

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ORDER

The Commission, on November 2, 2022, established this proceeding to examine, among other things, “the fuel adjustment clause, purchased power cost recovery, current and future fuel and power price volatility, and related cost recovery mechanisms.”¹ In the opening order for the proceeding, the Commission posed several questions regarding the Fuel Adjustment Clause (FAC) regulation and other fuel and power-related issues, and required all electric generator utilities to respond to those questions. The following entities requested and were granted intervention and filed responses: the Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (Attorney General), Kentucky Industrial Utility Customers, Inc. (KIUC); Kentuckians for the Commonwealth (KFTC); Mountain Association (MA); Metropolitan Housing Coalition (MHC); and Earth Tools, Inc. (ETI). The Kentucky Office of Energy Policy and Kentucky Solar Industries Association, Inc. (KYSEIA), also filed responses in this proceeding.

The Commission received numerous comments in response to the questions it posed in the November 2, 2022 Order. The Commission, having reviewed the responses

¹ Order (Ky. PSC Nov. 2, 2022) at 1.

and replies in the record, finds that parties should file responses to several proposed changes to 807 KAR 5:056, the FAC regulation. The Commission, therefore, will seek comments on the proposed changes to 807 KAR 5:056 as discussed below.

Commission Consideration

The Commission is considering making several changes to how and when the FAC adjustment factor is calculated. The first is that the FAC factor would be adjusted quarterly rather than monthly. Second, a review of the application of the FAC, as well as resetting the base FAC factor, would occur annually instead of the current six-month and two-year reviews. Finally, as discussed in more detail, the monthly expenses would be replaced with a 12-month actual rolling average and the sales would be based on a two-year average of the three months included in the quarter.

The current adjustment factor for the FAC is found in 807 KAR 5:056, Section 1, and is as follows:

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

F(m) is currently defined as, “the cost of fuel in the current period.”² F(m) would be changed such that the current period under review would be defined as the actual rolling average cost of fuel for the previous twelve months. The purpose of this change would be to protect customers against the volatility of significant increases in fuel and

² 807 KAR 5:056, Section 1(1).

power prices. This is, partially, consistent with Duke Energy Kentucky Inc's (Duke Kentucky) proposal to use a twelve-month rolling average for the FAC adjustment factor.³

S(m) is defined as, "sales in the current period."⁴ The Commission would change the calculation of S(m) to allow one of two methods. The first would be for the utility to use the two-year average for the months in that period. For example, if the reporting period is the quarter of January, February, and March, the generator would utilize the two-year average of previous sales for those months respectively when calculating S(m). Using an average for sales, as Kentucky Power Company (Kentucky Power) has noted, "can be expected to result in smaller over-under recoveries, and potentially a less volatile fluctuation in charges billed to customers."⁵

The Commission also is considering an alternative to calculating S(m) by allowing a utility to use projected sales for the upcoming three months. The Commission recognizes that there could be instances where an average of previous sales may not accurately reflect the upcoming period sales, especially when there has been a recent and significant change in load. Generators would be able to calculate S(m) by using projected sales for the upcoming period, which would be subject to a true-up in the following period. The use of projected sales would also be subject to examination in the Commission's annual review, assuming that the FAC review is changed to an annual review. Once an S(m) calculation method is chosen, the utility would be allowed to change its calculation method during an annual review only.

³ See, Comments of Duke Energy Kentucky, Inc. (Duke Kentucky) (filed Dec. 2, 2022) at 3.

⁴ 807 KAR 5:056, Section 1(1).

⁵ Comments of Kentucky Power (filed Dec. 2, 2022) at 4.

The Commission seeks comments on the above proposals and the effect on the volatility of the FAC. Specifically, the Commission will require the generators that are parties to this case to utilize this proposed formula and use it to calculate the FAC factor for 2024 and 2025.

Rolling Twelve-Month Average

Duke Kentucky proposes using a rolling twelve-month average to reduce volatility.⁶ In support of its proposal, Duke Kentucky provided a graph, based on its FAC from September 2021 through December 2022, showing that the use of the rolling average resulted in less volatility to FAC charges. Duke Kentucky proposed the rolling average in two previous rate cases, but the Commission denied the request both times noting that the FAC regulation did not provide for deviations.⁷ In the proposal Duke Kentucky contends that there would be no accounting changes needed for the rolling average.

No change to the FAC formula would be necessary to implement a rolling twelve-month average. However, other changes to the FAC regulation would be necessary. The Commission seeks comments on the effect on volatility of using a rolling twelve-month average, and what changes are necessary to 807 KAR 5:056 to allow for the use of a rolling twelve-month average.⁸ Specifically, the Commission will require the generators

⁶ Comments of Duke Kentucky (filed Dec. 2, 2022) at 3.

