
In the
Supreme Court of the United States

**KENT CHANDLER,
IN HIS OFFICIAL CAPACITY AS
CHAIRMAN AND COMMISSIONER OF
KENTUCKY PUBLIC SERVICE
COMMISSION, *et al.*,**

Petitioners,

v.

FORESIGHT COAL SALES, LLC,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

**SUPPLEMENTAL APPENDIX TO
BRIEF IN OPPOSITION TO
PETITION FOR CERTIORARI**

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[DATED MARCH 14, 2019]

19 RS BR 1916

A RESOLUTION urging the Public Service Commission to consider all costs related to the importation of coal for electricity generation.

WHEREAS, the amount of coal produced in Kentucky has decreased from 109,018,240 tons in 2011 to 39,587,320 tons in 2018; and

WHEREAS, revenue from the sale of Kentucky coal is reinvested by the Kentucky coal industry in local economies creating multiplier effects of other direct and indirect benefits; and

WHEREAS, in 2017, the largest contributor to real gross domestic product growth in Kentucky was mining, quarrying, and oil and gas extraction, which accounted for 0.65 percent of the total growth in real gross domestic product; and

WHEREAS, in 2018, annual coal employment declined to 6,409; and

WHEREAS, differences in severance tax policies of other states have impacted the competitiveness of Kentucky coal; and

WHEREAS, approximately 54 percent of coal consumed in Kentucky by electric-generating units was imported from Illinois, Indiana, Ohio, Pennsylvania, West Virginia, and Wyoming;

NOW, THEREFORE,

Be it resolved by the House of Representatives of the General Assembly of the Commonwealth of Kentucky:

→ Section 1. The Kentucky House of Representatives urges the Public Service Commission to amend its administrative regulations to consider all costs, including fossil fuel-related economic impacts within Kentucky, when analyzing coal purchases under the fuel adjustment clause.

→ Section 2. The Clerk of the House of Representatives shall send a copy of this Resolution and notification of its adoption to Public Service Commission Chairman Michael Schmitt, Vice Chairman Robert Cicero, and Commissioner Talina Mathews.

[DATED MARCH 29, 2019]

Matthew G. Bevin
GOVERNOR

Charles G. Snavely
SECRETARY

R. Bruce Scott
DEPUTY SECRETARY

ENERGY AND ENVIRONMENT CABINET

300 Sower Boulevard Deputy Secretary
FRANKFORT, KENTUCKY 40601
Telephone: 502-564-3350
Telefax: 502-564-7484

March 29, 2019

VIA ELECTRONIC AND MESSENGER MAIL

Mr. Michael J. Schmitt
Chairman
Kentucky Public Service Commission
200 Sower Boulevard
Frankfort, KY 40601

Dear Chairman:

I write to make a formal request that the Public Service Commission consider amending its regulations relating to the Fuel Adjustment Clause (FAC) requirements for Kentucky utilities. As you are aware, the Kentucky coal industry has experienced a decline of at least 50% within the past ten years. This decline has resulted in severe adverse impacts upon the economies of both the eastern and western coalfields of the Commonwealth. The Energy and Environment Cabinet, through its Office of Energy Policy, has conducted research and participated in discussions with stakeholders and with members of the legislature on actions to mitigate the economic decline.

We discovered that although Kentucky power plants burn approximately 25 million tons of coal annually, 13 million tons, or 54%, is imported from other states. One reason utilities purchase coal from other states is for environmental or technological needs for specific coal. However, the primary reason is because the Fuel Adjustment Clause requirements in 807 KAR 5:056 cause utilities to purchase imported coals if they cost less than Kentucky coals.

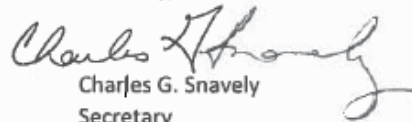
The fallacy in that regulatory compliance analysis is that Kentucky imposes a severance tax of 4.5% of the gross value of the sale of coals mined in Kentucky, while several other states do not impose that tax on their sales. Illinois and Indiana do not impose a severance tax at all, and Ohio's tax rate is less than 15 cents per ton. These three states alone account for half of the 13 million tons of coal imported into Kentucky each year. The discrepancy in excise tax rates often creates a perverse incentive for our own utilities to purchase coals from other states and create further economic distress in Kentucky.

Given that Governor Bevin's administration believes in making use of our own natural resources and supporting our own economy, the administration supports the resolution that Kentucky's House of Representatives recently passed. This resolution, HR 144, a copy of which is attached, urges the PSC to amend its regulations to address the tax discrepancy issue by considering the overall economic impact to Kentucky. On behalf of the Bevin Administration, I request that the Commission give this resolution serious consideration and determine whether the

5sa

current PSC regulatory requirements relating to fossil fuel purchases should be amended.

Sincerely,

A handwritten signature in cursive script, appearing to read "Charles G. Snavely".

Charles G. Snavely
Secretary
Energy and Environment Cabinet

[ON APRIL 16, 2019]

KENTUCKY PUBLIC SERVICE COMMISSION

* * *

PROCEEDINGS

CHAIRMAN CICERO: Would staff identify themselves and anyone with them?

MR. PINNEY: Yes, Your Honor: My name is Jeff Pinney. I'm with the Office of General Counsel for the Public Service Commission. Today I'm accompanied [sic] by Sarah Jankowski from our Division of Financial Analysis.

CHAIRMAN CICERO: Thank you. Do you have any questions for the witnesses?

MR. PINNEY: Just a few.

CHAIRMAN CICERO: Please proceed.

MR. PINNEY: So refreshingly, I have no questions about GreenHat. My first question I'd ask ref -- for you to look at KU and LG&E's response to data request 4, the Commission's first request, and it's a confidential information. I'll do my best to ask the questions so we don't have to go into confidential session. Just let me know when you all are ready. Okay. And on -- I -- this is page 1 of 2, our attachment to response, page 1 of 2. And here, it says, "The action taken states that an amount of coal in tons was lower than the offered amount by -- that was offered by the coal company. Say to this -- state if this had any effect of the final cost per ton, and if the final cost per ton is different than the amount listed under the offer, then explain why the cost is different."

MR. BILLITER: Delbert Billiter responding. It did not have any impact on the cost of the fuel. We -- we purchased it at the same price offered for the 300,000 tons. We just purchased less because at the time, we did not need 300,000 tons. We only needed 200,000 tons.

MR. PINNEY: Okay. Thank you. I've no more questions with any confidential information. So my next question simply refers to the Kentucky coal (phonetic) -- Coal Severance Tax. You've heard the questions I've asked of the other utilities. We've established that it is assessed on coal mined in Kentucky. Is -- are KU or LG&E aware of how that cost is factored into the cost of coal procured in Kentucky? Is it broken down into the coal procurement sheets that you receive or is it lumped together or what?

MR. BILLITER: Delbert Billiter responding. It is not broken out separately on the offers that we've received.

MR. PINNEY: Okay. And are you aware of what effect, if any, the Kentucky Coal Severance Tax would have on KU and LG&E's coal procurement practices?

MR. BILLITER: Delbert Billiter responding. On our practices, I think our practices would remain the same. The way those coals might evaluate could be different if, you know, Coal Severance Tax was factored into the evaluation sheet.

MR. PINNEY: Okay. And then are you aware of other states from which LG&E and KU procures coal, if those states have a severance tax or some kind of extraction tax similar to that in Kentucky?

MR. BILLITER: Delbert Billiter responding. We buy coal from several states. Some states do have severance tax similar to Kentucky, maybe different rates. Some states that we purchase from do not.

MR. PINNEY: No further questions, Your Honor.

CHAIRMAN CICERO: Chairman Schmitt?

MR. SCHMITT: Do you -- have you had a chance to review the proposed regulation that was published, what, yesterday?

MR. BILLITER: Delbert Billiter responding. I just briefly reviewed it maybe ten minutes ago, sir.

MR. SCHMITT: Well, I guess the -- the bottom line is, the -- the purpose of at least the portion of the regulation that deals with the Kentucky Coal Severance Tax is to either remove a disincentive or to incentivize -- incentivize Kentucky Utilities to purchase Kentucky coal. And that would require someone to calculate the severance tax and for purposes of reasonableness, the Commission would not -- would -- would not consider the higher price to be unreasonable under the -- under the circumstances. I think that's what all the questioning ultimately goes down to is an attempt to remove from consideration the increase in cost of Kentucky coal as a result of the Kentucky Coal Severance Tax. And that request was made by the Kentucky General Assembly or House of Representatives essentially to us. I have no further questions or statement.

CHAIRMAN CICERO: If it doesn't require a response on your part -- I -- I have no questions. Any cross?

MS. STURGEON: No.

CHAIRMAN CICERO: Mr. Pinney?

MR. PINNEY: No further questions.

CHAIRMAN CICERO: And that being the case,
then this case is adjourned.

MS. STURGEON: Okay. Thank you.

CHAIRMAN CICERO: You may be excused.

(CONCLUSION OF EXCERPT)

[DATED JUNE 14, 2019]

STATEMENT OF CONSIDERATION

Relating to 807 KAR 5:056

**Energy and Environment Cabinet, Public Service
Commission**

(Amended After Comments)

- I. The public hearing on 807 KAR 5:056 was conducted as scheduled on May 30, 2019, at 9:30 a.m. at the Kentucky Public Service Commission. The following people attended the public hearing:

<u>Name and Title</u>	<u>Organization/Entity/Other</u>
Jeb Pinney, Acting General Counsel	KY Public Service Commission
Benjamin Bellamy, Staff Attorney III	KY Public Service Commission
Nat Adams	KIUC/NAS
Kurt J. Boehm, Counsel for KIUC	Boehm, Kurtz, & Lowry
Jeff Broch	Alliance Coal
Patrick Keal	Duke Energy Kentucky, Inc.
Kendrick Riggs, Counsel for LG&E and KU	Stoll Keenan Ogden, PLLC
Robert Conroy, Vice President, St. Regulation/Rates	LG&E and KU Energy, LLC
Derek Rahn	LG&E and KU Energy, LLC
Allyson Sturgeon	LG&E and KU Energy, LLC
Amy Jeffries	Kentucky Power Company

Christen Blend	Kentucky Power Company
Brian West	Kentucky Power Company
Ranie Wohnhas	Kentucky Power Company
Mark Overstreet, Counsel for Kentucky Power	Stites and Harbison, PLLC
John Pollum, Counsel for Kentucky Power	Stites and Harbison, PLLC
Kent Chandler	KY Office of Attorney General

Public comments were offered at the hearing by Kurt Boehm, Kendrick Riggs, Robert Conroy, and John Pollum. Public comments were received at the hearing by Jeb Pinney and Benjamin Bellamy.

II. The following people submitted written comments:

<u>Name and Title</u>	<u>Organization/Entity/Other</u>
Tyler White, President	Kentucky Coal Association
Kurt J. Boehm, Counsel for KIUC	Boehm, Kurtz, & Lowry
Tyson Kamuf; Corporate Attorney	Big Rivers Electric Corporation
Rocco O. D'Ascenzo, Deputy General Counsel	Duke Energy Kentucky, Inc.
Kendrick Riggs, Counsel for LG&E and KU	Stoll Keenan Ogden, PLLC

Robert Conroy, Vice President, St. Regulation/Rates	LG&E and KU Energy, LLC
Mark Overstreet, Counsel for Kentucky Power	Stites and Harbison, PLLC
John Pollum, Counsel for Kentucky Power	Stites and Harbison, PLLC
David Smart, General Counsel	EKPC

III. The following people from the promulgating administrative body responded to the comments:

Name and Title

Gwen Pinson, Executive Director
Jeb Pinney, Acting General Counsel
Benjamin Bellamy, Staff Attorney III

IV Summary of Comments and Responses

- (1) Subject Matter: Enforceability of Section 3(5) under Dormant Commerce Clause
 - (a) Comments: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, argued in written comments and at the public hearing that Section 3(5), as proposed in the amendment, violates the Dormant Commerce Clause of the United States Constitution and suggested that the Commission to delete Section 3(5) as proposed.

Mark Overstreet - Mr. Overstreet, on behalf of Kentucky Power, argued in written comments that the proposed amendment adding Section 3(5) violates the Dormant Commerce Clause of the United States Constitution and suggested

that the Commission delete Section 3(5) as proposed, or in the alternative, that the Commission amend Section 3(5) to remove coal severance taxes from all states not just those imposed by Kentucky pursuant to KRS 143.020.

John Pollum - Mr. Pollum, on behalf of Kentucky Power, indicated at the public hearing that Kentucky Power agreed with LG&E and KU's position regarding the legality of Section 3(5) and referred to the written comments filed by Mr. Overstreet on behalf of Kentucky Power.

Rocco O. D'Ascenzo- Mr. D'Ascenzo, on behalf of Duke Kentucky, stated that the proposed amendment adding Section 3(5) may place Kentucky sourced coal on an unequal and more advantageous level than coal sourced from other states that also have a similar assessment, which raises potential constitutional concerns under the Dormant Commerce Clause of the United States Constitution and makes the regulations enforceability questionable. He suggested deleting Section 3(5) as proposed. Alternatively, he suggested amending Section 3(5) to exclude taxes from all states from the Commission's review and to make the exclusion of such taxes discretionary.

David Smart - Mr. Smart, on behalf of EKPC, argued in written comments that Section 3(5), as proposed in the amendment, violates the Dormant Commerce Clause of the United States Constitution and suggested that the Commission withdrawal the proposed amendment to Section 3(5) to review its potential impacts.

Tyler White - Tyler White, on behalf of KCA, argued in written comments that Section 3(5), as proposed in the amendment, does not violate the Dormant Commerce Clause of the United States Constitution and argued that it should be placed in effect as written.

- (b) Response: The Commission understands the commenters concerns regarding the enforceability of the regulation under the Dormant Commerce Clause. To address those concerns, the Commission will amend Section 3(5), as proposed, to remove coal severance taxes from all states from the reasonableness evaluation as suggested by a number of the commenters. Specifically, the Commission will amend Section 3(5) as follows:

... the commission shall, in determining the reasonableness of fuel costs in procurement contracts and fuel procurement practices. evaluate the reasonableness of fuel costs in contracts and competing bids based on the cost of the fuel less ~~[any tax collected under KRS 143.020] any coal severance tax imposed by any jurisdiction upon coal physically removed from the earth.~~

The amendments after comment are in bold.

- (2) Subject Matter: Section 3(5) applies a different standard than those used in other jurisdictions
- (a) Comments: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, argued that other jurisdictions in which LG&E and KU operate will not evaluate

coal contracts less any taxes collected pursuant KRS 143.020, and therefore, will likely disallow costs if the companies comply with Section 3(5), which will adversely affect the companies' financial health and increase the cost of raising capital. Mr. Riggs suggested that the Commission delete Section 3(5) from the proposed amendment.

