

**BEFORE THE GEORGIA PUBLIC SERVICE COMMISSION**

In Re: Georgia Power Company's	)	
2023 Fuel Cost Recovery (FCR)	)	Docket No. 44902
Application	)	

**DIRECT TESTIMONY**

**OF**

**JEREMY KALIN**

**ON BEHALF OF SIERRA CLUB AND SOUTHERN ALLIANCE FOR CLEAN ENERGY**

**("SACE")**

**14 April 2023**

1 **Q: PLEASE STATE YOUR NAME, POSITION, AND ADDRESS.**

2 **A:** My name is Jeremy Kalin. My business address is c/o Avisen Legal, P.A., 901 Marquette  
3 Avenue South, Suite 1675, Minneapolis MN 55402.

4 **Q: ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?**

5 **A:** Sierra Club and Southern Alliance for Clean Energy (“SACE”).

6 **Q: PLEASE DISCUSS YOUR RELEVANT EXPERIENCE, PROFESSIONAL EXPERTISE,**  
7 **AND EDUCATIONAL BACKGROUND.**

8 **A:** I am an advisor, consultant, attorney and shareholder at Avisen Legal., P.A. in Minneapolis,  
9 Minnesota. I am licensed to practice law in the State of Minnesota and the District of Columbia, first  
10 admitted to the Minnesota Bar in 2010. I serve as legal counsel to energy developers, investors, advocates,  
11 project hosts and state and local governments across the United States in my areas of expertise. I also serve  
12 as consultant and advisor in a number of capacities and organizations, including the Pearl Street Station  
13 Finance Lab; to the non-partisan nonprofit energy thought leadership organization RMI, the bipartisan  
14 National Caucus of Environmental Legislators, and the Novogradac Renewable Energy Tax Credit  
15 Working Group. I have attached a copy of my CV to my testimony (JK-Exhibit 1). I am an author of the  
16 recent paper published by Pearl Street Station Finance Lab, “Learning To Share: A Primer On Fuel-Cost  
17 Pass-Through Reform” which I have provided as an Exhibit to this testimony (JK-Exhibit 2).

18 I was elected to the Minnesota House of Representatives for two terms, where I served on the  
19 Energy Policy and Finance Committee, authoring numerous energy bills that became law including the  
20 Demand Efficiency Act, the Next Generation Energy Act, the Public Building Enhanced Energy Efficiency  
21 Program and the Commercial Property Assessed Clean Energy Act. Building on my research while a law  
22 student, I also authored the 2010 Ratepayer Protection Act calling for Commission action to better align  
23 utility financial incentives with macroeconomic factors and public policy goals at the state and federal level;  
24 while that bill did not become law, it was one of earlier calls across the country to modernize electric utility  
25 incentive structures, including the calls to update the Fuel Cost Recovery mechanism in Georgia and in  
26 dozens of other states.

1 From 2010 to 2017, I was CEO of Eutectics Consulting LLC, a mission-driven company focused  
2 on financing energy projects in underserved and untapped markets. Among other projects, in 2013, I led  
3 my company's work updating the nationally-recognized Energy Assurance Plan for the State of Minnesota.  
4 While in public office, I served as state legislative liaison for the White House climate and clean energy  
5 policy team, and later advised the U.S. Department of Energy Jobs Strategy Council under Democratic and  
6 Republican Secretaries.

7 My undergraduate degree is from the University of Minnesota. I pursued graduate studies in the  
8 University of New Mexico School of Architecture and Planning for two years and have a Juris Doctorate  
9 from William Mitchell College of Law in St. Paul, Minnesota. Like so many lawyers and former elected  
10 officials, my undergraduate degree is a Bachelor of Fine Arts in ceramics, and I spent several years as a  
11 working potter and teacher.

12 **Q: HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE GEORGIA COMMISSION?**

13 **A:** No. This is my first time testifying before the Georgia Public Service Commission.

14 **Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

15 **A:** In my testimony, I provide the following:

- 16 1. An overview of the relevant history of fuel-cost pass-through policies in place across  
17 the United States, including Georgia's Fuel Cost Recovery mechanism, to provide  
18 context for Georgia Power's FCR-25 and FCR-26 rate increases;
- 19 2. A specific discussion of the "moral hazard" presented by Georgia's Fuel Cost  
20 Recovery mechanism, and why the Georgia Power request poses a significant threat to  
21 Georgia ratepayers' economic wellbeing;
- 22 3. Factors the Commission should consider in evaluating whether Georgia Power's  
23 significant rate increases are prudent and justifiable, given Georgia Power's implied  
24 admission that the utility has not taken any meaningful steps to reduce ratepayers'  
25 exposure to Georgia Power's fuel costs;

- 1           4. The potential negative impact on reliability of continuing the current Fuel Cost  
2           Recovery mechanism, including an overreliance on natural gas as an electric  
3           generation source, wherein 100% of fuel costs are passed through to ratepayers, as  
4           proposed by Georgia Power in this docket;
- 5           5. A brief discussion of Georgia Power's proposal to essentially eliminate the need for  
6           future Fuel Cost Recovery dockets by increasing the Interim Fuel Rider cap to 40%.
- 7           6. A brief response to the proposed April 12, 2023 Stipulation between Georgia Power  
8           and the Georgia Public Service Commission Public Interest Advocacy Staff.
- 9           7. A recommendation to the Commission to establish a specific docket to more deeply  
10          evaluate the benefits of requiring some amount of risk and cost-sharing by Georgia  
11          Power in managing its fuel supply, including the benefits to ratepayers; to overall  
12          system reliability; to emissions and to national security. A modernized Fuel Cost  
13          Recovery mechanism could allow Georgia Power to secure earnings for its  
14          shareholders, while better protecting its customers from fuel price spikes and fuel price  
15          volatility.

16   **Q:     WHAT DOCUMENTS DID YOU REVIEW IN PREPARING THIS TESTIMONY?**

17   **A:**     I have reviewed Georgia Power's Direct Testimony; other Georgia Power filings as part of the  
18   docket; many of the Minimum Filing Requirement documents, and Georgia's Fuel Cost Recovery statute,  
19   O.C.G.A. 46-2-26. I have briefly reviewed other relevant sections of O.C.G.A. 46-2-20 through 46-2-33,  
20   as well as Department 515 Rules of Georgia, Public Service Commission. Further, I have reviewed the  
21   April 12, 2023 Stipulation between Georgia Power and Georgia Public Service Commission Public Interest  
22   Advocacy Staff as a proposed resolution to the Company's request in this docket, as well as the proposed  
23   revised Interim Fuel Rider provision attached to the Stipulation as Attachment A.

24           I have also briefly reviewed previous Fuel Cost Recovery dockets and other Commission materials  
25   to which I refer in this testimony. All of the material I reviewed is public data; I did not receive any trade  
26   secret or otherwise confidential information.

1   **Q:     PLEASE SUMMARIZE YOUR TESTIMONY**

2   **A:**     In my testimony I provide the following:

- 3       •     In the matter of the FCR-25 tariff under-recovered fuel balance, the Commission should rigorously  
4           review the prudence of Georgia Power's actions. While Georgia Power could not have predicted  
5           the specific events that contributed to the under-recovered fuel balance, multiple experts warned of  
6           the risks of excessive reliance on natural gas and the ongoing price volatility of natural gas even  
7           without winter storm Uri and Russia's invasion of Ukraine. Georgia Power could have taken any  
8           number of prudent steps to minimize its exposure to natural gas price volatility.
- 9       •     The Commission should not approve the forward-looking FCR-26 fuel rate adjustment. The  
10          Commission should instead initiate a Fuel Cost Recovery modernization docket to include some  
11          amount of fuel-cost-sharing and fuel-risk-sharing by the utility, to mitigate the moral hazard under  
12          the current policy of passing through 100% of fuel costs to ratepayers. The Commission has the  
13          authority under the Fuel Cost Recovery statute -- because of Georgia Power's failure to take  
14          sufficient prudent steps -- to make amendments that would better allocate risk and costs between  
15          utilities and ratepayers. A modernization docket is the best means to evaluate all the policy options,  
16          relevant factors and potential impacts.
- 17      •     Georgia Power's proposal to increase the Interim Fuel Rider maximum adjustment to 40% without  
18          Commission review risks violating the Commission's statutory responsibility to conduct a  
19          prudence review of Georgia Power's fuel costs. The Commission should reject this proposal.
- 20      •     Georgia Power's proposals also risk the utility's strong prior record on reliability. Addressing Fuel  
21          Cost Recovery tariffs without considering the impact of other ratemaking dockets has led to  
22          unintended consequences, including an outsized reliance on natural gas. Other non-fuel  
23          alternatives could have mitigated the multi-billion-dollar impact to ratepayers.

24  
25                   **I.     HISTORY OF FUEL COST RECOVERY POLICIES**

1 **Q: WHAT IS THE HISTORY OF FUEL PASS THROUGH CLAUSES, INCLUDING**  
2 **GEORGIA’S FUEL COST RECOVERY MECHANISM?**

3 **A:** During most of the first 100 years of the electric power industry, fuel costs were the complete  
4 responsibility of utilities.

5 The Chicago Gas Trust was incorporated in 1887 with an authorized \$25,000,000 in capital shares,  
6 and soon acquired controlling interests in the four gas companies operating in Chicago for just \$300,000.  
7 Immediately after the merger, gas prices rose 25%, which the Chicago Tribune blasted as “gas extortion.”  
8 While it took 20 more years for states to adopt the first Public Utility Commissions, the outcry over the  
9 Chicago Gas Trust consolidation helped cement the public’s interest in affordable, stable and reliable utility  
10 service, overseen by a utility commission.<sup>1</sup>

11 Ultimately, the National Electric Light Association (NELA) argued in 1907 for what we know  
12 today as the electric utility regulatory compact. Sustainable business models for electric utilities in 1907  
13 depended on access to capital to expand utility service and accepting state regulation with public oversight  
14 of capital investments would provide stable access to capital. NELA’s Subcommittee on Public Regulation  
15 and Control wrote, “[I]t should be impressed upon the officials controlling public-utility corporations that  
16 the public will is that these companies shall exist, not primarily to make dividends upon certain investments  
17 of capital, but as the most efficient means of supplying the public’s needs.”<sup>2</sup>In the interest of consumer  
18 protection and incentivizing efficient production of electricity, the newly created public utility commissions  
19 included fuel costs as just one of the utility’s many costs of doing business. These “inputs” were not a  
20 unique cost category requiring special ratemaking treatment.

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<sup>1</sup> Harold Platt, *The Electric City: Energy and the Growth of the Chicago Area, 1880-1930* (University of Chicago Press 1991) provides a good history of the early days of market development, competition, consolidation and predatory behavior that led to the National Electric Light Association’s call for regulation in exchange for a guaranteed utility service territory, the foundation of the electrical regulatory compact we know today, including in Georgia.

<sup>2</sup> National Electric Light Association, *Proceedings* 1907, p 649.

1           When World War I disrupted oil, coal, and gas supply globally and in the United States, causing  
2   fuel prices to soar, utilities lobbied commissions for relief from fuel-price volatility and the associated risk  
3   of significant financial loss. Public utility commissions responded by implementing the first temporary fuel-  
4   pass-through policies, and then discontinued the practice shortly after World War I's end.

5           World War II again disrupted global oil, coal and gas supply across the world, and again public  
6   utility commissions responded. The fuel pass-through-policy protected utilities from the severe supply  
7   challenges and price volatility. With domestic purchasing constrained by rationing and a national call for  
8   energy conservation, increased electricity bills – including the new fuel pass through costs - were likely  
9   understood as a citizen's contribution to the war effort. When peacetime returned to the United States,  
10   commissions again reverted to the prior policy, and for nearly 30 years, utilities were responsible for 100%  
11   of the fuel costs for power generation.<sup>3</sup>

12           The oil shocks of the 1970s sparked new utility demands to be insulated from global geopolitics  
13   and supply constraints. This time, state legislators joined utility commissions in adopting fuel pass through  
14   policies, ultimately enacting statutes such as Georgia's Fuel Cost Recovery Statute, O.C.G.A. 46-2-26,  
15   adopted by the Georgia Legislature in 1979.

16           The gasoline lines have disappeared, and the United States is substantially more energy secure than  
17   it was during the first days of OPEC. But while the wide lapels and bad disco dancing of the 1970s have  
18   been relegated to the history pages, the 100% pass-through-policies of fuel costs are still the law of the land  
19   in Georgia and nearly all other states.<sup>4</sup>

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<sup>3</sup> Electric Consumers Resource Council, "Fuel Adjustment Clauses and other Cost Trackers," <https://elcon.org/fuel-adjustment-clauses-cost-trackers/>, accessed April 10, 2023.

<sup>4</sup> S&P Global Market Intelligence, *RRA Regulatory Focus: Adjustment Clauses, a state by state overview 2* (2017), <https://www.spglobal.com/marketintelligence/en/documents/adjustment-clauses-state-by-state-overview.pdf>.

**Q: HOW IS THIS HISTORY RELEVANT TO THIS DOCKET AND GEORGIA POWER'S REQUEST TO RECOVER UNDER-COLLECTED COSTS UNDER FCR-25 RATES AND TO INCREASE RATES IN THE FCR-26 TARIFF GOING FORWARD?**

**A:** While the Fuel Cost Recovery has been in statute for 44 years, it is important to remember that utilities have been responsible for managing fuel costs and fuel price risks for most of the 116 years of utility regulation in the United States. The Fuel Cost Recovery pass-through policy is not a required element of the regulatory compact but is instead a regulatory creation.

The following two charts show the correlation between: (1) increased consumption of natural gas for power generation in Georgia, as shown in Chart 1, from 2008 to 2023, and (2) increased per-kilowatt-hour (per-kWh) retail rates for all ratepayers in Georgia, as shown in Chart 2, from 2000 to 2023.

*Chart 1*

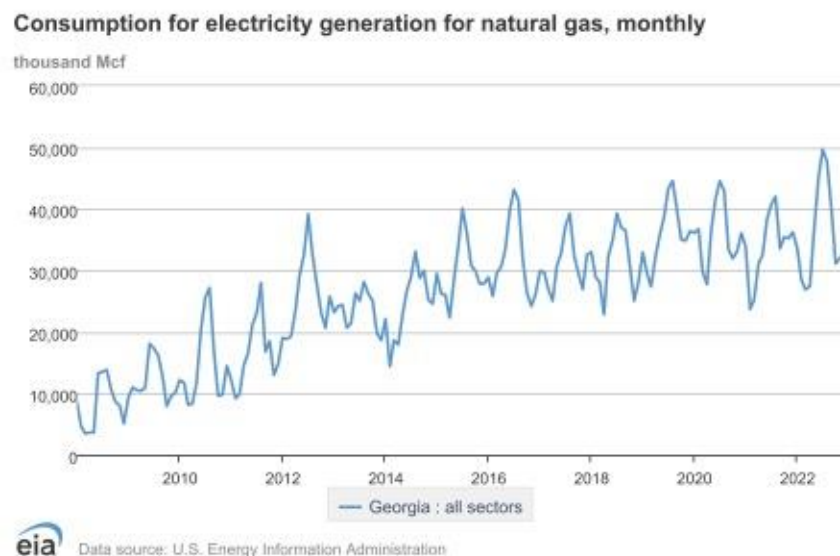
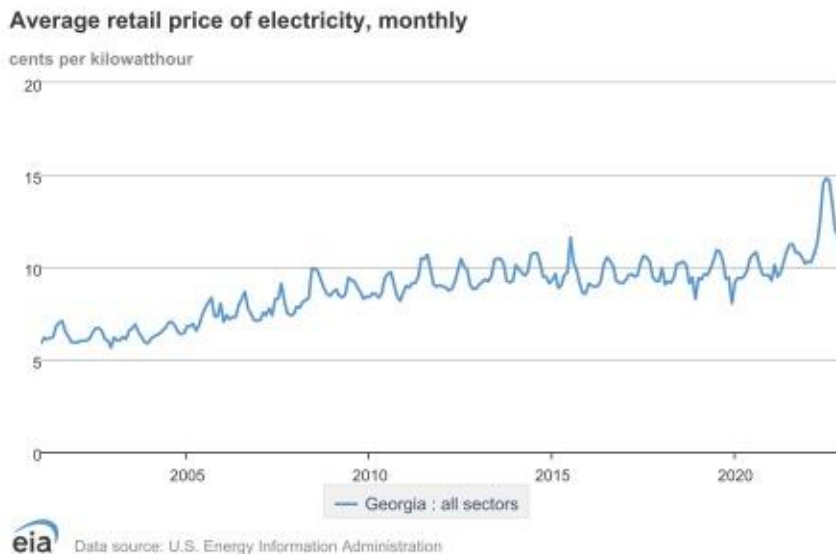


Chart 2



During this period, utilities have borne 0% of responsibility for fuel costs and managing fuel risk in Georgia and have passed 100% of both fuel costs and fuel risks to ratepayers.

## II. FUEL COST RECOVERY'S MORAL HAZARD

**Q: WHAT IS A “MORAL HAZARD?”**

**A:** In general terms, a moral hazard occurs when one party is incentivized to take more risk than they normally would because that party is insulated against that risk.<sup>5</sup> In other words, a moral hazard exists when the consequences of a decision are so disconnected from the decisionmaker that that party takes a bigger risk as a result.