⁷ See Case No. 2019-00271, *Electronic Application of Duke Energy Kentucky, Inc. for 1) an 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* (Ky. PSC Apr. 27, 2020) at 63; and Case No. 2022-00372, *Electronic Application of Duke Energy Kentucky, Inc. for 1) An 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* (Ky. PSC Oct. 12, 2023).

⁸ In reply to Duke Kentucky's proposal, East Kentucky Power Cooperative, Inc (EKPC) stated that it and its member-cooperatives had begun examining a rolling twelve-month average but had not completed

that are parties to this case to utilize this proposed formula and use it to calculate the FAC factor for 2024 and 2025.

Three-Year Historical Average for the Denominator

Kentucky Power proposes, *inter alia*, the use of a three-year historical average for the denominator, $S(m)$, of the FAC formula.⁹ Kentucky Power asserts that using a three-year historical average for sales can be expected to result in smaller over and under recoveries, which would reduce FAC volatility. The Commission seeks comments on the effect on volatility of using a three-year historical average for sales, and what changes are necessary to 807 KAR 5:056 to allow for the use of a three-year historical average for sales. Specifically, the Commission will require the generators that are parties to this case to utilize this proposed formula and use it to calculate the FAC factor for 2024 and 2025.

Hedging

Several commenters proposed being able to recover the costs of financial hedging through the FAC. Duke Kentucky proposed that the costs of financial natural gas hedging mechanisms be allowed to be recovered through the FAC.¹⁰ Kentucky Power asserts that physical and financial hedging contracts can manage wholesale power market volatility exposure, but also states that, while using these tools might reduce volatility, it might lead to higher costs and appear less economical upon review.¹¹ East Kentucky

its analysis at the time they filed their reply comments. See Reply Comments of EKPC (filed Dec. 19, 2022) at 3.

⁹ Comments of Kentucky Power (filed Dec. 2, 2022) at 4.

¹⁰ Comments of Duke Kentucky (filed Dec. 2, 2022) at 7-8.

¹¹ Comments of Kentucky Power (filed Dec. 2, 2022) at 5.

Power Cooperative, Inc. (EKPC), asserts that allowing electric utilities to recover through the FAC the costs of financial hedging for natural gas would mitigate price volatility.¹² Finally, Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (collectively KU/LG&E), although generally in favor of not amending 807 KAR 5:056, assert that the limitation in the FAC for cost recovery to natural gas consumed for generation limits a utility's ability to recover costs of financial hedges for natural gas. KU/LG&E propose that the FAC regulation be revised to remove this limitation and allow for the recovery of the costs associated with "prudently executed financial hedges."¹³ KU/LG&E, like Kentucky Power, note that allowing for the recovery of financial hedging costs, while reducing volatility, could lead to higher FAC prices.¹⁴

The Commission seeks comments on how the FAC regulation, and other Commission rules or policies, could be amended to allow for the recovery of financial hedges. Comments should also address whether recovery of hedging should be limited to natural gas purchases, whether natural gas purchased in anticipation of consumption but is subsequently sold because a generating unit was not dispatched could be used as an offset to FAC costs, and any specific language amendments necessary to the FAC regulation for the recovery of hedging costs through the FAC.

¹² Comments of EKPC (filed Dec. 5, 2022) at 3.

¹³ Reply Comments of LG&E and KU (filed Dec. 19, 2022) at 9–10.

¹⁴ Reply Comments of LG&E and KU (filed Dec. 19, 2022) at 10.

Senate Bill 172

Senate Bill 172, the Fuel Surcharge Stability Act (SB 172)¹⁵ was signed by the Governor and became effective on February 19, 2026. SB 172 amended KRS 278.277 and provides:

In the administration of an electric utility's fuel adjustment clause and any associated tariffs, the commission may, upon the request of an electric utility, extend the period for recovery of fuel adjustment costs that are typically recoverable in order to reduce volatility for consumers and encourage stability in rates.

The Commission has allowed utilities in the past, whether through notice to the Commission or through tariff changes, to spread the recovery of FAC-eligible costs over several months. With the enactment of SB 172, however, there is now a statute that specifically allows the Commission to allow this practice. The Commission solicits recommendations on the best procedure(s), via amendments to 807 KAR 5:056, to allow a utility to request such relief and regarding the way the Commission may grant such relief.

The Commission seeks comments on whether, and if so, how, the FAC regulation should be amended to establish procedures for a utility to propose a plan to extend the recovery period of FAC-eligible costs.