Robert Conroy- Mr. Conroy, on behalf of LG&E and KU, stated that the companies are regulated by the Federal Energy Regulatory Commission ("FERC") and the Virginia commission and noted that it was questionable as to whether those Commission's [sic] would allow recovery for increased fuel costs arising from Section 3(5), as proposed.

Tyler White - Mr. White, on behalf of Kentucky Coal Association, supported the proposed amendment and argued that Section 3(5) will not put utilities at risk for fuel cost disallowances in other jurisdictions, because the proposed amendment will "only control how costs are calculated for the fuel commodity relative to Kentucky." Mr. White noted that it is not uncommon for utilities operating in multiple jurisdictions to be subject to different regulatory frameworks. He also argues that fuel cost disallowances are generally rare. He suggested that there was no need to amend the regulation to make clear that it would apply retroactively.

- (b) Response: The Commission does not disagree that Section 3(5) will result in the Commission evaluating the reasonableness of coal contracts in a manner that is different than other jurisdictions. However, it is not usually [sic] for utility commissions in different jurisdictions to impose

different regulatory schemes, for utility commissions in different jurisdictions to evaluate the reasonableness of costs based on different criteria, or for one jurisdiction to find that a cost is reasonable and another to find that it is unreasonable. For that reason, most rate proceedings for utilities that operate in multiple jurisdictions require utilities to allocate costs between the jurisdictions in which it operates and require utility commissions to review those cost allocations to determine if they are reasonable. Any cost increase arising from Section 3(5) could be addressed in a similar manner. Thus, the concerns raised by these comments do not support withdrawing or amending Section 3(5).

- (3) Subject Matter: Potential effects of Section 3(5) on cost of energy
 - (a) Comments: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, argued that Section 3(5), as proposed, will require utilities to select a higher cost fuel source, which will result in increased costs to customers and affect off system sales. Mr. Riggs proposed that the amendment to 807 KAR 5:056 to add Section 3(5) be deleted.

Robert Conroy- Mr. Conroy, on behalf of LG&E and KU, argued that Section 3(5) could result in an increase in the cost of coal and the cost to customers.

Mark Overstreet - Mr. Overstreet, on behalf of Kentucky Power, argued that Section 3(5), as proposed, will require utilities to select a higher cost fuel source, which will result in increased costs to customers and is contrary to the Commission's long-standing least cost principles.

Mr. Overstreet proposed that the amendment to 807 KAR 5:056 to add Section 3(5) be deleted.

Rocco D'Ascenzo - Mr. D'Ascenzo, on behalf of Duke Kentucky, argued that Section 3(5), as proposed, could require utilities to purchase more expensive coal—he gave an example in which Kentucky coal at a price of \$50.00 per ton would be assessed as lower cost than non-Kentucky coal priced at \$49.00 per ton based on the proposed amendment to Section 3(5)—and he noted that Kentucky utility customers would then have to pay the difference, which he argues places utilities in the untenable position of having to purchase more expensive coal or be questioned on the reasonableness of its fuel procurement practices. He suggested deleting Section 3(5) as proposed. Alternatively, he suggested amending Section 3(5) to exclude taxes from all states from the Commission's review and to make the exclusion of such taxes discretionary.

David Smart - Mr. Smart, on behalf of EKPC, argued in written comments that the Commission does not currently know the effects that Section 3(5), as proposed, will have on utilities coal procurement practices, or the costs and benefits that will arise, and believes that the Commission should gather more information to determine the impacts of the proposal the proposed Section 3(5) before implementing it.

Tyler White - Mr. White, on behalf of Kentucky Coal Association, supported the proposed amendment and argued that it would not result in a significant increase in costs to customers, if any.

Kurt Boehm - Mr. Boehm, on behalf of KIUC, stated that KIUC supported the proposed amendment to Section 3(5). He acknowledged that it might result in a slight increase in fuel costs, but argued that the benefits of the proposed amendment would significantly outweigh the costs.

- (b) Response: There are occasions when Section 3(5) will require utilities to select a fuel source that is slightly more expensive than the alternative based on the proposed language. However, the increased cost would at most be the amount of the coal severance tax, and the increased cost of coal would generally be significantly lower. Additionally, the cost of coal is only one of many costs incurred by electric utilities, so a minor increase in the cost of coal would not significantly affect electric rates. Further, KIUC, which is the only group representing utility customers that commented on the regulation, argued that the benefits of the proposed regulation would outweigh the expected costs, and the Commission agrees with that comment. Thus, the potential increase in fuel costs do not support withdrawing Section 3(5), as amended.
- (4) Subject Matter: Section 3(5) incentivizes companies subject to KRS 143.020 to increase prices
- (a) Comments: Tyson Kamuf - Mr. Kamuf, on behalf of Big Rivers, noted that Big Rivers generally selects suppliers based on the lowest cost at delivery and that Big Rivers currently gets about 93% of its coal from Western Kentucky coal mines. Although he noted that the effects are uncertain,

he argued that the proposed amendment to Section 3(5) creates an incentive for Kentucky coal suppliers to increase their bids without any corresponding benefit to Big Rivers, its memberowners, or their retail-customer owners. This would increase the cost of electricity to customers and reduce off system sales, which in turn would further increase the cost of electricity for customers. He recommended that the Commission delete Section 3(5) until it can further investigate its potential effects.

- (b) Response: While there is a potential that suppliers may attempt to increase prices, the Commission does not believe it would be a significant issue or that it would have a significant effect on coal prices. Utilities generally engage in competitive bidding when procuring coal, so Kentucky suppliers would still have an incentive to keep their bids low. Further, coal prices are volatile and contracts are generally long term, so Kentucky suppliers would not simply be able to add 4.5% to their previous bids and expect to obtain contracts they were previously awarded [sic]. Finally, the amendment the Commission made after comments to Section 3(5) further eliminates the risk that suppliers would increase prices. Thus, the incentive to increase in fuel costs does not support withdrawing Section 3(5), as amended.
- (5) Subject Matter: Regulatory burdens imposed by Section 3(5)
 - (a) Comments: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, argued that Section 3(5), as proposed, requires utilities to develop and maintain more complex fuel cost information to

provide to the Commission, including information regarding taxes paid or to be paid pursuant to KRS 143.020, and that they will have to rely on suppliers, who may manipulate the information, to provide it. Mr. Riggs suggested that the Commission delete Section 3(5) from the proposed amendment.

Mark Overstreet - Mr. Overstreet, on behalf of Kentucky Power, argues that Section 3(5), as proposed, will require Kentucky Power to change its requests for proposals to require bidders to identify separately the amount of any tax imposed by KRS 143.020 and will require it to change the manner in which it analyzes coal bids to exclude the tax, which is contrary to the Commission's Regulatory Impact and Tiering Analysis. Mr. Overstreet indicated that Kentucky Power believes it could make those changes but questioned whether some suppliers would be willing to submit bids if they had to calculate the taxes and whether out of state suppliers would even bother submitting, which could reduce competition and artificially increase prices. Mr. Overstreet suggested that the Commission delete Section 3(5) from the proposed amendment to ensure a more competitive market.

Rocco D'Ascenzo - Mr. D'Ascenzo, on behalf of Duke Kentucky, observed that Duke Kentucky does not currently receive information from its suppliers regarding the taxes included in their bids and would therefore have to request this information be included as part of any future solicitation if Section 3(5) is adopted.

David Smart - Mr. Smart, on behalf of EKPC, argued in written comments that Section 3(5), as proposed in the amendment, would create additional burdens on utilities, contrary to the Commission's impact statement, by requiring them to obtain the tax information from suppliers, because severance taxes are not currently disclosed separately by suppliers in response to bids.

Tyler White - Tyler White, on behalf of the Kentucky Coal Association, argued in written comments that Section 3(5), as proposed, would not impose significant additional regulatory burdens on utilities and that any manipulation of the taxes in bids could be remedied without amending the regulation.

- (b) Response: The regulation will require utilities to obtain information from suppliers regarding the amount of taxes that have been paid or will be paid pursuant to KRS 143.020 in order to evaluate the cost of coal pursuant to Section 3(5). However, utilities should be able to accomplish it by including a requirement in their requests for bids that suppliers provide an estimate of the taxes they paid or expect to pay based on the source and cost of the coal. Moreover, the Commission expects suppliers will be eager to provide this information, because it will permit utilities to evaluate the cost of those suppliers' coal less any coal severance taxes when determining which contracts to accept. Thus, the Commission does not believe that Section 3(5) imposes a significant burden on utilities.

There will likely be situations in which suppliers will not provide accurate tax information with their bids, whether intentionally or unintentionally. However, there are numerous situations in which utilities enter into contracts based on cost or other estimates based on information from suppliers, i.e. expected useful life of equipment, as they would be required to do to comply with Section 3(5). A utility's review of the tax information when making decisions regarding coal contracts would be no different than the numerous other reviews it regularly completes to make purchasing and other decisions. Moreover, utilities could contractually shift the risk of unreasonable estimates of coal severance taxes to suppliers through indemnity or similar provisions in contracts, which would incentivize suppliers to provide accurate figures and reduce the risk of manipulation.¹ Thus, the commenters [sic] concern regarding the burden of obtaining accurate information to apply Section 3(5) does not justified [sic] withdrawing or amending Section 3(5).

- (6) Subject Matter: Effect of Section 3(5) on regulation by other states
 - (a) Rocco O. D'Ascenzo - Mr. D'Ascenzo, on behalf of Duke Kentucky, stated that the proposed amendment adding Section 3(5) may inspire similar provisions by other states that would negatively affect coal markets. He suggested

¹ If taxes were disallowed based on misrepresentations from the suppliers in a manner raised by LG&E and KU, utilities should also be able to assert claims for intentional and negligent misrepresentation to recover any cost that was disallowed even absent a contractual remedy, which similarly would incentivize suppliers to provide accurate information.

deleting Section 3(5) as proposed or amending Section 3(5) to exclude taxes from all states from the Commission's review and to make the exclusion of such taxes discretionary.

- (b) Response: The Commission does believe that actions taken by other states would be dependent on whether it moves forward with this proposed amendment. Moreover, given the amendment after comment, the Commission does not believe that it would have negative effects if other states passed similar regulations.
- (7) Subject Matter: Effect of Section 3(5) on a utilities recovery of severance taxes
 - (a) Comment: Rocco D'Ascenzo - Mr. D'Ascenzo, on behalf of Duke Kentucky, argued that the proposed amendment to the regulation is ambiguous as to whether utilities will be permitted to recover any increased cost arising from the application of Section 3(5) and that the proposed regulation should at minimum be clarified to state that utilities would still be permitted to recover the additional fuel costs associated with the severance tax through their fuel adjustment clauses regardless of whether it is considered as part of reasonableness evaluation.

Mark Overstreet - Mr. Overstreet, on behalf of Kentucky Power, argued that the proposed amendment to the regulation should be amended to make clear that a utility is entitled to recover its total contract cost of fuel, including any coal severance taxes, without regard to the exclusion of coal severance taxes for purpose of the Commission's reasonableness review.

Tyler White - Tyler White, on behalf of Kentucky Coal Association, argued that the proposed amendment would not affect the utilities [sic] ability to collect taxes collected pursuant KRS 143.020.

- (b) Response: With the proposed amendments, Section 1 of the fuel adjustment clause governs the amounts included in the calculation of the fuel adjustment. It does not require exclusion of severance taxes. Moreover, Section 3(5) indicates that it only applies to the evaluation of the contracts, not to the calculation of the fuel adjustment. Thus, no amendment to the proposed regulation is necessary to ensure that 807 KAR 5:056 is interpreted as allowing utilities to recover the amounts excluded in the evaluation of reasonableness pursuant to Section 3(5) through their fuel adjustment clause.
- (8) Subject Matter: Effect of Section 3(5) on the Commission's review of generation unit dispatching
 - (a) Comments: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, argued that Section 3(5), as proposed, does not address how the required exclusion of the Kentucky severance tax will affect the Commission's evaluation of an electric utility's dispatch of its generation units.

Tyler White - Tyler White, on behalf of the Kentucky Coal Association, argued in written comments that Section 3(5), as proposed, does not speak to utilities dispatching decisions and therefore should not affect utilities dispatching decisions.

- (b) Response: The proposed amendment to the regulation does not create ambiguity regarding the Commission's evaluation of an electric utility's dispatch of its generation units, because it specifically states that the change in Section 3(5) applies the Commission's review of "the reasonableness of fuel costs in procurement contracts and fuel procurement practices" and makes no mention of the Commission's evaluation of generation dispatching, so there is no basis for interpreting the proposed amendments as effecting [sic] the Commission's review of the dispatching of utility's generation units. Thus, the commenter's concern regarding whether Section 3(5) effects dispatching decisions does not justify withdrawing or amending Section 3(5).
- (9) Subject Matter: Effect of Section 3(5) on utilities' economic dispatching of generation units
- (a) Comment: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, argued that Section 3(5), as proposed, could have the perverse effect of making their coal generation facilities less economical and thereby could reduce their consumption of coal when they dispatch units based on the least cost alternative.
- (b) Response: Utilities are required to use their existing generation assets in order of the lowest cost to the highest cost when possible, so it is possible that an increase in costs could affect the dispatching of coal units. However, as noted above, Section 3(5) will not result in a significant increase in the cost of coal generation. Moreover, a number of other factors affect how a utility typically dispatches generation assets, including

limitations on when generation assets can be used i.e. solar, start-up procedures for the generation units, and the size of the generation units among many others. The coal units that currently are dispatched will likely continue to be dispatched due to the de minimis impact of this regulation on the marginal cost of electricity. Thus, this issue does not justify withdrawing or amending Section 3(5).

(10) Subject Matter: Retroactive application of Section 3(5)

(a) Comment: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, noted that Section 3(5), as proposed, does not make any provision for existing contracts or for contracts into which utilities might enter prior to the effective date of the section and argued that application of the new standard of review to those contracts would unlawfully penalize utilities in a retroactive manner.

Robert Conroy - Mr. Conroy, on behalf of LG&E and KU, noted that it was unclear how Section 3(5) would apply to contracts in existence prior to the effective date of the section.

Tyler White - Mr. White, on behalf of Kentucky Coal Association, supported the proposed amendment and argued that the current language does not indicate that fuel costs for contracts executed before the effective date of the proposed amendment would be disallowed based on Section 3(5). He acknowledged that it was unclear whether Section 3(5), as proposed, is intended to apply only to fuel contracts entered after the effective date. He noted that even if it were applied retroactively that there is no evidence that it would result in

inequities. He suggested that there was no need to amend the regulation to make clear that it would not apply retroactively.

- (b) Response: Section 3(5) was not intended to apply to contracts formed before it became effective. While the Commission felt it would be implied based on the current language and law, the comments have indicated that is not the case, and the Commission now agrees that it is ambiguous as to whether it is intended to apply retroactively. The Commission further agrees that it would be inequitable to apply Section 3(5) retroactively, because doing so could result in the disallowance of costs for contracts the utilities entered before they had notice of the change. Thus, to make it clear that Section 3(5) is not intended to apply to contracts formed prior to its effective date, the Commission has amended Section 3(5) based on the comments as shown below:

(5) For any contracts entered into [Beginning] three (3) or more months after the effective date of this regulation

...