**Q: HOW IS THE MORAL HAZARD EMBODIED IN GEORGIA’S FUEL COST RECOVERY STATUTE, O.C.G.A. 46-2-26?**

**A:** Georgia’s Fuel Cost Recovery statute permits Commission-regulated utilities to charge its ratepayers a rate sufficient to recover the cost of fuel, through a proposed formula based on “an estimate of

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<sup>5</sup> See generally Mark Thoma, *Explainer: What is Moral Hazard*, CBS News (Nov. 22, 2013), <https://www.cbsnews.com/news/explainer-moral-hazard/>.

1 [the utility's] fuel costs and retail sales for the next three conservative months and proposed base rates to  
2 recover those costs" (paragraph c) and an amendment which "shall include an adjustment based on actual  
3 expense to date in order that the accumulated retail costs of the utility shall equal, as nearly as possible, the  
4 revenues recovered pursuant to the fuel recovery allowance..." (paragraph g).

5 While the statute does not require the utility to collect all of its fuel costs from ratepayers, O.C.G.A.  
6 46-2-26 does permit the utility to set fuel recovery rates that pass along 100% of the fuel costs to ratepayers.<sup>6</sup>  
7 Georgia's fuel pass through policy is consistent with the pass-through statutes and Commission rules in  
8 nearly every other state. Like so often happens in policymaking, the 1970's energy crisis merited a response  
9 of some sort to address the global volatility at the time, not just in thermoelectric generation fuel  
10 procurement but across the oil, gas and coal industries. The trade-offs of the 1970s and early 1980s –  
11 exchanging consumer exposure to fuel costs in exchange for complete insulation of utility risk – may have  
12 made sense then. Though I understand some consumer advocates cited the potential moral hazard at the  
13 time, the 44-year history of the Georgia's Fuel Cost Recovery – and this current request from Georgia  
14 Power – shine a harsh light on the perils of continuing this policy of 100% pass-through to ratepayers, and  
15 0% responsibility for the costs and risks by shareholders.

16 **Q: DO YOU READ THE STATUTE TO REQUIRE THE COMMISSION TO IMPLEMENT**  
17 **FUEL COST RECOVERY IN A MANNER THAT EXACERBATES THE MORAL HAZARD?**

18 **A:** No, I do not.

19 I have seen enough similar fuel-cost pass-through statutes to support my belief that O.C.G.A. 46-  
20 2-26 provides enough flexibility for the Commission to adjust the risk- and cost-sharing ratios of the Fuel  
21 Cost Recovery mechanism in Georgia.

22 In O.C.G.A. 46-2-26(c), the statute requires the utility to propose "base rate tariffs to recover those  
23 (fuel) costs." The statute does not require the utility to propose a rate tariff to recover all of its fuel costs. I  
24 have read several sections of related Georgia statute and Commission rules, and have not yet seen any

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<sup>6</sup> Georgia Public Service Commission background on Fuel Cost Recovery, undated, [http://www.psc.state.ga.us/electric/regulation/Fuel\\_Cost\\_Recovery.pdf](http://www.psc.state.ga.us/electric/regulation/Fuel_Cost_Recovery.pdf), accessed April 10, 2023.

1 requirement that the Commission must approve a utility's fuel rate tariff such that the utility recovers 100%  
2 of its fuel costs – only that the Commission may approve such a tariff.

3 I see several areas where the Commission may establish a fuel rate tariff requiring the utility to  
4 accept some amount of responsibility for fuel costs and fuel risks. In particular, 46-2-26(e) requires the  
5 Commission to “issue an order stating the base rates to be used by the utility” going forward. This language  
6 suggests that the Commission has wide latitude, consistent with other sections of the Georgia Code and  
7 under Commission rules and policies, to modify the proposed fuel tariff, as the Commission has done  
8 specifically in prior Fuel Cost Recovery (FCR) dockets. For instance, in docket 19142-U, decided May 17,  
9 2005, the Commission reduced the FCR tariff proposed by Georgia Power, recognizing excess costs due to  
10 replacement energy expenses during unscheduled outages, and in docket 11884-U, decided March 30, 2000,  
11 the Commission made multiple changes to the proposed FCR tariff, in consideration of other pending rate-  
12 related matters by the filing utility, Savannah Electric and Power Company. In multiple Fuel Cost Recovery  
13 tariff dockets, the Commission has reduced the proposed FCR tariff by requiring extended amortization  
14 periods, including in dockets 19142-U and 21229-U, presumably during periods of lesser natural gas price  
15 volatility than these past three years.

16 **Q: DID YOU REVIEW THE DIRECT TESTIMONY OF MS. SARAH ADAMS AND MR.**  
17 **HOUSTON ON BEHALF OF GEORGIA POWER?**

18 **A:** Yes.

19 **Q: WHERE IN THE UTILITY'S TESTIMONY AND MINIMUM FILING REQUIREMENT**  
20 **DOCUMENTS DO YOU SEE THIS MORAL HAZARD IMPACTING GEORGIA POWER**  
21 **RATEPAYERS?**

22 **A:** Georgia Power's own supporting documents show a 78.4% increase from the current FCR-25 IFR-  
23 4 rates to the proposed FCR-26 rates, and an 87.4% summer rate increase.<sup>7</sup>

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<sup>7</sup> MFRP-1C.

1 I am hard pressed to find any better example of how ratepayers are bearing the cost of this moral  
2 hazard. It is not an academic question for many families, particularly those living on tight budgets. As a  
3 business owner, I also know the stress that such severe rate increases have on businesses doing everything  
4 they can to control costs and remain competitive in a global business environment.

5 **Q: HOW WOULD YOU DESCRIBE THE SCALE OF GEORGIA POWER'S FUEL COST**  
6 **RECOVERY RATE INCREASE PROPOSALS?**

7 **A:** Georgia Power's proposed rate increase is shocking, and the numbers speak for themselves.

8 I also believe that the Company may be muddying the waters as to the full scope of the Fuel Cost  
9 Recovery impact on ratepayers. Georgia Power has proposed amortizing the under-recovered fuel balance  
10 over 36 months rather than 24 months. It is unclear, if the FCR would be higher -- a 117.6% increase rather  
11 than the stated 78.4% increase -- if the shorter amortization period were applied. If so, "shocking" would  
12 no longer properly capture the scale of this rate increase.

13 In addition to the massive impact on individuals with limited means, the utility's proposed Fuel  
14 Cost Recovery rate increase has implications for broader regional competitiveness. Georgia businesses are  
15 no different from others across the country, facing significant challenges in attracting and retaining qualified  
16 employees. While the state of Georgia certainly has much to offer in terms of quality of life, the cost of  
17 living is a significant factor when workers decide where to make their home, and where to ply their trades  
18 -- including the cost of rent and home ownership, as well as the cost of energy during hot Georgia summers.

19 I understand that Georgia Power's per-kilowatt rates are just below the national average, overall.  
20 However, when it comes to overall electric bills, Georgia ratepayers pay the 8<sup>th</sup> highest average monthly  
21 electric bills in the country. Only South Carolinians pay a higher average monthly electric bill in the region.<sup>8</sup>  
22 Georgia Power's Fuel Cost Recovery rate increase request is substantially higher than the impact of Duke  
23 Energy Carolina's pending fuel cost pass through rate increase request in South Carolina, by approximately

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<sup>8</sup> EIA 2021 Average Monthly Bill -- Residential.

1 \$1.24 to \$7.24 per month more.<sup>9</sup> Depending on the final amortization period selected, Georgia Power's  
2 Fuel Cost Recovery rate request would likely make Georgians' electric bills the highest in the Southeast.

3  
4 **III. FACTORS FOR "PRUDENT" REVIEW BY THE COMMISSION**

5 **Q: COMPARING GEORGIA POWER'S REQUEST WITH OTHER FUEL COST**  
6 **RECOVERY REQUESTS NATIONALLY, DO YOU SEE SOME POSITIVES?**

7 **A:** Yes, very much so.

8 First, the best measurement of the efficiency of fuel costs to electric output is the ratio of fuel dollars  
9 spent for each Megawatt hour (MWh). Consistent with the stated challenges of the Company's request,  
10 Georgia Power states that the dollar per megawatt hour (\$/MWh) fuel cost for coal, natural gas and nuclear  
11 generation resources, and the costs of purchased power, are projected to increase 97%, 92%, 17% and 28%  
12 respectively. While I believe the utility could have prudently mitigated these increases through procurement  
13 of non-fuel technologies such as solar and energy storage, I am very pleased to see the utility use the \$/MWh  
14 metric for measuring economic efficiency.<sup>10</sup>

15 Second, Georgia Power recognizes that generation from renewable resources lowers the utility's  
16 overall cost of fuel.<sup>11</sup> It may be self-evident, but worth stating explicitly, that the use of non-fuel generation  
17 technologies adds MWhs to the utility's generation mix without any fuel costs that need to be first paid by  
18 the utility and then passed along to ratepayers. With the Inflation Reduction Act's increased tax credits for  
19 many non-fuel generation options, including solar, energy storage, wind and clean hydrogen, among others,  
20 these non-fuel resources will continue to be even more cost-competitive and even cost-advantageous to the  
21 utility's ratepayers. While ratemaking should never be conducted in a vacuum or from a single-issue  
22 perspective, the advantages of \$0 fuel costs for such resources warrant diversifying the utility's generation  
23 mix.

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<sup>9</sup> Docket 2022-3-E, South Carolina.

<sup>10</sup> Direct Testimony of Ms. Adams and Mr. Houston on behalf of Georgia Power Company, Docket No. 44902, p. 15.

<sup>11</sup> Ibid.

1 Third, Georgia Power recognizes that the Commission has substantial flexibility under the Fuel  
2 Cost Recovery statute, O.C.G.A. 46-2-26, to modify the specific mechanisms of Fuel Cost Recovery and  
3 the specific amounts that the utility can collect. I disagree with Georgia Power's proposal to authorize the  
4 utility to effectively remove the need for Fuel Cost Recovery dockets. But I do agree with Georgia Power  
5 that the Commission has sufficient latitude and authority to protect ratepayers by reforming the Fuel Cost  
6 Recovery itself.

7 **Q: ARE THERE ELEMENTS OF GEORGIA POWER'S REQUEST THAT REQUIRE**  
8 **FURTHER CLARIFICATION?**

9 **A:** Yes.

10 The Company's Direct Testimony includes in its list of other "primary drivers" to the increased  
11 fuel costs "energy purchased from a variety of renewable resources such as solar, wind, and biomass."<sup>12</sup>  
12 While biomass may have input costs, solar and wind generation technologies do not include fuel costs.

13 Further, the Company states that the FCR-26 upward rate adjustment will increase a typical  
14 residential customer's bills approximately \$17 to \$23. I believe that this \$204 to \$276 annual cost to a  
15 typical Georgia Power residential customer is understated by a factor of 50%, as the utility has proposed  
16 extending the recovery period out from the conventional two years to a total of three years. The Commission  
17 would be wise to secure utility clarification on this cost impact where the under-recovered balance from  
18 FCR-25 rates amortized over just the two years.

19 **Q: IS THE COMMISSION REQUIRED TO ACCEPT GEORGIA POWER'S POSITION**  
20 **THAT THE UTILITY COLLECT ALL OF ITS FUEL COSTS?**

21 **A:** No. Georgia's Fuel Cost Recovery statute states that the utility bears the burden of proof to show  
22 that the costs are prudent, as previously discussed. Ken Costello stated it best when he described these  
23 utility cost recovery claims:

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<sup>12</sup> Direct Testimony, p. 17.

1 Utilities sometimes convey the false assertion that they have a right to recover any costs they  
2 incurred, even before the regulator has assessed their reasonableness. Their position seems to be  
3 that “we expend money to satisfy mandates or serve our customers, so regulators should allow us  
4 recovery of this money in rates with little scrutiny.” It presumes that regulators should trust that  
5 utilities will always act in the public interest. Good regulation would question the prudence and  
6 legitimacy of any costs; it owes that much to utility customers.<sup>13</sup>

7 **Q: IN REVIEWING GEORGIA POWER’S FUEL COST RECOVERY RATE REQUEST,**  
8 **WHAT STANDARD SHOULD THE COMMISSION APPLY?**

9 **A:** The Fuel Cost Recovery statute states that the Commission shall “make appropriate adjustment for  
10 any reported fuel cost that is the result of illegal or **clearly imprudent conduct** on the part of the utility”  
11 (emphasis added).

12 **Q: DID YOU SEE EVIDENCE THAT GEORGIA POWER HAS TAKEN PRUDENT STEPS**  
13 **TO REDUCE THE UTILITY’S FUEL COSTS DURING THE FCR-25 RATE PERIOD?**

14 **A:** I do not see much evidence that the Company has taken sufficient prudent steps to protect ratepayers  
15 during the prior FCR-25 rate period.

16 **Q: PLEASE EXPLAIN.**

17 **A:** Sometimes, common sense can be as useful as precedent. Merriam-Webster defines the term  
18 “imprudent” as “lacking discretion, wisdom, or good judgment.” Collins defines the term as “without  
19 thought of consequences; lacking in judgment or caution; rash; indiscreet.”

20 As recently as last year, Georgia Power was warned that a continued reliance on highly volatile  
21 natural gas pricing, combined with the elevated coal market pricing and high volatility, would lead to this  
22 exact scenario of excessive fuel costs.<sup>14</sup> In the midst of the worst effects of the Russian invasion of Ukraine  
23 and global concerns about inflation dominating the news every day, Georgia Power submitted and

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<sup>13</sup> Ken Costello, “Alternative Rate Mechanisms and Their Compatibility with State Utility Commission Objectives,” National Regulatory Research Institute, April 2014, p. 23.

<sup>14</sup> Post-hearing brief of Southern Alliance for Clean Energy (SACE) and Southface Energy Institute (Southface), dockets 44160 and 44161, July 7, 2022, pp. 17-18.

1 advocated for the Company's triennial Integrated Resource Plan (IRP) and a Stipulation between the  
2 Company and the PSC Public Interest Advocacy Staff to procure Power Purchase Agreements from six  
3 natural gas plants.

4 On October 12, 2021, the Company had already recognized the substantial under-recovered fuel  
5 balance in the wake of winter storm Uri's natural gas price spikes in Georgia and nationally and filed the  
6 Interim Fuel Rider Notification and Plan with the Commission, increasing the FCR-25 Fuel Cost Recovery  
7 rates by the maximum 15%. As the Company testified in this current docket, "despite implementing the  
8 maximum allowed 15% increase... (which took effect in January 2022), the Company's [] under-recovered  
9 fuel balance increased dramatically in 2022."<sup>15</sup>

10 Yet, even as the Company was monitoring this "dramatic" increase in natural gas costs, Georgia  
11 Power persisted with their pursuit of even more costly and risky natural gas resources in the IRP and DSM  
12 Stipulation of 2022. Intervenors Southern Alliance for Clean Energy and Southface Energy Institute  
13 specifically recommended that Georgia Power not proceed with such plans, and that the Commission  
14 consider an order "setting an upper limit on the recovery of fuel costs for (the) PPAs to adequately protect  
15 ratepayers from market volatility and unprecedented price spikes."<sup>16</sup> In his Direct Testimony in these IRP  
16 and DSM Stipulation 2022 dockets, witness Ron Binz, former Chair of the Colorado Public Utility  
17 Commission, repeatedly highlighted the risks associated with natural gas spikes.<sup>17</sup>

18 **Q: DID YOU SEE ANY EVIDENCE THAT GEORGIA POWER PLANS TO TAKE**  
19 **SUFFICIENT PRUDENT STEPS TO REDUCE THE UTILITY'S FUEL COSTS GOING**  
20 **FORWARD, AS PROPOSED BY THE INCREASED FCR-26 RATE?**

21 **A:** No, at least not enough evidence that the Company is prudently trying to reduce its fuel costs  
22 looking forward.

23 **Q: PLEASE EXPLAIN.**

---

<sup>15</sup> Direct Testimony, p. 13

<sup>16</sup> Post-hearing brief of SACE and Southface, dockets 44160 and 44161, p. 18.

<sup>17</sup> Ibid.

1   **A:**     In discussing steps the Company is taking to mitigate the impact of FCR-26 rates on its customers,  
2   Ms. Adams and Mr. Houston point to only one Company action to reduce the actual fuel costs for Georgia  
3   Power operations;<sup>18</sup> this additional procurement of fuel-free solar generation resources amounts to only  
4   0.006%<sup>19</sup> of the total GWH's projected total power generation according to the Company's own filings in  
5   their Direct Testimony.<sup>20</sup>

6           When specifically describing the Company's efforts to mitigate the impact of fuel costs on  
7   ratepayers, Georgia Power boasts of implementing the maximum Interim Fuel Rider (IFR) increase on  
8   ratepayers of approximately 15% effective January 1, 2022.<sup>21</sup> Implementing an IFR increase is not actually  
9   a cost mitigation method, but instead is a risk mitigation method for the utility, at the literal expense of  
10   ratepayers. Rather than reducing actual fuel costs paid by the Company to generate electricity at coal- and  
11   natural-gas-fired power plants, increasing the IFR merely passes along the utility's increased fuel costs to  
12   its customers. The utility is thus allowed to collect more via the higher FCR tariff, effectively providing a  
13   further disincentive to the utility to aggressively reduce the fuel costs themselves. The IFR mechanism  
14   worsens the moral hazard, rather than mitigates it.

