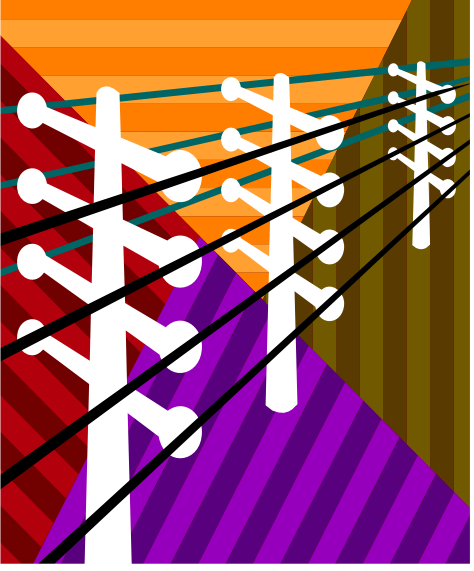
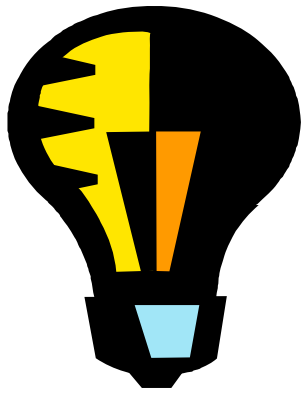
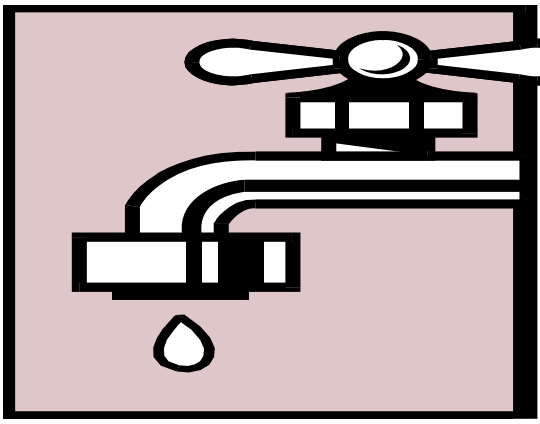


PSC
PUBLIC SERVICE
COMMISSION
OF KENTUCKY



BIENNIAL REPORT
JULY 1, 2005-
JUNE 30, 2007

ASSURING SAFE, RELIABLE UTILITY SERVICES FOR ALL KENTUCKIANS



Kentucky
UNBRIDLED SPIRIT™



Steven L. Beshear
Governor

Leonard K. Peters
Secretary
Energy and Environment Cabinet

Commonwealth of Kentucky
Energy and Environment Cabinet

Public Service Commission

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Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460

David L. Armstrong
Chairman

James W. Gardner
Vice Chairman

Charles R. Borders
Commissioner

October 19, 2009

The Honorable Steve Beshear
Governor
Commonwealth of Kentucky
The Capitol
700 Capitol Avenue
Frankfort, Kentucky 40601

Dear Governor Beshear:

The Kentucky Public Service Commission is pleased to submit to you, the members of the General Assembly, and the citizens of Kentucky, the Commission's 36th Biennial Report. This report presents the activities, and accomplishments of the Public Service Commission from July 2005 through June 2007.

The mission of the Kentucky Public Service Commission is to foster the provision of safe and reliable service at a reasonable price to the customers of jurisdictional utilities while providing for the financial stability of those utilities by setting fair and just rates, and supporting their operational competence by overseeing regulated activities.

Recent years have brought enormous change to the utility and telecommunication industries. The Public Service Commission carefully monitors each of the utilities we regulate, and seeks to be proactive in our approach to the changing regulatory environment. As the industries change, the Public Service Commission is committed to maintaining a positive regulatory environment for the citizens and businesses of the Commonwealth.

Respectfully submitted,

PUBLIC SERVICE COMMISSION OF KENTUCKY

/S/
David L. Armstrong
Chairman

/S/
James W. Gardner
Vice Chairman

/S/
Charles R. Borders
Commissioner



This report is dedicated
To the memory of
Ryan T. Gatewood
Director of Filings
July 6, 1977 - July 6, 2009



**The Kentucky Public Service
Commission**

**Biennial Report
July 1, 2005-June 30, 2007**

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The Kentucky Public Service Commission

Biennial Report

July 1, 2005-June 30, 2007

Introduction

The Kentucky Public Service Commission (PSC) is charged with regulating the intrastate rates and services of over 1,500 utility companies throughout the state of Kentucky. The Commission was created in Chapter 145 of the Acts of the Kentucky 1934 General Assembly.

The PSC is an independent agency that is attached, for administrative purposes only, to the Energy and Environment Cabinet. Three appointed Commissioners who have quasi-legislative and quasi-judicial duties lead the Commission. It has a staff of about 100.

The agency is funded through an assessment paid by utilities within the Commission's jurisdiction. The assessment is based upon annual gross intrastate revenues.

Utilities under PSC jurisdiction include investor-owned electric, natural gas, telecommunications, certain water and sewage utilities, electric cooperatives and telephone cooperatives, and water districts and associations. The PSC does not regulate utilities subject to the control of cities, political subdivisions or those served by the Tennessee Valley Authority.



The mission of the PSC is to ensure that utilities charge fair, just and reasonable rates for the services provided and that those services are adequate, efficient, safe and reliable.

To accomplish this objective, the PSC holds both public meetings and hearings. Public meetings provide the citizens of the Commonwealth an opportunity to express their views on utility issues. Hearings are designed to gather the technical and financial information and the sworn testimony needed by the commissioners to make an informed decision on the cases that come before them. Hearings may be viewed live on the PSC Web site.

Rules and procedures in hearings are similar to those used in a court of law. Through these processes, the Commission makes final decisions in cases that affect utility rates, construction, financing, certification, formal complaints brought against utilities and show cause proceedings to determine whether a utility has failed to comply with applicable statutes or regulations.

The Commission performs its regulatory functions through written orders following procedures outlined in Chapter 278 of the Kentucky Revised Statutes and administrative regulations promulgated by the Commission in Chapter 807 of the Kentucky Administrative Regulations.

Changes in PSC jurisdiction have included the removal of municipally owned utilities from Commission authority in 1936 by the Kentucky General Assembly.

In 1950, the legislature transferred street railways from the Commission's jurisdiction to that of the Department of Motor Transportation. In 1964, the PSC's jurisdiction was expanded to include water districts; again in 1972 to include water associations; and in 1975 to include privately owned sewage companies.

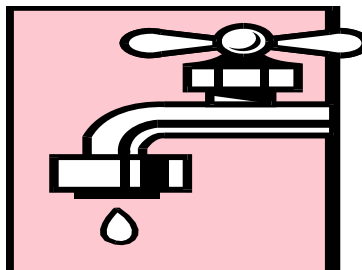
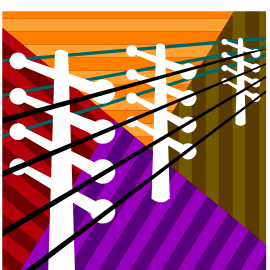
In 1987 sanitation districts were removed from Commission jurisdiction. In 1994, the Kentucky Supreme Court in the case of Simpson County Water District v. City of Franklin, Kentucky, Ky., 872 S.W.2d 460 (1994), concluded that the Commission retained jurisdiction to review the wholesale rates of municipal utilities that provide service to jurisdictional utilities.

In 2002, the Kentucky General Assembly relieved the PSC of its responsibility to determine cellular telephone tower placement in jurisdictions with local planning and zoning authority.

Also in 2002, the legislature created the Kentucky State Board on Electric Generation and Transmission Siting. All three PSC commissioners are *ex officio* members of the board. The PSC provides staff support to the Siting Board. The board considers requests for the construction of non-jurisdictional (merchant) power plants and transmission lines.

Legislation enacted in 2004 placed under PSC jurisdiction the construction of any electric transmission lines of more than 138 kilovolts and more than a mile in length. The legislation created a process for public participation in the PSC's consideration of construction requests.

The 2004 session of the General Assembly also enacted legislation that generally removed state regulation over broadband services. In 2006, the legislature deregulated most aspects of telephone service, with the exception of basic service and some wholesale transactions. The PSC retained its jurisdiction over consumer complaints.



Commission Organization

Commissioners' Office

The Commission is comprised of three full-time Commissioners, each appointed by the Governor with the consent of the Senate. The Commissioners serve staggered four-year terms.

The Governor names the Chairman, a Vice Chairman to serve in the Chairman's absence, and a Commissioner.

The current members are **Chairman David L. Armstrong, Vice Chairman James W. Gardner and Commissioner Charles R. Borders.**

No more than two members may be of the same occupation.

The Commissioners are primarily responsible for reviewing and deciding cases filed with the PSC, issuing regulations, and developing policy.

They work with staff to conduct investigations, to hold hearings and public meetings, and to review testimony and exhibits filed by utilities and other parties that appear before the Commission.

The Commissioners' Office also includes a Hearing Examiner who presides over selected public hearings.

Executive Director's Office

As Executive Director, **Jeff R. Derouen** serves as the chief administrative officer for the commission.

He is responsible for staff direction and coordination in implementing the programs and duties of the 100-member staff. Mr. Derouen is assisted by David S. Samford, Deputy Executive Director.

The Executive Director's office also schedules hearings, attests commission orders, and responds to specific and general inquiries. The office also includes the legislative affairs and public information offices and administrative services.

Mr. Derouen joined the PSC in January 2009.

PSC Commissioners

David L. Armstrong, Chairman

Governor Steve Beshear appointed David L. Armstrong Chairman of the Kentucky Public Service Commission on June 3, 2008. His term ends on June 30, 2011.

Prior to joining the PSC, Chairman Armstrong was of counsel to the law firm Greenebaum Doll & McDonald in Louisville.

Chairman Armstrong has had a lengthy career in government, beginning as Commonwealth's Attorney for the 30th Judicial District from 1976 to 1983. He served as mayor of Louisville from 1999 to 2003, Jefferson County Judge-Executive from 1989 to 1999 and Kentucky Attorney General from 1983 to 1988. Chairman Armstrong has also been a prosecutor and juvenile court judge and taught urban planning at the University of Louisville.

Chairman Armstrong is a member of the Louisville and Kentucky bar associations and the Society of Attorneys General Emeritus. He is admitted to the practice of law in Kentucky and before the Supreme Court of the United States.

Over the course of his career, Chairman Armstrong has served in many leadership positions, including as president of the National Council of County Executives, chairman of the Southern Conference of Attorneys General and president of the National District Attorneys of America. He was named Kentucky's Outstanding Mayor in 2002 and Louisville was twice named a Most Livable City in America during his tenure.



The University of Louisville's Brandeis School of Law has named him an Outstanding Alumnus and in 2008 he received an honorary Doctor of Laws degree from Hanover College.

Chairman Armstrong serves on many boards and civic groups. He is a trustee of the University of Louisville Brandeis School of Law and the University of Kentucky School of Design. He is on the boards of the Filson Historical Society in Louisville, the Kentucky Opera Board, the Muhammad Ali Center and the Partners for Livable Communities.

Chairman Armstrong is a member of the board of directors of the National Association of Regulatory Utility Commissioners and serves on its electricity committee and the subcommittee on clean coal technology. He is a member of the advisory committee to the Midwest Independent System Operator, a regional transmission organization and the advisory council for the Center for Public Utilities at New Mexico State University

Chairman Armstrong attended Hanover College and holds a Bachelor of Science degree in history from Murray State University. He received his law degree from the University of Louisville.

Chairman Armstrong and his wife Carol reside in Louisville. They have two grown children and two granddaughters.

Other Commissioners who served during the biennium were:

Mark David Goss (2004-2008) W. Gregory Coker (2004-2006) Teresa J. Hill (2005-2006)
Caroline Pitt Clark (2006-2008) John. W. Clay (2006-2009)

James W. Gardner, Vice Chairman

Governor Steve Beshear appointed James W. Gardner as vice chairman of the Kentucky Public Service Commission (PSC) on June 16, 2008. His term will expire on June 30, 2012.