The Commission's amendments based on the comments are in bold.

- (11) Subject Matter: Applicability of Section 3(5) to fuels other than coal
- (a) Comment: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, argued that Section 3(5), as proposed, is not fuel specific so it will require utilities to request the severance information when procuring oil and natural gas in addition to coal.

(b) Response: KRS 143.020 is specific to coal, so it would be reasonable for a utility to assume that no severance tax was paid pursuant to that statute in connection with natural gas, oil, or other fuels. There would be no reason for utilities to request information regarding the payment of taxes pursuant to KRS 143.020 when procuring natural gas, oil, and other fuels. Thus, this issue does not justify withdrawing or amending Section 3(5).

(12) Subject Matter: Purpose of Section 3(5)

(a) Comments: Mark Overstreet - Mr. Overstreet, on behalf of Kentucky Power, argues that Section 3(5), as proposed, is inconsistent with its stated purpose of ensuring that fuel costs are evaluated on a more level basis regardless of their state of origin, because it only excludes coal severance taxes from Kentucky from the analysis of reasonableness. He suggested that Section 3(5) be modified to exclude “any coal severance or similar tax applicable to the fuel” to accomplish the stated purpose. Alternatively, he suggested that the pertinent language could be modified to provide “based on the cost of the fuel less any tax of the nature of the tax imposed by KRS 143.020.”

Tyler White - Mr. White, on behalf of Kentucky Coal Association, supported the proposed amendment and argued that it allows coal severed or processed in Kentucky to be evaluated fairly against the coal of certain border states that have eliminated similar taxes.

(b) Response: There are a number of states that do not charge any severance tax on coal in a manner consistent with KRS 143.020. Section 3(5) allows coal subject to KRS 143.020 to be evaluated

against the coal severed and processed in states that do not charge a severance tax based on the actual cost to produce the coal. Moreover, the amendment the Commission made to Section 3(5) after receiving Comments, which is discussed above, further addresses Kentucky Power's concern, because coal from all states will be evaluated without regard to the coal severance taxes. Thus, it allows coal to be evaluated more fairly based on the actual cost to produce the coal.

(13) Subject Matter: Effect of the amendment to Section 1(1) on costs recoverable through fuel adjustment clauses

(a) Comment: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU. Opposed changing the word "expense" in the phrase "Where F is the expense of fossil fuel" in Section 1(1) to "cost," and argued those terms have different meanings, and that the amendment could change the meaning of the regulation and result in Kentucky's fuel adjustment regulation being interpreted differently from the federal regulation on which it was based. He recommended that the proposed substitution be withdrawn and that "expense" continue to be used in Section 1(1) to define F(b) and F(m).

Robert Conroy- Mr. Conroy, on behalf of LG&E and KU, stated that it was unclear how the change from "expense" to "cost" in Section 1(1) would affect amounts recoverable pursuant to the fuel adjustment clause.

(b) Response: Section 1(1) of the regulation, in its current form and as proposed, provides the formula used to calculate utilities' fuel

adjustments. The formula includes the variable “F” and the variable “S” in the base and the current periods. Currently, Section 1(1) states, among other things, that “F is the expense of fossil fuel ... ; and “S is sales ... , all as defined below.” Section 1(3) then states that “Fuel costs (F) shall be ...” before listing specific items that should be included and excluded from “Fuel cost (F).” Section 1(4) and Section 1(6) then further define and limit the items listed in Section 1(3) as being included in the variable F of the fuel adjustment formula.

If “expense of fossil fuel” and “Fuel cost (F)” had different meanings, then Section 1(3), which defines F, would have no meaning whatsoever. Since courts interpret regulations to give effect to all provisions, courts will not interpret “expense of fossil fuel” and “Fuel cost” as having different meaning, because they both refer to the variable F. See *Lewis v. Jackson Energy Co-op. Corp.* , 189 S.W.3d 87, 91 (Ky. 2005) (“Statutes should be construed in such a way that they do not become ineffectual or meaningless.”); see also *Marksberry v. Chandler*, 126 S.W.3d 747, 753 (Ky. App. 2003) (indicating that the rules of construction that apply to statutes also apply to regulations). This is particularly true given that Section 1(1), in which “expense of fossil fuel” is used to refer to F, specifically indicates that F is “defined below.” Thus, the proposed amendment should not change the definition of the variable F or the interpretation of the regulation, because “F” is specifically defined below.

However, the language of the regulation is ambiguous in its current form, because the variable F is referred to as “fuel cost” and the

“expense of fossil fuel.” That ambiguity can be resolved as discussed above through construction of the regulation, but the proposed change makes it clearer that the variable F as used in Section 1 (1) is the same variable F that is more explicitly defined in Section 1(3), (4), and (6) without having to engage in construction of the regulation. This clarity should ease the burden on parties attempting to apply the regulation. Thus, the commenters [sic] concern regarding the change from “expense” to “cost” in Section 1(1) does not provide a basis for amending or withdrawing that proposed change.

(14)Subject Matter: Effect of the amendment to Section 1(3)(c) on costs recoverable through fuel adjustment clauses

(a) Comment: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, oppose [sic] the revision of language in Section 1(3)(c) and argue [sic] that moving the phrase “irrespective of the designation assigned to such transaction” as proposed would result in that phrase modifying “energy purchases” as opposed to “demand charges” as it was originally intended. He recommends that the Commission withdraw that proposed amendment.

Robert Conroy- Mr. Conroy, on behalf of LG&E and KU, made the same point as Mr. Rigg’s on this subject.

(b) Response: LG&E and KU appear to be correct regarding this proposed amendment. The phrase “irrespective of the designation assigned to such transaction” is intended to modify “capacity or demand changes” and now modifies “energy purchases.” Thus, the Commission will

withdrawal the proposed amendment to Section 1(3)(c), except that the Commission will remove the parentheses and include a comma after “transaction” to make it clear that the phrase “when such energy is purchased on an economic dispatch basis” modifies the phrase “[t]he net energy cost of energy purchases.”

(15) Subject Matter: Effect of the amendment to Section 1(6) on costs recoverable through fuel adjustment clauses

(a) Comment: Mark Overstreet - Mr. Overstreet, on behalf of Kentucky Power, claims that the proposed amendment to Section 1(6) changed the meaning of the “cost of fossil fuel,” as used therein, by limiting it to items listed in FERC Account 151 whereas Section 1(6) currently defines the “cost of fossil fuel” to include items beyond those listed in FERC Account 151, including amounts listed in FERC Account 152 and “fuel-related” PJM billing line items in FERC Accounts 447 and 555. He suggested that the proposed amendment be deleted, and the current language be retained, or that the provision be amended to recognize unambiguously that fuel-related costs other than those listed in FERC Account 151 are properly treated as fossil fuel costs for the purposes of the regulation.

John Pollum - Mr. Pollum, on behalf of Kentucky Power, argued that this amendment should be struck or further clarified for the reasons discussed by Mr. Overstreet.

(b) Response: The proposed amendment to Section 1(6) does not narrow the meaning of the “cost of fossil fuel” in a manner that excludes items that

are currently recoverable under the plain language of the regulation, and therefore, Kentucky Power's concern regarding the meaning of Section 1(6) does not justify withdrawing this proposed amendment. In its current form, the first sentence of Section 1(6) limits the cost of fossil fuel to "the invoice price of fuel less any cash or other discounts." The second sentence then further defines "the invoice price of fuel" by stating that it "include[s] the cost of the fuel itself and necessary charges for transportation of the fuel from the point of acquisition to the unloading point, as listed in Account 151 of FERC Uniform System of Accounts for Public Utilities and Licensees." The proposed amendment simply moves the definition of the "invoiced price of fossil fuel" up to the first sentence and indicates that the cost of fuel only includes those items.

As asserted by Kentucky Power, the use of the term "include" in the second sentence would generally be interpreted as "including but not limited to," which would allow for the "cost of fossil fuel" to include items not specifically listed in the second sentence. However, as currently written, the first sentence explicitly limits the definition of the "cost of fossil fuel" to the "invoiced price of fuel."

The term "invoiced priced of fuel" is not defined, so courts would generally hold that it should be interpreted according to its plain meaning. However, where a term or phrase is technical in nature or is a term of art, courts will generally apply the technical meaning of the term. See *Lach v. Man O'War, LLC*, 256 S.W.3d 563, 568 (Ky. 2008) ("technical words and phrases, and such

others as may have acquired a peculiar and appropriate meaning in the law, shall be construed according to such meaning”).

The phrase “invoiced price of fuel less any cash or other discounts” is a technical term used by FERC to define items that should be recorded in FERC Account 151. Specifically, FERC regulations state that Account 151 should include:

1. Invoice price of fuel less any cash or other discounts.

2. Freight, switching, demurrage and other transportation charges, not including, however, any charges for unloading from the shipping medium.

3. Excise taxes, purchasing agents’ commissions, insurance and other expenses directly assignable to cost of fuel.

4. Operating, maintenance and depreciation expenses and ad valorem taxes on utility-owned transportation equipment used to transport fuel from the point of acquisition to the unloading point.

5. Lease or rental costs of transportation equipment used to transport fuel from the point of acquisition to the unloading point.

18 C.F.R. Part 101, Account 151 (emphasis added).

Given the use of the exact same phrase, there is a strong argument that as currently written the “cost of fossil fuel” is limited to the “invoice price

of fuel less any cash or other discounts” as used in FERC Account 151, or rather, 1 of 5 items listed in Account 151. Under that interpretation, the second sentence, as plainly written, could be interpreted as referring to the actual cost of coal and transportation costs in the invoice price of fuel, because in context with the first sentence, it would be limited to costs included in the invoiced price of fuel. Conversely, the language that refers to transportation costs in the second sentence of Section 1(6) could be interpreted as expanding the definition of “cost of fossil fuel” to include additional items listed in FERC Account 151, because the language used to refer to transportation costs in the second sentence of Section 1(6) is similar to the language used to define the transportation costs listed in FERC Account 151. However, there is no reasonable interpretation of Section 1(6), in its current form, that would allow items other than those listed in FERC Account 151 to be included within the meaning of the “cost of fossil fuel,” because to give effect to both sentences of Section 1(6), the “cost of fossil fuel” must be limited to the “invoice price of fuel less any cash or other discounts,” which is an item in FERC Account 151; and cost of the fuel and transportation charges “as listed in Account 151 of FERC Uniform System of Accounts for Public Utilities and Licensees.”

As noted by Kentucky Power, the phrase “as listed in Account 151 of FERC Uniform System of Accounts for Public Utilities and Licensees” in the proposed amendment would likely be interpreted as modifying the “cost of the fuel itself and necessary charges for transportation” and would

thereby limit the cost of fossil fuel to items listed in FERC Account 151. However, as discussed above, this limitation should be no more restrictive than the limitation on the definition of the cost of fossil fuel in the regulation as currently written. Moreover, restricting the “cost of fossil fuel” to items listed in FERC Account 151 is consistent with the purpose of the fuel adjustment regulation to allow timely recover of volatile fuel costs, because FERC Account 151 includes those items that could be attributed to the commodity cost of the fuel.² Conversely, FERC Account 152 includes

² In fact, 807 KAR 5:056, as currently written, was based on FERC’s fuel adjustment regulation, which explicitly limits the “cost of fossil fuel” to items listed in Account 151 of FERC’s Uniform System of Accounts. Case No. 1992-00493, *A [sic] examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company from November 1, 1990 to October 31, 1992*, Order at FN12 (Ky. PSC Jan. 2, 1997) (The Commission, noting that Kentucky’s fuel clause regulation was nearly identical to FERC’s regulation, held that buyout costs for not purchasing fuel pursuant to a contract were not recoverable, because they were not items recorded in FERC Account 151.); *but see* Case No. 1996-00089, *The Application of Louisville Gas and Electric Company for an Order Approving Certain Accounting Treatment for and Authorizing Recovery of Coal Contract Termination Costs*, Order (Ky. PSC Aug. 21, 1996) (The Commission allowed recovery of coal contract termination costs after it was granted permission to create a deferred debit and charge it to FERC Account 151.); Case No. 1994-00453, *Big Rivers Electric Corporations Proposed Mechanism to Credit Customers Amounts Recovered in Judicial Proceedings Involving Fuel Procurement Contracts*, Order (Ky. PSC Feb. 21, 1997) (The Commission indicated that Kentucky’s fuel adjustment clause was based on FERC’s, that the definition of the cost of fuel was narrow, and that amounts recovered in litigation against fuel suppliers and their agents did not meet the definition of the cost of fuel); Case No. 1993-00113, *Application of Kentucky Utilities Company to Amortize, by means*

those operational costs for handling the fuel once it has been unloaded at a utility's plant, which would not be volatile like the commodity cost of fuel and therefore can be recovered through base electric rates like any other operational cost. 18 C.F.R. Part 101, Account 151.

The Commission understands Kentucky Power's concern regarding the recovery of fossil fuel costs attributed to purchase power and recoverable pursuant to Section 1(3)(b). That section allows utilities to recover "the actual identifiable fossil ... fuel costs associated with energy purchased" through their fuel adjustment clauses. Those costs would not be record [sic] in a utility's FERC Account 151, so if the "cost of fossil fuel" were limited in the utilities FERC Account 151, then it would not be able to recover those costs.

However, 807 KAR 5:056 does not refer specifically to items listed in the utility's FERC Account 151, but rather, generally refers to items listed in "Account 151 of FERC Uniform System of Accounts for Public Utilities and Licensees." Moreover, Section 1(3)(b) clearly intended for utilities to recover fossil fuel costs associated with purchased power, subject to certain limitations,

of Temporary Decrease in Rates, Net Fuel Cost Savings Recovered in Coal Contract Litigation, Order 3-5 (Ky. PSC Dec. 8, 1993) (The Commission held that a refund of coal costs that had been paid by ratepayers through the fuel adjustment clause before being refunded to Kentucky Utilities following litigation against the supplier could not be reimbursed through the fuel adjustment clause, because it did not meet the very narrow definition of the cost of fuel in Kentucky's fuel adjustment regulation which was based on FERC's fuel adjustment regulation).

and those amounts would not be recorded in Account 151 of the utility that is purchasing the power. Rather, in context, the “fossil fuel costs” referred to in Section 1(3)(b) would be those identifiable fuel costs that the generator would be expected to record in Account 151.³ Thus, limiting the cost of fossil fuel to items listed in FERC Account 151 would not prohibit Kentucky Power from recovering the “the actual identifiable fossil...fuel costs associated with energy purchased” pursuant to Section 1(3)(b), so the concern raised by Kentucky Power does not justify amending or withdrawing the proposed edit.