15          Further, the utility cites as a positive cost-mitigation method its proposed amortization of the \$2.6  
16   billion under-recovered fuel balance under FCR-25 over 36 months instead of the more conventional 24  
17   months. Again, this is not actually a fuel cost mitigation measure. Instead, Georgia Power is effectively  
18   double-charging customers by increasing the forward-looking FCR-26 rates starting June 1, 2023, and  
19   adding on top of it the 36 months of amortized costs for prior fuel costs. This proposal is akin to a family  
20   charging its monthly grocery bills on the credit card, and spending the next three months paying off that  
21   month's grocery bills. That same family will need to buy groceries each subsequent month, but will be

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<sup>18</sup> Direct Testimony, p. 9 and p. 15.

<sup>19</sup> 1,150 GWh of the total 184,589 GWh projected on Table 2 of the Direct Testimony of Ms. Adams and Mr. Houston, p. 16.

<sup>20</sup> Ibid, p. 16.

<sup>21</sup> Ibid, p. 14.

1 paying principal and interest on the prior three month's groceries, making it harder and harder to make the  
2 family budget balance.

3 In Georgia Power's case, they are proposing a similar painful negative-feedback-loop of increased  
4 costs, with very minimal stated efforts to reduce actual fuel costs. And the impact on a typical residential  
5 customer in Georgia is profound. Over each of the three years of FCR-25 under-recovered collections, that  
6 typical residential customer will pay between \$204 and \$276 more on their Georgia Power bills.<sup>22</sup> If the  
7 Commission instead uses the conventional 24-month amortization period for the FCR under-recovered fuel  
8 cost collection, I infer that the typical residential customer will pay 50% more than stated in the three year  
9 test case, between \$306 and \$414 more each year – a shocking impact, made even more difficult to accept  
10 given Georgia Power's *de minimis* steps to mitigate and reduce the actual fuel costs during the period.

11 Ironically, it may be in ratepayers' interests for the Commission to approve Georgia Power's  
12 proposal to spread out this painful impact for ratepayers across multiple years. But it is imperative that the  
13 Commission take additional steps to prevent increased pain through the higher forward-looking FCR-26  
14 rate, and to take a proactive look at modernizing the Fuel Cost Recovery mechanism itself.

15 **Q: COMPARED TO OTHER UTILITIES, HOW DO YOU VIEW GEORGIA POWER'S**  
16 **ACTIONS TO PROTECT RATEPAYERS FROM NATURAL GAS PRICE HIKES AND**  
17 **OVERALL NATURAL GAS PRICE VOLATILITY?**

18 **A:** Over the last 30 months, advising the Pearl Street Station Finance Lab, I have participated in a  
19 broad review of fuel pass through clauses across the United States. I have also closely monitored utility  
20 actions during the COVID-19 pandemic period, starting in March 2020, and in response to multiple severe  
21 weather events such as winter storms Uri and Elliot as well as to the geopolitical chaos in Russia and  
22 Ukraine. I find Georgia Power's actions to be consistent with some of the less proactive utilities, slow to  
23 respond to the ratepayer risks and reliability impacts of overreliance on natural gas. The Company's Direct  
24 Testimony frequently mistakes accounting mechanisms for actual steps to reduce their fuel expenditures.<sup>23</sup>

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<sup>22</sup> Ibid. p. 4

<sup>23</sup> Direct Testimony, pp. 8-9, among others.

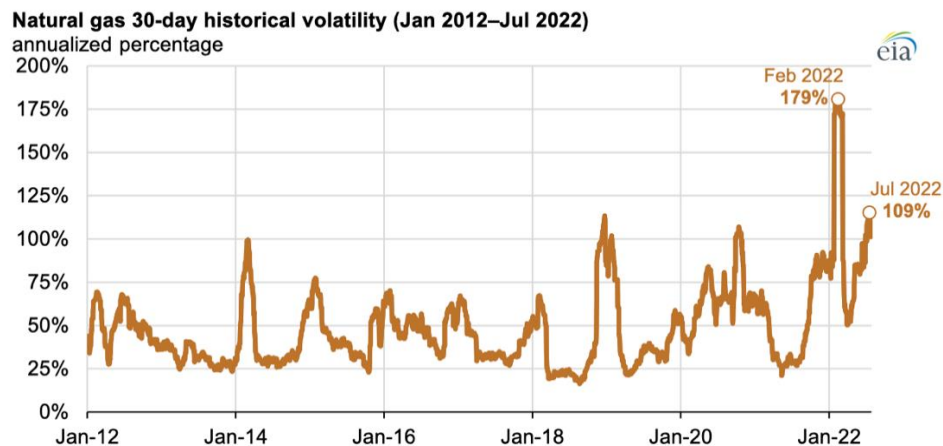
**Q: WHAT IS “VOLATILITY”?**

**A:** For commodities like gas or coal, “volatility” describes how quickly the price of a commodity changes over time. In economic and financial terms, volatility refers to the standard deviation of changes in a price variable over time. “Price volatility” does not necessarily mean that prices are increasing, or that prices are decreasing. Instead, price volatility means that prices are changing rapidly over a short period of time.

**Q: CAN VOLATILITY ACTUALLY BE “UNEXPECTED?”**

**A:** No, not anymore. Natural gas 30-day historical price volatility approached summer 2022’s price volatility index at least three times during the last decade, not including the late winter 2022 volatility spike in the wake of Russia’s invasion of Ukraine.

*Chart 3*



1  
2 **Q: HOW WOULD YOU CHARACTERIZE GEORGIA POWER'S DESCRIPTION OF THE**  
3 **DRIVERS TO THE UTILITY'S FUEL COST INCREASES?**

4 **A:** I have a lot of sympathy for their circumstances. Georgia Power does not have any meaningful  
5 influence on geopolitical affairs, such as the Russian invasion of Ukraine in early 2022. Georgia Power is  
6 also not directly responsible for individual severe weather events, even as we must all recognize the impact  
7 of carbon emissions in driving a changed climate, including increased frequency and scale of severe weather  
8 events such as hurricanes and major winter storms.

9 **Q: DO YOU AGREE THAT DEMAND AND PRICE INCREASES ARE "HIGHER THAN**  
10 **EXPECTED" AND "UNPRECEDENTED?"**

11 **A:** Not really. I already discussed how natural gas price volatility cannot be reasonably described as  
12 "unexpected." The number and severity of significant weather events is also not "unexpected," as the effects  
13 of climate change accelerate globally, nationally, and in the Southeastern United States.

14 In June 2020, Investor advocacy organization Ceres released its updated report, "Addressing  
15 Climate as a Systemic Risk: a call to action for U.S. financial regulators," yet another in a series of reports  
16 detailing the quantifiable and known risks of climate-related severe events, which Ceres has released since  
17 at least 2012. In its June 2020 report, Ceres stated:

18 Systemic risks have the potential to destabilize capital markets and lead to serious  
19 negative consequences for financial institutions and the broader economy. Under  
20 this definition, climate change, like the current COVID-19 crisis, is indisputably a  
21 systemic risk. Its wide-ranging physical impacts... are likely to manifest in both  
22 cumulative and unexpected ways and present clear systemic risks to U.S. financial  
23 markets -- and the broader economy. Left unmanaged, these risks could have

significant, disruptive consequences on asset valuations, global financial markets  
and global economic stability.<sup>24</sup>

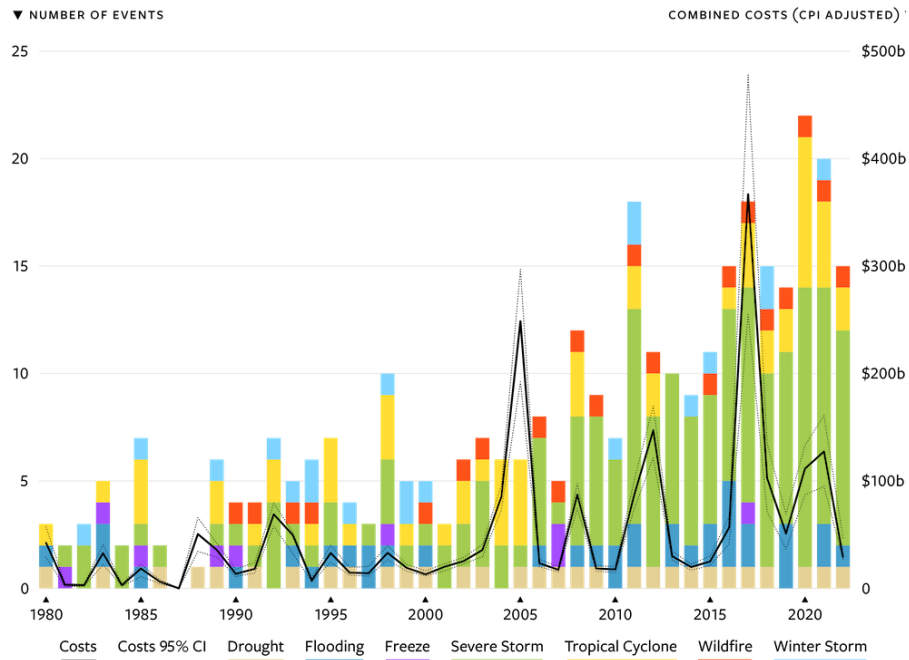
The National Oceanographic Institute’s National Centers for Environmental Information monitors  
the number and cause of CPI-adjusted billion-dollar weather and climate-related disaster events. Since  
1980, the United States has sustained 348 such billion-dollar disasters, including 20 winter storms and  
freezes. Chart 4 shows the significant increase in the number, scale and scope of such major disaster events  
in the last decade.<sup>25</sup>

*Chart 4 – Billion-dollar climate and severe-weather events by type since 1980*

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<sup>24</sup> Ceres, “Addressing Climate as a System Risk: a call to action for U.S. financial regulators”, June 2020, <https://www.ceres.org/resources/reports/addressing-climate-systemic-risk>.

<sup>25</sup> NOAA National Centers for Environmental Information (NCEI) U.S. Billion-Dollar Weather and Climate Disasters (2023), <https://www.ncei.noaa.gov/access/billions/>.



Georgia Power has repeatedly been warned of the volatility and risk of relying on fuel-based power generation, as recently as the 2022 IRP and PPA dockets. As intervenors SACE and Southface stated, by only focusing on natural gas and coal as supply options, Georgia Power left the Commission, and thus, the utility's ratepayers, "a choice between two volatile, risky fossil fuels, at the expense of innovative, cost controlled and less risky renewables projects."<sup>26</sup>

**Q: THE COMPANY STATES THAT IT DOES NOT EARN A RETURN ON FUEL COSTS. DO YOU AGREE?**

**A:** Georgia Power is not alone in making this statement related to fuel pass through policies such as the Fuel Cost Recovery here in Georgia. That said, these statements are misleading, and do not tell the whole story.

Like nearly every Investor-Owned Utility, it is true that Georgia Power does simply pass along all of the fuel costs to ratepayers through the Fuel Cost Recovery mechanism. However, the Fuel Cost

<sup>26</sup> SACE and Southface Post-hearing brief, dockets 44160 and 44161, 2022, p. 17.

1 Recovery policy of passing along 100% of all fuel costs to ratepayers, and requiring no assumption of risk  
2 or cost by the utility, results in an extraordinary situation of ratepayer risk and utility profit.

3 While Georgia Power does not make a profit or generate any return on investment for the fuel  
4 purchased, they do make a profit on the power plants that burn this fuel. In Georgia, as in most cost-of-  
5 service regulated states, Georgia Power's profit margin is calculated as a rate-of-return, multiplied by the  
6 value of the rate-based capital assets owned by the utility. When Georgia Power owns and operates a power  
7 plant, regardless of the generation technology, the utility can increase its earnings. I believe it is a general  
8 axiom of electric utility economics that earning a return on the capital rate base is the principal driver of  
9 Investor-Owned Utilities' shareholder earnings.

10 As a fiscally conservative former lawmaker, I have always found it useful to think about how public  
11 officials – and the general public – might view a state or local government procurement process for  
12 purchasing vehicles in its fleet. The government might have to choose between Option One and Option  
13 Two, where Option One is a lower-initial-price truck but with lower fuel economy on a mileage-per-gallon  
14 (or equivalent kWh-per-mile) basis, and Option Two is a higher-initial-price truck but with higher fuel  
15 economy. Option One will be more cost-effective initially, but would ultimately cost more in taxpayer funds  
16 over long-term operation. Option Two will be more expensive initially, but will save taxpayer funds over  
17 long-term operation. The government procurement team will then have to determine how quickly it will  
18 realize the financial benefit of Option Two, as well as whether capital expenditure fund levels are sufficient  
19 to support Option Two's higher upfront cost. Further, as public stewards of both taxpayer funds and of  
20 overall public health and other public goods, the government needs to determine whether other public goods  
21 would be served by the higher initial cost of Option Two's greater fuel economy, including fleet reliability,  
22 reduced emissions and related increased public health, and other factors. Any competitive business faces  
23 similar decisions of upfront cost and long-term operational expenses, though the private-sector intangible  
24 factors typically replace public goods for the business's brand improvement and reputational benefits.

25 The Fuel Cost Recovery severely distorts this budgeting and planning consideration for Georgia  
26 Power and other Investor-Owned Utilities. Building and operating natural gas plants has grown Georgia

1 Power's rate base, with no risk to the utility. The Fuel Cost Recovery mechanism ensures that the utility  
2 will collect all fuel costs from ratepayers, no matter the price volatility, so long as the Commission  
3 determines these costs are prudently incurred. Over the years, Georgia Power has grown its capital rate base  
4 of power plants, completely insulated from the risk of price volatility, particularly for the purchase of natural  
5 gas and coal. This moral hazard, explained above, is not just theoretical. The consequence of the moral  
6 hazard inherent in a 100% Fuel Cost Recovery mechanism within the capital-rate-based financial model is  
7 that Georgia Power is able to increase its earnings base, in spite of the narrow claim that the "Company  
8 does *not* earn a return on these fuel costs."<sup>27</sup>

9 Not only are the costs "directly passed through to customers,"<sup>28</sup> by taking a "single-issue"  
10 ratemaking approach through Fuel Cost Recovery dockets, the larger earnings base for the utility creates  
11 additional inflationary pressure on ratepayers.

12 **Q: IS IT APPROPRIATE TO VIEW FUEL COST RECOVERY DOCKETS IN ISOLATION?**

13 **A:** No, I do not believe it is appropriate to review these Fuel Cost Recovery dockets without  
14 understanding the interplay with other ratemaking dockets, as well as Integrated Resource Plans and  
15 specific-plant Certificate of Need applications, for the reasons cited above. I believe the Commission  
16 would be wise to consider the multiple factors and broader economic forces through a specific Fuel Cost  
17 Recovery modernization docket. The Commission may determine that the interests of fairness require the  
18 Commission to evaluate at least the FCR-25 rate recovery request under the existing Fuel Cost Recovery  
19 mechanism. However, given other active dockets and Georgia Power requests in front of the Commission,  
20 I believe the Commission would be wise to reassess the overall Fuel Cost Recovery approach in tandem  
21 with the other dockets, and to defer decisions on the forward-looking FCR-26 upward rate adjustment.

22 **Q: TO PROTECT RATEPAYERS, DO YOU BELIEVE THE COMMISSION SHOULD**  
23 **APPROVE GEORGIA POWER'S FCR-25 RATE RECOVERY REQUEST?**

24 **A:** No.

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<sup>27</sup> Direct Testimony, p. 3.

<sup>28</sup> Ibid.

1 **Q: TO PROTECT RATEPAYERS, DO YOU BELIEVE THE COMMISSION SHOULD**  
2 **APPROVE GEORGIA POWER'S FCR-26 TARIFF INCREASE?**

3 **A:** No.

4 **Q: IF THE COMMISSION DOES APPROVE GEORGIA POWER'S INCREASED RATE**  
5 **REQUESTS NOW, WHAT SHOULD THE COMMISSION DO TO PROTECT RATEPAYERS IN**  
6 **FUTURE YEARS?**

7 **A:** At the very least, I believe the Commission should initiate a docket to review all of the varied  
8 policy goals and conduct a robust financial analysis of changes to the Commission's Fuel Cost Recovery  
9 process.

10 **Q: IN YOUR REVIEW OF GEORGIA'S FUEL COST RECOVERY AND SIMILAR**  
11 **MECHANISMS, WILL THE CURRENT UPWARD RATE REQUEST IMPACT GEORGIA**  
12 **POWER'S ABILITY TO PROVIDE AFFORDABLE AND RELIABLE SERVICE?**

13 **A:** Yes. Very much so.  
14

15 **IV. FUEL COST RECOVERY IMPLICATIONS FOR RELIABILITY**

16 **Q: TO PRESERVE RELIABILITY, DO YOU BELIEVE THE COMMISSION SHOULD**  
17 **APPROVE GEORGIA POWER'S FCR-25 RATE RECOVERY REQUEST?**

18 **A:** From a reliability standpoint, the under-recovered fuel balance is essentially water over the dam,  
19 or more accurately, money burned up the smokestack. It is not useful to assess the FCR-25 rate recovery  
20 request from the paradigm of reliability.

