largely due to the policy decisions of President Biden and administration officials in Washington, D.C. This Commission is, therefore, limited in its ability to address those issues directly. However, where possible the Commission should take reasonable steps to mitigate the impact of those policies on Kentucky ratepayers. As a threshold matter, the Commission can do so by pursuing common sense policies that require utilities subject to its jurisdiction to operate in a manner that appropriately balances costs and long-term reliability. And as it relates to

⁴⁶ 807 KAR 5:001(13).

the FAC in particular, the Commission should explore options for allowing utilities to “smooth” collection of extraordinary fuel costs. The Commission should also engage in continuous oversight of fuel adjustment filings to ensure that utilities do not receive compensation for costs that are not meant to flow through the FAC.

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Certificate of Service and Filing

Pursuant to the Commission's Orders and in accord with all other applicable law, Counsel certifies that, on December 1, 2022, a copy of the forgoing was served by electronic mail to the following.

This 1st day of December, 2022

A handwritten signature in blue ink, appearing to read "J. Michael O'Neil". The signature is written in a cursive style with a long horizontal stroke at the end.

Assistant Attorney General