- (16)Subject Matter: Effect of the amendment to Section 1 (7) [Re-codified as Section 2(1)]
- (a) Comment: Mark Overstreet - Mr. Overstreet, on behalf of Kentucky Power, opposed the proposed amendment to Section 1(7) that explicitly stated that utilities must file all fuel contracts when they seek to reestablish the base period and that they should file “any other documents and information required by 807 KAR 5:001 and 807 KAR 5:011,” and argued that those changes created ambiguity regarding which provisions of 807 KAR 5:001 and 807 KAR 5:011 would apply when they seek to reestablish the base period. Mr. Overstreet suggested that the proposed amendment by [sic] modified to remove the references to 807 KAR

³ FERC limits the definition of the “cost of fossil fuel” to items listed in Account 151 and includes nearly identical language regarding the recovery of identifiable fossil fuel costs in energy purchases, so there is no reason to expect that Kentucky’s regulation would be applied differently than FERCs regulation.

5:001 and 807 KAR 5:011 or to specify which sections of those regulations apply.

John Pollum - Mr. Pollum, on behalf of Kentucky Power, argued that this amendment should be struck or further clarified for the reasons discussed by Mr. Overstreet.

- (b) Response: The intent of the proposed amendment to Section 1(7) [Re-codified as Section 2(1)] was to make it clear that the requirement that utilities file all fuel contracts when proposing a fuel adjustment clause or seeking to establish a new base period for a fuel adjustment clause is in addition to as opposed to in lieu of any applicable filing requirements in 807 KAR 5:001 and 807 KAR 5:011. However, as noted by Kentucky Power, the relevant provisions of 807 KAR 5:001 and 807 KAR 5:011 would still apply even if they are not referenced in this regulation. Thus, to avoid the confusion identified by Kentucky Power, the Commission will amend Section 1(7) [Re-codified as Section 2(1)] based on the comments as shown below:

(1)[~~(7) At the time the fuel clause is initially filed,~~] If a utility initially proposes a fuel adjustment clause ~~[or proposes to reset the base period fuel costs used in a fuel adjustment clause].~~ the utility shall submit copies of each fossil fuel purchase contract not otherwise on file with the commission and all other agreements, options, amendments, modifications, and~~[or]~~ similar such documents~~[- and all amendments and modifications thereof]~~

related to the procurement of fuel supply~~[and]~~ or purchased power~~[-in addition to any other documents and information required by 807 KAR 5:001 and 807 KAR 5:011].~~~~[Incorporation by reference is permissible.]~~

The amendments in response to comments are in bold.

(17) Subject Matter: Public Hearings in review proceedings

(a) Comment: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, stated in written comments that the companies support the commission's proposed amendments to Section 1(11) [re-codified as Section 3(3)] and Section 1(12) [recodified as Section 3(4)] that making public hearings regarding fuel adjustment clauses discretionary, because the amendments eliminate unnecessary hearings but allow the Commission to adequately review utilities' fuel adjustments and conduct hearings when appropriate. However, he observed that the proposed amendment, as written, only includes a standard for determining when a hearing should take place in the provision discussing the 2 year review. He suggested that the standard applicable to the 2 year review would be appropriate for the 6 month review also.

Robert Conroy - Mr. Conroy, on behalf of LG&E and KU, indicated that the companies agreed with the Commission's decision to make hearings on the fuel adjustment clauses discretionary.

Mark R. Overstreet - Mr. Overstreet, on behalf of Kentucky Power, stated in written comments that Kentucky Power supported the proposed amendments to Section 1(11) [re-codified as Section 3(3)] and Section 1(12) [re-codified as Section 3(4)] making public hearings regarding fuel adjustment clauses discretionary, because the amendments eliminate unnecessary hearings, which impose a cost on utilities that are passed on to ratepayers, but allow the Commission to adequately review utilities' fuel adjustments and conduct hearings when appropriate.

Tyson Kamuf - Mr. Kamuf, on behalf of Big Rivers, stated in written comments that Big Rivers supported the proposed amendments to Section 1(11) [re-codified as Section 3(3)] and Section 1(12) [re-codified as Section 3(4)] making public hearings regarding fuel adjustment clauses discretionary, which Big Rivers believes will eliminate public hearings when they are unnecessary and will thereby eliminate unnecessary costs.

Rocco D'Ascenzo - Mr. D'Ascenzo, on behalf of Duke Kentucky, stated that Duke Kentucky supported the proposed amendments to Section 1(11) [re-codified as Section 3(3)] and Section 1(12) [re-codified as Section 3(4)] making public hearings regarding fuel adjustment clauses discretionary, because the hearings are often a formality simply to satisfy the regulation but still impose costs.

Kurt Boehm - Mr. Boehm, on behalf of KIUC, supported the proposed amendments to Section 1(11) [re-codified as Section 3(3)] and Section 1(12)

[recodified as Section 3(4)] making public hearings regarding fuel adjustment clauses discretionary.

David Smart - Mr. Smart, on behalf of EKPC, supported the proposal to make the hearing requirements discretionary but recommend changing the standard for determining whether to conduct a hearing to whether a hearing is “necessary” as opposed to whether a hearing is “necessary for the protection of a substantial interest or is in the public interest.”

- (b) Response: The Commission continues to believe that the hearings should be discretionary for the reasons previously stated and for those reasons stated by the commenters. The Commission does not believe it is necessary to amend Section 1(11) [re-codified as Section 3(3)] or Section 1(12) [re-codified as Section 3(4)] to include a standard in Section 3(3) for when a hearing should be conducted. The Commission notes that the standard in Section 3(4) is consistent with the standard in 807 KAR 5:001, which would apply in the absence of a standard.

(18)Subject Matter: Provision that permits the Commission to grant deviations

- (a) Comment: Kendrick Riggs - Mr. Riggs, on behalf of LG&E and KU, requested that the Commission include a provision in 807 KAR 5:056 that allows it to grant deviations.

Robert Conroy - Mr. Conroy, on behalf of LG&E and KU, requested that the Commission include a provision in 807 KAR 5:056 that allows it to grant deviations.

Kurt Boehm - Mr. Boehm, on behalf of KIUC, supported LG&E and KU's comment that the Commission include a provision in 807 KAR 5:056 that allows it to grant deviations.

- (b) Response: The Commission observes that utilities included fuel adjustment clauses in their tariffs long before the Commission promulgated 807 KAR 5:056. Further, the Commission adopted 807 KAR 5:056, in part, to standardize utilities' fuel adjustment clauses. This standardization of fuel adjustment clauses permits to Commission to efficiently review utilities adjustments each month in a manner that would be difficult if each utility's fuel adjustment clause were different or modified by numerous, unique deviations.

Even without language in the regulation permitting deviations, parties regularly attempt to expand the definition of fuel costs as used in the regulation to pass additional costs through the fuel adjustment clause. If language were included to allow the Commission to grant deviations to 807 KAR 5:056, then the Commission expects that it would regularly receive requests for additional costs to be passed through utilities' fuel adjustment clauses, which would increase the complexity of the Commission's review of fuel adjustments, make oversight more difficult, and affect the ability of utility customers to understand the fuel adjustments on their bills.

Moreover, since the cost of fuel is already recoverable under the fuel adjustment, the Commission expects that any substantive deviations requested would be to pass items other than fuel costs through the fuel adjustment clause.

It would be inconsistent with the purpose of the regulation, which is to allow timely recover [sic] of volatile fuel costs, to pass such costs through the fuel adjustment clauses. The Commission also has other mechanisms that allow utilities to account for and pass unexpected costs and windfalls through to customers, including the creation of regulatory liabilities and assets that can later to be passed through to customers as part of a base rate adjustment. Thus, the Commission submits that allowing deviations to 807 KAR 5:056 is not justified at this time.

(19)Subject Matter: Deleting Section 1(10) [re-codified as Section 2(5)]

(a) Comment: Kendrick Riggs- Mr. Riggs, on behalf of LG&E and KU, requested that the Commission delete Section 1(10) [re-codified as Section 2(5)], because the Commission could then keep coal contracts confidential. He argued that suppliers [sic] current review such contracts and that they can use that information to increase bids, which, in turn, increases prices to customers.

Robert Conroy - Mr. Conroy, on behalf of LG&E and KU, requested that the Commission delete Section 1(10) [re-codified as Section 2(5)] to allow the Commission to keep coal contracts confidential.

(b) Response: The Commission does not believe that removing the provision referred to by LG&E/KU would actually affect whether the items should be exempt from disclosure, because the Commission previously found that the contracts were subject to disclosure pursuant to the Kentucky Opens Records Act, which regulations cannot modify. *See,*

e.g. Case No. 1997-00197, Petition of Kentucky Utilities Company for Confidential Protection of Certain Information Contained in Barge Transportation and Coal Purchase Contracts, Order (Ky. PSC Mar 18, 1998).

- (20) Subject Matter: Levelized Fuel Adjustments for Energy Intensive Users
- (a) Comment: Kurt Boehm - Mr. Boehm, on behalf of KIUC, suggested that the Commission propose allowing “energy intensive customers” to contract with utilities or petition the Commission to levelize the fuel adjustments over a longer period, perhaps a year, to allow such customers to set prices based on a fixed cost. He noted the month to month volatility creates significant issues for high intensity users, which can cause swings of tens of thousands of dollars or more in expenses. He suggested a mechanism to provide a true-up to the utilities at the end of each period. He provided draft language and requested that the Commission consider adding that or similar language to 807 KAR 5:056.
- (b) Response: KIUC’s proposal is, in part, is contrary to the intent of the fuel adjustment clause regulations to permit timely recovery of volatile fuel costs. Conversely, the Commission understands the benefits of levelizing costs for certain customers. which, among other things, could allow them to more effectively set prices. However, KIUC’s proposal would represent a significant change in the manner in which fuel costs are determined. Moreover, as proposed, it would create an ad hoc approach that would be difficult to manage (as noted above, one purpose of

the fuel adjustment clause regulation was to standardize fuel adjustment clauses). The Commission believes that it would need to investigate this matter further and obtain input from other stakeholders before it could support such an amendment. Thus, the Commission has not proposed to adopt KIUC's proposed amendment at this time.

V. Summary of Statement of Consideration and Action Taken by Promulgating Administrative Body

The public hearing on this administrative regulation was conducted, and the Commission received comments at the hearing. Additionally, written comments were received. The Commission responded to the comments and amends the administrative regulation as follows:

Page 2

Section 1 (3)(c)

Line 21-22

After "purchases," [sic for punctuation through the end of 47sa], delete "irrespective of the designation assigned to such transaction and".

Page 2

Section 1 (3)(c)

Line 22-23

After "charges", add "irrespective of the designation assigned to such transaction,"

Page 4

Section 2(1)

Line 16-17

After “clause”, delete “or proposes to reset the base period fuel costs used in a fuel adjustment clause”.

Page 4
Section 2(1)
Line 20-21

After “power”, delete “in addition to any other documents and information required by 807 KAR 5:001 and 807 KAR 5:011”.

Page 6
Section 3(5)
Line 16

Delete “Beginning”.
Before “three”, insert “For any contracts entered into”.
After “three (3)”, insert “or more”.

Page 6
Section 3(5)
Line 19

After “less”, delete “any tax collected under KRS 143.020”
After “less, insert “any coal severance tax imposed by any jurisdiction upon coal physically removed from the earth”

[DATED SEPTEMBER 12, 2019]



September 12, 2019

**RE: SPOT AND TERM BID INVITATION:
LG&E/KU/19-05**

**Deadline for Bids: 5:00 p.m. EDT
Thursday, October 10, 2019**

Louisville Gas and Electric Company (“LG&E”) and Kentucky Utilities Company (“KU”), the “Company” collectively, are soliciting proposals for steam coal for LG&E’s Trimble County and Mill Creek Generating Stations and KU’s Ghent and Brown Generating Stations.

Please note that the Company is interested in evaluating longer term proposals and will consider offers for up to ten (10) years.

High Sulfur Rail Coal: Term coal for up to ten (10) years in length, beginning January 2021 for Mill Creek and E.W. Brown Stations.

High Sulfur Barge Coal: Term coal for up to ten (10) years in length, beginning January 2021 for Trimble County, Mill Creek, and Ghent Stations.

This Bid Package contains a cover letter, Exhibit A – Coal Supply Bid, Exhibit B – Coal Quality Specifications, Exhibit C – Sample Coal Payment Calculation, and Exhibit D – Sample Insurance Requirements. These documents can be downloaded from the website: apps.lge-

ku.com/RegulatedFuelBids/. The bid form (Exhibit A) must be used in submitting your bid. Failure to use this bid form may result in the rejection of your bid. The bid must be fully completed in ink or in typewritten form and submitted as described below and in the bid documents.

COAL SEVERANCE TAX:

The Kentucky Public Service Commission is now requiring utilities to evaluate the reasonableness of fuel costs in contracts and competing bids based on the cost of the fuel less any coal severance tax imposed by any jurisdiction. Therefore, Bidders must provide the severance tax that the producer would pay, in dollars per ton, for each year coal is offered. All calculations used to arrive at this annual severance tax amount must be included, in addition to any supporting information.

BIDDER MAY OFFER ANY COAL (OR ALTERNATIVE FUELS), INCLUDING VOLUME FLEXIBILITY

Bidder is invited to submit more than one quotation for differing coal specifications. However, all requested information must be provided for each individual set of coal specifications proposed, including a COAL SUPPLY BID (Exhibit A), an ULTIMATE COAL ANALYSIS, and MINERAL ASH ANALYSIS. **Bidder must provide a recent ULTIMATE COAL ANALYSIS, along with an ASH MINERAL, TRACE ELEMENTS, and EQUILIBRIUM MOISTURE ANALYSIS for the bid to be considered.**

No premium for lower ash and/or sulfur will be added to the agreed upon price.

FOB RAIL/BARGE QUOTES: Prices quoted shall be inclusive of any and all costs, including but not limited to taxes, fees, insurance requirements, **barge fleetings and switching charges, harbor costs, port costs, third party costs**, etc., which are the responsibility of the Bidder and **shall be priced F.O.B. railcar or F.O.B. barge. The barges should be free of all costs to the Company's barge transportation contractor. Any and all additional costs must be included in the quoted price of the coal. The price shall include all costs up to the point the Buyer's transportation contractor takes possession and control of the barge(s) and/or railcars.**

Attached is a coal quality specification sheet (Exhibit B). Quality offered should be quality delivered on a monthly weighted average, subject to contract rejection limits.

All quotations may be subject to a pre-award audit, which may include an examination of the Bidder's operational and financial records and operations (as reasonably necessary), to ensure that the Bidder is financially stable and has the coal of the quantity and quality as offered herein.

The Company reserves the right to have its representative(s) visit the mine(s) and loading facilities of the Bidder, to take coal samples for analysis, to obtain other information as to the suitability of the coal, and to evaluate the Bidder's capability to perform, etc. Acceptance of bid(s) may be made conditional upon the results of such investigations.