21 **Q: TO PRESERVE RELIABILITY, DO YOU BELIEVE THE COMMISSION SHOULD**  
22 **APPROVE GEORGIA POWER'S FCR-26 TARIFF INCREASE?**

23 **A:** No. More critically, approving the Georgia Power FCR-26 rate increase is likely to exacerbate  
24 Georgia Power's concentrated risk as a large consumer of natural gas, and heavily reliant on natural gas  
25 generation. Ms. Adams and Mr. Houston state that the coal and natural gas supply constraints of 2020 to

1 2022 “resulted in natural gas customers across the country paying higher prices for gas due to high demand  
2 and limited availability for alternative fuel sources.”<sup>29</sup>

3 Continuing the Fuel Cost Recovery mechanism status quo would spur Georgia Power to continue  
4 to rely on natural gas generation as a primary resource, as the utility could count on recouping 100% of its  
5 fuel supply costs, even in the case of renewed supply constraints, global geopolitical disruptions, and  
6 ongoing price volatility.

7 **Q: EARLIER YOU STATED THAT THE CURRENT FUEL COST RECOVERY**  
8 **MECHANISM HAS RELIABILITY AND HOMELAND SECURITY IMPLICATIONS. CAN YOU**  
9 **EXPLAIN FURTHER?**

10 **A:** As required by the federal Department of Homeland Security’s Federal Emergency Management  
11 Agency (FEMA), the Georgia Emergency Management and Homeland Security Agency (GEMA/HS)  
12 maintains Georgia’s Emergency Operations Plan (GEOP). The GEOP is developed by GEMA/HS in  
13 coordination with other state agencies, non-governmental organizations and private sector partners and is  
14 aligned with the National Incident Management System, National Response Framework and the National  
15 Disaster Recovery Framework. Every four years, GEMA/HS updates the GEOP itself and all of the GEOP  
16 annexes, including Annex 12 – the Energy Annex.

17 Like all statewide Emergency Operations Plans, the GEOP takes the approach of “All Hazard  
18 Planning” including identification of past and potential future emergencies in the state. The GEOP then  
19 conducts a vulnerability analysis, a function of the built environment, local economy, demographics and  
20 environmental uses of a region. The GEOP states very clearly that damage and/or destruction to any of  
21 Georgia’s six critical lifeline sectors, including Energy, “represents enormous economic, social, and general  
22 functional costs to a community, while also impeding emergency response and recovery activities.”<sup>30</sup>

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<sup>29</sup> Direct Testimony, p. 11.

<sup>30</sup> Georgia’s Emergency Operations Plan (GEOP), 2017 with 2019 updates, p. 6.

1           The GEOP does not mince words in describing the public health, safety and lifeline support  
2 implications of events that would damage or destroy parts of the state’s Energy infrastructure, particularly  
3 for electrical power.<sup>31</sup>

4           The 2019 GEOP identified several specific “Hazards of Concern” based on past emergencies as  
5 well as current and future vulnerabilities. During the period included by GEMA/HS for the GEOP, Severe  
6 Weather was the most common cause of declared disaster events in Georgia, accounting for 29 of 42  
7 disasters. Of these severe weather events through 2019, 4 were severe winter weather events – a Hazard of  
8 Concern identified three years before winter storm Elliott wreaked havoc in Georgia, and two years before  
9 Superstorm Uri created substantial natural gas price increases and subsequent price volatility for months,  
10 including substantial impacts in Georgia.

11           Emergency Support Function 12 – Energy Annex supports the GEOP and provides guidance to  
12 prepare for, respond to, recover from and mitigate the effects of a disaster or emergency on Georgia’s  
13 Energy System, and is the principal conduit by which the critical energy infrastructure is protected and  
14 restored. The Commission assumes primary oversight of emergency and disaster operations pertaining to  
15 electrical infrastructure, including planning and coordinating preparedness and mitigation activities  
16 pertaining to electrical and natural gas infrastructures.

17           I had the honor of escorting recently retired general and flag officers, Navy SEALs, and other  
18 veterans of the United States Special Forces. I recall frequent references to the need for multiple tools in  
19 case of the loss or failure of one tool. One Navy SEAL officer stated often: “You have to assume that if  
20 you have three tools for the job, one will break, and you will lose another one. So, what’s three is really  
21 two. If you have two, it’s really one. And if you have just one, you’re sure as done.”

22           The Fuel Cost Recovery mechanism and policy of 100% pass through to ratepayers has incented  
23 Georgia Power to rely far too heavily on a single source of new electrical generation: natural gas-fueled  
24 power plants.

---

<sup>31</sup> Ibid.

1  
2 **V. PROPOSAL TO CHANGE INTERIM FUEL RIDER MECHANISM**

3 **Q: HOW SHOULD THE COMMISSION VIEW GEORGIA POWER’S REQUEST TO RAISE**  
4 **THE INTERIM FUEL RIDER INCREASE MAXIMUM FROM 15% to 40%?**

5 **A:** With respectful skepticism. I believe the Company’s proposal would negate any future need for a  
6 Fuel Cost Recovery docket whatsoever. Georgia Power could rely entirely on the Interim Fuel Rider notice  
7 requirements under Commission rules, thus circumventing the spirit and the letter of O.C.G.A. 46-2-26.  
8 The Commission does indeed have the authority to adjust the Fuel Cost Recovery mechanism under the  
9 statute, but the Commission may not actually have the authority to permit any utility to avoid the public  
10 scrutiny and oversight that a Fuel Cost Recovery docket provides.

11 **Q: WHAT DO YOU MEAN BY AVOIDING PUBLIC SCRUTINY, IF THE INTERIM FUEL**  
12 **RIDER CAP IS INCREASED TO 40%?**

13 **A:** Fuel Cost Recovery dockets include an opportunity for the Commission to determine whether  
14 utility fuel expenses are the result of “illegal or clearly imprudent conduct on the part of the utility,” in  
15 which case the Commission is obligated to disallow such fuel cost recovery by the utility.<sup>32</sup> I do not see  
16 how the Commission could exercise its obligation if the Interim Fuel Rider maximum adjustment is higher  
17 than the current 15%, permitting the utility to avoid any needed Fuel Cost Recovery docket going forward.

18  
19 **VI. APRIL 12, 2023, STIPULATION**

20 **Q: DID YOU REVIEW THE STIPULATION AGREEMENT BETWEEN GEORGIA POWER**  
21 **AND THE COMMISSION’S PUBLIC INTEREST ADVOCACY STAFF?**

22 **A:** Yes, as well as the Attachment A related to the Interim Fuel Rider mechanics.

23 **Q: DOES THE STIPULATION AGREEMENT SOLVE THE ISSUES RAISED IN YOUR**  
24 **TESTIMONY?**

---

<sup>32</sup> O.C.G.A. 46-2-26(h).

1    **A:**     No, it does not. The Stipulation would only reduce the Company’s approximate \$2,520,000,000  
2    under-recovered fuel balance by \$7,000,000, retaining 99.72% of Georgia Power’s original request under  
3    this docket. Further, the Stipulation does not address the significant negative consequences of increasing  
4    the Interim Fuel Rider cap to 40%.

5           I do not see any reason to modify my description of the docket, amended by the Stipulation, as  
6    “shocking.”

7    **Q:     SHOULD THE COMMISSION APPROVE THE DOCKET AS AMENDED BY THE**  
8    **PROPOSED STIPULATION AGREEMENT?**

9    **A:**     No. My overall recommendation has not changed after my review of the Stipulation documents.  
10

11           **VII.    COMMISSION DOCKET ON MODERNIZING FUEL COST RECOVERY**

12   **Q:     WHAT SHOULD THE COMMISSION CONSIDER IN A FUEL COST RECOVERY**  
13   **MODERNIZATION DOCKET?**

14   **A:**     I believe the Commission should follow other states, such as Missouri and Idaho, among others, in  
15    pursuing a modernized sharing of fuel costs and fuel risk between the utility and its ratepayers. Such Fuel  
16    Cost Recovery reforms require balancing utility shareholder concerns against ratepayer protection; ensuring  
17    reliability and mitigation of emissions, and achieving transparency alongside reasonable business  
18    considerations.

19           I believe the Commission can best consider these issues in a holistic fashion through a specific  
20    docket focused on modernizing the Commission’s Fuel Cost Recovery mechanism, including a reasonable  
21    amount of risk to be assumed by utilities.

22           As laid out in the Primer on Fuel-Cost Pass-Through Reform, such a docket should address these  
23    factors:

- 24           1. **The proper amount of fuel cost sharing and fuel risk sharing to be assigned to the**  
25           **utility.** There is not one “best” sharing amount that should be applied to all utilities  
26           because utilities vary in multiple ways. Each utility relies on different mixes of fuel-

1 and non-fuel generation sources, and each utility faces different risk profiles in their  
2 jurisdictions.

- 3 2. **Symmetrical or asymmetrical incentives and penalties.** A symmetrical fuel-cost  
4 sharing assigns the same percentage of fuel risk and fuel cost responsibility to the  
5 utility regardless of whether the actual fuel costs are higher or lower than expected. An  
6 asymmetrical mechanism shares a different amount in each case. Both symmetrical  
7 and asymmetrical sharing can be structured to provide both rewards and penalties.
- 8 3. **Straight sharing of fuel costs and risks, or the use of “deadbands.”** The simplest  
9 structure for a fuel-cost sharing mechanism is to always require the same level of utility  
10 fuel cost responsibility (e.g., 10 percent) regardless of how much the utility’s actual  
11 costs deviate from expectations or forecasts. A “deadband” approach can ensure that  
12 risk-sharing and cost-sharing changes the greater utility’s actual costs have deviated  
13 from expectation or forecast. For instance, with respect to natural gas price volatility,  
14 the deviation from forecasted gas prices was significant enough over the past three  
15 years to merit some adjustment to a risk-sharing formula; the Commission would be  
16 able to evaluate different scenarios through modeling in a modernization docket.
- 17 4. **Reliance on forecasts versus actual historic pricing.** Forecasting natural gas pricing  
18 can feel like an exercise in futility. Some states, such as my home state of Minnesota,  
19 have adjusted the timing of fuel cost reviews to ensure greater reliability of actual  
20 pricing and costs, given the challenge of reliable forecasting.
- 21 5. **Transparency of key contract terms.** Georgia’s current Fuel Cost Recovery rules  
22 require some disclosure of fuel supply agreement terms. But I believe that some critical  
23 contract terms can still be treated as confidential trade secret information, such as  
24 minimum delivery amounts (“take or pay” provisions), automatic price increases and  
25 others.

- 1           6. **Review for Prudence.** The Commission may find that it has ample authorization under  
2           the current FCR mechanism to properly review utility acts to ensure they address  
3           known or foreseeable risks that can result in shocking rate impacts as proposed in this  
4           docket. Any modernization effort should ensure that this prudence review continues.
- 5           7. **Hedging.** As the Company implies in the current docket, a utility can purchase stability  
6           and price predictability in exchange for a premium payment for such future fuel supply.  
7           Hedging is currently a permitted strategy by Georgia Power to address price risk – at  
8           an initial cost to its ratepayers. The Commission should evaluate the use of hedging as  
9           a cost-effective strategy over decades, and not just in times of geopolitical turmoil and  
10          a global pandemic.
- 11          8. **Purchased Power.** Georgia’s Fuel Cost Recovery mechanism currently ensures that  
12          the fuel costs of purchased power are included in the utility’s fuel rate calculations.  
13          Any risk-sharing and cost-sharing proposal should consider continuing this policy  
14          component, lest a utility attempt to sidestep the fuel risk requirements strictly through  
15          Power Purchase Agreements rather than utility-owned assets.
- 16          9. **Integrating Fuel Sharing in Other Ratemaking.** Fuel cost recovery has become a  
17          form of single-issue ratemaking that even Georgia Power admits could become more  
18          than 36% of the total revenue collected via ratepayers’ bills.<sup>33</sup> Fuel costs and fuel risk  
19          continue to be critical factors in utility Integrated Resource Plans. Modernizing Fuel  
20          Cost Recovery in Georgia will make for a more efficient and consistent resource  
21          review across multiple dockets and multiple factors.

22   **Q:     IS THERE AN OPTIMAL AMOUNT OF UTILITY RESPONSIBILITY THAT THE**  
23   **COMMISSION SHOULD CONSIDER?**

---

<sup>33</sup> MFRP 1-1.

1   **A:**     I do not believe it is worthwhile to even consider returning to the pre-OPEC days of assigning to  
2   the utility 100% of fuel cost and fuel risk responsibility. Fuel risk sharing efforts in Hawaii, Idaho and other  
3   states suggest that sharing even 10% of fuel risk and fuel costs with the utility can have a dramatic benefit  
4   for reliability, resource diversity, ratepayer protection and utility performance.

5   **Q:     DOES THE UTILITY HAVE ANYTHING TO GAIN BY ACCEPTING FUEL RISK-**  
6   **SHARING AND FUEL COST-SHARING?**

7   **A:**     Absolutely. When designed well, a modernized fuel-sharing policy will provide utilities with a  
8   form of a performance incentive mechanism. If the utility can actively reduce fuel risks and fuel costs, as  
9   determined in a Fuel Cost Recovery docket, the utility should be rewarded for such efforts. The total fuel  
10  risk and fuel cost savings to the ratepayer should exceed any additional earnings awarded to the investor-  
11  owned-utility, of course. But designed well, a modernized Fuel Cost Recovery mechanism in Georgia will  
12  provide consistent benefits to the utility and to ratepayers.

## 15                                   **CONCLUSION**

16   **Q:     PLEASE PROVIDE A SUMMARY OF YOUR TESTIMONY.**

17   **A:**     1. In the matter of the FCR-25 tariff under-recovered fuel balance, the Commission should  
18  rigorously review the prudence of Georgia Power's actions. While Georgia Power could not have predicted  
19  the specific events that contributed to the under-recovered fuel balance, multiple experts warned of the risks  
20  of excessive reliance on natural gas and the ongoing price volatility of natural gas even without winter  
21  storm Uri and Russia's invasion of Ukraine. Georgia Power could have taken any number of prudent steps  
22  to minimize its exposure to natural gas price volatility.

23           2. The Commission should not approve the forward-looking FCR-26 fuel rate adjustment. The  
24  Commission should instead initiate a Fuel Cost Recovery modernization docket to include some amount of  
25  fuel-cost-sharing and fuel-risk-sharing by the utility, to mitigate the moral hazard under the current policy  
26  of passing through 100% of fuel costs to ratepayers. The Commission has the authority under the Fuel Cost

1 Recovery statute -- because of Georgia Power's failure to take sufficient prudent steps -- to make  
2 amendments that would better allocate risk and costs between utilities and ratepayers. A modernization  
3 docket is the best means to evaluate all the policy options, relevant factors and potential impacts.

4 3. Georgia Power's proposal to increase the Interim Fuel Rider maximum adjustment to 40%  
5 without Commission review risks violating the Commission's statutory responsibility to conduct a  
6 prudency review of Georgia Power's fuel costs. The Commission should reject this proposal.

7 4. Georgia Power's proposals also risk the utility's strong prior record on reliability. Addressing  
8 Fuel Cost Recovery tariffs without considering the impact of other ratemaking dockets has led to unintended  
9 consequences, including an outsized reliability on natural gas. Other non-fuel alternatives could have  
10 mitigated the multi-billion-dollar impact to ratepayers.

11 5. The Commission should not accept the proposed April 12, 2023, Stipulation between Georgia  
12 Power and the Georgia Public Service Commission Public Interest Advocacy Staff, as it does not materially  
13 address the issues raised in this testimony.

14  
15 **Q: DOES THIS COMPLETE YOUR TESTIMONY?**

16 **A:** Yes. Thank you.

# JEREMY KALIN

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## EDUCATION

- J.D. **William Mitchell College of Law**, St. Paul, MN.  
**University of New Mexico, School of Architecture and Planning**, Albuquerque, NM.
- B.F.A. **University of Minnesota**, Minneapolis, MN.

## PROFESSIONAL EXPERIENCE

- Attorney and Shareholder, Avisen Legal P.A.** 2019 - present
- Impact Counsel practice focused on low-carbon project finance and early-stage investment. Practice areas include energy policy; climate finance and related impact investment; solar electricity and energy efficiency; greenhouse gas reduction and related projects.
  - Clean energy financing and impact investment consulting for underserved and untapped markets in clean energy, clean water and green infrastructure.
  - General Counsel for venture capital funds investing in technology companies.
  - Admissions: Minnesota and the District of Columbia.
- Kalin LLC, Principal** 2017 - present
- Clean energy financing and impact investment consulting for underserved and untapped markets in clean energy, clean water and green infrastructure.
  - Built and launched multiple award-winning low- and moderate-income solar finance platforms for U.S. Department of Energy.
  - Built and launched Credit Unions' CU Green® clean energy investment platform.
- Senior Advisor, National Caucus of Environmental Legislators (NCEL)** 2016 - present
- National, bipartisan non-profit organization supporting state lawmakers advancing clean energy and resilient communities policies across all 50 states.
- Senior Advisor, GOVERNING Institute** 2014 - 2020
- Advisor and Speaker on Infrastructure, Workforce and Clean Energy Economy
- Eutectics®, CEO** 2010 - 2018
- Nationally-recognized, mission-driven clean energy finance consulting firm with over \$273 Million in projects in progress or completed nationwide.
  - Clients include: U.S. Department of Energy; City of Morris (MN); Baltimore City (MD); Chisago County HRA-EDA; Philadelphia (PA) Energy Authority; St. Paul PHA; The Nature Conservancy; University of Minnesota; etc.
- State Representative, Minnesota House of Representatives District 17B (Chisago County)** 2007 - 2011
- **Coalition of Legislators for Energy Action Now (CLEAN), Chair;** Obama White House bipartisan task force of legislative leaders on clean energy and climate policy.
  - **Minnesota Green Jobs Task Force, Co-Chair.**
  - **Legislative Chief Author:** 2010 Property Assessed Clean Energy (PACE) Act; 2009 Green Jobs Act / ARRA Energy Appropriation; 2008 Military and Overseas Voter Act; 2007 Demand Efficiency Act (*selected legislation*).
- Vice-Chair, East Central (MN) Regional Development Commission** 2004 - 2006
- Vice-Chair and Chisago County Representative on regional economic development authority serving Pine, Isanti, Chisago, Kanabec and Mille Lacs Counties.