Before joining the PSC, Vice Chairman Gardner was a partner in the law firm of Henry Watz Gardner & Sellars PLLC, where he specialized in bankruptcy law. He is a member of the Kentucky Bar Association and the Fayette County Bar Association. He is admitted to practice in Kentucky and federal district courts, the Sixth Circuit Court of Appeals and the Supreme Court of the United States.

Vice Chairman Gardner has served as a bankruptcy trustee and has taught international business law and legal writing at the University of Kentucky College of Law.

Vice Chairman Gardner was elected to the Lexington-Fayette Urban County Council in 1982 and served until 1986. He was a member of the Fayette County Board of Education from 1993 to 1997, serving as its chairman from 1995 to 1997. Vice Chairman Gardner was president of the Bluegrass International Trade Association from 1991 to 1992.

Vice Chairman Gardner is a member of the National Association of Regulatory Utility Commissioners and serves on the consumer affairs committee and the committee on energy resources and the environment.

A native of Calgary, Alberta, Canada, Vice Chairman Gardner was raised in Frankfort, Kentucky. He received his Bachelor of Arts degree in mathematics and philosophy from Georgetown College, graduating *summa cum laude*. Vice Chairman Gardner holds a Juris Doctor degree from the University of Kentucky College of Law, where he was a member of the Kentucky Law Journal and Order of the Coif.

Vice Chairman Gardner, his wife Michelle and their son Will reside in Lexington and attend Maxwell Presbyterian Church.



Charles R. Borders, Commissioner

Governor Steve Beshear appointed Charles R. Borders as a member of the Kentucky Public Service Commission (PSC) on July 15, 2009. His term expires June 30, 2013.

Before joining the PSC, Commissioner Borders served in the Kentucky Senate, representing the 18th District in northeast Kentucky since 1991. He most recently chaired the Appropriations and Revenue Committee and served on the committees on Education and Health and Welfare.

Prior to joining the PSC, Commissioner Borders was executive director of King's Daughters Health Foundation and director of administrative services for King's Daughters Medical Center in Ashland. He also has been a real estate broker. From 1971 to 1993 he held various corporate finance positions for Ashland, Inc.

Commissioner Borders is a member of the National Association of Regulatory Utility Commissioners and serves on its water committee.

Commissioner Borders is a past member of the Kentucky Council on Post-Secondary Education and of the Kentucky Workforce Investment Board. He is a past president of the Russell Rotary Club and a member of Oak Grove Church of Christ.

Commissioner Borders is a graduate of Morehead State University, where he received a Bachelor of Science degree in Business Administration and a Master of Business Administration.

Commissioner Borders and his wife Carol have homes in Grayson and Georgetown. They have two children and two grandchildren.



Division of Consumer Services

From July 2005 through June 2007, \$515,307 was recovered on behalf of consumers.

The Division of Consumer Services, led by Director **Virginia L. Smith**, provides informal complaint resolution for the state's regulated utility customers.

The Division of Consumer Services staff's objective is to resolve complaints at the informal level, if possible, instead of opening a formal proceeding.

During the biennium, the division handled 6,620 informal complaints against utilities. These

complaints are received by telephone, fax, letter, e-mail, and walk-ins. During this same period, the division received many times more telephone calls from consumers seeking general information or wishing to file a complaint.

Many of these calls resulted in savings to customers. From July 2003 through June 2005, \$515,307 was recovered on behalf of consumers.

The division is also responsible for consumer education and has developed a number of brochures on various issues of importance to consumers.

Ginny Smith and her staff of four investigators work closely with utilities to resolve concerns before they become major issues that would require the Commission's action.

Division of Financial Analysis

In the 2005-2007 biennium, the Financial Analysis Division handled eight major utility base rate cases.

The Division of Financial Analysis, headed by director **Wayne Miller** and assistant director **Aaron D. Greenwell**, consists of seven branches: the Electric and Gas Rate Design Branch, the Electric and Gas Revenue Requirements Branch, the Water and Sewer Rate Design Branch, the Water and Sewer Revenue Requirements Branch, the Communications Revenue Requirements Branch, the Management Audit Branch, and the Financial Audits Branch.

The division is responsible for providing expert financial advice to the Commission relative to utility requests for rate increases, tariffed rates and services, cost of service studies, rate designs, financing, and acquisitions. The division takes the lead in processing the six-month and two-year electric fuel adjustment cases, purchased gas and purchased water adjustment cases, the environmental surcharge cases, the merger surcredit cases and the earnings-sharing cases. Additionally, the division conducts financial audits and management audits of utilities as needed and provides guidance on accounting and financial matters to the Commission.

Other responsibilities include analyzing and providing recommendations related to changes in federal and state policies that could affect Kentucky ratepayers, and implementing new accounting policies.

The Financial Analysis Division also provides support to the Commission and Commission staff through analysis of regulatory matters.

Research duties include monitoring emerging regulatory and energy issues and evaluating the potential impact of developing business practices and legislative proposals on utility customers and utility regulation in Kentucky. Pending state and federal legislation and agency rulemakings that may significantly affect utility customers in Kentucky are analyzed in depth so the Commission may participate when necessary to support or oppose these actions. Economic analyses in cases that involve issues of first impression that come before the Commission are also provided. The Financial Analysis Division is comprised of 19 employees.

Division of Engineering

During the biennium, the Division of Engineering conducted 971 inspections and investigated 54 accidents.

The Division of Engineering, directed by **Reggie Chaney, P.E.**, consists of the Electric Branch, the Communications Branch, the Gas Branch and the Water and Sewer Branch.

The division is responsible for the service aspects of utility operations. The division conducts service and safety investigations, investigates accidents, performs

utility plant inspections, and tests and certifies utility meter standards.

The division provides the Commission with an analysis of all utility requests for construction certificates, changes in depreciation rates, service-related expenses in rate cases, and load management programs.

Additionally, the engineering

staff is involved in advising the PSC and outside groups on the technical aspects of utility industry restructuring and de-regulation issues.

The division assists in the development of emergency plans to meet service interruptions and administers certain federally-mandated gas safety programs. The division includes 23 employees.

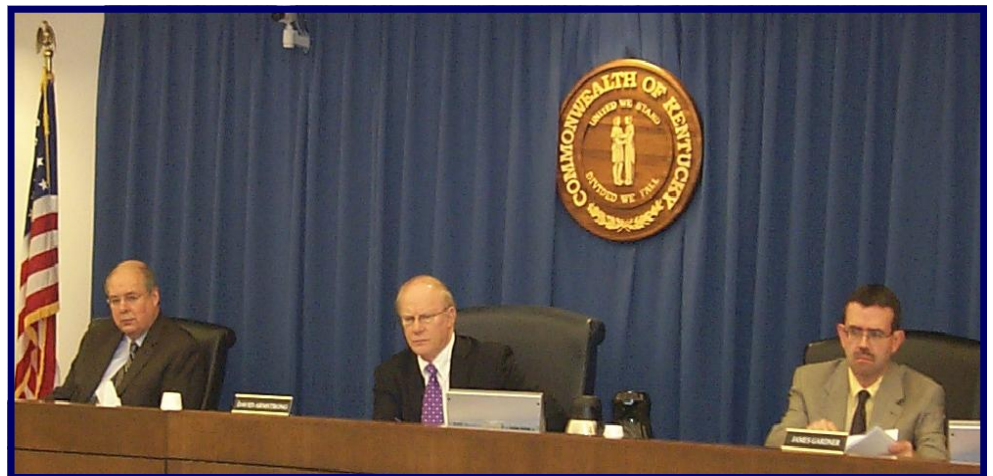
Division of General Counsel

The Division of General Counsel represents the PSC staff during hearings before the Commission.

The Division of General Counsel is directed by **Helen Helton**. It provides legal counsel to the Commission and the staff regarding the legal issues involved in jurisdiction, rate-making, financing, facility construction, quality of service and safety. The legal staff also advises the PSC on potential legislation and handles the regulatory promulgation process.

Additionally, the attorneys represent the Commission before state and federal courts and federal agencies such as the Federal Communications Commission and the Federal Energy Regulatory Commission.

The division includes 12 attorneys and two support staff.



PSC Hearing

From left: **Commissioner Charles R. Borders,**
Chairman David L. Armstrong,
Vice Chairman James W. Gardner

Filings Division

The Filings Division, directed by **Linda Faulkner**, serves as the primary point of contact for daily business relations between the Commission, regulated utility operations, other state agencies and members of the public. The Director of Filings is charged with the oversight of all documents submitted to, and issued by, the Commission in regulatory matters. Functional responsibilities within the Division are divided among five primary areas of expertise, consisting of docket control, utility financial reports, utility tariff review, information technology and geographic information systems. The Division continues to work to expand electronic filing of case-

related materials. The Division has implemented a system that makes electronic copies of most paper filings available on the PSC Web site.

The division also has implemented an electronic case management system that tracks case progress and has improved workflow and timely processing of cases.

The division keeps the PSC web page up to date and provides information to the public. The PSC Web site is heavily used by the business community and the public, registering more than 150,000 visits annually. It received its one-millionth visit in 2005.

The geographic information systems specialists provide information to staff in the form of maps and reports for cases before the Commission or the Electric Generation and Transmission Siting Board, support for emergency situations such as gas transmission line incidents and power outages, and maintaining existing databases to support Commission decisions.

The information technology staff is responsible for development and maintenance of all automated systems used within the Public Service Commission.

The division serves as a liaison between the public, the Commission and utilities. It has 18 employees.

ANNUAL REPORT BRANCH FILES

ANNUAL REPORTS

2005

2004

2003

All PSC orders and nearly all case documents, as well as annual reports and other records, are available to the public through the PSC Web site.

Commission administration

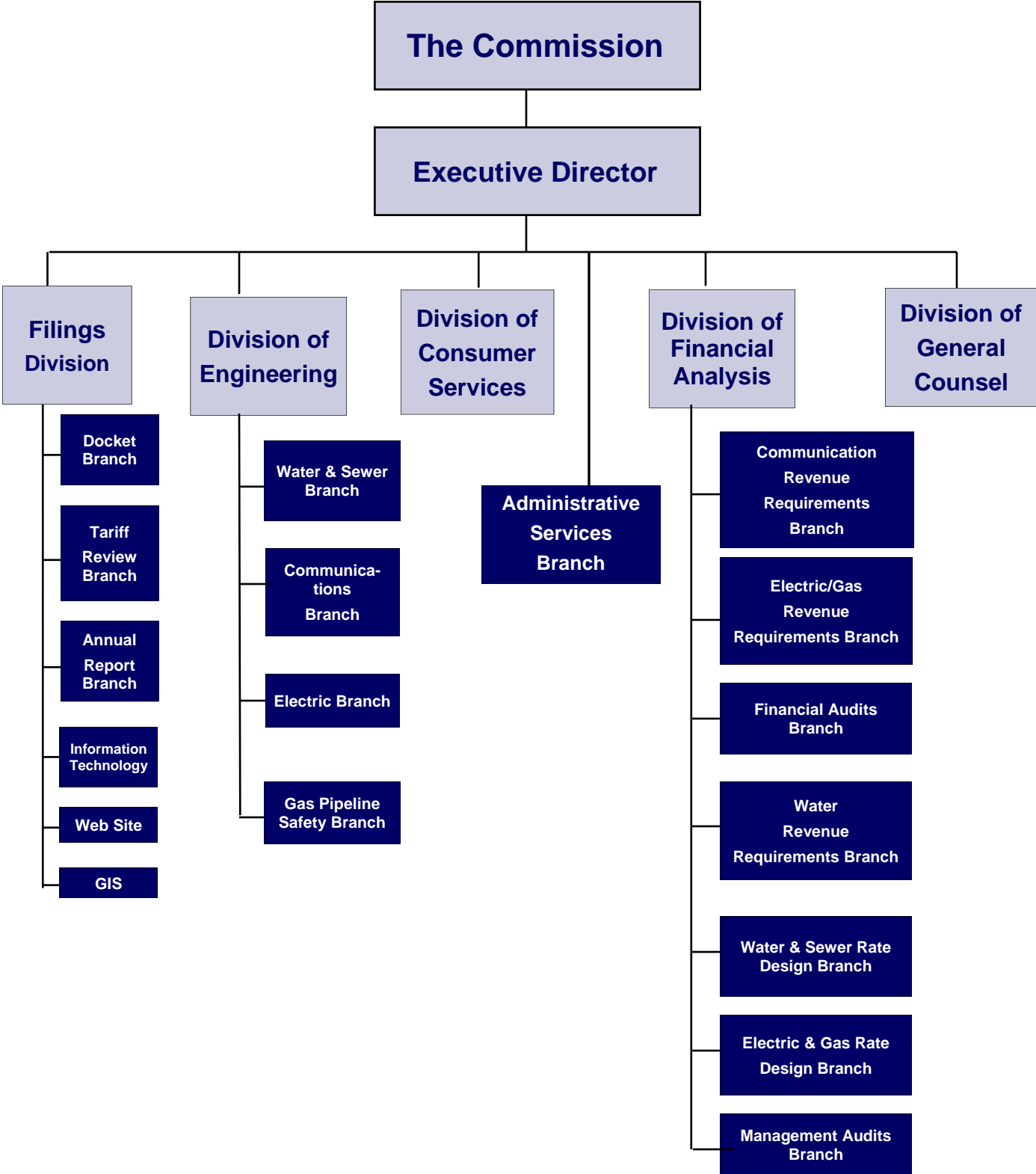
In 2003, the former Division of Administrative Services was consolidated within the Office of Executive Director. The principal function remains the production of and adherence to the Public Service Commission's biennial budget.