Regulatory Assets

The Commission previously denied regulatory accounting for Duke Kentucky for FAC-eligible costs incurred in one calendar year, to be collected in the beginning months

¹⁵ 26 RS SB 172/GA.

of the next calendar year.¹⁶ Some parties have recommended that the Commission allow the use of deferred accounting by creating regulatory assets for FAC-eligible costs. EKPC¹⁷ and KU/LG&E¹⁸ both suggest that the use of regulatory assets can help address volatility for deferral of large fuel prices. Given the enactment of SB 172, which statutorily provides for the spreading out of recovery of FAC-eligible expenses, the Commission solicits comments on whether regulatory accounting would be beneficial to executing SB 172 and, if it is helpful, what limitations may be put on the use of regulatory accounting for large FAC expenses.

Distribution Cooperative Concerns

Jackson Energy Cooperative Corporation (Jackson Energy) raises two issues that affect distribution cooperatives. The first issue is the regulatory lag between the time when fuel costs are incurred by a Generation and Transmission cooperative (G and T) and when a cooperative's share of the costs is billed and recovered from its members.¹⁹ Jackson Energy asserts that this lag can be as much as four months during which the cost of fuel is increasing and the distribution cooperative is recovering less from its members than the distribution cooperative owes its G and T.²⁰

¹⁶ Case No. 2021-00459, *Electronic Application of Duke Energy Kentucky, Inc. for Proposed Accounting and Fuel Adjustment Clause Treatment and for Declaratory Ruling* (Ky. PSC Dec 17, 2021).

¹⁷ Comments of EKPC at 12-15.

¹⁸ Comments of EKPC. (filed Dec. 5, 2022) at 3.

¹⁸ Reply Comments of LG&E and KU (filed Dec. 19, 2022) at 10–11.

¹⁹ Comments of Jackson Energy (filed Dec. 5, 2022) at 1–2.

²⁰ Comments of Jackson Energy (filed Dec. 5, 2022) at 1–2.

The second issue concerns the timing of recovery experienced by a distribution cooperative of the costs of the FAC.²¹ Jackson Energy asserts that there is a two-month delay between when a G and T files its fuel cost expenses and when they are actually billed to the distribution cooperative.²² The fuel adjustment is then passed on to the distribution cooperative's members on the bills issued for that month. However, Jackson Energy asserts that the amount recovered by a distribution cooperative will generally not match the amount billed to it by the G and T because the fuel costs are billed to the members based on their usage, which varies from month to month.²³ Jackson Energy asserts that this often results in an under-recovery of fuel costs by the distribution cooperative.

The Commission solicits comments on suggested changes to 807 KAR 5:056 and Commission policies that can address the regulatory lag for distribution cooperatives and address the potential recurring under recovery of FAC expenses.

Options for FAC Formula

The Commission above has set forth discussions regarding several changes to the FAC formula. At least one commenter has stated that the current FAC formula works fine and does not need to be amended.²⁴ The Commission comments on whether, assuming the Commission amends the FAC formula, a generator could choose to use the original

²¹ Comments of Jackson Energy (filed Dec. 5, 2022) at 2.

²² Comments of Jackson Energy (filed Dec. 5, 2022) at 2.

²³ Comments of Jackson Energy (filed Dec. 5, 2022) at 2.

²⁴ See, Comments of LG&E and KU (filed Dec. 2, 2022) at 5. ("Based upon the Companies' experience with the UFAC Regulation, the UFAC Regulation and the mechanics of the fuel cost recovery calculations have performed well, have accomplished their intended purposes, and do not require modification.")

FAC formula or the amended FAC formula. Additionally, if the Commission allows for two FAC formulas, the Commission solicits comments on how that choice could be implemented.

Based on the foregoing, the Commission finds that within 60 days after service of this Order, Kentucky's six generators: Kentucky Power; EKPC; LG&E; KU; BREC; and Duke Kentucky, should file responses to the proposals and issues listed above. All other parties may file responses or comments within the same time. Responses and comments should also explain what other changes to 807 KAR 5:056 should be made to implement the Commission's proposed changes.

IT IS THEREFORE ORDERED that:

1. Kentucky Power, EKPC, LG&E, KU, BREC, and Duke Kentucky shall file responses to the Commission's proposed changes to the FAC adjustment factor and other topics for comments within 30 days of the date of service of this Order.
2. All other comments and responses to proposals raised herein shall be filed within 30 days of the date of service of this Order.