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<b>Mississippi Headwaters Fund Advisory Board</b> , The Nature Conservancy	2016 – 2018
<b>The Violence Project Research Center</b> , Board Member	2020 - present
<b>Safety and Security Committee Chair</b> , Shir Tikvah Synagogue	2018 - present
<b>Jewish Family and Children's Service of Minneapolis</b> , Director	2013 - 2021
<b>Capital Expansion Working Group, Innovative Housing Network</b> , Chair	2016 - 2017
<b>FBI Citizens Academy</b> , Minneapolis Division	2018
<b>Minnesota Chamber of Commerce</b> , Energy Policy Committee	2014 - 2016
<b>State Innovation Exchange (SiX)</b> , Founding Advisory Board	2012 - present
<b>Overseas Vote Foundation</b> , Advisory Board	2009 - 2012
<b>James J. Hill Business Reference Library</b> , Board Member	2010 – 2012
<b>Chisago County (MN) Land Use Coalition</b>	2004 - 2006
<b>East Central (MN) Arts Council</b>	2004 – 2006

## **SELECTED AWARDS AND RECOGNITION**

<b>Royal Society of the Arts</b> , Fellow	2018 - present
<b>British American Project</b> , Fellow	2014 - present
<b>Progress Minnesota 2017 Honoree</b> (Eutectics)	2017
<b>Midwest Energy Efficiency Alliance</b> , Inspiring Leadership Award	2008
<b>Legislator of Distinction</b> , League of Minnesota Cities	2008
<b>Legislative All-Star</b> , Fresh Energy Minnesota	2007
<b>Graduate Teacher of the Year</b> , University of New Mexico, School of Architecture and Planning	2003

## **TEACHING EXPERIENCE**

<b>University of Minnesota</b> , College of Design, “Design Thinking for Public Policy”
<b>University of New Mexico</b> , Graduate Teaching Assistant, School of Architecture and Planning
<b>Massachusetts College of Art</b> , Visiting Faculty
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<b>IMPACT</b> , United States Green Building Council, Minnesota
<b>American Institute of Architects</b> , National Conference
<b>Minnesota Real Estate Journal</b> , Energy Summit
<b>National Press Club</b> , GOVERNING Outlook
<b>United States Senate</b> , Climate and Energy Security briefing
<b>Center for Climate Strategies Forum on State and Subnational Leadership</b> , United Nations Conference of Partners (COP15), Copenhagen, Denmark
<b>University of Minnesota</b> , College of Design, Commencement Speaker
<b>National Press Club</b> , United States Green Building Council Green Schools Caucus national launch
<b>The White House</b> , State Leadership on Clean Energy

**Energy Efficiency Finance Forum**, American Council for an Energy Efficient Economy  
**Georgetown University Climate Center**, State Leadership on Climate and Energy  
**Good Jobs, Green Jobs Conference**, Blue-Green Alliance Conference  
**Midwest Energy Solutions Conference**, Midwest Energy Efficiency Alliance

### **SELECTED RECENT ARTICLES**

**Learning to Share: A Primer on Fuel-Cost Pass-Through Reform**, Pearl Street Station Finance Lab, April 2023

**Commentary: Clean Energy Still Trumps Partisan Politics**, Midwest Energy News, November 2016

**Sustainable: The Business Case for Going Green**, Finance & Commerce, June 2016

**Minnesota Community's Energy Focus Gives It Edge in National Competition**, Midwest Energy News, June 2016

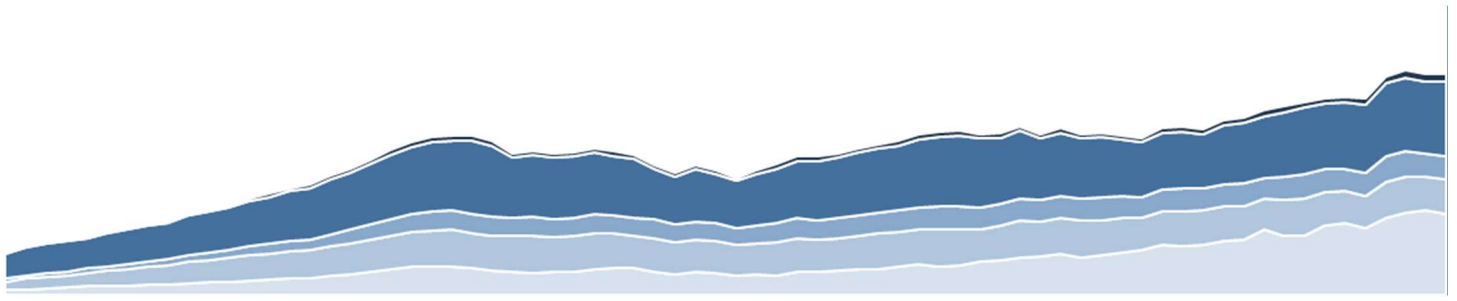
**Minnesota Firm Has a New Approach to Clean Energy Financing**, Midwest Energy News, May 2016

**Energy Finance Advisor Helps Businesses Go Green**, Minneapolis Star Tribune, October 2014

**PACE Creating Efficiency Opportunities**, Midwest Energy News, June 2014

**'SolarNote' Aims to Reduce Complexity in Financing**, Finance & Commerce, February 2014

**From Commodity to Service: Why the Capitalization Model for Electric Regulation is Failing Minnesota**, J.D. thesis paper, June 2010



# LEARNING TO SHARE: A PRIMER ON FUEL-COST PASS-THROUGH REFORM

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April 5, 2023

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## Executive Summary

Electric utilities in the United States spend billions of dollars annually buying fuel to generate electricity. These costs often make up a sizable share of customer bills, and unlike other bill components, they can vary substantially from month to month. This makes it imperative that utilities manage their spending on fuels carefully—but most utilities have no financial incentive to do so. This is because in most states today, utilities are allowed to pass on 100 percent of their actual spending to customers through policies called “fuel adjustment clauses” (FACs).

FACs create a problem that economists call “moral hazard.” Moral hazard exists when one party does not suffer the consequences of making bad decisions, so it takes bigger risks as a result. Current 100 percent pass-through policies create moral hazard because if utilities manage to reduce fuel costs (for example, by negotiating better prices or reducing their fleet’s reliance on fuel) their customers receive all of the benefits, and if utilities manage their costs poorly, their customers pick up the bill.

Ever since FACs were implemented, they have created this moral hazard problem. However, in recent decades its real-world consequences have grown more acute due to a series of developments. These include several trends which have magnified the risks of heavily relying on price-volatile fuels for electricity generation, and others which have decreased the cost of fuel-free alternatives. In addition to the heavy cost burden that FACs impose on today’s customers, they also fail to incentivize utilities to properly consider low- and no-fuel options that could help lower carbon emissions.

Though FACs are the norm today, these policies are ripe for revision by legislators and public utility commissioners interested in addressing these growing challenges. However, not all policy makers understand the downsides of current FAC policies, and not all those who do are motivated to take proactive actions to address them. Advocates can play important roles in educating key policymakers, encouraging them to act, and enlisting the support of other parties when needed to advance reforms in their state.

Eliminating FACs altogether may seem like the simplest policy fix, but moving from a 100 percent pass-through to a zero-percent pass-through overnight could create financial difficulties for utility companies. Fortunately, such an abrupt change is not necessary. Updating the FAC to pass through a lower share of the utility’s actual spending to customers can successfully address the moral hazard problem while limiting the total risk the utility is exposed to. This type of reform is called “fuel-cost sharing.”

Fuel-cost sharing can be implemented in different ways. The basic fuel-cost sharing policy that has been adopted by most states to date represents only a modest departure from the status quo. It entails first building a forecast of fuel costs into the utility’s base rates (as is true of FAC policies), and then truing up less than 100 percent of the difference between the forecasted and actual spending. However, this is not necessarily the optimal design, since relying on forecasts makes this approach vulnerable to gaming by the utility. FAC reforms can also be designed in other ways that may better serve local policy priorities.

A range of design considerations are relevant. These include the extent of fuel-cost sharing, whether the sharing is symmetrical, and which costs are included in the mechanism. Other policies can also

be used to complement the fuel-cost sharing mechanism or serve as alternatives to it, including reforms that increase transparency, encourage hedging, and increase the scrutiny of utility spending decisions.

While FAC policies remain the norm across the United States today, a few states have adopted fuel-cost sharing policies or other reforms. These include Hawaii, Idaho, Oregon, Wyoming, Montana, Washington, Wisconsin, Vermont, and others.

Reforming FAC policies could enhance affordability by motivating utilities to manage their fuel costs more carefully. It could also reduce carbon emissions by encouraging utilities to switch more quickly to fuel-free technologies. It is time for these outdated policies to change, and both commissions and advocates can play important roles in advancing reforms.

## Introduction

Every year in the United States, electric utilities spend billions of dollars purchasing fuel to generate electricity. During the COVID-19 pandemic, between 2020 and 2021, vertically integrated utility companies alone spent \$70 billion in fuel costs.<sup>1</sup> This represents a sizable share of the total cost of producing electricity.

However, thanks to an obscure policy commonly known as the “fuel adjustment clause” (FAC), most US utilities lack any financial incentive to reduce how much money they pay for fuel.<sup>2</sup> Instead, these utilities are allowed to “pass through” 100 percent of these costs to their customers via a bill rider. Customers then have little choice but to pay for these costs—since the alternative would be to lose their access to electricity. In many states, the FAC is a specific line item on electric utility bills, as illustrated in Figure 1.

**Figure 1. Sample Electric Bill from Xcel Energy**

<b>ELECTRICITY CHARGES</b>		<b>RATE: Net Energy Billing Svc</b>	
DESCRIPTION	USAGE UNITS	RATE	CHARGE
Basic Service Chg			\$8.00
Basic Service Chg			\$1.90
Energy Charge Winter	946 kWh	\$0.088030	\$83.28
Energy Charge Winter	0 kWh	-\$0.121590	\$0.00
Fuel Cost Charge	946 kWh	\$0.035507	\$33.59
Sales True Up	946 kWh	-\$0.007360	-\$6.96 <b>CR</b>
Affordability Chrg			\$0.98
Resource Adjustment			\$14.23
Interim Rate Adj			\$8.14
<b>Subtotal</b>			<b>\$143.16</b>
City Fees		5.00%	\$7.06
Transit Improvement Tax		0.50%	\$0.74
City Tax		0.50%	\$0.74
County Tax		0.15%	\$0.23
State Tax		6.875%	\$10.20
<b>Total</b>			<b>\$162.13</b>
<b>Premises Total</b>			<b>\$162.13</b>

A FAC often appears as a separate line item on customer electricity bills. It is highlighted on this residential bill from Minnesota.

The burden on customers is further increased by the variability of fuel costs. Unlike most components of utility bills, the size of the fuel charge fluctuates substantially over time. This is largely due to the volatility of natural gas prices (and to a lesser extent, coal prices) coupled with changing weather. For example, in January 2022, fuel-cost volatility combined with Kentucky

<sup>1</sup> Albert Lin and Joe Daniel, Electricity Customers are Getting Burnt by Soaring Fossil Fuel Prices, RMI, June 23, 2023, [www.rmi.org/electricity-customers-are-getting-burnt-by-soaring-fossil-fuel-prices](https://www.rmi.org/electricity-customers-are-getting-burnt-by-soaring-fossil-fuel-prices)

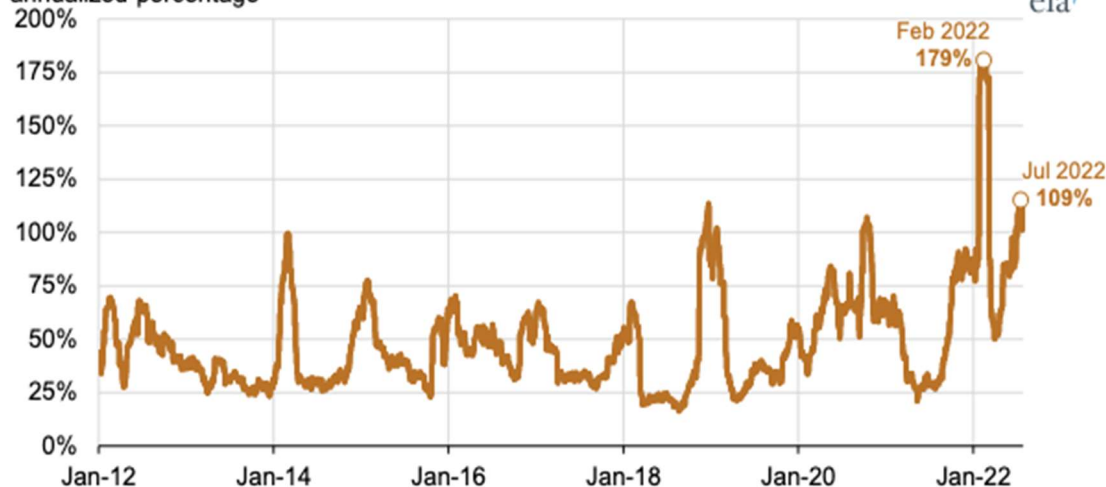
<sup>2</sup> Fuel costs are passed through to customers via FACs by both electric utilities and natural gas utilities. While this primer focuses specifically on electric utilities, many of the same arguments for FAC reform apply to gas utilities as well. We refer to policies that pass 100 percent of fuel costs through to customers via a bill rider as “fuel adjustment clauses” (FACs), but in some states these policies go by different names (e.g., the Energy Adjustment Clause in Iowa, Energy Cost Recovery in Alabama).

Power's FAC resulted in “roller coaster” rates that made it difficult for some customers to make ends meet.<sup>3</sup> Figure 2 illustrates the volatile nature of natural gas prices over the last decade.

**Figure 2. Historical Price Volatility of Natural Gas**

**Natural gas 30-day historical volatility (Jan 2012–Jul 2022)**

annualized percentage



Natural gas prices are highly volatile. Though the price spike in early 2022 was particularly severe, gas prices continually rise and fall in unpredictable ways.<sup>4</sup>

Though FACs pass through 100 percent of actual costs to customers, most components of utility rates do not work this way. The basic rates utilities charge customers for electric service (known as base rates) are set in advance according to the projected costs of power generation and delivery over a set period of time. These base rates establish a predictable per-kWh rate, even if utilities spend more or less than was expected when the rates were set.

In contrast, a FAC allows a utility to charge customers for the exact amount spent on fuel. As a result, fuel does not represent a business cost or profit center for utility companies. This means utilities are able to ignore the cost and volatility of fossil fuels in their decisions, even though customers end up paying more as a result.

Allowing utilities to ignore the consequences of relying on fuels distorts decision-making about what types of resources to invest in, which can disadvantage fuel-free resources in utility planning and investment decisions. Since earnings are not affected if fuel prices rise, the utility can ignore the risk of volatile and elevated costs when making investment decisions. Ignoring the volatility of fossil fuels tips the scales towards them—and away from more cost-effective fuel-free alternatives like wind, solar, and energy efficiency. FACs also give utilities no incentive to find shorter-term strategies to lower fuel costs, such as negotiating better fuel-supply contracts.

This phenomenon differs from what happens in a competitive market, where a company that succeeds in reducing its costs will gain an advantage over its competitors. A regulated utility with a

<sup>3</sup> Emily Bennett, WSAZ Investigates: Kentucky Power bill spike, January 28, 2022, <https://www.wsaz.com/2022/01/28/wsaz-investigates-kentucky-power-bill-spike>

<sup>4</sup> Figure from EIA, U.S. natural gas price saw record volatility in the first quarter of 2022, August 24, 2022, <https://www.eia.gov/todayinenergy/detail.php?id=53579>

FAC gains nothing if it succeeds in reducing its fuel costs. Because of this 100 percent pass-through policy, a utility that manages its fuel costs well earns no reward—and one that manages them poorly faces no consequences because its customers pick up the bill.

## History of Fuel-Cost Pass-Through Policies

Fuel costs were not always treated as a 100 percent pass-through to utility customers. For almost the whole first century of US utility regulation, utilities were expected to manage their fuel costs in the same fashion as other business expenses.

“Because of this 100 percent pass-through policy, a utility that manages its fuel costs well earns no reward—and one that manages them poorly faces no consequences because its customers pick up the bill.”

The first power plants were built in the last few decades of the 19<sup>th</sup> century. To prevent privately owned utilities from overcharging customers, local and state governments stepped in to regulate the rates they could charge. The newly created public utility commissions treated fuel costs as just one aspect of the costs of doing business, rather than as a unique cost category requiring special ratemaking treatment.<sup>5</sup>

When World War I caused fuel prices to soar, utilities lobbied commissions for relief from fuel-price volatility and the associated risk of significant financial loss. Public utility commissions responded by implementing the first temporary FACs, which they discontinued shortly after the war. When World War II also created global fossil-fuel supply challenges, commissions reinstituted temporary FACs—which were likewise curtailed once peacetime resumed.