Commission administrative personnel process and ensure all receipts, expenditures, fiscal inventory, and personnel actions comply with established policies, procedures, rules, and regulations.

Staff members also: administer the Equal Employment Opportunity and American's with Disability Acts; coordinate insurance coverage and time and attendance records for Commission employees; operate the telephone switchboard; and provide clerical support to other Divisions within the Commission.

Four staff members within the Office of Executive Director are responsible for carrying out these functions.

PSC Organizational Chart





Staff Directory

All Commission staff may be reached at (502) 564-3940.

To contact a specific division or staff member, please use the extensions listed below.

Commission Operations

David L. Armstrong, Chairman	201
James W. Gardner, Vice Chairman	202
Charles R. Borders, Commissioner	203

Executive Director's Office

Jeff R. Derouen, Executive Director	212
David S. Samford, Deputy Executive Director	270
Stephanie Bell, Legislative Liaison	247
Andrew O. Melnykovich, Public Information	208

Filings Division

Linda Faulkner, Director	266
Annual Reports Branch	218
Docket Branch	228
Tariff Branch	269
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Web Master	224
Geographic Information Services	451

Division of Engineering

Reggie Chaney, Director	400
Communications Branch	418
Electric Branch	421
Gas Branch	416
Water and Sewer Branch	409

Division of Consumer Services

Virginia L. Smith, Director	404
Consumer Hotline	1-800-772-4636 (1-800-PSC-INFO)

Division of General Counsel

Helen Helton, General Counsel	255
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Financial Audits Branch	239
Water Revenue Req. Branch	232
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Information Management

The PSC's Web site offers a wealth of information to consumers, utility personnel, journalists and anyone else needing information about utility services in Kentucky. The Web site is updated daily, so the information is always current.

The site includes general information about the PSC, such as consumer information, news releases, commissioner biographies and recent speeches, and a staff directory.

Information about major electric service disruptions and boil water advisories also may be found on the Web site. This information is available on the Web site when it is filed by the affected utility.

Customers of regulated water utilities may sign up to receive e-mail notifications of boil water advisories.

Statutes and regulations governing regulated utilities may be found on the Web site.

All orders issued by the Commission are posted promptly on the Web site. A searchable repository of all Commission decisions issued since 1980 also is available.

The Web site also may be used to access the PSC docket, including a listing of past cases and a schedule of hearings and informal conferences.

Electronic filing is available to utilities through a secure Web portal. Documents filed electronically are available online immediately. Documents filed in non-electronic cases are available on the Web site via an FTP server.

Commission hearings are broadcast live on the Web site. A video archive of past hearings also is

available, and past hearings may be downloaded as well.

Utility information available on the Web site includes utility profiles, annual reports dating to 1994, tariffs, service area maps and links to company Web sites. The information is organized to make it readily accessible to the public.

Forms needed by utilities are available for download directly from the Web site.

Consumer may file complaints via the Web site. They also may contact the Consumer Services Division by e-mail. A variety of consumer brochures on various issues related to telecommunications, electricity, gas and water service are available for downloading.

The PSC Web site receives more than 150,000 visits annually and logged its 1,500,000th visit in 2007

Using technology more effectively

The Public Service Commission took a number of steps during the 2005-2007 biennium to make more effective use of information management technology.

Efforts continued to encourage the use of electronic filing by utilities. A number of major cases were filed in electronic form, including all cases coming before the Kentucky State Board on Electric Generation and Transmission. The PSC continues to undertake efforts to re-

duce the volume of paper produced by PSC proceedings. A major step in this direction is an FTP repository for electronic copies of documents filed in non-electronic cases. Originally intended for internal use, this repository was subsequently made available to the public on the PSC Web site and has significantly reduced the number of requests for paper copies of documents on file at the PSC.

The PSC also instituted an online reporting system for water utilities. Utilities use a se-

secure Web portal to submit information about boil water advisories. After an initial trial period, this information also was made available on the PSC Web site.

The PSC's internal operations also have been significantly improved through more effective use of technology. An electronic case management system tracks cases through the PSC system. An electronic system also is used to track non-case-related meetings with regulated utilities.

Complaint Resolution/PSC Consumer Hotline

The Kentucky Public Service Commission seeks to provide consumers with relevant information, timely assistance and convenient access to the regulatory process .

Informal Complaint Resolution

Before contacting the PSC, a consumer should first try to resolve his complaint directly with the utility. If the customer has contacted the utility and been unable to resolve the situation, the Consumer Services staff will begin an investigation into the complaint.

Utility customers who contact the commission should be prepared to supply the following information to the Consumer Services staff:

- ◆ Name, phone number, address, city, county and zip code.
- ◆ The name of the utility representative with whom the customer has already made contact.
- ◆ The complete facts of the complaint, including any supporting documents, bills, letters, etc.
- ◆ Any action the utility took on the complaint.
- ◆ A brief explanation of the solution desired.

The Consumer Services staff assists in resolving a wide range of utility problems including improper termination of service, unauthorized or incorrect charges on utility bills, problems reading meters, customer deposits for utility services, poor quality of service and problems with delayed connection of services.

Although the PSC cannot resolve every complaint to the customer's satisfaction, investigators take prompt action on all complaints, and resolve them appropriately, as determined by the statutes and regulations that apply to the utilities under our jurisdiction.

CONSUMER HOTLINE

The Public Service Commission operates a hotline to answer complaints and questions customers have about utility services under PSC jurisdiction. Through this hotline, Consumer Services investigators resolve thousands of complaints through informal means, saving Commission staff and utility customers time and money.

When customers are looking for information about utility services, or would like to report a problem, they can find help by dialing 1-800-772-4636 or 1-800 PSC INFO. The hotline is open 8 a.m. to 5 p.m. Monday through Friday, Eastern time, except for state holidays.



800-772-4636
psc.ky.gov

FORMAL COMPLAINTS

When a complainant feels that only formal action by the Commission can resolve the matter, a formal complaint may be filed. A formal complaint must be made in writing, but an attorney is not required.

In response to a formal complaint, the Commission will require the utility to explain why the complaint cannot be resolved. The Commission also may schedule a formal hearing on the complaint.

Consumer Complaints Addressed by the Consumer Services Division During the 2005-2007 Biennium

July 1, 2005 to June 30, 2006

	Telephone	Electric	Gas	Water	Sewer	Total
Billing	571	333	132	84	2	1122
Slamming	48	0	0	0	0	48
Service	559	94	19	59	1	732
Disconnect	214	207	69	35	0	525
Other	597	298	121	125	7	1148
TOTALS	1989	932	341	303	10	3575

In the **1993-1995** period, the PSC received **3,813** consumer complaints. In the **2003-2005** biennium, **9,062** consumer complaints were received. The **6,620** complaints received in **2005-2007** represent the first substantial decrease in the last six biennial periods.

July 1, 2006 to June 30, 2007

	Telephone	Electric	Gas	Water	Sewer	Total
Billing	526	210	49	67	5	857
Slamming	51	0	0	0	0	51
Service	207	115	11	101	3	437
Disconnect	137	184	49	40	0	410
Other	862	275	64	82	7	1290
TOTALS	1783	784	173	290	15	3045

Significant Cases and Issues

The Kentucky Public Service Commission faced complex and contentious issues during the 2005-2007 biennium. The PSC issued major reports on the future of the state's electric industry, electric distribution reliability and smart metering. It addressed issues such as rising natural gas prices, copper theft and reporting of power outages. The PSC ruled on transfers of control of both of Kentucky's major telephone providers, the largest water utility and one of the major investor-owned combined electric and gas utilities. Major construction projects coming before the PSC included electric generating facilities and a new water treatment plant and pipeline to serve the Lexington area. The PSC also considered a number of significant rate adjustment cases for electric, natural gas and water utilities. While the regulation of telephone service was further reduced during the biennium, the PSC addressed the need for a new area code in western Kentucky.

Electricity Issues and Cases

The Kentucky Public Service Commission (PSC) addressed a wide variety of electricity issues during the 2005-2007 biennium. As is typical, a number of rate cases and construction certificate cases came before the PSC. The PSC also conducted administrative proceedings related to electric distribution reliability and real-time pricing. Other cases dealt with the merger of one of the four major investor-owned utilities, a pilot program involving the use of "smart meter" technology and the transfer of utility property to make way for the construction of a new arena in Louisville.

In an effort to make electric outage information more readily available to emergency responders and the general public, the PSC created a system for reporting outages that posts information on the PSC Web site as soon as it is submitted by a utility company. In another major public outreach effort, the PSC sought to highlight the safety and operation problems arising from the increased theft of copper from electric utility facilities.

The PSC also increased its involvement in the state, regional and national dialogue regarding the efforts to control greenhouse gases and the impact of those efforts on Kentucky's electric utilities.



COPPER THEFT

Rising prices for copper in 2005 and 2006 sparked an increase in the theft of wire, switches and other copper-containing material from electric utilities. The rising number of thefts was accompanied by an alarming increase in serious injuries and fatalities from contact with high voltages or, less commonly, falls from height. Copper thefts also led to service interruptions and imposed costs on utilities. In the first few months of 2006, there were at least four fatalities in



Kentucky related to theft or removal of copper from utility property.

In May 2006, the PSC initiated a public information campaign in an effort to reduce copper theft and the associated problems. This effort kicked off with a May 31, 2006, event at the PSC that included a demonstration of the dangers posed by high-voltage lines. Participants in the event included investor-owned utilities and electric cooperatives. The PSC's public information campaign also included news releases, other media outreach

and public service announcements on radio stations across Kentucky.

Additional efforts by the PSC focused on making copper theft less attractive by creating obstacles to the sale of stolen copper. The PSC met with utility industry representatives, metal recyclers and law enforcement officials to discuss the problem. These discussions focused on boosting compliance with existing laws requiring scrap dealers to keep records of copper purchases, encouraging cooperation between metal recyclers and law

enforcement authorities and opening lines of communication between electric utilities and metal recyclers. Among the results of these efforts was facilitating the use by electric utilities in Kentucky of a national theft-

notification system that alerts major metal recyclers to the theft of large quantities of copper-containing material from electric facilities.

Although fatal electrocutions resulting from attempted copper theft continued through 2006 and 2007, they became less frequent. The frequency of major thefts also appeared to decline, although it was unclear whether this was the result of more aggressive law enforcement, improved vigilance by scrap dealers, better public awareness of the problem or some combination of factors.