PUBLIC SERVICE COMMISSION



Chairman



Commissioner



Commissioner

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ATTEST:



Executive Director



*Aaron Baldwin
South Kentucky R.E.C.C.
P. O. Box 910
Somerset, KY 42502-0910

*Byron Gary
Kentucky Resources Council, Inc.
Post Office Box 1070
Frankfort, KY 40602

*Farmers R.E.C.C.
Farmers R.E.C.C.
504 South Broadway
P. O. Box 1298
Glasgow, KY 42141-1298

*Alan Q. Zaring
Attorney at Law
Zaring & Sullivan Law Office, PSC
P.O. Box 226
New Castle, KY 40050

*J. Christopher Hopgood
Dorsey, Gray, Norment & Hopgood
318 Second Street
Henderson, KY 42420

*Tom Fitzgerald
Kentucky Resources Council, Inc.
Post Office Box 1070
Frankfort, KY 40602

*L. Allyson Honaker
Honaker Law Office, PLLC
1795 Alysheba Way
Suite 1203
Lexington, KY 40509

*Clayton O Oswald
Taylor, Keller & Oswald, PLLC
1306 West Fifth Street, Suite 100
Post Office Box 3440
London, KY 40743-3440

*Jackson Purchase Energy Corporation
Jackson Purchase Energy Corporation
6525 US Highway 60 W
Paducah, KY 42001

*Andrea M. Fackler
Manager, Revenue Requirement
LG&E and KU Energy LLC
220 West Main Street
Louisville, KY 40202

*David T Royse
Attorney At Law
Ransdell Roach & Royse PLLC
176 Pasadena Drive, Building I
Lexington, KY 40503

*Heather Temple
Honaker Law Office, PLLC
1795 Alysheba Way
Suite 1203
Lexington, KY 40509

*Angela M Goad
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KY 40601-8204

*Deborah Day
Paralegal
Cumberland Valley Electric, Inc.
Highway 25E
P. O. Box 440
Gray, KY 40734

*Hector Garcia
Kentucky Power Company
1645 Winchester Avenue
Ashland, KY 41101

*Ashley Wilmes
Kentucky Resources Council, Inc.
Post Office Box 1070
Frankfort, KY 40602

*Hon. Derrick Willis
Attorney at Law
Willis Law Office
117 S. Hord Street
Grayson, KY 41143

*Honorable James M Crawford
Crawford & Baxter, P.S.C. Attorneys at Law
523 Highland Avenue
P. O. Box 353
Carrollton, KY 41008

*Honorable Allyson K Sturgeon
Vice President and Deputy General Counsel-
LG&E and KU Energy LLC
220 West Main Street
Louisville, KY 40202

*Attorney Earl Rogers III
Campbell Rogers & Hill, PLLC
Campbell & Rogers
154 Flemingsburg Road
Morehead, KY 40351

*John Douglas Hubbard
Fulton, Hubbard & Hubbard
117 E. Stephen Foster Avenue
P.O. Box 88
Bardstown, KY 40004

*Jeffrey Hohn
President
Kenergy Corp.
6402 Old Corydon Road
P. O. Box 18
Henderson, KY 42419

*Kentucky Power Company
Kentucky Power Company
1645 Winchester Avenue
Ashland, KY 41101

*Nolin R.E.C.C.
Nolin R.E.C.C.
411 Ring Road
Elizabethtown, KY 42701-6767

*Jody Kyler Cohn
Boehm, Kurtz & Lowry
425 Walnut Street
Suite 2400
Cincinnati, OH 45202

*Kevin Newton
President and CEO
South Kentucky R.E.C.C.
P. O. Box 910
Somerset, KY 42502-0910

*South Kentucky R.E.C.C.
South Kentucky R.E.C.C.
200 Electric Avenue
Somerset, KY 42501

*Jody M Kyler Cohn
Boehm, Kurtz & Lowry
425 Walnut Street
Suite 2400
Cincinnati, OH 45202

*Katie M Glass
Stites & Harbison
421 West Main Street
P. O. Box 634
Frankfort, KY 40602-0634

*Larisa Vaysman
Duke Energy Kentucky, Inc.
139 East Fourth Street
Cincinnati, OH 45201

*John G Horne, II
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KY 40601-8204

*Kenergy Corp.
Kenergy Corp.
6402 Old Corydon Road
P. O. Box 18
Henderson, KY 42419

*Larry Cook
Assistant Attorney General
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KY 40601-8204

*Big Sandy R.E.C.C.
Big Sandy R.E.C.C.
504 11th Street
Paintsville, KY 41240

*Duke Energy Kentucky, Inc.
Duke Energy Kentucky, Inc.
139 East Fourth Street
Cincinnati, OH 45202