Bidder must be willing to warrant that there are reserves equivalent to the total required to supply the

tonnage and quality for the proposed term. Bidder **must** furnish **recent** coal quality analysis of the coal being offered. This data must be supplied as an attachment to Exhibit A. Such analyses should show the ranges of coal quality and who performed the testing. Guaranteed Coal Quality should be supplied on sheets 4, 5, 6 and 7 of Exhibit A.

ENCLOSED IS A COPY OF THE BID FORM (EXHIBIT A) WHICH MUST BE USED IN SUBMITTING YOUR BID. FAILURE TO USE THIS BID FORM MAY RESULT IN THE REJECTION OF YOUR BID. THE BID MUST BE FULLY COMPLETED IN INK OR IN TYPEWRITTEN FORM AND SUBMITTED AS DESCRIBED BELOW. A COPY SHOULD BE RETAINED FOR YOUR RECORDS.

AN ORIGINAL OF EACH BID PROPOSAL MUST BE SUBMITTED IN A SEALED ENVELOPE AND THE ENVELOPE MUST BE MARKED: **LG&E/KU COAL OFFER LGE/KU 19-05**. BIDS SHOULD BE EITHER MAILED BY CERTIFIED MAIL OR DELIVERED BY THE BIDDER TO:

Mr. Delbert Billiter
Manager LG&E and KU Fuels
LG&E and KU Energy LLC
220 W. Main Street
Louisville, KY 40202

Bids **must** be received on or before 5:00 p.m. EDT, on Thursday, October 10, 2019 at the above address.

Bids shall remain in effect until 5:00 p.m. EST, on Thursday, December 12, 2019 and may not be withdrawn within this period unless a written request from the Bidder is approved by the Company.

A "Short List" of Bidders (a list of the finalists) will be developed taking into account, but not limited to such factors as:

1. Suitability of the coal.
2. Bidder's ability to meet quality specifications based on coal reserve characteristics and quality control procedures.
3. Total evaluated cost to the Company (to include assessment of transportation costs and quality impact on operating costs) of burning the coal (in cents per million BTU).
4. Demonstrated reliability of supplier.
5. Reserves.
6. Financial capabilities and strength.
7. Results of test shipment(s) of coal, if required.
8. Geological evaluation and testing.
9. References.
10. Interstate Experience Modification Rate (EMR)

The Company also reserves the right to require the Bidder to furnish a performance bond of an amount sufficient to provide adequate protection to the Company in the event the Bidder is unable to satisfactorily perform the duties and obligations imposed on Bidder, under any contract which is entered into as a result of this bid.

Each bidder must sign the proposal letter with its usual signature and shall give its full business address. Bids shall be signed in the official corporate name of the corporation, followed by the signature and the designation of the president, secretary, or other persons signing who are authorized to bind the corporation. The names of all persons signing shall also be typed or printed below the signature. For non-

corporate proposers, evidence of authority to sign and legally bind the entity must be provided.

The Company will retain in confidence, all proposals and other information received pursuant to this Request, but reserves the right to disclose such information and/or proposals to consultants that the Company may retain to assist in the evaluation and contract effort, or when so requested by a court or government agency.

Bidder will be responsible for the completeness and accuracy of all information contained or used in preparation of the proposal and will also be responsible for supplying all necessary supporting information.

THE COMPANY RESERVES THE RIGHT TO MODIFY OR WITHDRAW THIS REQUEST, TO REQUEST ADDITIONAL INFORMATION, TO WAIVE TECHNICALITIES OR IRREGULARITIES, TO REJECT ANY OR ALL PROPOSALS, AND TO TERMINATE ANY SUBSEQUENT DISCUSSIONS AT ANY TIME. THE COMPANY ALSO RESERVES THE RIGHT TO ACCEPT ONE OR MORE PROPOSAL(S) FOR A PORTION OR FOR ALL OF THE QUANTITIES OF COAL. THE COMPANY ALSO RESERVES THE RIGHT TO NEGOTIATE WITH BIDDER THE TERMS AND CONDITIONS OF THIS QUOTATION.

Nothing herein shall obligate the Company to compensate or reimburse Bidder for any costs or expenses incurred in the preparation of this proposal, or the submission of any information or data in connection therewith, and we shall not be obligated under any contract or order resulting from any proposal unless and until the contract or order has

been signed by a duly authorized official of the Company.

The Bidders placed on the "Short List" will be notified of their selection to the list as promptly as possible.

[DATED JANUARY 8, 2020]

Andy Beshear
Governor

Michael J. Schmitt
Chairman

Rebecca W. Goodman
Secretary
Energy and Environment Cabinet

Robert Cicero
Vice Chairman

Talina R. Mathews
Commissioner

Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone; (502) 564-3940
Fax; (502) 564-3460
psc.ky.gov

January 8, 2020

To: All Electric Utilities

RE: Constitutional Challenge to Administrative
Regulation 807 KAR 5:056, Section 3(5)

To Whom It May Concern:

The Commission is issuing this letter to inform you of a possible legal challenge to Administrative Regulation 807 KAR 5:056, (“807 KAR 5:056”). The Commission has received notice of a potential constitutional challenge by Foresight Coal Sales, LLC, (“Foresight”), that Foresight intends to pursue legal action to invalidate as unconstitutional 807 KAR 5:056 Section 3(5), (“Section 3(5)”).

The Commission has requested a legal opinion from the Attorney General for the Commonwealth of

Kentucky regarding the constitutionality of Section 3(5). A copy of the request is attached, which includes a copy of Foresight's letter. In light of that pending request and the potential for a legal challenge to Section 3(5), the Commission is suspending enforcement of the requirements of Section 3(5) until the Attorney General has rendered an opinion on the constitutionality of Section 3(5). After the Attorney General renders his opinion, the Commission will determine the next steps regarding Section 3(5).

If you have any questions, please contact J.E.B. Pinney, Acting General Counsel, at (502) 782-2587 or ieb.pinney@ky.gov.

CC: Nicholas S. Johnson

Sincerely,



Gwen R. Pinson
Executive Director



Andy Beshear
Governor

Michael J. Schmitt
Chairman

Rebecca W. Goodman
Secretary
Energy and Environment Cabinet

Robert Cicero
Vice Chairman

Talina R. Mathews
Commissioner

Commonwealth of Kentucky
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211 Sower Blvd.
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Frankfort, Kentucky 40602-0615
Telephone; (502) 564-3940
Fax; (502) 564-3460
psc.ky.gov

January 8, 2020

Hon. Daniel Cameron
Attorney General
Commonwealth of Kentucky
700 Capital Avenue
Suite 118
Frankfort, Kentucky 40601

Re: Constitutionality of Administrative
Regulation 807 KAR 5:056

Attorney General Cameron:

The Kentucky Public Service Commission (“Commission”) is submitting this letter requesting a legal opinion from your office regarding the constitutionality of a recent amendment to Administrative Regulation 807 KAR 5:056 (“807 KAR 5:056”). The Commission has received notice of a potential constitutional challenge by Foresight Coal

Sales, LLC, (“Foresight”), a copy of which is attached to this letter, that Foresight intends to pursue legal action to invalidate as unconstitutional 807 KAR 5:056, Section 3(5) (“Section 3(5)”). The Commission will cease enforcement of Section 3(5) until it receives an opinion from your office.

Background

807 KAR 5:056 is the Commission’s regulation addressing the Fuel Adjustment Clause (“FAC”). The FAC is a mechanism by which the Commission, *inter alia*, reviews fossil fuel and power purchases of utilities in Kentucky that generate their own electricity, making adjustments to the utilities’ FAC surcharges recovered from a monthly surcharge on customers’ bills. Several amendments to 807 KAR 5:056 became effective on August 20, 2019, among those amendments was a new section, Section 3(5) which provides that the Commission would review the reasonableness of the costs of proposals to supply fossil fuels “based on the cost of the fuel less any coal severance tax imposed by any jurisdiction.” The Commission adopted this amendment in response to House Resolution 144 from the 2019 Regular Session, which noted a decline in Kentucky coal production; noted that much of the coal consumed in Kentucky was imported from out of state, including from Illinois; and urged the Commission to consider “all costs, including fossil fuel-related economic impacts within Kentucky, when analyzing coal purchases under the fuel adjustment clause.”

On December 5, 2019, the Commission received a letter from Foresight, dated November 29, 2019, the purpose of which was “to place [the Commission] on notice that it intends to pursue legal action to

invalidate an unconstitutional regulation found at [807 KAR 5:056, Section 3(5)], unless [Foresight is] sooner advised that the subject regulation has been revoked or otherwise held in abeyance from applying to contracts.” Foresight alleges that Section 3(5) violates the dormant Commerce Clause of the United States Constitution because it was enacted with the intent of providing a competitive advantage to Kentucky coal.

As of the date of this letter, litigation has not yet been initiated in this matter but has been threatened by Foresight. Foresight also indicated that it is currently in discussions with the Illinois Coal Association to bring a lawsuit on its behalf and on behalf of other coal producers in Illinois.

Specifically, Foresight observes that the original language proposed by the Commission required that the cost of coal be evaluated “based on the cost of the fuel less any tax collected under KRS 143.020,” i.e., Kentucky’s coal severance tax statute. Foresight alleges that despite the change in the language that “the intent of the regulation remains the same: improperly advantaging Kentucky coal producers to the detriment of the direct competition in Illinois and Indiana, where no severance tax exists.”

Foresight further alleges that “statements issued in the notice and comment period for the rule make it clear the intent behind the rule.” Foresight noted that:

Those comments state that the idea behind the rule is “to incentivize Kentucky utilities to purchase Kentucky coal . . . [and is] an attempt to remove from [a utility’s] consideration the increase in the cost of Kentucky coal as a result

of the Kentucky coal severance tax.” Commenters lauded the PSC’s “efforts to protect coal jobs in Kentucky.” Further, commenters specifically noted the intent to make Kentucky coal artificially appear more competitive “with out of state coal that originates from states that do not apply coal severance taxes, such as Illinois and Indiana.”

Foresight noted, among other things, that the United States Supreme Court in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) “struck down a Massachusetts milk-pricing order which employed a tax on all milk sold to fund a subsidy to in-state producers” because the Court, according to Foresight, “viewed the regulation as a tariff or customs duty-neutralizing the advantage possessed by lower cost out of state producers.” Foresight argued that is the motivation, intent, and effect of 807 KAR 5:056, Section 3(5).

Foresight further pointed to the decision of the 7th Circuit Court of Appeals in *Alliance for Clean Coal v. Miller*, 44 F.3d 591 (7th Cir. 1995), that held that an Illinois law, which required, among other things, that “utilities formulate Clean Air Act compliance plans that took into account the need to use coal mined in Illinois in an environmentally responsible manner in the production of electricity and the need to maintain and preserve as a valuable State resource the mining of coal in Illinois,” violated the dormant Commerce Clause. Foresight argued Section 3(5), like the Illinois law, violates the cardinal rule of nondiscrimination and, therefore, will be invalidated.

Foresight indicated that it has notified the affected utilities that it intends to initiate legal action

regarding the regulation and cautioned them against entering into contracts based on Section 3(5). Further, it indicated that it intends to seek judicial review of the rule and reserves the right to use any remedies available to recover any damages arising from this rule.

Request for an Opinion

The Commission's request is simple: is Section 3(5) unconstitutional because it violates the dormant commerce clause by discriminating against coal from states with no severance tax? The regulation is not facially discriminatory, as the effect of the regulation will be to reduce the cost of coal subject to severance taxes imposed by any jurisdiction for the purpose of the Commission's cost evaluation.

Based on the foregoing, the Commission respectfully requests an opinion regarding the Constitutionality of 807 KAR 5:056 Section 3(5).

Sincerely,

A handwritten signature in blue ink, appearing to read "J.E.B. Pinney", with a large, loopy flourish extending to the right.

J.E.B. Pinney
Acting General Counsel
Kentucky Public Service Commission
(502) 782-2587
Jeb.pinney@ky.gov

[DATED MARCH 4, 2020]

Andy Beshear
Governor

Michael J. Schmitt
Chairman

Rebecca W. Goodman
Secretary
Energy and Environment Cabinet

Robert Cicero
Vice Chairman

Talina R. Mathews
Commissioner

Commonwealth of Kentucky
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psc.ky.gov

March 4, 2020

To: All Electric Utilities

RE: Constitutional Challenge to Administrative
Regulation 807 KAR 5:056, Section 3(5)

To Whom It May Concern:

On January 8, 2020, the Commission issued a letter to inform you of a possible legal challenge to Administrative Regulation 807 KAR 5:056, (“807 KAR 5:056”). The Commission had received notice of a potential constitutional challenge by Foresight Coal Sales, LLC, (“Foresight”), that Foresight intended to pursue legal action to invalidate as unconstitutional 807 KAR 5:056 Section 3(5), (“Section 3(5)”). The January 8, 2020 letter stated that the Commission had requested a legal opinion from the Attorney General for the Commonwealth of Kentucky

“Attorney General”) regarding the constitutionality of Section 3(5). The letter also stated that, in light of that pending request and the potential for a legal challenge to Section 3(5), the Commission was suspending enforcement of the requirements of Section 3(5) until the Attorney General had rendered an opinion on the constitutionality of Section 3(5).

On March 4, 2020, the Commission received the attached opinion of the Attorney General in which the Attorney General concluded that Section 3(5) does not violate on its face the dormant commerce clause and is therefore constitutional. Having received this opinion from the Attorney General, the Commission will no longer suspend enforcement of the requirements of Section 3(5).

If you have any questions, please contact J.E.B. Pinney, Acting General Counsel, at (502) 782-2587 or ieb.pinney@ky.gov.

Sincerely,



Kent A. Chandler
Executive Director

CC: Nicholas S. Johnson

Commonwealth of Kentucky
Office of the Attorney General

Daniel Cameron
Attorney General

Capitol Building, Suite 118
700 Capital Avenue
Frankfort, Kentucky 40601
(502) 696-5300
Fax: (502) 564-2894

March 4, 2020

OAG 20-04

- Subject:* Whether 807 KAR 5:056 § 3(5) violates the dormant commerce clause.
- Requested by:* J.E.B. Pinney, Acting General Counsel
Public Service Commission
- Written by:* Carmine G. Iaccarino, Executive Director
Brett R. Nolan, Special Litigation Counsel
- Syllabus:* 807 KAR 5:056 § 3(5) does not violate the dormant commerce clause.

Opinion of the Attorney General

The Kentucky Public Service Commission requests this Office's opinion on whether 807 KAR 5:056 § 3(5) (the "Regulation") is unconstitutional under the "dormant commerce cause" of the United States Constitution. For the reasons that follow, the Office finds that the Regulation is not unconstitutional.