POWER OUTAGE REPORTING

Access to timely information about electric outages is important to emergency responders, local officials, the news media and the general public, including affected customers. In 2006, the PSC took a major step toward making outage information more readily accessible.

In August 2006, the PSC moved to make electric outage information available on its Web site as soon as the outage is reported. The driving factor behind the PSC's decision to establish the online reporting system was widespread concern during previous outage events about the difficulty of obtaining information about the extent, expected duration and cause of the outage.

PSC regulations require that utilities report any outages affecting 500 or more customers for four hours or longer. Utilities sometimes report smaller outages as well.

Before the online system was developed, utilities reported outages to the PSC by phone or e-mail. The data then had to be compiled for further use or distribution.

Even though customers without power are unlikely to have Web access, the reporting system nevertheless benefits them by providing the news media and emergency responders with current information.

Only regulated electric utilities make outage reports using the online system. The PSC invited non-jurisdictional utilities to participate, but none chose to do so. Non-jurisdictional electric utilities include those owned and operated by municipalities and rural electric cooperatives that are part of the Tennessee Valley Authority system.

In addition to information about current outages, the Web site also allows users to search for information about past outages, based on the date and time of the outage.



ENERGY POLICY

During the 2005-2007 biennium, the PSC was actively engaged in electricity policy at the state, regional and federal level. It concluded administrative proceedings related to electric infrastructure and standards for smart metering and interconnection; opened an administrative proceeding on distribution system reliability; and concluded an examination of the membership of Kentucky's two largest utilities in a regional transmission organization. These proceedings are described in detail later in this section.

In addition, commissioners and staff were active in the National Association of Regulatory Utility Commissioners (NARUC) and other groups engaged in energy policy, especially those examining the ramifications of imposing limits on carbon emissions in response to global climate change. In January 2007, PSC Chairman Mark David Goss was selected to chair NARUC's subcommittee on clean coal technology. Later that year, he was named to the U.S. Environmental Protection Agency's Advanced Coal Technology Work Group and was appointed by U.S. Secretary of Energy Samuel W. Bodman to represent NARUC on the National Coal Council, the chief advisory panel on federal coal policy.

STRATEGIC BLUEPRINT FOR ELECTRIC INDUSTRY – Case No. 2005-00090

In Executive Order 2005-121, issued Feb. 7, 2005, Governor Ernie Fletcher called on the Kentucky Public Service Commission to develop a strategic blueprint for Kentucky's continued use and development of low-cost electric energy, as called for by the Commonwealth Energy Policy Task Force. While this case was initiated in the previous biennium, the report was issued during the 2005-2007 biennium, and thus is summarized herein.

Work on the strategic blueprint began in March 2005. In an order issued March 10, 2005, the PSC made the six major regulated electric utilities and the 19 regulated rural electric cooperatives parties to the case, and directed those utilities to answer an initial set of questions relating to current and future electric generation, transmission and distribution needs and plans. The six major utilities made parties to the case were Big Rivers Electric Corp., East Kentucky Power Cooperative, Kentucky Power Co. (American Electric Power), Kentucky Utilities Co., Louisville Gas and Electric Co. and The Union Light, Heat and Power Co. (now Duke Kentucky).

Electric companies not regulated by the PSC, including the Tennessee Valley Authority, municipal power companies and independent power producers, also participated, as did other interested parties, such as groups representing industrial or residential customers.

The PSC's order noted that Kentucky's low electric rates have been a major factor in economic development and a significant

benefit to residential consumers. But low rates in the future are not assured, the Commission said. Changes in both state and federal laws and regulations, as well as changes in both fuel and electricity markets, have the potential to increase rates, the PSC said. Increasing concerns over the reliability of the regional electric transmission grid also must be considered, the PSC said.

The work to develop a strategic blueprint updated and expanded on information gathered by the PSC in Administrative Case 387, established in 2001. In that proceeding, the PSC examined the adequacy of Kentucky's electric generation and transmission facilities. The report in that case was issued Dec. 20, 2001.

A technical conference in the strategic blueprint proceeding was held June 14, 2005. Information was provided by jurisdictional and non-jurisdictional electric utilities as well as other interested parties

The final report in the case was issued Sept. 15, 2005.

The report concluded that Kentucky's electric utilities have adequate infrastructure to serve their current customers but will need to invest in new generation, transmission and distribution facilities to meet projected demand. Key findings of the infrastructure assessment included:

- Kentucky's electric utilities, both jurisdictional and non-jurisdictional, have adequate generation infrastructure to serve their current customers and have demonstrated that they are adequately planning to serve the needs of their customers through 2025.

- Kentucky will need more than 7,000 megawatts of additional electric generating capacity by the year 2025 to meet anticipated demand.
- Kentucky's electric transmission system has been highly reliable but is limited in the amount of power it can transfer through the state, particularly along a north-south axis.
- Further consideration should be given to the establishment of right-of-way maintenance parameters for Kentucky's jurisdictional electric distribution utilities.
- Kentucky's energy policy should include incentives to use renewable energy and an effort to educate the public regarding the benefits of renewables.
- Financial incentives should be available for coal gasification and other clean coal technologies.
- Kentucky should adopt a cautious approach toward restructuring of its electric utilities. Kentucky must insist on full participation in any federal decisions that impact its status as a low cost energy state.

Concurrently with the report prepared in Case No. 2005-00090, the PSC, also at Governor Fletcher's direction (Executive Order 2005-00120), prepared a separate report entitled "The Impact of Federal and International Policy on Kentucky's Energy Future." A formal proceeding was not established for the preparation of this report.

The purpose of the report was to evaluate the impact on Kentucky of recent developments such as the passage of the federal Energy Policy Act of 2005. The report also examined the impact of

federal policies with respect to regional transmission organizations, deregulation of electricity, standard market design, construction of interstate natural gas pipelines and the potential impacts of international trade agreements. The final report was made public on Sept. 15, 2005.

ELECTRIC DISTRIBUTION RELIABILITY – Case No. 2006-00494

Following key recommendations made in case No. 2005-00090 and a study of Kentucky's electric infrastructure, the PSC on December, 12, 2006, opened an investigation into how Kentucky's electric distribution utilities measure reliability and how they manage vegetation in their rights of way.

The PSC required regulated electric distribution utilities to provide information on how they keep track of outages. The Commission also ordered the utilities to provide information on tree trimming and other measures used to prevent vegetation from contacting lines and disrupting service.

Information collected from utilities was used by the PSC to determine whether a need existed for standards both for reliability reporting and vegetation management. The previous studies had noted that utilities in Kentucky are not required to and do not report reliability data in a standard way. Similarly, Kentucky has no parameters for vegetation management.

In ordering the study, the PSC noted that Kentucky law requires utilities to assure their customers of "reasonable continuity of service." PSC regulations re-

quire service to be restored as quickly as possible and set standards for reporting outages to the Commission.



Initial questions to utilities included:

- How does the utility monitor distribution system reliability?
- How are outages detected, measured and recorded?
- What parameters are recorded for each outage?
- How is reliability calculated?
- What standards does the utility use in trimming trees?
- What local codes or ordinances affect vegetation management? How often are easements cleared, by whom, and at what cost?

A public hearing in case was held on May 23, 2007.

(On October 26, 2007, the PSC ordered electric utilities to provide on an annual basis more detailed information about the reliability of their distribution systems. The PSC also requires electric utilities to submit plans detailing how they manage

vegetation along distribution system power lines.

The PSC determined that a reliability standard is not needed at this time, in part because there is “no broad evidence of inadequate service or sufficient comparative information” to support such a standard.

Furthermore, considerable differences in “geography, customer density, age of infrastructure, past operating practices, and other factors” can lead to differing expected reliability levels among utilities, the PSC said. A uniform standard might be too lenient for some utilities but unreasonable for others.

But the PSC required utilities to report their reliability data in a uniform manner. The PSC set out the following reporting requirements:

- ◆ Utilities are required to report reliability using specific methodologies and indices that are standard in the electric industry.
- ◆ Each reliability index should be calculated for at least the five calendar years preceding the filing of the annual report, which is due by April 1 of each year.
- ◆ Each reliability index should be calculated for the utility’s entire system.
- ◆ Utilities are to record outages and their duration.
- ◆ Reports must include an analysis of the causes of outages in the previous year and how much

each cause contributed to outages overall.

- ◆ Utilities are to identify the 10 worst-performing circuits for each outage index and identify the predominant cause of the reliability problems on that circuit.

The PSC found that formal vegetation management plans meeting certain minimum requirements are necessary and ordered utilities to submit such plans by the end of this year. The formal plans are to include information on how often rights-of-way are cleared, how reliability data are used in setting vegetation management practices and how a utility evaluates the effectiveness of its vegetation management practices.)

SMART METERING AND INTERCONNECTION STANDARD - Case No. 2006-00045

On February 24, 2006, the PSC opened a proceeding to consider certain provisions of the federal Energy Policy Act of 2005 (EPAcT 2005). The administrative case determined whether Kentucky should implement two new standards that EPAcT 2005 requires states to consider: smart metering and interconnection.

Smart metering is based on setting electric rates that rise or fall depending on the varying costs of providing service at different times. It is intended to encourage energy conservation during times of peak demand, when the costs of providing electricity typically are highest. If rates are set to reflect the higher costs, customers may reduce usage or shift it to periods when rates are lower.

Such time-based rate setting requires the use of meters that can track consumption based on time of day. Smart metering also includes demand response, which is the use of other rate-related methods to encourage customers to reduce usage during times of peak demand. For example, large users may enter into agreements that call for their service to be curtailed under certain conditions.

EPAcT 2005 required states to consider whether it is appropriate to implement the a time-based rate requirement. If the requirement is adopted, utilities are to offer time-based rates to consumers and provide the necessary smart meters.

The second standard to be considered addresses whether and under what engineering rules and conditions electric generating facilities located on utility customer property should be connected to the local electric distribution grid. The standard generally is intended to apply to generating facilities of 10 megawatts or less, such as small hydroelectric facilities, solar panels or windmills that may produce more power than the user needs.

All of Kentucky’s regulated electric utilities were made parties to the case. A public hearing was held on July 18, 2006.

The PSC issued concluded its review on December 21, 2006, with an order directing electric utilities to develop voluntary real-time pricing pilot programs for large industrial and commercial customers. The pilot programs will be used to test the viability and effectiveness of such programs, the PSC said.

The PSC decided against mandatory adoption of either the smart metering or interconnection standard.

“The Commission finds that the combination of Kentucky’s low rates for electricity, the significant costs and the uncertainty of benefits do not support the need for mandated smart metering standards at this time,” the PSC said. “It does appear, however, that certain aspects of demand response programs and time-based pricing are not only practical but economically feasible at this time and should be further explored.”

The PSC noted that many electric utilities in Kentucky already have programs aimed at conserving energy, particularly at times of peak demand. Large industrial and commercial customers operate under rate plans that include prices based on when the electricity is used and whether the customer can be required to limit usage. Residential customer programs generally are focused more on limiting demand through methods such as allowing a utility to remotely switch off air conditioners for brief periods on very hot days.

The PSC urged utilities with such conservation programs “to consider greater promotion of their benefits and minimal costs and strongly encourages those utilities without these types of programs to study the practicality of introducing a residential load management program.”

However, the PSC found that a mandatory real-time pricing program for residential customers is not yet warranted. It is questionable whether such programs would be cost-effective, the PSC said, adding that past efforts to offer time-of-day pricing for resi-

dential service have attracted few customers.

The PSC determined that Kentucky’s utilities all have interconnection rules that are specific to their circumstances. Utilities testified that, although the EAct 2005 standard is a good starting point, it alone is not sufficient and does not address every safety or reliability issue related to interconnection. The PSC concurred and opted not to adopt a single statewide standard. However, the EAct 2005 standard should serve as the core for utility-specific standards, the PSC said.

LOUISVILLE GAS & ELECTRIC - SMART METERING PILOT PROJECT – Case No. 2007-00117

In its order Case No. 2006-00045 (see above), the PSC ordered Louisville Gas & Electric Co. (LG&E) to fulfill an earlier commitment institute a pilot program to test the efficacy of smart metering technology in residential and small commercial settings. On March 21, 2007, LG&E submitted an application for such a program.