The oil shocks of the 1970s again sparked utility demands for insulation from global supply disruptions, and this time both state legislators and public utility commissions responded. Though the gasoline lines of the 1970s soon disappeared, in most states the statutes and commission decisions that established FACs have never been meaningfully revisited.

Today, these policies are the norm across the country. In most states, the process through which costs are approved for recovery through FACs is opaque to customers and their advocates, since investor-owned utilities are allowed to treat their fuel-supply agreements as trade secrets. This means that despite being saddled with 100 percent of the costs, ratepayers cannot generally evaluate whether the fuel-supply agreement terms are reasonable.

It is reasonable to wonder why legislators and public utility commissions have left these policies in place for so long. FACs are typically justified based on the idea that utilities cannot control the cost of fuel. However, this assertion was never entirely true, and it is even less true today. For example, utilities make decisions about how much natural gas capacity to build, and they negotiate the fuel-supply contracts that determine the prices they pay for natural gas. In addition, due to technological

---

<sup>5</sup> We refer to all such regulatory bodies as “public utility commissions.” In many states the body has a similar name (e.g., the Nevada Public Utilities Commission), but this is not always the case (e.g., the Maryland Public Service Commission, the Kansas Corporation Commission, the Washington Utilities and Transportation Commission).

advances, utilities can now displace fuel-based generation with a range of cost-competitive alternatives that use little to no fuel (e.g., solar, wind, batteries, energy efficiency). Yet, because FACs insulate utilities from the financial consequences of relying on fuel, the companies have little incentive to change.

## **The Problem: Moral Hazard and Inefficient Investment Decisions**

FACs create a problem that economists call “moral hazard.” Moral hazard exists when one party does not suffer the consequences of making bad decisions, so they may take bigger risks as a result. The moral hazard problem crops up in many spheres, including insurance, investing—and utility regulation.<sup>6</sup>

In the regulatory sphere, 100 percent fuel-cost pass-through policies provide a particularly stark example of moral hazard. When a FAC is in place, the utility decides how much fuel to buy and at what price—but it is the utility’s customers who pay the cost if the utility spends more money than necessary. In other words, the utility (and its shareholders) are held harmless from the consequences of poor fuel-management decisions.

The moral hazard problem has existed since the first FACs were implemented; however, in recent decades, the real-world consequences of this have grown more acute. This is due to two types of recent trends. First, a series of developments have magnified the risks of relying heavily on fuels. Second, the costs of fuel-free alternatives have decreased.

“The moral hazard problem has existed since the first FACs were implemented; however, in recent decades the real-world consequences of this have grown more acute.”

### ***Trends that Have Magnified the Risks of Relying Heavily on Fuels***

The first category is developments that have increased the risks associated with relying on fuels. These include the following:

**Greater utility dependence on natural gas.** Over the last two decades, utilities have been building gas-fired power plants at a rapid pace. Because of this construction spree, the share of electricity generated from gas has risen dramatically (Figure 3), and electric utilities have grown from being small, niche buyers of natural gas to being the gas industry’s biggest buyers (Figure 4). This has created a situation in which customers are much more exposed to the effects of gas-price volatility than they used to be. Natural gas prices are by their nature volatile, and now a much higher share of electricity generation depends on gas purchases.<sup>7</sup> In addition, the electric sector’s demand tends to rise and fall in a pattern driven by seasonal

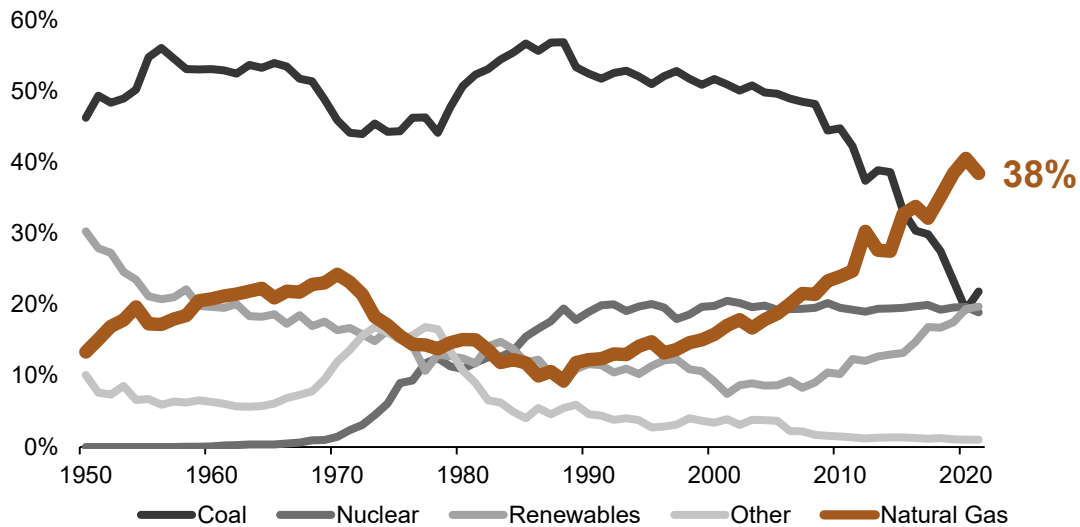
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<sup>6</sup> The classic insurance example is that an insured party may take more risks than they would otherwise, since the insurer will pay for any loss that may occur. An example from the world of investing is that a money manager may take excessive risks with other people’s wealth.

<sup>7</sup> Jamison Cocklin, U.S. Natural Gas Price Volatility at All-Time High in 2022, Natural Gas Intelligence, August 16, 2022, <https://www.naturalgasintel.com/u-s-natural-gas-price-volatility-at-all-time-high-in-2022>

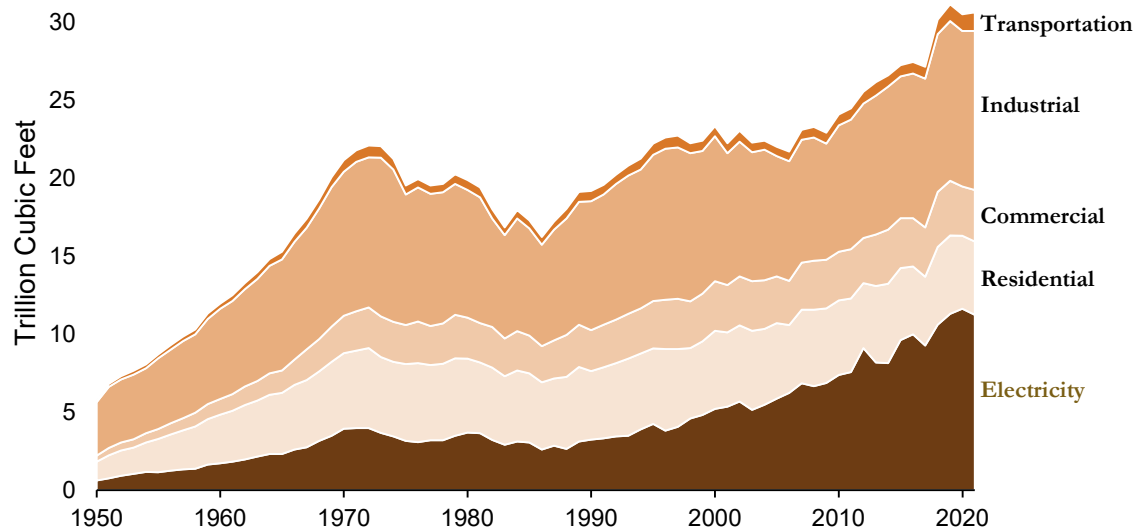
changes and regional weather events—which can cause supply constraints. For example, if a major heat wave hits the eastern United States, the electric utilities in all impacted states will consume more natural gas than usual to meet the increased need for air conditioning, resulting in rapid price increases as regional gas inventories are depleted.

**Figure 3. US Electricity Generation by Resource**



Between 1950 and 2022, the share of electricity generated from natural gas roughly tripled, from 13 percent to 38 percent.<sup>8</sup>

**Figure 4. US Natural Gas Consumption by Sector**



In recent years, the electric power sector has become the largest customer of the natural gas industry.<sup>9</sup>

<sup>8</sup> Data from EIA, February 2023 Monthly Energy Review, Table 7.2a, <https://www.eia.gov/totalenergy/data/monthly>

<sup>9</sup> Data from EIA, February 2023 Monthly Energy Review, Table 4.3, <https://www.eia.gov/totalenergy/data/monthly>

**More severe weather.** Another recent trend is that weather is becoming more severe due to climate change. The growing intensity of both summer heat waves and winter cold snaps increases the odds of large fuel-price spikes as gas demand outstrips available supply. For example, in 2021, Winter Storm Uri led to a steep drop in natural gas production, leading to supply constraints and record-setting prices.<sup>10</sup> Forest fires, hurricanes, and even seasonal weather events can also trigger fuel-supply disruptions that translate into price volatility.

**Increasing exposure to geopolitical risks.** Globalization has made the international economy increasingly interconnected. With heightened natural gas prices in Asia and Europe, US producers ship a sizable share of domestically produced gas abroad as liquified natural gas (LNG)—and the United States recently became the world’s largest LNG exporter.<sup>11</sup> This heavy involvement in international trade makes the US natural gas sector vulnerable to conflict-induced supply disruptions, which can translate into increased fuel-price volatility. For example, when Russia invaded Ukraine in February of 2022, the combination of sanctions against Russian gas and increased exports to Europe caused global prices for natural gas to soar.<sup>12</sup>

### ***Trends that Have Made Fuel-Free Alternatives More Attractive***

In addition to the trends magnifying the risks of relying heavily on fuels for electricity generation, a series of developments have made fuel-free alternatives more reliable and cost-effective. These include the following:

**Cheaper fuel-free alternatives.** Through the end of the twentieth century, most commercially viable generation technologies (e.g., coal, natural gas, nuclear) required fuel. Today, fuel-free energy resources like energy efficiency, solar, and wind are often the lowest-cost sources of power,<sup>13</sup> while new technologies like advanced metering infrastructure (AMI) and distributed energy resource management systems (DERMS) can enable storage, energy efficiency, and demand response to be deployed in ways that allow a much higher share of demand to be met by these resources.<sup>14</sup> Utilities today can choose to reduce fuel dependence in ways that were not possible even a few years ago.

**Supportive federal policies.** The Inflation Reduction Act (IRA), passed in 2022, featured a range of provisions that increased the economic attractiveness of fuel-free alternatives. These include the extension of the production tax credit (PTC) and investment tax credit (ITC) that are available to renewable and storage facilities, changes that better position

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<sup>10</sup> American Public Power Association, Winter Storm Uri, Extreme Winter Events, And Natural Gas Reforms, Issue Brief, January 2022, <https://www.publicpower.org/system/files/documents/January%202022%20-%20Winter%20Storm%20Uri.pdf>

<sup>11</sup> EIA, The United States became the world’s largest LNG exporter in the first half of 2022, July 25, 2022,

<sup>12</sup> IEA, Russia's War on Ukraine: Analysing the impacts of Russia's invasion of Ukraine on global energy markets and international energy security, <https://www.iea.org/topics/russias-war-on-ukraine>

<sup>13</sup> Zachary Shahan, Wind & Solar Are Cheaper Than Everything, Lazard Reports, CleanTechnica, November 15, 2020, <https://cleantechnica.com/2020/11/15/wind-solar-are-cheaper-than-everything-lazard-reports>

<sup>14</sup> Lauren Schwisberg, The Business Case for New Gas Is Shrinking, RMI, December 8, 2022, <https://rmi.org/business-case-for-new-gas-is-shrinking>

regulated utilities to take advantage of these tax credits, and access to low-cost debt to help retire existing fossil-fired power plants.<sup>15</sup>

### ***The Consequences of Moral Hazard Have Grown More Acute***

Taken together, these recent trends have fundamentally changed the US energy landscape. The risks of overreliance on fuel-based generation have increased while fuel-free alternatives have become more reliable and cost effective. In the present world, it literally pays to reduce utilities' reliance on fuel, but it is the customer not the utility that benefits from those cost reductions.

While a utility doesn't profit from using more fuel, it doesn't profit from decreasing fuel usage either. It's also important to realize that managing fuel costs carefully isn't free. It takes managerial effort and investment in expertise, and utility managers are incentivized to focus on other areas of operations and investment. Because of this, utilities are not taking full advantage of current opportunities to reduce fuel costs. Fortunately, a practical solution to this moral hazard problem is available. We turn to this next.

### **A Promising Solution: Fuel-Cost Sharing**

FACs are the norm today, but this can be changed. These outdated policies are ripe for revision by legislators and public utility commissioners who care about making utility services more affordable, protecting customers from unnecessary risks, and/or reducing carbon emissions. The moral hazard created by 100 percent pass-through policies undermines all of these goals. Updating these policies can yield multiple benefits by motivating the party that is best positioned to reduce fuel costs to use its information, abilities, and skills to do so.

Since FACs have only been the norm for a few decades, it may seem like the best solution would be to eliminate them altogether. However, such a marked departure from current practice could pose significant risks. Today's utilities would be more sensitive to unexpected fuel-cost fluctuations than their early 20<sup>th</sup>-century counterparts, since current business models have developed based on the expectation that utilities will be sheltered from this source of volatility.<sup>16</sup> For this reason, suddenly moving from a 100 percent passthrough to a zero-percent pass-through policy could undermine a utility's financial stability, driving up its cost of capital and eventually necessitating rate hikes.<sup>17</sup>

Fortunately, states do not need to shift 100 percent of the fuel-cost risk back onto the utility. The goal of reforming the FAC is simply to motivate the utility to keep its fuel costs in check—and this can be done while limiting the total risk the utility is exposed to.

This reform can be accomplished by updating the FAC to only pass through part of the fuel costs to customers. This does not mean that customers wouldn't pay anything for the rest—just that they

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<sup>15</sup> Jessie Ciulla, Gennelle Wilson, and Rachel Gold, What Utility Regulators Needs to Know about the Inflation Reduction Act: How to Ensure the Biggest Boon to the Energy System in US History Supports Affordable, Reliable Electric Service, RMI, 2022, <https://rmi.org/insight/what-utility-regulators-need-know-about-ira>

<sup>16</sup> The relevant features of current utility business models include but are not limited to their capital structure, organizational structure, and risk profile.

<sup>17</sup> A utility's cost of capital is the minimum amount the utility would need to pay debt and equity investors to secure the funds it needs to run its business. This is sometimes referred to the utility's "true" cost of capital to distinguish it from the estimated cost of capital regulators use when setting rates, which is generally higher than the true cost of capital.

would reimburse the utility for the rest of the fuel in the same way they pay for most utility expenditures. In other words, these costs would be recovered in rates that are set in advance and not trueed up afterwards to match actual expenditures. This reform is called “fuel-cost sharing,” though in reality what it does is share the risk that fuel costs will deviate from expectations between the utility and its customers.

Fuel-cost sharing can be implemented in different ways—and we discuss key design options later. However, at this point it would be helpful to understand the basic mechanics of the form that has been most often adopted by states thus far.

This form of fuel-cost sharing requires only a modest departure from the way most FACs are implemented today. Under the typical 100 percent pass-through policy, a forecast of fuel costs is first built into base rates and the FAC then truees up the forecast once the actual expenditure has been made. The FAC does this by charging or crediting customers for the difference between the forecasted and actual fuel costs via a rider; this usually appears as a separate line item on customer bills. The only change to this status-quo policy that is made to implement the reform is to true up less than 100 percent of this difference.

For example, a fuel-cost sharing policy of this type could true up just 90 percent of the gap between the forecasted and actual fuel costs. This would mean that if fuel costs are less than forecast the utility will get to keep 10 percent of the underspend, and if fuel costs exceed the forecast it will bear 10 percent of the excess amount. In other words, the utility will now have a financial incentive to seek ways to reduce fuel costs—and customers will receive 90 percent of any savings.

While this is the variant of fuel-cost sharing that has been most widely adopted to date by the states addressing the FAC, it is not necessarily the optimal one. One of its biggest drawbacks is that if the utility is able to inflate the fuel-cost forecast that is built into base rates, it will be able to retain a share of that inflated amount (e.g., 10 percent in our example). In other words, anchoring the fuel-cost sharing mechanism to a forecast can invite the utility to game the forecast.

Fortunately, there are ways to avoid this problem, and there are also alternative structures that can allow regulators to tailor their fuel-cost sharing policy to local circumstances. We will discuss some of these policy design options later.

## **Avenues for Reform**

It is one thing to identify a needed reform—and a different thing entirely to make it happen. The most fruitful strategy will vary by state, and it may also vary by utility.

To identify appropriate reforms, it is important to first understand how fuel costs are currently regulated. The biggest question is whether 100 percent of fuel costs are passed through to customers or if there is some form of fuel-cost sharing already in place. Keep in mind that 100 percent fuel-pass-through mechanisms are sometimes called different names, even though we refer to them all as FACs here.

The next step is to determine which decision makers have the ability to reform the existing policy. Public utility commissions are responsible for overseeing regulated utilities and setting the prices

they can charge, so achieving FAC reform will likely require engaging with the commission. However, some state legislatures have passed laws that mandate 100 percent pass-through policies, so, in these states, reform will require revising these statutes. In addition, interested legislatures can motivate reform at the commission by encouraging or requiring it to revisit these policies.