*Mark David Goss
South Kentucky R.E.C.C.
P. O. Box 910
Somerset, KY 42502-0910

*Jake A Thompson
Crawford & Baxter, P.S.C. Attorneys at Law
523 Highland Avenue
P. O. Box 353
Carrollton, KY 41008

*Fleming-Mason Energy Cooperative, In
Fleming-Mason Energy Cooperative, Inc.
1449 Elizaville Road
P. O. Box 328
Flemingsburg, KY 41041

*J. Michael West
Office of the Attorney General Office of Rate
700 Capitol Avenue
Suite 20
Frankfort, KY 40601-8204

*Honorable Kurt J Boehm
Attorney at Law
Boehm, Kurtz & Lowry
425 Walnut Street
Suite 2400
Cincinnati, OH 45202

*Meade County R.E.C.C.
Meade County R.E.C.C.
P. O. Box 489
Brandenburg, KY 40108-0489

*Honorable Michael L Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
425 Walnut Street
Suite 2400
Cincinnati, OH 45202

*Martin Littrel
Pres. CEO
Meade County R.E.C.C.
P. O. Box 489
Brandenburg, KY 40108-0489

*Licking Valley R.E.C.C.
Licking Valley R.E.C.C.
P. O. Box 605
271 Main Street
West Liberty, KY 41472

*Big Rivers Electric Corporation
Big Rivers Electric Corporation
710 West 2nd Street
P. O. Box 20015
Owensboro, KY 42304

*W. Patrick Hauser
Attorney
Cumberland Valley Electric, Inc.
Highway 25E
P. O. Box 440
Gray, KY 40734

*Owen Electric Cooperative, Inc.
Owen Electric Cooperative, Inc.
8205 Highway 127 North
P. O. Box 400
Owenton, KY 40359

*Robert Conroy
Vice President, State Regulation and Rates
LG&E and KU Energy LLC
220 West Main Street
Louisville, KY 40202

*Clark Energy Cooperative, Inc.
Clark Energy Cooperative, Inc.
2640 Ironworks Road
P. O. Box 748
Winchester, KY 40392-0748

*Shelby Energy Cooperative, Inc.
Shelby Energy Cooperative, Inc.
620 Old Finchville Road
Shelbyville, KY 40065

*Rocco O D'Ascenzo
Duke Energy Kentucky, Inc.
139 East Fourth Street
Cincinnati, OH 45201

*Cumberland Valley Electric, Inc.
Cumberland Valley Electric, Inc.
Highway 25E
P. O. Box 440
Gray, KY 40734

*Salt River Electric Cooperative Corp
Salt River Electric Cooperative Corp.
111 West Brashear Avenue
P. O. Box 609
Bardstown, KY 40004

*Senthia Santana
Big Rivers Electric Corporation
710 West 2nd Street
P. O. Box 20015
Owensboro, KY 42304

*East Kentucky Power Cooperative, Inc
East Kentucky Power Cooperative, Inc.
4775 Lexington Road
P. O. Box 707
Winchester, KY 40392-0707

*Blue Grass Energy Cooperative Corp.
Blue Grass Energy Cooperative Corp.
1201 Lexington Road
P. O. Box 990
Nicholasville, KY 40340-0990

*Kentucky Utilities Company
Kentucky Utilities Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40232-2010

*Inter-County Energy Cooperative Corp
Inter-County Energy Cooperative Corporation
1009 Hustonville Road
P. O. Box 87
Danville, KY 40423-0087

*Grayson R.E.C.C.
Grayson R.E.C.C.
109 Bagby Park
Grayson, KY 41143

*Louisville Gas and Electric Company
Louisville Gas and Electric Company
820 West Broadway
Louisville, KY 40203

*Jackson Energy Cooperative Corporati
Jackson Energy Cooperative Corporation
115 Jackson Energy Lane
McKee, KY 40447

*Taylor County R.E.C.C.
Taylor County R.E.C.C.
625 West Main Street
P. O. Box 100
Campbellsville, KY 42719

*Kentucky Utilities Company
Kentucky Utilities Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40232-2010

*Louisville Gas and Electric Company
Louisville Gas and Electric Company
820 West Broadway
Louisville, KY 40203

*Sara Judd
Senior Corporate Attorney
LG&E and KU Energy LLC
220 West Main Street
Louisville, KY 40202

*Tyson Kamuf
Corporate Attorney
Big Rivers Electric Corporation
710 West 2nd Street
P. O. Box 20015
Owensboro, KY 42304

*Whitney Kegley
Big Rivers Electric Corporation
710 West 2nd Street
P. O. Box 20015
Owensboro, KY 42304