The PSC conducted extensive discovery in the proceeding. The Kentucky Industrial Utility Customers, Inc. and the Kentucky Office of Attorney General intervened, with the latter submitting extensive comments on the specifics of the proposed program.

(On July 17, 2007, the PSC issued an order approving the program. It allowed 150 LG&E customers to join a voluntary program designed to test the idea that consumers will shift usage patterns in response to varying prices at different times of day. The customers received

a special meter, devices to help them control electric usage and equipment that will provide information on the price of power.

Electric rates for the 150 participants (up to 100 residential customers and 50 commercial customers) are designed to be below the current rate for about 87 percent of the hours in year. However, they are higher than the current rates during times when electric usage overall is high, and would be about five times higher than current rates during brief periods of peak usage.

The rates are designed so that a customer who does not alter electric usage patterns would pay about the same under the variable rates as the current rates.

However, a customer who chooses to reduce usage during the high-cost periods would see an overall reduction in their electric bill.

Because a utility’s generation and transmission systems must be built to meet peak loads, shifting usage away from those periods can benefit both the utility and its customers by reducing the maximum loads and thus lessening the need to build new facilities to meet the peak demand.

An additional 1,850 customers were to serve as a “control group” and receive other combinations of specialized equipment. Their electric rates did not change. Data from these customers will to be compared to information gathered from participants in the pilot program.

The 150 participants in the program and the control group customers have a “smart” meter that allows communication be-

tween LG&E and the meter. LG&E knows how much electricity is being used in any given period. The meter can communicate with an in-home display device that informs the customer of their current electric consumption and current electric rate and provides at least a 30-minute warning before the highest rates take effect.

The 150 “responsive pricing” participants also receive the display devices and programmable thermostats that also will communicate with the meter. The thermostats can be programmed to vary the temperature with the price of electricity. LG&E also provided “load control” switches to reduce usage by electric water heaters and other high-consumption appliances.

As many as 400 customers in the control group received some combination of display devices, programmable thermostats or load control switches. The remaining 1,450 customers in the control group received smart meters only.

Only the 150 responsive pricing participants were subject to the time-based rates, which were structured in four tiers:

- ◆ A low-cost rate designed to apply 56 percent of the time.
- ◆ A medium-cost rate applying 31 percent of the time.
- ◆ A high-cost rate which would apply 12 percent of the time, generally in

the afternoon from June through September and in the evening during the rest of the year.

- ◆ A critical cost rate that would take effect only at times of extremely high electric demand in the LG&E system and which would be in effect for no more than 1 percent of the time, or no more than 80 hours per year.



In order to defray a portion of the equipment costs, residential customers who volunteered for the pilot program pay an additional monthly customer charge of \$5. LG&E will recover overall program costs through its existing surcharge which funds energy conservation programs.

Data collected from the participants and control group will be analyzed to determine whether customers are more likely to reduce or shift electric consumption when provided with information on usage and rates and devices that facilitate energy management.

The pilot program will continue for at least three years. Participants were asked to make a one-year commitment.)

LOUISVILLE GAS & ELECTRIC AND KENTUCKY UTILITIES - WITHDRAWAL FROM THE MIDWEST INDEPENDENT SYSTEM OPERATOR – Case No. 2003-00266

On July 17, 2003, the PSC initiated an investigation into whether Louisville Gas & Electric Co. (LG&E) and Kentucky Utilities Co. (KU) should continue as members of the Midwest Independent System Operator, Inc. (MISO). MISO is a non-profit corporation formed by LG&E and KU and numerous other transmission-owning utilities in the Midwest for the purpose of independently controlling and operating its members’ transmission facilities. MISO also has been approved by the Federal Energy Regulatory Commission (FERC) to operate as a regional transmission organization, or RTO. LG&E and KU joined MISO in 1998.

The PSC opened the proceeding to examine four issues:

- ◆ Whether the utilities benefit from MISO membership.
- ◆ Whether MISO’s expansion into areas not in its original mission would interfere with state regulation of the utilities.
- ◆ Whether the two utilities should have sought PSC approval prior to transferring control of their transmission systems to MISO.
- ◆ Whether LG&E and KU would be better served by joining an RTO based in the South, where utilities operate under regulatory schemes similar to that in Kentucky.

Subsequently, the proceeding was expanded to consider MISO's move to establish and operate an energy market and whether LG&E and KU should consider joining other RTOs, not just those based in the South.

Intervenors in the case included the Kentucky Office of Attorney General, MISO, and Kentucky Industrial Utility Customers, Inc. LG&E, KU, and MISO filed extensive testimony. Hearings were held on Feb. 25-27, 2004 and April 8, 2004. On June 22, 2004, the PSC reopened the record to receive additional evidence on MISO's new Transmission and Energy Markets Tariff.

A final hearing was held on July 20, 2005. On March 17, 2006, FERC gave approval for the two utilities to withdraw from MISO.

The PSC, in an order issued on May 31, 2006, followed suit, ruling that allowing LG&E and KU to withdraw from MISO would serve the interests of their customers by reducing costs and maintaining local control over key aspects of the utilities' operations. The PSC action cleared the way for the two utilities to begin the withdrawal process.

Even though the utilities were to pay MISO an exit fee estimated at about \$40 million, they argued that getting out of MISO would produce annual savings of \$4 million to \$13 million. The PSC found the utilities' analysis more persuasive than a MISO-produced study claiming net benefits for continued membership.

LG&E and KU were ordered to balance the exit fee against the money that will be saved by no longer paying MISO administrative fees, and account for both in their next request for a rate adjustment.

The PSC also found that MISO's creation of a wholesale energy market, combined with MISO's functional control of the LG&E and KU transmission system, had the effect of reducing the ability of the PSC to exercise jurisdiction over LG&E and KU's electric costs.

LG&E and KU retained the Tennessee Valley Authority (TVA) to provide grid reliability coordination services and the Southeast Power Pool (SPP) to comply with FERC requirements regarding electric power marketing. The TVA and SPP agreements were approved separately by the PSC.

LOUISVILLE GAS & ELECTRIC - PROPERTY TRANSFER FOR LOUISVILLE ARENA – Case No. 2006-00391

On August 24, 2006, Louisville Gas & Electric Co. (LG&E) applied to the PSC to transfer property in downtown Louisville to the Louisville Arena Authority, Inc. for use as a portion of the site for a new arena.

The PSC approved the transaction on September 28, 2006, saying that the agreement between LG&E and the Arena Authority adequately protected LG&E customers.

The Arena Authority was to pay LG&E \$10 million for the property and an estimated \$63 million to relocate LG&E facilities, notably a major electric substation and gas transmission lines.

Two outmoded natural gas-fired electric generators on the site will be abandoned. The PSC determined they were not needed to provide service reliability.

LG&E bore the cost of relocating its electric transmission control facilities, which were due for replacement with newer technology. The relocation was estimated to cost \$15.5 million, but the company agreed to not seek a rate increase solely for the purpose of recovering the cost in its electric rates.

The PSC's order required LG&E to file with the PSC any changes to the agreement with the Arena Authority and to submit a full accounting of the completed transaction.



ELECTRIC RATE CASES

LOUISVILLE GAS & ELECTRIC AND KENTUCKY UTILITIES - GENERAL RATE ADJUSTMENTS/EARNING SHARING MECHANISMS – Case Nos. 2003-00433, 2003-00434, 2003-00335, 2003-00334

Louisville Gas & Electric Co. (LG&E) and Kentucky Utilities Co. (KU) filed applications for adjustments to their base electric rates on Dec. 29, 2003. LG&E's application also requested an adjustment in its base rates for natural gas distribution.

KU requested a \$58.2 million annual electric revenue increase. LG&E applied for a \$63.7 million increase in annual electric revenue. On March 31, 2004, the PSC consolidated the rate increase cases with several other rate-related matters involving LG&E and KU.

The PSC granted intervention to a number of parties in one or both cases. They included the Kentucky Office of Attorney General, the U.S. Department of Defense, the Division of Energy of the Kentucky Environmental and Public Protection Cabinet, the Kentucky Industrial Utility Customers, Inc., The Kroger Company, North American Stainless, L. P., the Kentucky Association for Community Action, Inc., the Metro Human Needs Alliance, People Organized and Working for Energy Reform, and the Community Action Council for Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc.

Hearings in the case began as scheduled on May 4, but were suspended to permit ongoing settlement discussions. On May

5, all parties except the Attorney General reached a settlement on all issues in the cases. The Attorney General accepted settlement on all issues except the amount of electric rate increases.

The hearing on the electric rate increases resumed on May 6, but was continued in order to allow the settlement document to be prepared for submission to the PSC. The hearing concluded on May 12.

On June 30, 2004, the PSC issued its decision in the cases. It accepted the settlement reached by all parties on all issues except the electric rates.

LG&E was granted a \$43.4 million increase in annual revenue, which was 32 percent less than requested. KU was allowed a \$46.1 million increase in annual revenue, 21 percent less than requested. In both cases, the amounts were consistent with the settlement reached by all parties except the Attorney General.

Five days after the PSC's approval of the rate adjustment, the Attorney General issued civil subpoenas and document requests to the PSC and announced an investigation into alleged collusion and improper *ex parte* contacts regarding the electric rate adjustments granted LG&E and KU. (*Ex parte* contacts are those in which all parties to a case do not have the opportunity to participate. They are generally deemed improper only if substantive issues are discussed.) The allegations had been made by the Attorney General following the conclusion of settlement negotiations. At the hearing that day, all parties to the case had been queried on the record and had stated they

were unaware of any improper *ex parte* contacts.

On July 15, 2004, the PSC reopened the record in both the LG&E and KU rates cases in order to conduct its own investigation. At the same time, the PSC cooperated fully with the Attorney General's requests to interview PSC members and staff and also provided the Attorney General with access to the requested PSC documents. In the interest of such cooperation, the PSC on Aug. 12, 2004, suspended its investigation pending completion of Attorney General's investigation.

The Attorney General delivered his report to the PSC on Feb. 28, 2005. It remains under seal by order of the Franklin Circuit Court. After receiving the Attorney General's report, the PSC retained independent counsel in order to complete its investigation into whether there had been improper conduct in deciding the cases. The independent counsel's investigation included a review of the record and sworn testimony from 38 people, both inside and outside the PSC, who participated in the case.

The independent counsel's report was issued Dec. 14, 2005. It determined that there was no improper conduct involved in the PSC's approval of electric rate increases for LG&E and KU and found no evidence of improper *ex parte* contacts. Therefore, the PSC decided not to reconsider its decision in the LG&E and KU rate cases.

KENTUCKY POWER - GENERAL RATE ADJUSTMENT – Case No. 2005-00341

Kentucky Power Co., a subsidiary of American Electric Power Corp. (AEP), on September 26, 2005, filed an application seeking an increase in annual revenue of \$64.8 million or 19.2 percent. After deficiencies were corrected, the application was deemed complete and accepted as of October 11, 2005.

Kentucky Power serves 175,000 consumers in all or portions of 20 counties in eastern Kentucky. Its previous base rate increase had been awarded in December 1984.

Intervention was granted to the Kentucky Office of Attorney General, the Kentucky Industrial Utility Customers, Inc., the Kentucky Cable Telecommunications Association, and the Kentucky Association for Community Action, Inc.

On February 7, 2006, Kentucky Power and the intervenors submitted to the PSC a unanimous settlement agreement which addressed and resolved all issues pending in the rate case. A hearing on the settlement agreement was conducted that day. Revisions to the settlement agreement were filed with the PSC on March 3, 2006.

The PSC accepted the settlement on March 14, 2006. The settlement raised base rates for Kentucky Power residential customers by about \$11 per month, or 14.7 percent. The agreement increased annual revenue by \$41 million, an overall increase of 12.13 percent.

Included in the settlement was a monthly charge of 10 cents per residential customer to fund a program to assist low-income rate-payers. The program was ex-

pected to raise \$174,000 annually, which Kentucky Power pledged to match for at least two years.