### ***How to Engage a Public Utility Commission on Fuel Adjustment Clause Reform***

To engage a public utility commission on the topic of FAC reform, advocates first need to identify the best formal venue.

Commissions make decisions through individual proceedings (aka “dockets”) that focus on particular regulatory issues. Each proceeding is assigned a specific identifying number (often called a “docket number”), and the documents associated with the proceeding can generally be obtained through a commission’s online docket search.<sup>18</sup> Participating in a proceeding typically requires applying for intervenor status, but sometimes the commission will issue a notice inviting comments from the general public.<sup>19</sup> The types of proceedings that may be good venues for FAC reform include the following:

**Dedicated FAC dockets.** Commissions typically periodically review and approve fuel costs for recovery in specific FAC-related dockets, so engaging in these proceedings can be one way to push for changes. However, in some states, these proceedings offer little opportunity to scrutinize utility requests for fuel-cost recovery—for example, where stakeholders lack access to key data, face rapid turn-around times for comment submission, are constrained by a narrow definition of the issues in scope for the proceeding, or face other barriers that prevent them from advocating effectively for reform. In these cases, pushing for changes to the way the commission conducts these dockets may be a prerequisite to reforming a FAC through them.

**Rate cases.** General rate cases may also provide a venue for stakeholders to raise concerns about fuel-cost treatment and offer solutions. The basic function of rate cases is to set the utility’s base rates going forward, and to do this the commission examines a wide array of different topics that pertain to utility expenditures. Rate cases are typically conducted over a longer time frame than dedicated FAC dockets and in a way that invites more input from stakeholders.

“It is one thing to identify a needed reform—and a different thing entirely to make it happen. The most fruitful strategy will vary by state, and it may also vary by utility.”

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<sup>18</sup> The structure of online docket searches varies greatly—some are relatively intuitive while others can be very difficult to navigate. If you have trouble with the docket search (or more general questions about what to look for), commission staff are often willing assist if asked.

<sup>19</sup> To become an intervenor, a party must typically submit a request to the commission that justifies why they should be granted intervenor status. Generally, this means showing that they have a compelling interest in the outcome and that they will make some kind of unique/valuable contribution because they represent a particular group/perspective. The commission will then either grant or deny them intervenor status.

**Performance-based regulation proceedings.** Proceedings that focus on investigating or implementing performance-based regulation (PBR) are another potential venue for FAC reform. The purpose of fuel-cost sharing is to better align the utility's incentives with the interests of customers and society, which is precisely the definition of PBR. In other words, fuel-cost sharing can be considered a PBR mechanism, and it is therefore appropriate to discuss in PBR proceedings.

**Special dockets.** Commission rules vary on the authorized scope and process for dockets on special topics. However, in nearly every state, a commission could open a special docket to review current fuel-cost recovery policies, consider the implications of updating these policies, and solicit public input. In some cases, a legislative hearing can spur a commission to open a special docket, and in other cases customers or other stakeholders can petition it to do so.

Public utility commissions vary greatly across states. Some may quickly recognize the problems created by 100 percent pass-through policies and act decisively to change them. In many cases, this type of response is driven by a particularly proactive commission member, so it is worthwhile for advocates to consider which commissioners may be inclined to act as champions for reform. Other commissions may not be receptive to the idea of addressing FAC reform without outside pressure.

### ***How to Enlist Other Actors to Encourage a Commission to Act***

Where a public utility commission is not inclined to take up the issue of FAC reform or is prohibited from doing so, advocates should consider enlisting the help of other parties. These include the following:

**State Legislators.** Though setting utility rates is the commission's responsibility, state legislators may be able to direct or encourage the commission to take action. For example, lawmakers could hold a hearing on the FAC, introduce legislation directing the commission to align its mission and operations with state policy goals, distribute sign-on letters for colleagues to join them in encouraging commission attention to fuel-cost pass-through policies, or hold stakeholder meetings on the topic.

**Governors.** Governors may also be able to encourage FAC updates. For example, a governor may be able to issue an executive order requiring the commission to consider or recommend reforms that align its activities with affordability or climate goals, or one that provides guidance about key design criteria (e.g., what constitutes "the public interest" for the purpose of regulatory decision-making). Also, in many states the governor is responsible for appointing commission members. In these cases, the governor could prioritize FAC reform as a significant consumer protection agenda item when appointing (or reappointing) individuals to serve on the commission.

**Attorneys general.** In some states, the attorney general can petition the public utility commission to open a proceeding to consider a particular issue—which could include FAC reform. Also, in most states, an attorney general can initiate a review of confidential information in fuel-supply agreements to determine whether alleged trade secret information

meets the legal standard for being withheld from public view. Such a review could examine key contract terms, such as guaranteed delivery volumes regardless of need, as well as cost or price escalators that are above consumer price index averages. Some attorneys general also serve as the consumer advocate, which may give them the power to request commission dockets and take other actions to support FAC reform.

“Exactly which steps will be needed might not be clear at the outset, and advocates should be prepared to adapt their strategy if they encounter twists and turns on what they had imagined would be a straight path. However, to be successful the most important thing is to get started.”

**Utilities.** Since the idea of FAC reform is to expose utilities to a share of the fuel-cost risk, they may not be in favor of updating the policy. However, in some cases a utility may be receptive to the idea if it expects to be able to profit by reducing fuel costs. Utility proposals often carry substantial weight with both public utility commissions and legislators, so utility support of reform can help move the process forward.

Though the recommendations discussed are broadly applicable, every public utility commission is unique. FAC reform advocates can tailor their approach to their particular commission by researching its processes, mission, and relevant recent decisions, as well as the attitudes and policy positions its members demonstrate through their statements and actions.

### ***How to Achieve Reform Through Legislative Action***

In all states, a public utility commission can only operate within the constraints of state statutes, which are established by state legislatures.

In some states, the legislature has enshrined the FAC into statute. In these states, the public utility commission alone will not be able to update the policy since the legislature must first amend the statute. Where this is the case, would-be changemakers should develop a legislative strategy prior to—or at least in parallel with—their efforts to engage the commission.

In other states, the legislature has provided the public utility commission with the statutory authority necessary to revise the fuel-cost pass-through policy. In these states, advocates may wish to focus their efforts solely on the commission. However, even in these states, a legislative route to change is possible. For example, state lawmakers could introduce legislation to reform the FAC, even if the existing policy was implemented by the commission.

When drafting a bill, state legislators often meet with other lawmakers and affected parties to inform policy design and secure buy-in. Advocates should be aware that this may occur, and they may even wish to encourage their legislative champions to meet with utility representatives, consumer

advocates, and other stakeholders. These parties may be more open to policy reforms when consulted early and away from the media attention that can occur once a bill is introduced or a hearing is in progress, and meeting with them may also result in better policies. However, utilities or other stakeholders may also use this opportunity to urge lawmakers to weaken or abandon the proposed reforms. To guard against this possibility, advocates can educate their legislative champions ahead of time about the arguments against reform that they are likely to hear and whether those arguments are reasonable.

Depending on the state's policies governing communication between lawmakers and commissioners, legislators may also wish to engage commissioners directly in crafting statutory reforms to fuel-cost pass-through policies. Some commissioners may choose to be deeply involved in such discussions, and they may even be willing to endorse specific legislative changes or testify at public hearings. Other commissioners may be reluctant to step outside of their quasi-judicial role in this way, even if they agree that a legislative update would be beneficial.

Advocates interested in legislative reform can increase the chances for success by providing their legislative champions with specific policy recommendations and examples to follow. In particular, advocates would be wise to point to precedents for FAC reform from other states, as lawmakers may be reluctant to act if they believe they will be the first state to implement such a change.<sup>20</sup>

### ***How to Get Started on Reforms in Your State***

Achieving fuel-cost pass-through reform in a state may be a complex process, as advocates may need to intervene in arcane regulatory proceedings, navigate legislative policymaking, and/or enlist the support of other parties. The process may be relatively quick, but it could also take years to update a FAC policy.

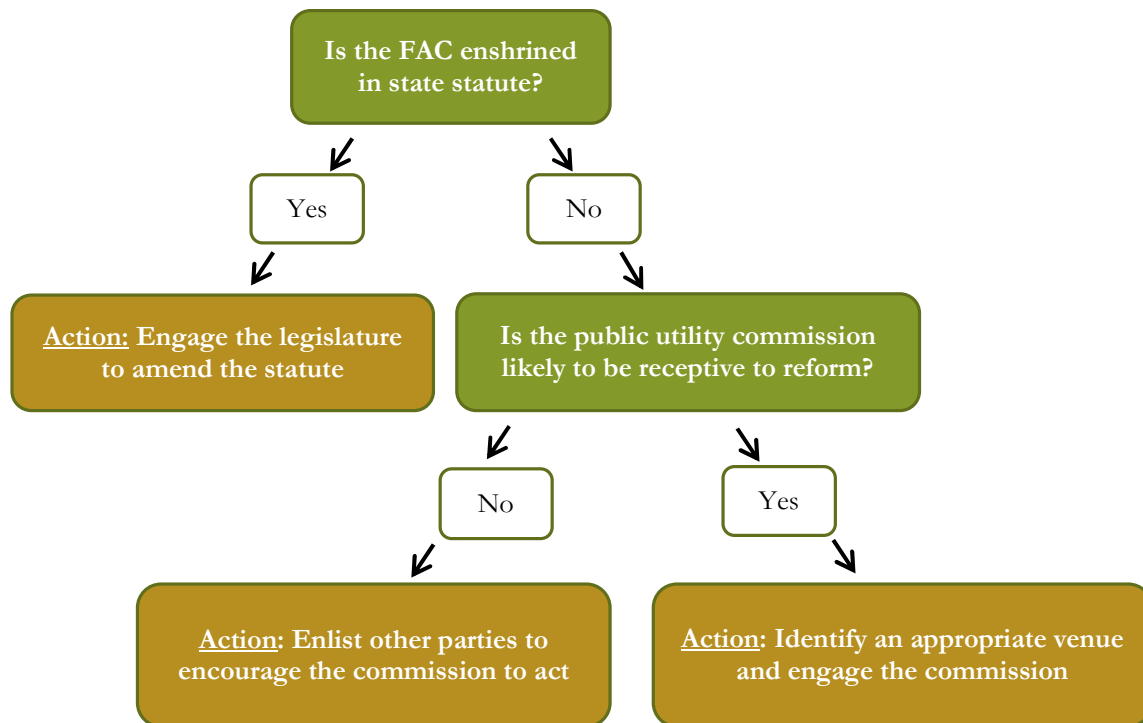
Exactly which steps will be needed might not be clear at the outset, and advocates should be prepared to adapt their strategy if they encounter twists and turns on what they had imagined would be a straight path. However, to be successful, the most important thing is to get started.

Once advocates have decided they want to reform the policy in their state, they are ready to start crafting a strategy. Figure 5 illustrates the key questions that advocates embarking on this process will face.

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<sup>20</sup> We provide some examples of states that have implemented FAC reforms later in this primer, and national nonpartisan organizations like the National Conference of State Legislators may be able to provide additional information.

**Figure 5. Key Steps for Achieving Fuel Adjustment Clause Reform**



## Key Policy Considerations

Though the concept of fuel-cost sharing is simple, this reform can be implemented in a variety of ways. In addition, there are other reforms that could also help address related problems. When considering ways to reform an existing FAC, the following topics are worthy of consideration.

### *Amount of Fuel-Cost Sharing*

When designing a fuel-cost sharing policy, advocates should consider the degree of sharing between the utility and its customers. For example, a utility could be responsible for just 5 percent of fuel costs (i.e., passing through 95 percent to customers) or for 20 percent (i.e., passing through 80 percent to customers). The ideal sharing percentage is a level that is high enough to motivate the utility to keep its fuel costs in check, but low enough that the utility is not exposed to unreasonable levels of risk.<sup>21</sup>

There is not one “best” sharing amount that should be applied to all utilities because utilities vary in multiple ways. For example, utilities rely on different mixes of fuel- and non-fuel generation sources, and they face different risk profiles in their jurisdictions.

<sup>21</sup> If the utility is exposed to a level of risk that is excessive, it could make it harder for the company to access low-cost capital. This could drive up its cost of capital (and by extension, the rates it must charge customers to remain financially whole), and at the extreme it could even create cash-flow problems severe enough to prevent it from serving its customers. While moderate sharing percentage would be unlikely to cause such problems, there may be an upper limit to how much sharing is in customers’ best interest.

## Symmetry

Another design question is whether a fuel-cost sharing mechanism should be symmetrical or asymmetrical. A symmetrical mechanism shares the same percentage regardless of whether the actual fuel costs are higher or lower than expected. An asymmetrical mechanism shares a different amount in each case. Both symmetrical and asymmetrical sharing can be structured to provide both rewards and penalties.

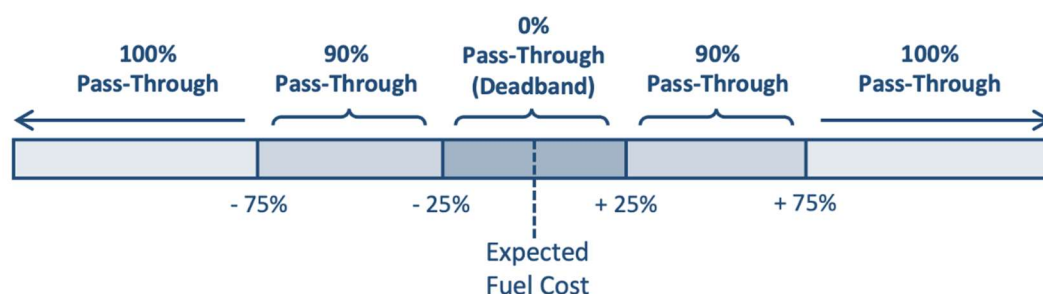
For example, a commission may design a mechanism with a higher pass-through percentage when fuel costs are lower than expected (thus passing more of the savings on to customers) than when fuel costs are higher than expected. Such a mechanism can direct more of the benefits of fuel-cost savings to customers—but it also weakens the utility’s incentive to pursue opportunities to reduce fuel costs below a certain level. Symmetrical mechanisms also tend to be easier for customers to understand than asymmetrical mechanisms. These tradeoffs should be carefully considered when deciding between symmetrical and asymmetrical designs.

## Straight Sharing Versus Sharing Bands

The simplest structure for a fuel-cost sharing mechanism is to always require the same level of utility fuel cost responsibility (e.g., 10 percent) regardless of how much the utility’s actual costs deviate from expectations. This approach, which is sometimes call “straight sharing,” is the most common among existing fuel-cost sharing policies.

Another option is to use bands (also sometimes called thresholds). For example, a regulator could adopt a mechanism that performs no true-up if actual fuel costs fall within 25 percent of the expected value (this is called a “deadband”), a 90 percent true-up if actual costs are 25-75 percent greater than or less than that value, and a 100 percent true-up if they deviate by more than 75 percent. Figure 6 illustrates this hypothetical banded design.

**Figure 6. Example of a Policy Design with Sharing Bands**



In this example, the pass-through amount increases as the size of the deviation from the expected fuel cost becomes larger. Such a design can reduce the risk to the utility posed by large fuel-cost spikes, as well as the risk to customers of paying for large windfall profits if fuel costs dip very low. Alternatively, sharing bands could be used to increase (rather than decrease) the utility’s risk exposure as fuel costs deviate more from the expected level; this could greatly increase the utility’s incentive to reduce its reliance on fuel. Sharing bands could also be deployed in an asymmetrical fashion.

While banded designs can reduce the risk of extreme outcomes to the utility or its customers, they can also create uneven incentives. For example, a banded design that passes through 100 percent of fuel costs beyond a certain threshold dissolves the utility's financial incentive to reduce costs beyond that threshold. In addition, banded designs can be harder for customers to understand and more complex to administer than straight sharing.

### ***Forecast Versus Historical Prices***

Fuel-cost sharing mechanisms in place today share the difference between the actual fuel costs a utility incurs and the costs it was expected to incur. These “expected” costs can be based on either a forecast (i.e., a forward-looking estimate) or historical values. Forecasts are the most common approach used today, but that does not necessarily mean they are the best choice.

Traditional 100 percent pass-through policies typically utilize forecasts to set the base rates that the FAC then trues up, and most states that have adopted fuel-cost sharing have continued to rely on them. Forecasts may also be preferred because they can be tailored to reflect changing conditions—but, in reality, the accuracy of fuel-cost forecasts may be low. This is particularly true for forecasted natural gas costs, as this fuel is subject to substantial price volatility that is hard to predict.<sup>22, 23</sup>

However, forecasts have another drawback in the context of fuel-cost sharing: they open the door to possible gaming. Specifically, if the utility is able to inflate the forecast, it will be rewarded with a greater amount of “savings” relative to it (and also be less likely to have to bear a share of any “overspends”). It is important to note that any such gaming will not reduce the utility's financial incentive to seek savings once the forecast is adopted—so the fuel-cost sharing mechanism will still encourage the utility to reduce fuel costs. However, if the utility manages to game the forecast this will increase the costs of the policy to customers.<sup>24</sup>

The alternative is to use historical spending to set the expected fuel-cost baseline. Relying on historical actuals rather than forecasts avoids the gaming problem just described, and it is also more straightforward to calculate.

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<sup>22</sup> The price volatility of natural gas is driven by multiple factors. These include domestic transportation and storage constraints, shifting levels of international demand, and global supply-chain disruptions (e.g., due to extreme weather events and geopolitical events).