"The Commerce Clause provides that the Congress shall have Power to regulate Commerce among the

several States.” *Or. Waste Sys., Inc. v. Dep’t of Envtl. Quality of State of Or.*, 511 U.S. 93, 98 (1994) (quoting Art. I, § 8, cl. 3) (cleaned up). Despite its name, the so-called “dormant commerce clause” is nowhere found in a clause to the United States Constitution. *Tyler Pipe Indus., Inc. u. Wash. State Dep’t of Revenue*, 483 U.S. 232, 265 (1987) (Scalia, J., dissenting) (“[T]he Court for over a century has engaged in an enterprise that it has been unable to justify by textual support[.]”). Regardless, it “denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce.” *Or. Waste Sys., Inc.*, 511 U.S. at 98. Thus, states may not engage in “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.” *Id.* at 99. On the other hand, “nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.” *Id.* (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)). Despite the negative thrust of the Commerce Clause, the Supreme Court has recognized that “the Framers’ distrust of economic Balkanization was limited by their federalism favoring a degree of local autonomy.” *Dep’t of Revenue of Ky. v. Davis*, 553 U.S. 328, 338 (2008) (citing *The Federalist* Nos. 7 (A. Hamilton), 11 (A. Hamilton), and 42 (J. Madison), and 51 (J. Madison)).

According to the Commission, “807 KAR 5:056 is the Commission’s regulation addressing the Fuel Adjustment Clause (‘FAC’). The FAC is a mechanism by which the Commission ... reviews fossil fuel and power purchases of utilities in Kentucky that generate their own electricity, making adjustments to

the utilities' FAC surcharges recovered from a monthly surcharge on customers' bills." Relevant to this Office's inquiry, the Regulation provides:

For any contracts entered into on or after December 1, 2019, the commission shall, in determining the reasonableness of fuel costs in procurement contracts and fuel procurement practices, evaluate the reasonableness of fuel costs in contracts and competing bids based on the cost of the fuel less any coal severance tax imposed by any jurisdiction.

807 KAR 5:056 § 3(5).

"Severance taxes are excise taxes on natural resources 'severed' from the earth." <https://www.ncsl.org/research/fiscal-policy/2011-state-severance-taxcollections.aspx> (last accessed Feb. 27, 2020). Kentucky's severance tax is 4.5% on coal severed or processed in Kentucky. KRS 143.020. Ohio, Tennessee, and West Virginia have also enacted their own severance taxes for coal mined in those states. *See* Ohio Rev. Code Ann. 5749.02; Tenn. Code Ann. 67-7-103; W. Va. Code 11-13A-3. Indiana and Illinois have not enacted coal severance taxes.

In the 2019 Regular Session of the General Assembly, the Kentucky House of Representatives passed House Resolution 144, which "urg[ed] the Public Service Commission to amend its administrative regulations to consider all costs, including fossil fuel-related economic impacts within Kentucky, when analyzing coal purchases under the fuel adjustment clause." House Resolution 144 prompted the Commission amend 807 KAR 5:056 § 3(5).

Based on the plain text of the Regulation, this Office agrees with the Public Service Commission that the Regulation “is not facially discriminatory.” Request at 3. The Regulation provides that coal severance taxes “imposed by *any* jurisdiction” should not be considered when evaluating the reasonableness of fuel costs. 807 KAR 5:056 § 3(5) (emphasis added). This does not require the “differential treatment of instate and out-of-state economic interests that benefits the former and burdens the latter.” *Or. Waste Sys., Inc.*, 511 U.S. at 99. Rather, it requires treating all economic interests the same by deducting the coal severance tax imposed by *any* jurisdiction when evaluating “the reasonableness of fuel costs in contracts and competing bids.” 807 KAR 5:056 § 3(5). Because the Regulation treats coal sourced from within the Commonwealth the same as coal sourced from outside its borders, it is not facially discriminatory.

Laws that are facially neutral might nevertheless violate the dormant commerce clause if “the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits.” *Or. Waste Sys., Inc.*, 511 U.S. at 99; *see also Pike*, 397 U.S. at 137 (“Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”). But this is a narrower kind of claim that often involves weighing factual issues that are difficult to balance. *See Bendix Autolite Corp. v. Midwesco Enters., Inc.*, 486 U.S. 888, 897 (1988) (Scalia, J., dissenting) (“Weighing the governmental interests of a State against the needs of interstate

commerce is, by contrast, a task squarely within the responsibility of Congress”). So “[s]tate laws frequently survive this *Pike* scrutiny,” *Dep’t of Revenue of Ky.*, 553 U.S. at 339 (collecting cases), in part because it requires high deference to the state’s policy choices. See *Tenn. Scrap Recyclers Ass’n v. Bredesen*, 556 F.3d 442, 450 (6th Cir. 2009) (explaining that any challenge under *Pike* must demonstrate that the burden on interstate commerce is “clearly excessive”) (quoting *C & A Carbone, Inc. v. Town of Clarkstown, N. Y.*, 511 U.S. 383, 390 (1994)).

Though this Office’s analysis is necessarily limited without a factual record to consider, it is not clear that the Regulation will burden interstate commerce. States are free to enact coal severance taxes at a chosen rate. An adjustment to offset coal severance taxes would cause Kentucky coal to be priced more competitively in comparison to some states and less competitively with respect to other states, depending on which states have chosen to enact severance taxes and at what rate. Kentucky has enacted a coal severance tax of 4.5% on coal severed or processed in Kentucky, but states like Indiana and Illinois have not enacted a coal severance tax. So while the Regulation might arguably benefit coal producers in Kentucky relative to those in Indiana or Illinois, the same logic would mean that it could hurt Kentucky coal producers relative to those states where the severance tax may be higher. Either way, nothing prevents states from altering their severance tax if they believe it will provide their coal producers with a competitive advantage in Kentucky. Thus, there is no merit to the argument that discounting severance taxes in the Commission’s consideration will favor

Kentucky coal producers to the detriment of all out-of-state interests.

For these reasons, this Office concludes that the Regulation does not violate the so-called “dormant commerce clause.”

Daniel Cameron
ATTORNEY GENERAL

Brett R. Nolan, Special Litigation Counsel
Carmine G. Iaccarino, Executive Director

[DATED NOVEMBER 30, 2020]
AGREEMENT

This Agreement is entered into by and between: (i) Foresight Coal Sales, LLC (“Foresight”); (ii) Michael Schmitt, Talina Mathews, Kent Chandler, and the Public Service Commission’s Executive Director, all in their official capacities (the “PSC Defendants”); and (iii) Daniel Cameron, in his official capacity (the “Attorney General”) (all parties together, the “Parties”).

The Parties hereby agree as follows:

1. The PSC Defendants agree that the Public Service Commission will notify Kentucky’s jurisdictional electric utilities via letter that, beginning immediately, the Public Service Commission will no longer apply 807 Ky. Admin. Reg. 5:056 § 3(5) (the “Challenged Regulation”) and that the Challenged Regulation will be withdrawn through the Public Service Commission’s ordinary regulatory process. This letter will be sent promptly upon this Agreement becoming effective.

2. The PSC Defendants agree that the Public Service Commission will withdraw the Challenged Regulation through the ordinary regulatory process outlined in KRS Chapter 1 3A. The PSC Defendants agree that the Public Service Commission will submit a regulatory amendment withdrawing the Challenged Regulation to the Legislative Research Commission by December 15, 2020.

3. The Parties agree to jointly move to dismiss the appeal in *Foresight Coal Sales, LLC v. Schmitt, et al.*, No. 20-5549 (6th Cir.) (the “Sixth Circuit matter”), and to seek remand of the oral argument scheduled

for December 4, 2020. This joint motion will be promptly filed upon this Agreement becoming effective.

4. The Parties agree to jointly move to stay and remand all deadlines in *Foresight Coal Sales, LLC v. Schmitt, et al.*, 3:20-cv-21 (E.D. Ky.) (the “ District Court matter”), until the Challenged Regulation has been officially withdrawn through the ordinary regulatory process. This joint motion will be promptly filed upon this Agreement becoming effective. Once the Challenged Regulation has been officially withdrawn, the Parties agree to dismiss the District Court matter with prejudice.

5. Once the Challenged Regulation is officially withdrawn, Foresight expressly waives any right or entitlement to, and will not seek, reimbursement of its attorneys’ fees and/or any of its costs or expenses associated with the District Court matter and/or the Sixth Circuit matter.

6. By entering into this Agreement, no party admits any liability to any other party with respect to any claim or matter raised in the District Court matter or the Sixth Circuit matter, including but not limited to with respect to the Challenged Regulation. This Agreement shall not be construed as an admission of liability by any party.


7. This Agreement is governed by, and shall be construed in accordance with, Kentucky law. Any dispute regarding this Agreement shall be resolved in a Kentucky court of competent jurisdiction.

8. This Agreement is binding on the Parties and their successors.


9. This Agreement constitutes the entirety of the Parties' agreement. This Agreement supersedes all prior or existing agreements among the Parties or their representatives relating thereto. No amendment to or modification of this Agreement shall be effective unless in writing executed by the Parties.

10. This Agreement may be executed in counterparts.

11. This Agreement is effective on November 30, 2020.

Foresight Coal Sales, LLC

Date: 11/30/20
By: Robert D. Moore
President and Chief Executive Officer

Attorney General Daniel Cameron, in his official capacity


Date: 11/30/2020
By: Asst. Deputy Attorney General

Michael Schmitt, in his official capacity

Michael J. Schmitt Date: 11/30/20
By: Michael J. Schmitt

Talina Mathews, in her official capacity

Talina Mathews Date: 11/30/2020
By: Talina Mathews

Kent Chandler, in his official capacity

Kent Chandler Date: 11/30/2020

By: Kent A. Chandler

Public Service Commission's Executive Director, in his or her official capacity

By: _____

Public Service Commission's Executive Director, in his or her official capacity

Liz Rose Fox Date: 11/30/2020
By: Liz Rose Fox

[ON MARCH 3, 2021]

EXCERPT OF HEARING BEFORE THE
SENATE STANDING COMMITTEE
ON NATURAL RESOURCES AND ENERGY

* * *

PROCEEDINGS

CLERK: Senator Carpenter? Senator Castlen?

SENATOR CASTLEN: Here.

CLERK: Senator Embry?

SENATOR EMBRY: Here, in the room.

CLERK: Senator Harper Angel?

SENATOR HARPER ANGEL: Present remotely in my district.

CLERK: Thank you, Senator. Senator Schickel?
Senator Southworth?

SENATOR SOUTHWORTH: Here.

CLERK: Senator Webb?

SENATOR WEBB: Present.

CLERK: Senator Westerfield?

SENATOR WESTERFIELD: Here.

CLERK: Senator Wheeler?

SENATOR WHEELER: Here.

CLERK: Senator Turner?

SENATOR TURNER: Here.

CLERK: Chair Smith?

CHAIRMAN SMITH: Present. And a quorum?

CLERK: Yes.

CHAIRMAN SMITH: All right. Very good. I need a motion on our minutes for our previous meeting. Motion and a second. All those in favor, sign of aye. Opposed, likewise. Motion carries. All right. We have a very, very busy meeting, and so I'd like to ask each one of those that are going to be presenting to please be conscious of the other people that are going to go. And I will apologize to Senator Southwood. I actually, due to a scheduling conflict, need to actually let Senator Mills go ahead of you. And like I said, a thousand apologies, but if Senator Mills is here -- Senator Mills, please go ahead. There is going to get -- we -- we have a lot of bills to get through, so I ask you to -- to be as informed as you can be and as brief as you can be. So I'm going to turn it over to you. Thank you.

SENATOR MILLS: Thank you, Chairman Smith. I'm Robby Mills. I represent the Fourth Senate District in Western Kentucky, and I'm talking about Senate Bill 257 today that you have before you. 257 is a fuel -- it's a fuel adjustment. It addresses a fuel adjustment issue with the PSC. As you all know, the PSC periodically reviews the utility fuel-buying decisions, and they're charged with assessing the reasonableness of those charges. What this bill does is helps emphasize the re -- the word "reasonableness," and it allows -- it allows the coal severance tax that is added to coal in the State of Kentucky to be considered reasonable when compared with coal contracts that do not have a severance tax on there. And the reason that it is reasonable is because we all know what coal severance tax does for our community and what it returns back to the state, and those are benefits above and beyond just the price

for the consumers. I know, in Webster County, that takes -- gets some coal severance back. We've built a senior citizen center. We've built walking trails. We've done a lot of good things with this severance tax, so...

CHAIRMAN SMITH: I've got a motion and second.

Do you have anybody else that's going to speak with you?

SENATOR MILLS: I do not.

CHAIRMAN SMITH: Very good. I ask the clerk to call the roll.

CLERK: Senator Carpenter? Senator Castlen?

SENATOR CASTLEN: Aye.

CLERK: Senator Embry?

SENATOR EMBRY: Aye.

CLERK: Senator Schickel?

SENATOR SCHICKEL: Aye.

CLERK: Senator Southworth?

SENATOR SOUTHWORTH: Aye.

CLERK: Senator Turner?

SENATOR TURNER: Aye.

CLERK: Senator Webb?

SENATOR WEBB: Aye.

CLERK: Senator Westerfield?

SENATOR WESTERFIELD: Aye.

CLERK: Senator Wheeler?

SENATOR WHEELER: Mr. Chairman, to explain my vote, I think this is a great bill. I'm proud to co-sponsor it with Senator Mills, and I proudly vote aye.

SENATOR MILLS: Thank you.

CLERK: Chair Smith?

CHAIRMAN SMITH: I vote aye, and the motion's approved favorable. Your bill passes. Do I have motion to put this on consent? Second? All those in favor, sign of aye.

SENATE: Aye.

CHAIRMAN SMITH: Opposed, likewise. Senator Mills, thank you for coming in front of our committee.

(CONCLUSION OF EXCERPT)

[ON MARCH 11, 2021]

EXCERPT OF HEARING BEFORE THE
SENATE STANDING COMMITTEE

ON NATURAL RESOURCES

* * *

PROCEEDINGS

CHAIRMAN GOOCH: Okay. Next, we're going to take up Senate Bill 257. Representative Mills.

SENATOR MILLS: Chairman Gooch and Committee, thank you for having me.

CHAIRMAN GOOCH: Yes.

SENATOR MILLS: I'm Robby Mills. I represent the Fourth District in Western Kentucky, and that's coal country, and this is what our bills is about today. If it's okay to go ahead and proceed?

CHAIRMAN GOOCH: Yes. Go right ahead.