In its order accepting the settlement, the PSC praised Kentucky Power for the corporate contribution, which will come from AEP's shareholders.

The settlement also provided for the inclusion of about \$28 million in annual environmental costs in Kentucky Power's revenue base. The costs, which reflect environmental compliance costs at Kentucky Power's facilities as well as a share of environmental improvements throughout the AEP Midwest system, had been recovered through a surcharge.



The PSC noted that the settlement agreement did not address the question of how much Kentucky Power spends on managing vegetation in its rights of way. Vegetation issues, such as trees falling into power lines, are the single largest cause of outages in the Kentucky Power system.

When it applied for the rate increase, Kentucky Power had proposed to increase spending significantly on managing vegetation in its power line corridors. During a hearing on the settlement, the company said that the lower revenue included in the settlement will prevent implementation of the more aggressive program of vegetation management it had proposed.

DUKE ENERGY KENTUCKY - GENERAL RATE ADJUSTMENT – Case No. 2006-00172

On May 31, 2006, Duke Energy Kentucky, Inc. submitted an application to increase its annual revenue from retail sales of electricity by \$66.56 million, an increase of nearly 28 percent. After deficiencies were corrected, the application was accepted by the PSC on June 16, 2006.

At the time, Duke Kentucky served about 132,000 electric customers in all or portions of five counties in Northern Kentucky. Its last increase in electric rates occurred in May 1992.

Intervening in the case were the Kentucky Office of Attorney General, The Kroger Company, and the St. Elizabeth Medical Center.

On October 26, 2006, Duke Kentucky and the intervenors filed a unanimous settlement agreement with the PSC, resolving all issues in the case. A public hearing on the settlement was held on October 30, 2006.

The PSC accepted the settlement in an order issued December 21, 2006. The settlement agreement allowed Duke Kentucky an annual revenue increase of \$49 million. The increase includes a roll-in of \$20 million in annual fuel costs and a resetting of the fuel surcharge to zero.

For an average residential electric customer, the settlement projected an increase in the monthly bill of \$8.61, or 11.8 percent. That was less than half the amount originally requested by Duke Kentucky. The company had sought to raise the average monthly residential bill by \$17.57 (24.1 percent).

The rates adopted in the settlement more accurately reflect the costs of serving each type of customer, whether residential, commercial or large industrial. The settlement also addressed numerous other issues, including depreciation rates, accounting procedures and certain other rates and services.

EAST KENTUCKY POWER – GENERAL RATE ADJUSTMENT/INTERIM RATE RELIEF/ INVESTIGATION OF FINANCIAL CONDITION – Case Nos. 2006-00472 and 2006-00455

On October 27, 2006, the PSC, noting the deteriorating financial condition of East Kentucky Power Cooperative, Inc. (EKPC), opened an investigation into the causes of EKPC's financial difficulties and possible remedial actions.

Subsequently, on January 27, 2007, EKPC submitted an application to increase annual revenue by \$43 million and requested that the increase be granted on an emergency and interim basis pending a full examination by the PSC. After deficiencies were corrected, the application was accepted as of February 6, 2007.

Intervention was granted to the Kentucky Office of Attorney General, the Kentucky Industrial Utility Customers, Inc. and the Cumberland Chapter of the Sierra Club. Gallatin Steel Company and the Attorney General separately intervened in the financial investigation.

A hearing in the rate case was held on March 22, 2007.

On April 1, 2007, the PSC granted EKPC the immediate rate increase, saying it was needed to maintain the utility's financial and operational viabil-

ity. Since suffering an unplanned outage in 2004 at one of its electric generating facilities, "East Kentucky's financial condition has steadily and consistently deteriorated and shows no immediate signs of improvement," the PSC said.

The financial problems threatened to impair EKPC's operations, which could affect the reliability of service to the 16 distribution cooperatives to which it provides electricity, the PSC said. EKPC is owned by those distribution cooperatives, which serve about 500,000 customers in 89 Kentucky counties.

The interim rate adjustment effectively increased EKPC's annual revenues by about \$19 million. The rate increase was passed through to the customers of the distribution cooperatives, with specific increases to be determined for each cooperative in the next 10 days.

The request for a \$43 million increase remained pending before the PSC.

A utility normally must wait at least five months before putting

any proposed new rates into effect. When it asked for the \$43 million increase, EKPC, citing its financial condition, asked to be allowed to put the rates into effect immediately.

The request for immediate rate relief was later revised to \$19 million on an annualized basis, based on an agreement with other parties to the case.

In granting the interim increase, the PSC noted a number of factors that contributed to EKPC's financial condition. The power plant outage forced EKPC to purchase electricity from outside its system, driving up its costs. EKPC also faces possibly having to pay substantial penalties to the U.S. Environmental Protection Agency for alleged violations at some of its generating facilities.

The utility borrowed money to finance new generation facilities, driving up its interest expenses. As a result, EKPC's credit ratings declined, making it more expensive for the utility to borrow additional funds.



Furthermore, EKPC faced additional costs associated with the Army Corps of Engineers' lowering of Lake Cumberland during repairs to Wolf Creek Dam. EKPC expected to spend about \$25 million to maintain operations at its Cooper generating station, which draws water from the lake, and also faced the prospect of having to purchase higher-cost electricity to replace inexpensive hydroelectric power it normally receives from the Corps of Engineers' own power station at Wolf Creek Dam.

The PSC noted that EKPC was unable to meet certain requirements of its loan agreement with the Rural Utilities Service, the federal agency which lends money to electric cooperatives at favorable interest rates.

Because of EKPC's circumstances, the PSC ordered the utility to begin providing additional financial information, including monthly reports of revenues and expenses.

EKPC on May 1, 2007, filed with the PSC a "plan of remedy" intended to restore compliance with certain requirements of its loan agreement with the Rural Utilities Service. The plan anticipated applications for several rate increases in the next few years.

On June 19, 2007, the PSC closed the investigation of EKPC's financial condition, saying that "the pending general rate case affords a more suitable proceeding for EKPC's financial challenges to be evaluated."

(EKPC, the Attorney General and the Kentucky Industrial Utility Customers reached an agreement in the rate case and presented it to the PSC on Au-

gust 31, 2007. The Sierra Club was not a party to the agreement. The agreement provided for an additional annual increase in revenues of \$19.5 million over the interim increase of \$19.0 million, for a total increase of \$38.5 million. It also called for a redesign of EKPC's rates.

A public hearing was held on September 5, 2007. On December 5, 2007, the PSC – saying it could not consider the proposed agreement because it was not unanimous - instead made permanent a \$19 million increase in annual revenue that had been granted to EKPC on an interim basis in April.

While the increase was only about half the amount requested by EKPC, the PSC noted in its order that EKPC indicated it will request two or three more rate increases in the next four or five years "in order to keep its finances on a strong footing."

The PSC was unable to grant the increase requested by EKPC because the company structured the rate request in ways that did not conform to accepted rate-making principles. Bringing the request into line with established ratemaking principles and precedents lowered the allowed revenue increase down to just below \$19 million. After examining all the evidence, the PSC concluded that the interim increase of \$19 million should be made permanent.

The PSC ordered EKPC to continue providing additional financial information, including monthly reports of revenues and expenses.)

KENTUCKY UTILITIES AND LOUISVILLE GAS & ELECTRIC - ENVIRONMENTAL SURCHARGE MECHANISMS – Case Nos. 2006-00206 and 2006-00208

Kentucky Utilities Co. and Louisville Gas & Electric Co., both subsidiaries of E.ON U.S. LLC, on June 23, 2006, filed applications pursuant to KRS 278.020 (1) and 278.183, requesting approval of an amended compliance plan for purposes of recovering the costs of new and additional pollution control facilities and an amended environmental cost recovery surcharge.

Intervention was granted to the Kentucky Office of Attorney General and Kentucky Industrial Utility Customers, Inc. A hearing in the two cases was held November 8, 2006.

On December 21, 2006, the PSC approved the environmental improvement projects proposed by LG&E and KU. The PSC also authorized the companies to begin recovering their portion of the air emission control costs associated with the construction of a new 750-megawatt coal-fired generation facility at their Trimble County station.

All of the projects were required in order for KU and LG&E to comply with government regulations, particularly U.S. Environmental Protection Agency (EPA) requirements to reduce air emissions from coal-fired power plants.

KU's five new projects had an estimated cost of about \$325.1 million. LG&E estimated its four new projects will cost a total of about \$65.8 million. The new Trimble County facility represents about \$185 million of the



CUMBERLAND VALLEY ELECTRIC – GENERAL RATE ADJUSTMENT/FOCUSED MANAGEMENT AUDIT – Case No. 2005-00187

On July 22, 2005, Cumberland Valley Electric, Inc. applied for a \$1.4 million increase in annual revenue from retail electric sales, an increase of nearly 5 percent.

The Kentucky Office of Attorney General was granted intervention in the case. As permitted by law, Cumberland Valley put its proposed rates into effect on February 4, 2006. The increase – the rural electric cooperative’s first in 26 years – would raise the average monthly residential bill by \$5.10 (7.1 percent), to \$76.76.

Public hearings were conducted on April 11, 2006, and April 14, 2006.

Cumberland Valley has about 23,000 member-customers in eight counties in southeast Kentucky. It is one of 16 distribution cooperatives that jointly own and purchase power from East Kentucky Power Cooperative.

The PSC approved the higher rates on June 2, 2006. The PSC said the increase was necessary in order for Cumberland Valley’s revenue to keep pace with expenses and stay within financial guidelines established by the Rural Utility Service (RUS), the federal agency which provides low-interest loans to rural electric cooperatives.

The PSC noted that information arising out of the rate review had raised questions about certain aspects of Cumberland Valley’s operations. Therefore, the PSC ordered that a focused management audit be conducted to review the cooperative’s management, its business and operating policies and procedures, its finan-

KU total cost and about \$43 million of the LG&E total. LG&E and KU are paying for and will own 75 percent of the new Trimble County facility, with the remainder paid for and owned by municipal utilities in Indiana and Illinois.

The emission controls for the new Trimble County power plant were approved as part of the PSC’s overall approval of the \$1.1 billion facility in November 2005. The emission controls at the Trimble County facility include equipment to reduce emissions of sulfur dioxide, sulfur trioxide, nitrogen oxide and soot. KU estimated the additional monthly surcharge for an average residential customer would be 82 cents in 2007, rising to \$2.52 by 2010. LG&E estimated the additional monthly surcharge for the average customer would be 41 cents in 2007 and 76 cents by 2010.

The other projects include:

- ◆ Installation of monitors to measure mercury emissions at all LG&E and KU power plants.
- ◆ Addition of equipment to remove sulfur trioxide from boiler exhaust at KU’s Ghent plant in Car-

roll County, LG&E’s Mill Creek plant in Jefferson County and the existing plant in Trimble County.

- ◆ Installation of equipment to reduce nitrogen oxide emissions from KU’s Ghent plant.
- ◆ Improvements to soot controls at KU’s E.W. Brown plant in Mercer County.
- ◆ New soot monitors at LG&E’s Mill Creek plant.

Using pollution-control equipment – commonly known as “scrubbers” – to remove sulfur dioxide enable a utility to use high-sulfur coal, which is generally less costly than low-sulfur coal. Electric utilities in Kentucky are required to pass on to consumers any savings that result from reductions in fuel costs.

The PSC denied a request by LG&E and KU to begin recovering the projected operating and maintenance costs for the emission control equipment at the new Trimble County facility. The Commission ruled that such cost recovery would be premature.

cial accountability and the role of its board of directors.

Cumberland Valley said it had no objection to the audit. The independent audit was performed by Vantage Consulting Inc., and paid for by Cumberland Valley.

The PSC released the audit findings on May 9, 2007. The audit found that Cumberland Valley “does an excellent job of providing reliable service at a reasonable cost,” given the difficulties inherent to providing electricity in a very rural and mountainous area.