<sup>23</sup> For example, the price forecasts shown on pg. 11 of the following report are typical: Deloitte, Energy, oil, and gas price forecast: Energy costs are stretching price elasticity and energy affordability, December 31, 2022. <https://www2.deloitte.com/ca/en/pages/resource-evaluation-and-advisory/topics/deloitte-canadian-price-forecast.html>

<sup>24</sup> The company will have the same financial incentive to reduce fuel costs because the utility's marginal incentive (i.e., the reward it can earn for reducing fuel costs by the next increment) is not changed by the level of the forecast. For example, imagine a utility that is subject to a 90 percent pass-through policy and that is expected to use 100 units of fuel at \$5/unit. If this utility can find a way to spend \$4/unit on fuel instead of \$5/unit, it will earn a \$10 reward for doing so (i.e., 100 units x \$1/unit \* 10 percent). If these are real savings that would not have occurred without the utility's effort, everyone wins: the utility gets its \$10 reward and customers receive \$90 of savings. However, if the utility can convince its regulator that the price of fuel is likely to be \$6/unit instead of \$5/unit, it will earn a \$10 reward for doing nothing (i.e., for spending \$5/unit) and then another \$10 for reducing its spending to \$4/unit. Either way, the utility earns the same incentive (\$10) for reducing its fuel costs from \$5/unit to \$4/unit, so its marginal incentive to pursue this savings opportunity is the same. However, if the utility is able to inflate its forecast to \$6/unit, its customers will pay an extra \$10 incentive and receive nothing in return.

However, relying on historical spending could itself create an incentive problem under certain policy designs. When the utility's historical spending is used to set the baseline, reducing fuel costs in one year will reduce the expected-cost baseline in future years. This means that if the utility's reward for reducing fuel costs now is not large enough to offset the burden of operating under a lower baseline in the future, the utility will not be motivated to reduce its fuel costs. This situation is most likely to occur where an asymmetrical design is used that requires a utility to bear most of the cost when actual fuel prices are higher than expected, but which passes on most of the savings to customers when they are lower than expected.

### ***Transparency***

In many states today, the moral hazard problem created by FACs is compounded by a lack of visibility into fuel-supply contracts. While commission staff often have access to otherwise undisclosed contracts and key terms, they may not have the time or expertise to complete a thorough review on their own. When advocates and other stakeholders are barred from accessing key documents, they cannot identify potential prudence issues and flag them for the commission and its staff to consider. The end result is less regulatory scrutiny of utility fuel expenditures.

Though fuel-cost sharing addresses the moral hazard problem created by traditional 100 percent pass-through policies, transparency is still important. State lawmakers and utility regulatory commissions can take steps to ensure that the key terms of utility fuel-supply contracts are transparent to customers and other stakeholders, while protecting necessary trade secrets as appropriate. Such terms include (but are not limited to) pricing, annual escalators or other pre-determined price increases, minimum delivery amounts, and contract length.

### ***Disallowance on Prudence Grounds***

The purpose of fuel-cost sharing is to motivate the utility to seek ways to reduce its fuel costs. However, it is not the only policy tool available to accomplish this objective. Another option is to identify fuel-cost savings opportunities that are available to the utility and to disallow cost recovery if the utility fails to take advantage of these opportunities.

For example, a regulator might determine that a certain utility could reduce its reliance on natural gas for power generation by 5 percent a year if it aggressively pursues a demand-side portfolio of energy efficiency, demand response, and load-shifting measures. The regulator could then allow the utility to pass through all natural gas costs up to this level via the existing FAC, while disallowing any recovery of costs beyond this level on the grounds that they were imprudently incurred.<sup>25</sup>

As another example, a regulator could demonstrate a willingness to scrutinize all fuel costs presented for recovery and disallow any for which the utility cannot convincingly demonstrate prudence. This more rigorous prudence review could encourage the utility to pursue opportunities to reduce fuel costs, to be more transparent as a strategy to show the regulator that it has been making an effort, and to reduce its reliance on fuel-fired generation over time. For this strategy to be effective, however, it must be clear to the utility that disallowance is a real and substantive risk—simply

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<sup>25</sup> The allowed level of natural gas usage could also be adjusted to reflect actual weather conditions. Such a normalization could reduce the risk of windfall losses or gains due to usage fluctuations driven by weather events, which are not under the control of the utility.

applying a slightly higher level of review to an existing FAC docket that currently functions as a rubber stamp is unlikely to be effective.

### ***Hedging***

Fuel-cost sharing can reduce the risk posed by fuel-price spikes by encouraging the utility to secure more favorable fuel-supply contracts and reduce its reliance on fuel-based generation sources. However, another way to reduce the risk of price volatility is hedging. Hedging refers to the use of financial instruments to mitigate the risk of unexpected negative investment outcomes. Requiring that utilities hedge can reduce the risk of fuel-price spikes to customers, but hedging also means incurring an additional cost that is then passed on to customers. Whether to encourage or require hedging (or particular kinds of hedging) is a question that should be considered whether or not fuel-cost sharing is in place.

### ***Purchased Power***

Fuel-cost sharing is only relevant for vertically integrated utilities that purchase fuel to generate power and then sell that power to customers. However, some regulated utilities do not own generation (these “wires only” utilities are the norm in restructured states), and even vertically integrated utilities may buy substantial amounts of power from other parties to serve their customers. These parties may include independent power producers, other regulated utilities, and unregulated affiliate companies of the purchasing utility.

Typically, the cost of purchased power is recouped in the same fashion that fuel costs are: as a 100 percent pass-through to customers. A sharing mechanism can be implemented for purchased power in the same way as for fuel costs, but whether this makes sense will depend on local circumstances.

In cases where a regulator is implementing fuel-cost sharing for a vertically integrated utility, applying an equivalent sharing policy to purchased power should be seriously considered—because without this, gaming may occur. For example, during a natural-gas price spike a utility that is subject to fuel-cost sharing but not purchased-power cost sharing could substitute spot-market purchases for its own generation. Such a move would likely raise rather than lower costs to customers, contrary to the goal of the fuel-cost sharing policy. Applying sharing to both fuel and purchased power could avoid this type of behavior.<sup>26</sup>

However, in cases where the utility does not own generation, the case for applying a sharing policy to purchased power is less clear. For a utility that has substantive opportunities to lower these costs through its own actions, a purchased-power sharing policy could make sense. For instance, a wires-only utility may be able to lower the cost of the power it purchases by aggressively promoting energy efficiency programs to its customers. It could also lower costs by negotiating better contracts, switching to different suppliers, or helping customers shift demand to lower-cost hours (e.g., via demand-response programs, managed EV charging, and time-varying rates). However, if a wires-only utility has limited control over purchased-power prices (e.g., because it purchases most of its power through wholesale markets where it acts as a price-taker rather than as a price-setter) and

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<sup>26</sup> If a purchased-power sharing policy is adopted alongside a fuel-cost sharing policy, they should be equivalent—but this does not mean identical. Since fuel costs only make up a portion of purchased-power costs, the sharing factor for purchased power could be lower than the one applied to the utility’s own fuel costs.

limited ability to influence customer behavior (e.g., because a separate state entity is responsible for administering demand-side management programs), it may make little sense to apply a sharing mechanism to its purchased power costs.

Stakeholders should also note that purchased power includes electricity generated from both fuel- and non-fuel resources. This means that purchased-power cost sharing will not necessarily drive decarbonization in the same way as fuel-cost sharing would be expected to. Where reducing carbon emissions is an important policy goal, additional strategies to accomplish this aim could be considered. For example, the sharing mechanism could be designed in a way that distinguishes between different types of generation resources (e.g., it could apply a higher pass-through percentage to renewables than to fossil fuel-fired generation).

## **Examples of State Fuel-Cost Sharing Policies**

A few states have adopted fuel-cost sharing mechanisms to varying degrees, and interest in this neglected aspect of utility regulation has been growing in recent years. However, advocates should keep in mind that just because a particular design feature is common does not necessarily mean it is a good idea. Being familiar with existing forms of fuel-cost sharing policies but also willing to advocate for improvements to them is likely to result in the best outcome. States that have implemented fuel-cost sharing include Hawaii, Idaho, Oregon, Wyoming, Montana, Washington, Wisconsin, Vermont, and others. Below we discuss how a few of those states have adopted such policies.

### ***Hawaii***

The Hawaii Public Utilities Commission adopted fuel-cost sharing for the Hawaiian Electric Companies (HECO) in 2018.<sup>27</sup> The Energy Cost Recovery Clause (ECRC) utilizes a straight-sharing approach anchored to a forecast of fuel costs, in which the utility passes through 98 percent of fuel costs to customers regardless of whether its actual costs are above or below the forecast. HECO's annual financial exposure under the policy is capped at \$2.5 million. In 2022, the Commission invited intervenors to consider proposals to modify the risk sharing component of the ECRC, signaling an openness to increase the sharing factor—though no decision to adjust it has yet been made.<sup>28</sup>

### ***Idaho***

The Idaho Public Utilities Commission adopted the Power Cost Adjustment (PCA) mechanism for Idaho Power in 1992 to share power supply costs between the utility and its customers. The mechanism features a straight sharing design, relies on forecasts, is symmetrical, and includes purchased power. The PCA initially passed through 90 percent of power supply costs, but in 2009 the commission increased this to 95 percent. In approving this change, it explained that “power supply cost volatility has increased significantly since the PCA was implemented, and that with increased volatility, a sharing percentage of 5% still provides strong incentive for the Company to

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<sup>27</sup> Hawaii Public Utilities Commission, Final Decision and Order No. 35545, Docket No. 2016-0328, June 22, 2018, <https://puc.hawaii.gov/wp-content/uploads/2018/06/DO-No.-35545.pdf>

<sup>28</sup> Hawaii Public Utilities Commission, Decision and Order No. 38429, Docket No. 2018-0088, June 17, 2022, pg. 56.

make prudent power purchases.”<sup>29</sup> In 2009, the commission also adopted a mechanism called the Energy Cost Adjustment Mechanism (ECAM) for Rocky Mountain Power. The ECAM features straight sharing with a 95 percent pass-through, has a symmetrical design, employs forecasts, and includes purchased power.<sup>30</sup>

## ***Wyoming***

In 2011, the Wyoming Public Service Commission adopted the Energy Cost Adjustment Mechanism (ECAM) for Rocky Mountain Power. The ECAM was a modification of a prior sharing policy called the Power Cost Adjustment Mechanism (PCAM), which was created based on a statute that allowed the commission to use non-traditional rate tools to optimize outcomes.<sup>31</sup> The ECAM trues up the utility’s actual net power costs (which include fuel, purchased power, and certain other costs) to its forecasted costs in a symmetrical fashion. The ECAM previously featured a 70 percent pass-through and it employs an 80 percent pass-through today.<sup>32</sup>

## ***Missouri***

In 2005, the Missouri legislature enacted Senate Bill 179, which was subsequently codified as Section 386.266 of the Revised Missouri Statutes (RSMo). The legislation authorized the utilities to pass fuel and purchased power costs through to customers if approved by the Missouri Public Service Commission, and it also granted authority to the commission to include an incentive for efficiency and cost-effectiveness as part of the mechanism. The commission implemented the first mechanism in 2007 (and the last one in 2015). In Missouri, these mechanisms are referred to as “fuel adjustment clauses” (FACs) even if they feature fuel-cost sharing.<sup>33</sup> The mechanisms in place for Ameren, Evergy, and Liberty Utilities all feature straight sharing with a 95 percent pass-through.<sup>34</sup>

## ***Wisconsin***

The Wisconsin Public Service Commission was authorized by Wisconsin Statute § 196.20(4) to establish automatic adjustment clauses for regulated utilities, and the commission codified the rules

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<sup>29</sup> Idaho Public Utilities Commission, Order No. 30715, Case No. IPPC-E-08-19, January 9, 2009, [https://puc.idaho.gov/Fileroom/PublicFiles/ELEC/IPC/IPCE0819/OrdNote/20090109final\\_order\\_no\\_30715.pdf](https://puc.idaho.gov/Fileroom/PublicFiles/ELEC/IPC/IPCE0819/OrdNote/20090109final_order_no_30715.pdf)

<sup>30</sup> Idaho Public Utilities Commission, Order No. 30904, Case No. PAC-E-08-08, September 29, 2009, [https://puc.idaho.gov/Fileroom/PublicFiles/ELEC/PAC/PACE0808/OrdNote/20090929final\\_order\\_no\\_30904.pdf](https://puc.idaho.gov/Fileroom/PublicFiles/ELEC/PAC/PACE0808/OrdNote/20090929final_order_no_30904.pdf); Idaho Public Utilities Commission, Order No. 35419, Case No. PAC-E-22-05, May 26, 2022, [https://puc.idaho.gov/Fileroom/PublicFiles/ELEC/PAC/PACE2205/OrdNote/20220526Final\\_Order\\_No\\_35419.pdf](https://puc.idaho.gov/Fileroom/PublicFiles/ELEC/PAC/PACE2205/OrdNote/20220526Final_Order_No_35419.pdf)

<sup>31</sup> Wyoming Public Service Commission, Memorandum Opinion, Findings, and Order, Docket No. 20000-368-EA-10, February 4, 2011, <https://pscdocs.utah.gov/electric/09docs/0903515/71051ExhibitA2-9-11.pdf>

<sup>32</sup> For the present 80 percent pass-through policy, see the current version of Sheet No 95-6 (P.S.C. Wyoming No. 17, Original Sheet No. 95-6). For the previous 70 percent pass-through policy, see P.S.C. Wyoming No. 16, First Revision of Amended Original Sheet No. 95-6 Canceling Amended Original Sheet No. 95-6. Source: Rocky Mountain Power, Energy Cost Adjustment Mechanism, Schedule 95. The current tariff can be downloaded at: [https://www.rockymountainpower.net/content/dam/pcorp/documents/en/rockymountainpower/rates-regulation/wyoming/rates/095\\_Energy\\_Cost\\_Adjustment\\_Mechanism.pdf](https://www.rockymountainpower.net/content/dam/pcorp/documents/en/rockymountainpower/rates-regulation/wyoming/rates/095_Energy_Cost_Adjustment_Mechanism.pdf)

<sup>33</sup> This is different from how we use this term in this primer, where we define a FAC as a 100 percent fuel-cost pass-through mechanism.

<sup>34</sup> Lena M. Mantle, Electric Utility Fuel Adjustment Clause in Missouri: History and Application Whitepaper; Office of the Public Counsel, Revised January 14, 2022, <https://efis.psc.mo.gov/mpsc/commoncomponents/viewdocument.asp?DocId=939661980>

for doing so as Wisconsin Administrative Code § PSC 116.03.<sup>35,36</sup> Under these rules, each of the state's five major investor owned electric utilities (Wisconsin Electric Power Company, Wisconsin Public Service Corporation, Madison Gas & Electric, Wisconsin Power and Light, and Northern States Power – Wisconsin) are required to file fuel cost plans.<sup>37</sup> Each plan includes a forecast of the utility's expected costs for fuel, purchased power, and related expenditure categories to be collected from customers. Once the utility's actual fuel (and related) costs are known, the commission can approve a true-up to collect or refund any difference that represents 2 percent of the forecasted amount. In other words, there is a 2 percent deadband where no sharing occurs and a 100 percent pass-through outside this deadband. The commission has the authority to rule on whether or not the utility's actions were prudent when determining the extent of cost recovery to be allowed. The true-up occurs through a fuel adjustment which appears on customers' bills.<sup>38</sup>

## Conclusion

Many Americans today struggle to pay their electric bills. Fuel costs often represent a large share of customer bills, and unlike most rate components these charges can vary substantially from month to month. Reducing fuel costs—as well as fuel-cost volatility—is imperative to ensuring that electricity is affordable and accessible to all.

Fortunately, electric utilities have more ways to reduce fuel costs today than ever before. These opportunities exist on both the supply and demand side (e.g., increasingly cheap solar and wind generation, distributed energy resources that shift load to lower-cost hours), and they are enhanced by supportive federal policies like the Inflation Reduction Act (IRA). However, these opportunities have not spurred a utility rush to decrease fuel costs. Why?

The answer is that most states pass 100 percent of fuel costs through to customers, which gives utilities no financial incentive to reduce these costs. If a utility finds any savings, customers reap all the benefits—and if it spends more than necessary, customers pick up the bill.

It is time for these outdated policies to change, and advocates can play important roles in this process. This primer has described the problems created by existing 100 percent pass-through policies, explained how fuel-cost sharing reforms can produce better outcomes, and provided tools that advocates can leverage to encourage reforms in their states. If these reforms are well designed, they will result in lasting benefits for customers, utilities, and the environment.

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<sup>35</sup> Wisconsin Statutes, <https://docs.legis.wisconsin.gov/statutes/statutes/196/20>

<sup>36</sup> Wisconsin Public Service Commission, Chapter PSC 116, March 15, 2023, [https://docs.legis.wisconsin.gov/code/admin\\_code/psc/116.pdf](https://docs.legis.wisconsin.gov/code/admin_code/psc/116.pdf)

<sup>37</sup> Wisconsin Public Service Commission, Final Decision, Docket 6680-ER-103, December 13, 2022,

<sup>38</sup> Alliant Energy, RE: Wisconsin Power and Light Company Electric Tariff for Fuel Adjustment, Docket No. 6680-ER-103, December 21, 2022, <https://apps.psc.wi.gov/pages/viewdoc.htm?docid=455114>