SENATOR MILLS: Okay. Very good. So Senate Bill 257 deals with the Public Service Commission, and hopefully you've read it. It was a long bill, about two paragraphs, and -- but it is an important bill. If you're not aware, every so often, the PSC periodically reviews purchase contracts to make sure that electric utilities fuel-buying decisions are reasonable, and when considering whether a fuel purchase is reasonable, the PSC should -- and this is what the bill is about -- consider more than just the cost of the fuel. They should fact -- they should look at factors like reliable fuel source. I know you've talked -- we've talked about this in this committee, and in the Senate committee, about coal as a reliable fuel source. It's sitting there in a pile. It's ready to go. All it has to do

is be burned. And the other thing that they should consider is the economic benefits of the severance tax that's paid on that coal, and those economic benefits are spread out in two ways. They're spread out through the state budget, and they're also spread out individually in the -- in the communities that that fuel and that coal come from through the state. So a low -- cost coal contract doesn't always mean that it's the most reasonable contract. And so what this bill does is this bill asks the Public Service Commission to -- in determining the reasonableness of the fuel cost in procurement of the contracts for the fuel, to evaluate the reasonableness of the fuel cost in contracts and competing bids based on the cost of the fuel less any coal severance tax imposed by any jurisdiction.

CHAIRMAN GOOCH: And thank you, Senator, for bringing this. I know I was taking testimony one time in a committee when I first got here, and I can remember, of course, the PSC at the time wanted to make sure you had the lowest cost or whatever, and there was one utility that testified that they were buying some compliant West Virginia coal that was eight cents a ton cheaper than what the same compliant coal in Kentucky was. Now, we're talking about eight cents pers ton --

SENATOR MILLS: Yeah.

CHAIRMAN GOOCH: -- which wouldn't even been measured in cost, and when you looked at, you know, the -- the employment, the economic development, the way the dollars turned over, the coal severance, and all of that, that certainly was not something that really made any sense to this --

SENATOR MILLS: Right.

CHAIRMAN GOOCH: -- state, and -- and, you know, it's one thing to, you know, allow someone to -- to take the lowest bid or whatever, but for the state to actually promote something --

SENATOR MILLS: Right.

CHAIRMAN GOOCH: -- like that, you know, certainly was not in our best interest, and so with that, are there any questions? Representative Blanton?

REPRESENTATIVE BLANTON: Thank you, Mr. Chairman, Senator Mills for bringing this piece. I do support the legislation.

SENATOR MILLS: Thank you.

REPRESENTATIVE BLANTON: Just a curious question. Is this similar language that PSC actually had in a reg a few years ago and they removed?

SENATOR MILLS: Yeah. Yeah, it is. We -- the House actually passed a resolution, like, 99 to one, two years ago. The PSC had this in a regulation, and they were as -- they're asking us to put it in statute, and it gives them more firm ground to stand on in doing this.

REPRESENTATIVE BLANTON: All right. Thank you, Mr. Chairman.

SENATOR MILLS: Thank you. Good question.

CHAIRMAN GOOCH: Okay. Any other questions? Tom Fitzgerald, are you on the line? Did you want to make any comments?

MR. FITZGERALD: Mr. Chairman, thank you very much. I -- I was just curious, and -- and Senator Mills may or may not know this, but I was -- I'd -- I'd

like to -- Representative Blanton, I support the bill. I was just curious -- I know when the cabinet -- or when the PSC had this in their regulation, they were sued by an out-of-state coal company, and they settled the case by agreeing to remove the language, and -- and I think the reg is actually -- just was -- was just heard by the administrative reg committee. I'm just curious -- I know the AG had looked at the language and had said there didn't seem to be a constitutional issue, but I didn't know whether Senator Mills -- how confident we are that if this goes into the statute, we're not going to get another suit saying that we're violating interstate commerce.

SENATOR MILLS: Yeah, that's -- that's a great question, and, you know, I think the reason the PSC did away with the regulation that they were operating under is really because -- really because of the cost of pursuing that, and I think it's kind of a -- as a kind of a backup situation. It's easier for them to come to the legislature and give, you know -- ask for a statute that gives them more solid ground, and from the folks that I've talked to, I believe the statute puts them on, like I said, much more solid ground if there are any legal challenges moving forward.

MR. FITZGERALD: Okay. And I would hope that the AG's office will -- will stand behind their opinion and will vigorously defend the statute if there is another challenge claiming that it was a civil rights violation. I think that was what -- and I think the PSC acted prudently in settling that because of the potential liability that they were facing.

SENATOR MILLS: It is --

MR. FITZGERALD: Thank you, sir.

SENATOR MILLS: I'll -- I'll reach out to the Attorney General after this and touch base with him. Good question. Thank you.

MR. FITZGERALD: That would be -- that would be great. Thank you, Senator.

SENATOR MILLS: You're welcome.

MR. FITZGERALD: Thank you, Mr. Chairman.

CHAIRMAN GOOCH: Thanks, Tom. And I think we often realize -- and we've seen this a lot of times -- where regulatory groups will be sued by a -- you know, some group out there, and -- and they'll -- they'll settle in court and --

SENATOR MILLS: Yeah.

CHAIRMAN GOOCH: -- that settlement sometimes becomes kind of a consent decree that it's hard to overturn or do -- do much with --

SENATOR MILLS: Sure.

CHAIRMAN GOOCH: -- but we're hopeful in this case, and we don't --

SENATOR MILLS: Right.

CHAIRMAN GOOCH: -- know until we try, and, you know, certainly, people can sue, and interstate com -- being a foul of the interstate commerce clause is something that I've been trying to, you know -- kind of looking at in things that I've done here for 26 years -- seven years, so --

SENATOR MILLS: Yep.

CHAIRMAN GOOCH: -- it is an issue. Any other questions or comments? We ask the clerk to call the roll, please.

CLERK: Representative Blanton?

REPRESENTATIVE BLANTON: Aye.

CLERK: Representative Bowling?

REPRESENTATIVE BOWLING: Yes.

CLERK: Representative Bridges?

REPRESENTATIVE BRIDGES: Yes.

CLERK: Representative Burch?

REPRESENTATIVE BURCH: Yes.

CLERK: Representative Cantrell?

REPRESENTATIVE CANTRELL: I vote yes. I couldn't tell when I looked into the interstate commerce market just a little bit in large (Inaudible). Based on my reading I did, it doesn't look discriminatory -- it doesn't say an interference with interstate commerce just to the extent that the entity here might say it (Inaudible) which is pretty -- you know, pretty fair and reasonable because a lot of entities do effect from this board, (Inaudible) so I vote yes.

CHAIRMAN GOOCH: Thank you.

CLERK: Representative Dossett?

REPRESENTATIVE DOSSETT: Yes.

CLERK: Representative Dotson?

REPRESENTATIVE DOTSON: Yes.

CLERK: Representative DuPlessis?

REPRESENTATIVE DUPLESSIS: Yes.

CLERK: Representative Flannery?

REPRESENTATIVE FLANNERY: Yes.

CLERK: Representative Fugate?

REPRESENTATIVE FUGATE: Yes.

CLERK: Representative Johnson?

REPRESENTATIVE JOHNSON: Yes.

CLERK: Representative Kirk-McCormick?

REPRESENTATIVE KIRK-MCCORMICK: Yes.
May I explain my vote?

CHAIRMAN GOOCH: Yes.

REPRESENTATIVE KIRK-MCCORMICK: Yes, I
am from the coal fields, too, so anything that's going
to support, I'm for it. Thank you.

CLERK: Representative Marzian?

REPRESENTATIVE MARZIAN: Yes.

CLERK: Representative Miles?

REPRESENTATIVE MILES: Yes.

CLERK: Representative Gibbons Prunty?

REPRESENTATIVE GIBSON-PRUNTY: Yes.

CLERK: Representative Scott?

REPRESENTATIVE SCOTT: Pass.

CLERK: Representative Stevenson?

REPRESENTATIVE STEVENSON: (No audible
response.)

CLERK: Representative Wesley?

REPRESENTATIVE WESLEY: Yes.

CLERK: Representative White?

REPRESENTATIVE WHITE: Yes.

CLERK: Chair Gooch?

CHAIRMAN GOOCH: Yes. And thank you that -- I always want to point out that this is my Senator bringing good bills before our committee, and the bill does pass with favorable expression that things should pass.

SENATOR MILLS: Thank you.

CHAIRMAN GOOCH: Thank you.

(CONCLUSION OF EXCERPT)

[ON MARCH 15, 2021]

EXCERPT OF HOUSE FLOOR PROCEEDING

* * *

PROCEEDINGS

SPEAKER OSBORNE: Gentleman from McCracken.

REPRESENTATIVE RUDY: Mr. Speaker, I move you, sir, that Senate Bill 257 be taken from its place in the orders of the day, read for a third time by title and sponsor only, and placed upon its passage.

SPEAKER OSBORNE: Motion's made and seconded that Senate Bill 257 be taken from its place in the orders of the day, read for the third time by title and sponsor only, and placed upon its passage. Clerk, please report.

CLERK: Senate Bill 257, an act relating to utility fuel costs, Senator Mills.

SPEAKER OSBORNE: Gentleman from McCracken.

REPRESENTATIVE RUDY: Mr. Speaker, I yield to the gentleman from Webster for explanation of the bill and motion thereon.

SPEAKER OSBORNE: The Chair recognizes the gentleman from Webster for explanation of the bill and a motion thereon.

REPRESENTATIVE GOOCH: Thank you, Mr. Speaker, ladies and gentlemen. Senate Bill 257 is a -- a very simple bill. It passed the Senate 36 to nothing. And what it applies to is reasonableness of costs in procurement contracts about fuel procedures, procurement, and practices. I think, as many of you

know, we sometimes see on our fuel bills -- our utility bills a fuel adjustment clause, and this allows the utilities to pass on the cost or even sometimes the decreased cost of the fuel cost that they're purchasing. This is something that they're allowed to do, but from time to time, the PSC periodically reviews these to make sure that the most reasonable fuel costs are being used. But the purpose of this bill is to make sure that the PSC understands that sometimes you may need to consider more than just cost. For instance, factors like reliable fuel sources, and other factors like economic benefits need to sometimes also be considered. A perfect example of this -- I remember, several years ago, I was in a committee where we actually heard a utility testify that they had actually bought compliant West Virginia coal over Kentucky coal because it was eight cents a ton cheaper. Now, I think we all know that eight cents a ton was so miniscule that it would not have really affected the rates at all, but when you consider the -- the loss of -- of those severance taxes that went to those local communities, and the jobs, and the taxes that the state was paid from -- from the employment on those jobs, that we really would have been much better off to have paid eight cents a ton more and got the benefits of the coal severance and -- and -- and those jobs. So many of you remember that in 2019, I had a bill that -- actually, it was a resolution where we asked the Public Service Commission to consider more than just the -- the lowest cost possible, and they did that. They wrote some regulations, but they were recently sued by an out-of-state coal company. We -- we understand that these types of laws cannot run afoul of interstate commerce. That's why this bill has been drafted in a way that makes sure that any

jurisdiction, not just the State of Kentucky, that provides or has severance taxes, that those would also be considered there as well. The Public Service Commission feels that it would be better for us to put this in the statute than passing a resolution such as I did in 2019, and then having them just make regulations. So with that, I'd be happy to answer any questions, but I would move for passage of Senate Bill 257.

SPEAKER OSBORNE: Question before the body is passage of Senate Bill 257. Is there any discussion? Seeing none, the clerk will sound the chimes. Those in favor, vote aye. Those opposed, vote nay. And roll call is open for your voting. Have all members voted? Does any member wish to change or explain their vote? The clerk will take the roll. Being 93 members voting aye, one member voting nay, Senate Bill 257 is passed. Gentleman from Webster.

REPRESENTATIVE GOOCH: Move for the clincher.

SPEAKER OSBORNE: That objection clincher is applied.

(CONCLUSION OF EXCERPT)

[ON MAY 27, 2021]

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
CENTRAL DIVISION
FRANKFORT

3 3:21-cv-00016-GFVT-EBA

FORESIGHT COAL SALES, LLC,
PLAINTIFF,

vs.

MICHAEL SCHMITT, et al.,
DEFENDANTS.

WITNESS: JEB PINNEY

The remote videotaped deposition of Jeb Pinney, 30(b)(6) designee of the Kentucky Public Service Commission, was taken before Janine N. Leroux, Stenographic Court Reporter and Notary Public in and for the State of Kentucky at Large on Thursday, May 27, 2021, commencing at the approximate hour of 1:04 p.m. Said deposition was taken pursuant to Rule 30(b)(6) of the Federal Rules of Civil Procedure.

* * *

Q. All right. Mr. Pinney, there was a draft regulation and enacted regulation and now there's SB 257, right?

A. When you refer to the regulation, you mean 807 Kentucky Administrative Regulation 5:056?

Q. 3 Sub 5, yes. The language specifically about the backing out any coal severance tax from any jurisdiction, right? That's how the adopted regulation was worded, correct?

A. Without looking at the regulation, that seems consistent with what I would think.

* * *

Q. And that SB 257 language is virtually identical to the language of the adopted regulation, correct?

A. With a few changes, I think materially it seems to be the same.

Q. Materially it's the same, right?

A. It appears to be, yes.

* * *

Q. Okay. And let's look at 257 again, and again I'll ask you that this language instructs the PSC to treat coal differently depending on where it was produced, correct?

MR. KUHN: Object to the form.

THE WITNESS: I can answer?

MR. KUHN: You can answer.

A. Yes.

Q. Okay. Under the law the only characteristic that leads to differential treatment is the state of origin for the coal, correct?

A. You -- you -- when you say under the law, are you referring specifically to Senate Bill 257?

Q. Yes.

A. And then your question is that the only -- it only relates to fuel coal severance taxes?

Q. My question was: Under SB 257 the only characteristic that leads to differential treatment is the coal's state of origin, correct?

A. Okay. I thought you said under the law. But under Senate Bill 257 I would agree, yes.

* * *

Q. When PSC is reviewing the reasonableness of a coal purchase, the primary driver is cost, right?

A. I would say that there are other factors when the commission is reviewing it, but I believe we discussed some of those factors, including reliability of -- of supply.

Q. Holding those things constant, cost drives the analysis, agreed?

MR. KUHN: Objection, asked and answered. Object to the form. You can answer.

A. I would say it would be fair to characterize that the cost is a -- one of the most substantial factors.

Q. And just to finish that thought, cost is one of the most substantial factors in the PSC's analysis of the reasonableness of coal purchases, correct?

A. Yes.

* * *

Q. Okay. So when the PSC conducts its review for reasonableness, it is required by SB 257 to use that evaluated bid price minus coal severance taxes, correct?

MR. KUHN: Objection, asked and answered.

A. That's what the statute says.

Q. Okay. So for Kentucky, that would mean that the PSC will review the utility's evaluated price minus 4.5 percent, correct?

A. Once again, assuming that that's the -- the Kentucky tax severance tax rate, correct.

Q. Okay. And when the PSC reviews a utility's purchase of an Illinois coal, it will not have any credit for any kind of tax paid by that Illinois coal company, correct?

MR. KUHN: Object to form. You can answer.