Key findings of the audit include:

- ◆ Cumberland Valley is headed by an experienced, effective, capable and committed management team that adheres to a strict work ethic.
- ◆ Succession planning should be undertaken to ensure that experienced senior managers will be replaced with competent employees who can continue the success of the cooperative.
- ◆ Cumberland Valley’s organization is flexible and appropriate for the size of the company. Its staffing level of 52 employees reflects a desire to control costs while providing adequate service.
- ◆ Cumberland Valley generally falls in the top third for most statistical measures in comparison to the other 23 electric distribution cooperatives in Kentucky.
- ◆ Cumberland Valley has implemented a number of technological improve-

ments, including automated meter reading and electronic mapping of all equipment and facilities.

- ◆ Cumberland Valley has specific plans in place to upgrade three of its substations, further reducing system electric losses. It also continues to address system issues that arise due to the electric load at coal mines in the region.
- ◆ The procurement process at Cumberland Valley is well designed with appropriate procedures and controls in place. After extensive analysis of recent major purchases, the consultants could find no reason for concern.
- ◆ Concerns about the internal audit functions at Cumberland Valley were addressed and resolved before the PSC audit was complete.
- ◆ The employees at Cumberland Valley are competent, committed and flexible. They understand the need to work in a safe manner, yet ensure quick responses to outages. The typical practice of hiring the best contract employees after they have experience provides a base of proven and tested employees.
- ◆ Most training, except for safety training, is provided through on-the-job experience. There is some concern that there needs to be a more formalized program and assurance that each employee is fully capable.

The final audit report contains four recommendations for Cumberland Valley:

- ◆ Develop a succession plan that addresses the potential retirement of the general manager.
- ◆ Institute a formal program for training all new members of the board of directors.
- ◆ Cumberland Valley should investigate the possibility of establishing a joint internal audit function through a utility cooperative association, or a joint agreement with other utilities.
- ◆ Perform an assessment of training needs, identify deficiencies for individual employees and address any needs.



Generating Facility Cases

EAST KENTUCKY POWER COOPERATIVE – SPURLOCK STATION - Case No. 2004-00423

In October 2004, East Kentucky Power Cooperative, Inc. (EKPC) applied for a certificate to construct a second circulating fluidized bed generating unit, with 278 megawatts of capacity, at its H.L. Spurlock Power Station near Maysville.



EKPC said the unit was needed to meet the demand created by its commitment to begin supplying power in 2008 to the Warren Rural Electric Cooperative Corp. (RECC). Warren RECC had proposed to stop buying power from the Tennessee Valley Authority in 2008.

The PSC granted the certificate on September 12, 2005.

EKPC is owned by the 16 distribution cooperatives to which it provides wholesale electric generation and transmission service. Those distribution cooperatives serve about 500,000 customers in 89 Kentucky counties.

The new unit is the fourth at Spurlock. It will use a technology known as circulating fluidized bed (CFB), which burns coal more cleanly than conventional boilers without the need for extensive pollution-control equipment. EKPC earlier this year began operating a nearly identical 268-megawatt CFB unit at Spurlock.

In its review of EKPC's application, the PSC concluded that construction of the new plant would be the most cost-effective

way for the utility to meet its future need for base load generation.

When Warren RECC decided to remain as part of the TVA system, the PSC initiated a review (described in detail below) of EKPC's planned additional generating capacity. EKPC was permitted to retain the certificate for the Spurlock unit in order to meet future needs.

EAST KENTUCKY POWER COOPERATIVE – SMITH STATION - Case No. 2005-00053

In January 2005, EKPC sought permission to construct a coal-fired unit and five gas-fired units at its J.K. Smith Power Station in Clark County. EKPC proposed to build a 278-megawatt circulating fluidized bed identical to the second such unit at its Spurlock station. The five gas-fired turbines had capacities of 90 megawatts each and were to be used to supply power at times of peak demand.

The PSC granted certificates for the facilities on August 29, 2006.

EKPC stated that it requires the additional generating capacity to meet rising demand from its 16 member electric cooperatives and additional load that would be created when it begins supplying power in 2008 to the Warren Rural Electric Cooperative Corp.

The coal-fired unit, with a capacity of 278 megawatts, will be the first at Smith. It will use a technology known as circulating fluidized bed (CFB), which burns coal more cleanly than conventional boilers without the need for extensive pollution-control equipment. EKPC operates seven gas-fired turbine generators of varying capacities at the Smith facility.

EKPC said three of the new units would be needed to meet the increasing needs of EKPC's current members, while two would be needed in 2008 to supply Warren RECC.

In its review of EKPC's application, the PSC concluded that construction of the new plant would be the most cost-effective way for the utility to meet its future need for base load and peaking generation. The additional generation would reduce EKPC's need to purchase power from outside sources.

The new generating facilities were proposed in the same general location as a 540-megawatt plant proposed earlier by Kentucky Pioneer Energy, which in 2000 had contracted to sell power to EKPC. Kentucky Pioneer was unable to begin construction of the plant on schedule and EKPC terminated the contract in October 2004.

Following Warren RECC's decision not to purchase power from EKPC, the PSC initiated a review of the continued need for the facilities. EKPC was permitted to retain the certificates for the coal-fired unit and two of the gas turbines, and voluntarily relinquished the certificates for the remaining three units.

EAST KENTUCKY POWER CO-OPERATIVE – REVIEW OF GENERATION NEEDS – Case No. 2006-00564

On January 5, 2007, the PSC initiated a review of EKPC's continued need for additional generating capacity. The review was triggered by a decision by the 30,000-customer Warren Rural Electric Cooperative Corp. (RECC) to rescind its contract to purchase its power from EKPC. The addition of the Warren RECC customers, along with projected growth throughout its system, has prompted EKPC to apply for and receive certificates to construct two coal-fired

baseload units and five gas-fired peak units.

The PSC concluded its review on May 11, 2007, allowing EKPC to proceed with construction of most of the new electric generating facilities. The PSC said the new power plants will be needed despite Warren RECC's decision.

EKPC was allowed to complete construction of a coal-burning 278-megawatt plant near Maysville in Mason County and to build a similar generating facility near Trapp in Clark County. The PSC also allowed EKPC to build two of the five 90-megawatt gas-fired turbine generators planned at its Clark County plant. EKPC voluntarily dropped plans for the other three.

In allowing EKPC to continue expanding its generating capacity, the PSC said it was balancing the cost of constructing the plants and possibly creating excess capacity against the costs of canceling or delaying projects already underway and the potential costs to EKPC and its customers should the utility have to purchase power from outside suppliers.

In its review, the PSC examined the need for each facility individually.

EKPC had already invested more than \$210 million in the 278-megawatt Spurlock 4 plant in Mason County. It was scheduled for completion in April 2009. The PSC said that the power from Spurlock 4 will be needed in order to meet growing demand from the other 16 distribution cooperatives that both own and purchase power from EKPC.

Completion of the similar Smith 1 plant was delayed a year, to

June 2011. EKPC had invested more than \$50 million in the plant at the time of the PSC review. The delay reduced the likelihood that EKPC will find itself with excess generating capacity, the PSC said.

Unlike the coal-burning plants, which are used to meet steady demand for power, EKPC's gas turbine generators are used mostly to supply electricity during short periods of peak demand. After Warren RECC decided to remain with TVA, EKPC voluntarily decided to build only two of the five units which the PSC had authorized in November 2006. The PSC said the remaining two gas turbine units may proceed. EKPC said it would not reapply for the others until 2011 at the earliest.

EAST KENTUCKY POWER CO-OPERATIVE – SPURLOCK SCRUBBERS – Case No. 2005-00417 and 2006-00132

During the biennium, EKPC sought approval of two major emission control projects at its H.L. Spurlock Power Station in Mason County. Both projects involved construction of scrubbers.

The need for both units was triggered by new U.S. Environmental Protection Agency (EPA) rules – announced in December 2003 and finalized in March 2005 – requiring companies to achieve substantial further reductions in sulfur dioxide emissions by 2010. The scrubbers also reduce emissions of small particulates.

Under Kentucky law, EKPC will recover the cost of the scrubbers through a surcharge on the electric bills of customers served

by the rural electric cooperatives to which EKPC provides power. The impact on individual electric bills will depend on actual construction costs, interest rates and other factors.

The first scrubber was approved by the PSC on April 18, 2006. The \$159 million scrubber was to be added to the Spurlock 2 unit.

EKPC predicted that the cost of the scrubber would be offset by lower fuel costs, since the scrubber will enable the Spurlock unit to burn high-sulfur coal, which is generally less expensive than low-sulfur fuel. Electric utilities in Kentucky are required to pass on to consumers any savings that result from reductions in fuel costs.

The scrubber will produce an estimated total cost savings of \$338 million in the 29 years following its start-up in 2008, EKPC said in its application.

EKPC first added a scrubber to Spurlock 2 in 1982, enabling the utility to use high-sulfur coal, which is generally less costly than low-sulfur coal. But, after operating the scrubber for 9,000 hours, EKPC concluded that it was less expensive to burn low-sulfur coal and purchase emission allowances in order to meet emission requirements, so it mothballed the scrubber.

Most low-sulfur coal is mined in Wyoming and other western states, with smaller quantities coming from Appalachia. High-sulfur is abundant in Appalachia and the Illinois Basin, which includes the coalfields of western Kentucky.

EKPC considered three options: refurbishing the old scrubber, modifying the old scrubber to use less expensive technology,

and building an entirely new scrubber. Based on operational costs and construction estimates, EKPC concluded that a new scrubber would be the least expensive option over the long term.

On August 11, 2006, the PSC approved construction of a second scrubber at the Spurlock Station. The \$142 million scrubber will be added to the Spurlock 1 unit.

EKPC predicted that the costs of the second scrubber also would be offset by lower fuel costs, since the scrubber will enable the Spurlock unit to burn high-sulfur coal.

EKPC examined three options for meeting the new standards: burn low-sulfur coal from the Central Appalachians and purchase emission allowances as needed; burn low-sulfur coal from Wyoming and Montana and buy emission allowances; and construct the scrubber, which will allow the use of high-sulfur coal from Kentucky and nearby states

An economic analysis showed that building the scrubber would be less expensive than using low-sulfur Appalachian coal, with savings of about \$206 million over 30 years. The scrubber would produce minimal savings when compared to the use of low-sulfur Powder River Basin coal from Wyoming and Montana.

The PSC said that the scrubber is reasonable and cost-effective way for EKPC to comply with the new air emission standards.

EAST KENTUCKY POWER COOPERATIVE – COOPER STATION MODIFICATIONS – Case No. 2007-00168

In late 2006 and early 2007, the U.S. Army Corps of Engineers began lowering the water level in Lake Cumberland because of concerns over the structural integrity of Wolf Creek Dam, which is undergoing repairs to stop persistent leaks.

The Corps of Engineers initially lowered the level to an elevation of 680 feet. In February, the Corps of Engineers warned EKPC and others who use lake water that the level might have to be lowered another 30 feet in order to keep the dam stable.

EKPC's 341-megawatt John Sherman Cooper Power Station is on Lake Cumberland near Somerset. It draws its water from the lake.

On May 11, 2007, following an expedited review that took only two weeks, the PSC allowed EKPC to modify the Cooper Station in order to keep power flowing if the water level in the lake is lowered again.

The modifications, costing about \$24 million, include barge-mounted pumps to draw water from deeper in the lake and a cooling tower system that will significantly reduce water use at the plant.

Loss of the Cooper station's output would have raised costs for the customers of the 16 electric distribution cooperatives that purchase power from EKPC and harmed the area's economy by disrupting power supplies.

Water intakes for the Cooper station are at 670 feet and cannot operate if the water level falls below 675 feet. The modifications allow Cooper to remain in full operation if water levels in Lake Cumberland fall to 650 feet and in partial operation at lower levels.

EKPC purchases a portion of the electricity generated by the hydroelectric plant at Wolf Creek Dam. A further lowering of the water level in Lake Cumberland would shut down not only the Cooper station, but the dam's generators as well.

Losing the generating capacity of both facilities would force EKPC to purchase costly power from outside sources, with the higher cost passed on to consumers. Even with the outside power, EKPC might be unable to meet peak demand, necessitating periodic power outages (rolling blackouts) in its service area in south-central Kentucky.