A. If Illinois has a severance tax, then that would also be removed from the evaluation.

Q. Does Illinois have a severance tax?

A. I honestly don't know. I would hazard a guess that because your client is based in Illinois, that it does not.

* * *

Q. Is there any other tax that would be backed out from the Illinois coal producer's evaluated cost?

A. Not under Senate Bill 257.

Q. Under any other PSC regulation?

A. Not of which I'm aware.

* * *

Q. Okay. So you told me earlier today that the PSC is a creature of statute, right?

A. Correct.

Q. And SB 257 is a statute, right?

A. Yes.

Q. The PSC will follow that statute, right?

A. As a creature of statute, the commission would.

Q. Okay. In all instance, regardless of state of origin, the utility actually pays the producer's bid price, right?

A. I -- I can assume that they do.

* * *

Q. Let's return to the regulation, the enacted regulation for just a minute.

The PSC's purpose in promulgating that regulation was to level the competitive landscape by eliminating coal severance tax as a consideration in utility's coal purchasing decisions, right?

MR. KUHN: Object to the form.

A. Well, they -- there were several purposes to amending the regulation, one of which was to -- and I think -- yeah, it was to evaluate costs in a more levelized basis and seek diverse -- diverse fuel sources.

* * *

Q. In what way was it intended to level the consideration?

A. You mean levelize?

Q. Sure.

A. By backing out the cost of any severance taxes.

Q. Why coal severance taxes in particular?

A. I -- I'm really not -- I cannot remember why that was specifically chosen.

Q. Well, coal severance taxes vary from state to state, right?

A. I would assume so.

Q. And lots of other taxes vary from state to state, too, right?

A. I would assume so.

Q. And other politically driven costs might vary from state to state, right?

MR. KUHN: Object to form. What are politically driven costs?

Q. As an example, minimum wage laws vary from state to state, right?

A. That's outside my ken of knowledge, but I would assume so, yes.

Q. And environmental laws vary from state to state, right?

A. I would assume so.

Q. Property taxes vary from state to state, right?

A. I would assume so.

Q. If we describe all of those things as politically driven costs, meaning producers bear them because states impose them, does that make sense?

A. Yes.

Q. Okay. And the PSC selected just one politically driven cost for special treatment, correct?

MR. KUHN: Object to form.

A. Correct.

* * *

Q. Sure. The regulation did not levelized [sic] consideration of competing interstate bids with respect to politically driven costs, right?

MR. KUHN: Object to form.

A. Do you mean all politically driven costs?

Q. I do.

A. Then it did not.

Q. The only thing it did was single out coal severance tax, right?

MR. KUHN: Object to the form.

A. That is what the regulation says.

Q. And the same is true of SB 257, correct?

A. Correct.

* * *

Q. Sure. Neither the regulation nor SB 257 was levelizing the consideration with respect to those other taxes, correct?

A. If -- if you are referring to what you previously called politically driven costs, then, yes.

Q. Okay. By backing out coal severance taxes, the regulation was intended to make Kentucky coal more competitive, correct?

MR. KUHN: Object to form.

A. I don't believe that the regulation as promulgated does that.

Q. Was it intended to do that?

A. Not as it was promulgated.

Q. Was it intended to do that when it was first drafted?

A. I think that it would be fair to say that because it identified specifically the severance tax applied in Kentucky, then it would -- it was originally drafted to do so.

* * *

Q. Was the regulation adopted in response to HR 144?

A. In part, yes.

* * *

Q. Okay. Setting aside coal severance tax for a moment, the PSC doesn't assess how much of the evaluated cost is caused by various state tax structures, does it?

A. Not in my experience it does not.

Q. And it doesn't assess how much was caused by differing minimum wage laws, right?

A. In my experience the commission has not.

Q. And it doesn't assess how any of those other politically driven costs are baked into the evaluated cost, right?

A. In my experience the commission has not.

Q. From the PSC's perspective, there's no effort to differentiate earned competitive benefits from unearned competitive benefits, is there?

MR. KUHN: Object to form.

A. Could you describe both of those terms before I answer?

Q. Let's say that politically driven costs create unearned competitive benefits. Does that make sense?

A. Unearned? Unearned by whom?

Q. By the producer. So, for example, let's say the producer operates in a state with lower taxes, lower minimum wage laws, et cetera, and is thus able to bid lower amounts. Does that make sense?

A. Yes.

Q. Does the PSC undertake any effort to differentiate those unearned competitive benefits driven by politics from earned competitive benefits?

A. In my experience the commission has not.

* * *

Q. Okay. So you are aware of evidence that a utility was reducing coal severance taxes from bid prices, right?

A. Correct.

Q. Okay. And Foresight got no such deduction, right?

A. Correct.

Q. Did Kentucky producers get that deduction from that utility?

A. Subject to check, I don't know if in every situation the -- the providence, the origin of the coal, was listed. It just listed the subtraction of the severance tax. So I -- in some cases the -- the name of the -- of the coal company might have Kentucky in its name, but in other situations it might not.

Q. Okay. I guess, in any event, some producers were getting that deduction from the utility for coal severance taxes, right?

A. Correct.

* * *

Q. And this is responses to the PSC from Kentucky Utilities Company. Do you see that, Mr. Pinney?

A. I do.

* * *

Q. All right. So we are looking at the same request and then this utility's responses. Do you see that, Mr. Pinney?

A. I do.

Q. And, again, they provided, it looks like, a confidential set of bid evaluation sheets, is that right?

A. Correct.

Q. And do you have those sheets?

A. I do.

Q. Okay. Do you know whether this utility backed out coal severance taxes on the bid evaluation sheets you have in front of you?

A. Yes, they did. And I will say, it's not just one utility because both Louisville Gas & Electric and Kentucky Utilities are somewhat the same company, so their coal solicitations are done together.

* * *

Q. But it sounds like you're saying that in this case reducing the evaluated costs by severance taxes did not affect the ranking, is that correct?

A. It -- it didn't affect the award of the contracts.

Q. But it did affect the ranking?

A. Yes.

Q. Okay. So which rankings would change based on severance tax? Or strike that.

Which rankings did change because of severance tax?

A. Give me a second to double-check. This is -- it's really fine print. It takes me a second to read it.

Q. Sure.

A. It -- it appears that it changed the rankings for three of the contracts.

Q. I'm sorry, when you say three of the contracts, do you mean bids?

A. Yes, I apologize for that.

Q. Yeah, okay. I just want to be sure we're talking about the same thing.

So three of the bids would have been ranked differently had coal severance tax not been deducted, correct?

A. Correct.

Q. And they would have been ranked higher, right?

A. Let me think about that. Yes.

Q. Okay. Would any of them have moved into a position where they would have been awarded the contract?

A. No.

Q. Okay. Not in this case anyway, right?

A. Yes.

* * *

Q. Is that true that the PSC did not want SB 257 to be enacted?

A. I think it's accurate to say the commission did not ask for it at all.

Q. Well, that's a different question. Did they want it to be enacted?

A. No.

Q. Why not?

A. Because -- honestly, because we wanted to wrap up the litigation, put it behind us. I have a great deal of respect for our attorneys from the Attorney

General's Office, but the commission is not interested in paying attorneys' fees.

Q. So basically you didn't want to get sued again, in short?

A. Yes.

* * *

Q. All right. I want to just make sure that I understood a couple of things from our conversation about the bid evaluation sheets.

One is that the PSC has received information from utilities to show that the regulation affected evaluated prices, correct?

A. Once again, I don't know that the regulation affects the utilities. The commission asked for that information.

Q. Well, I guess maybe a different way of putting it would be that you received information showing that utilities were backing out coal severance taxes from evaluated prices, correct?

A. Some utilities, correct.

Q. Okay. And that information also shows that at least in one instance the utilities backing out coal severance taxes changed the rankings of bids, correct?

A. Not -- the rankings, but not the awards.

Q. Right, yeah, just the rankings.

A. Yes.

Q. Correct?

A. Yes.

* * *

Q. And, Mr. Pinney, you are the speaker here. Do you see that?

A. Yes. Can you make it just slightly a bit smaller? I can't see one of the edges.

Q. Sure.

A. Okay. Thank you. Hold on. I have to switch glasses to see that now.

Q. I want to direct your attention toward the bottom of the kind of top right rectangle there to Line 21.

A. Right.

Q. And you say in 2019, in response to the joint resolution from the legislature: The PSC undertook to amend many of the provisions in the fuel adjustment clause. Do you see that?

A. Yes.

Q. And one of them was to address a request to incent the burning of Kentucky coal over others, do you see that?

A. Yes.

Q. What does that mean?

A. I believe that meant that by backing out -- and this is in the original version, not the one that was enacted. The one that's going to be deleted --

Q. SB 257 --

A. -- per the regulation.

Q. Go ahead.

A. I'm sorry. I was -- this was in regard to the -- the original version of the -- of the regulation before it was amended before comment.

Q. Right. And it was intended to incentivize utilities to burn Kentucky coal?

A. That was one -- one of the reasons. I don't think that that's -- yeah, yeah, yeah.

Q. The PSC's response to all of these concerns about utilities having to buy more expensive coal was that there are occasions when Section 3, Sub 5 will require utilities to select a fuel source that is slightly more expensive than the alternative based on the proposed language. Do you see that?

A. Yes.

* * *

Q. So I'm asking whether the first sentence of that response you see in Part B is true.

A. Yes.

* * *

Q. And we talked earlier about how the regulation and SB 257 are in all material respects identical, right?

A. Yes.

* * *

Q. Okay. Why would the regulation require utilities to select a fuel source that is slightly more expensive?

A. Well, I think that if -- if read with the totality of the rest of the -- the rest of the discussion, that it's just one factor to be considered in the reasonableness of the purchase of -- of fuel.

Q. Yeah, not my question.

A. Oh.

Q. The question -- you've already said that the statement is true. I'm asking: Why would the regulation require utilities to select a fuel source that's slightly more expensive?

MR. KUHN: Objection, asked and answered. You can answer.

THE WITNESS: Okay.

A. It would not -- it would require the utility to purchase that fuel in this -- under the penalty or under the possibility, not the penalty, that the commission might disallow certain fuel costs.

* * *

Q. Okay. This is the Attorney General's letter, and he says: The adjustment to offset coal severance tax would cause Kentucky coal to be priced more competitively in comparison to some states and less competitively with respect to other states. Do you see that?

MR. HAMMACK: Manny, you can highlight it for him.

A. Is that about the third sentence down?

Q. Yeah.

A. Okay. I see that.

Q. Is that statement true?

A. In a vacuum, yes.

Q. Okay. A couple lines down it says: While the regulation might arguably benefit coal producers in Kentucky relative to those in Indiana or Illinois. Do you see that?

A. I'm sorry, in relative, is that --

Q. The regulation might arguably benefit the coal producers in Kentucky relative to those in Indiana or Illinois.

MR. HAMMACK: Manny, you can highlight it for him?

A. I've got it.

Q. Okay. Is that statement true?

A. I would give a qualified yes.

Q. Okay. What's the qualification?

A. That there are still other factors that go into a general coal electricity generator's evaluation of -- of the cost of the fuel.

* * *

Q. Do you agree that it favors Kentucky coal producers to the detriment of some out-of-state interests?

MR. KUHN: Object to the form.

A. No, I don't agree.

Q. Well, you just said that it would make Kentucky coal more competitive as compared to Illinois and Indiana, right?

A. Yes.

* * *

[ON JUNE 7, 2022]

TRANSCRIPTION OF AUDIO OF
THE ORAL ARGUMENTS FROM THE
U.S. COURT OF APPEALS FOR THE
SIXTH CIRCUIT

RE: FORESIGHT COAL SALES v.
KENT CHANDLER

APPEARANCES:

JUDGE ALICE BATCHELDER
JUDGE ERIC CLAY
JUDGE JOAN LARSEN
JOSHUA HAMMACK, ESQ.
MATTHEW F. KUHN, ESQ.

* * *

JUDGE LARSEN: But going back to facial discrimination, it seems to me that you argue that the purpose here is to level the playing field, and you argue that in order to survive, an advantage must be earned by the industry. What does an “earned advantage” mean? Why don’t they earn their advantage by not having a severance tax?

MR. KUHN: So I think we have to look at Hunt as an example of what’s earned. The Washington apple industry there was investing roughly a million dollars a year in complying with Washington state grade, and the court --

JUDGE LARSEN: Which was mandated by the Washington state legislature.

MR. KUHN: State law, correct.

And so they were spending a million dollars a year of their own money to grade --

JUDGE LARSEN: Under compulsion.

MR. KUHN: Under compulsion. They were businesses there to make money.

JUDGE LARSEN: Right.

MR. KUHN: That were grade --

JUDGE LARSEN: But the state made them do that. So it was state law that required them to do that. So you can't be saying well, they didn't earn their advantage because there's no state law that imposes the severance tax.

MR. KUHN: If you look at the quote from the opinion in Hunt, it talks about the Washington apple industry earning the advantage. They were able to command --

JUDGE LARSEN: Earned it under compulsion by a state agency. Okay.

MR. KUHN: Another way to think about that though is would you say that having to -- not to pay a coal severance tax allows somebody to command a market advantage?

JUDGE LARSEN: Sure. Why not? So their minimum wage is \$12 an hour.

MR. KUHN: So --

JUDGE LARSEN: Your minimum wage is 7.25. So

--

MR. KUHN: Assuming that's true, then --

JUDGE LARSEN: -- didn't you earn an advantage in your labor market by not raising your minimum

wage above the federal minimum wage? They got to pay higher labor costs in Illinois.

MR. KUHN: So I think the problem with that argument is we get to a point where Kentucky can never repeal its coal severance tax --

JUDGE LARSEN: Why?

MR. KUHN: -- because it's created, under their paradigm has created an advantage for out-of-state coal producers that's protected by the Dormant Commerce Clause. They're saying their advantage --

JUDGE LARSEN: I don't understand that here. Can you --

MR. KUHN: So they're saying that the advantage that they have by not paying a coal severance tax is protected by the Dormant Commerce Clause. If that advantage is protected by the constitution, how can Kentucky eliminate that?

JUDGE LARSEN: Well, it's -- it's just that you can't -- you'd have to impose the costs on your own people. You'd have to -- you could withdraw the severance tax. If you withdraw -- drew the severance tax, Kentucky coffers would be diminished. You just wouldn't be exporting the costs to another state.

MR. KUHN: Think about this from an effects perspective, though. If we repealed our severance tax --

JUDGE LARSEN: Uh-huh.

MR. KUHN: -- a Kentucky coal producer and an Illinois coal producer would be in the exact same shoes than the -- than Senate Bill 257, if Senate Bill 257 were in effect.

I don't understand how you can get to a discriminatory effect --

JUDGE LARSEN: Because you want to have your cake and eat it, too. You want the revenue from the severance tax, and you want your -- you want your market for coal not to be affected by the fact that they don't have -- so let me just ask the question. Could they do the same thing with respect to the labor component of producing coal, so they -- so Illinois could enact the exact same thing for its regulated coal industry? It's just going to discount the prices by the \$5 an hour labor gap.

MR. KUHN: Of course. It's a -- it is an -- just like Kentucky could reduce its minimum wage, they could reduce the minimum wage. They could regulate in the same way.

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