To keep the Cooper plant in operation, EKPC proposed to spend nearly \$8 million for seven barge-mounted pumps that together can supply up to 70,000 gallons per minute of water to the flow-through cooling system for the smaller of the plant's two generating units. The pumps also provide water for a cooling tower to serve the larger unit.

Because a cooling tower recirculates water, the changes reduced the plant's water use by more than half, from the previous maximum usage of 150,000 gallons per minute. The cooling tower cost \$15 million, with engineering work adding \$1 million to the cost of the project.

Completion of the project was expected by Dec. 31, 2007, the date by which the Corps of Engineers warned lake users to be ready for a possible lowering of the water level to 650 feet.

LOUISVILLE GAS AND ELECTRIC/KENTUCKY UTILITIES – TRIMBLE COUNTY PLANT EXPANSION - Case No. 2004-00507

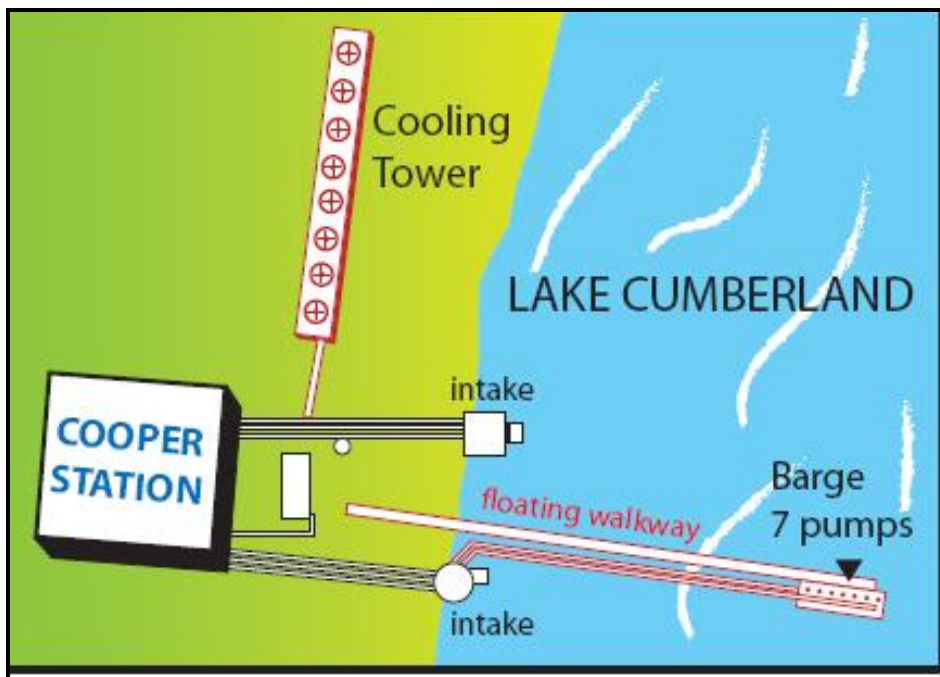
In December 2004, Louisville Gas & Electric Co. and Kentucky Utilities Co. sought a certificate to expand the Trimble County electric generating plant near Bedford by constructing a 750-megawatt coal-fired generating unit at the plant. The cost of the new unit was projected at \$1.1 billion and the planned completion date was in 2010.

The Trimble County Station currently includes a 514-megawatt coal-fired unit and six gas turbine generators with a total capacity of more than 900 megawatts.

KU would own 81 percent and LG&E 19 percent of their joint 75 percent share of the facility. Costs would be allocated to the utilities' ratepayers in the same proportion. The Illinois Municipal Electric Agency and the Indiana Municipal Power Agency would jointly own 25 percent of the new facility. Their application was considered separately by the Kentucky State Board on Electric Generation and Transmission Siting.

On November 1, 2005, the PSC approved the project, saying that the new unit appears to be needed to meet projected demand for electricity in the area served by the two utilities. However, if that demand does not materialize, the companies should be prepared to modify the project, the PSC said.

LG&E and KU were ordered to notify the PSC "immediately if they notice any material divergence between their (demand) forecasts and actual usage that



could call into question the advisability of further pursuit of construction” of the new unit, the PSC said. Under those circumstances, the PSC could reopen the case.

The PSC said falling short of needed capacity is riskier than overbuilding. A shortfall creates a need to generate or purchase high-priced peaking power that ultimately would be paid for by consumers, a risk “of such significance that it should be avoided, if at all possible,” the PSC said.

If it appears that LG&E and KU are building too much capacity, the project can be slowed or even canceled before too much money is invested in it, the PSC said.

While declining to require certain hiring practices, as requested by labor unions, the PSC said it “strongly encourage(s) the Companies to provide as many jobs as possible to Kentucky citizens.”

UNION LIGHT, HEAT AND POWER - ACQUISITION OF GENERATING CAPACITY – Case No. 2003-00252

In February 2007, the PSC gave its final approval to a proposal by what was at the time Union Light, Heat and Power Co. (ULH&P) to purchase electric generating capacity from its parent company, The Cincinnati Gas & Electric Co. (CG&E).

Under the transaction, originally applied for on December 5, 2003, ULH&P acquired partial or total ownership of three power plants owned and operated by CG&E. Final approval of the acquisition was conditioned on the PSC’s review of the final transaction documents between

ULH&P and CG&E. Both companies were then subsidiaries of Cinergy Corp.

The final approval was delayed as a result of the merger of Cinergy with Duke Energy Corp.

The acquisition was intended to protect ULH&P’s customers by placing the company’s generating facilities under PSC regulation. ULH&P had been relying on power purchased from CG&E, which operates in the deregulated market in Ohio, putting ULH&P at risk of potential future fluctuations in wholesale power prices.

The purchase of the generating facilities stemmed from the PSC’s approval in 2001 of a new power purchasing agreement between ULH&P and CG&E. At that time, the PSC urged ULH&P to consider acquiring its own generating capacity in order to protect itself from the impacts of market prices for wholesale power.

The generating capacity acquired totals 1,105 megawatts (MW) and includes:

- ◆ CG&E’s 69% share in the 648 MW East Bend No. 2 coal-fired baseload unit in Rabbit Hash, KY.
- ◆ Miami Fort No. 6, a 168 MW coal-fired unit in North Bend, Ohio.
- ◆ The 490 MW Woodsdale Generating Station in Trenton, Ohio, which consists of six gas-fired turbines used only during periods of peak demand.

Electric Transmission Line Siting Cases

The 2004 Kentucky General Assembly enacted legislation requiring utilities to obtain certificates of public convenience and necessity for most new electric transmission lines of 138 kilovolts or more and greater than a mile in length (KRS 278.020 (2)). The legislation also provided for intervention by affected landowners and hearings in the affected county (KRS 278.020 (8)). The PSC promulgated regulations further outlining the application and review process for new transmission lines (807 KAR 5:120). No significant transmission line cases were conducted during the 2005-2007 biennium. The cases summarized below were initiated during the 2003-2005 biennium and concluded during the 2005-2007 biennium.

East Kentucky Power Cooperative – Case No. 2005-00089

EKPC proposed to construct 6.9 miles of 138-kilovolt line that would connect a substation near Morehead to a substation near Triplett. About 4.8 miles of the proposed line was across the Daniel Boone National Forest. After initially rejecting the proposal because EKPC had not shown sufficient evidence that other routes were not practical, the PSC granted a certificate for the line in April 2006. Public meetings regarding the line were held in Morehead.

Louisville Gas and Electric Co./
Kentucky Utilities Co. - Case No.
2005-00142

Louisville Gas and Electric Co. (LG&E) and Kentucky Utilities Co. (KU) proposed to construct 41.9 miles of 345-kilovolt line to extend from LG&E's Mill Creek Generating Station in southwest Jefferson County to KU's Hardin County substation southwest of Elizabethtown. The PSC initially denied the application, citing insufficient evidence that other routes had been fully considered. LG&E and KU subsequently resubmitted applications for two alternative routes, the first slightly different from the original and the second substantially different. The PSC granted a certificate for the slightly modified route in May 2006. Public meetings regarding the line were held in Elizabethtown.

Kentucky Utilities Co. - Case No.
2005-00154

KU applied to construct 12.4 miles of 138-kilovolt line that would connect a substation in west Frankfort in Franklin County to the Tyrone substation in Woodford County. A public meeting was held in Frankfort. Following testimony in the evidentiary hearing regarding other routes that would use existing transmission corridors, the PSC rejected the application in September 2005. KU did not resubmit an application.

East Kentucky Power Cooperative - Case No. 2005-00207

EKPC proposed to construct four segments of 161-kilovolt line, totaling about 93 miles, in Barren, Butler, Ohio and Warren counties. About 47 miles of line was in new right-of-way. The

line was to serve the additional load created by the planned entry of the Warren Rural Electric Cooperative Corp. into the EKPC system. A public meeting was held in Bowling Green. The PSC approved the application in October 2005. Warren subsequently reversed its decision to purchase power from EKPC and the certificate was revoked in May 2007.

Siting Board Cases

The Kentucky State Board on Electric Generation and Transmission Siting was created in 2002 by the Kentucky General Assembly to address issues related to the construction of independent electric power generation facilities (also known as merchant power plants) and non-utility-owned electric transmission lines in Kentucky. The Siting Board's areas of oversight include interconnection of independent power facilities with the state's electric infrastructure and environmental and community impact issues, such as noise, visual impacts, economic impacts and traffic, not addressed by other state permitting processes.

The Siting Board consists of the three members of the Kentucky Public Service Commission, the secretary of the Kentucky Environmental and Public Protection Cabinet or his or her designee, the secretary of the Kentucky Cabinet for Economic Development or his or her designee and two local representatives named by the governor for each individual case. The Siting Board administrative functions are carried out by members of the PSC staff.

**THE ILLINOIS MUNICIPAL
ELECTRIC AGENCY/INDIANA
MUNICIPAL POWER AGENCY—
25% OF A 750 MW GENERATING
FACILITY IN TRIMBLE
COUNTY - Case No. 2005-00152**

On May 11, 2005, the Illinois Municipal Electric Agency (IMEA) and the Indiana Municipal Power Agency (IMPA) applied for a certificate for their joint 25 percent ownership of a 750-megawatt coal-fired facility that the Louisville Gas & Electric Co. (LG&E) and the Kentucky Utilities Co. (KU) are proposing to build at LG&E's existing Trimble County Station. Because IMEA and IMPA would be selling their portion of the plant's output on the wholesale market to their member utilities, they are classified as independent power producers and required to apply for a certificate from the Siting Board.

Deficiencies were noted in the application. They were corrected and the application was deemed complete on June 1, 2005. The Siting Board set a procedural schedule for the case that included a local public meeting in Trimble County on July 6, 2005, and an evidentiary hearing at the PSC offices on Sept. 19, 2005.

Further deficiencies were discovered in the application following the local public meeting. The application was again deemed incomplete and was corrected and accepted on July 21, 2005. The evidentiary hearing proceeded as scheduled. The Siting Board approved the application Nov. 16, 2005. It imposed conditions on a number of matters, including noise abatement and mitigation of visual impacts, and encouraged the applicants to use as much local labor as possible in constructing the facility.

Natural Gas Issues and Cases

The 2005-2007 biennium saw wholesale prices again emerge as the dominant natural gas issue. Severe supply disruptions on the Gulf Coast following Hurricanes Katrina and Rita in the fall of 2005 sent prices to record levels. The Kentucky Public Service Commission (PSC), in conjunction with the state's five major local distribution companies (LDCs), again conducted a substantial public information effort aimed at warning the 44 percent of Kentuckians who heat with natural gas to expect higher prices. Explaining the dynamics of the natural gas market and offering information on energy conservation and other steps consumers can take to lessen the impact of price increases.

The PSC also concluded its consideration of a base rate increase sought by one of the major LDCs and received applications for base rate increases from three other major LDCs. Small local distribution companies continued to pose a challenge due to their operational and financial limitations. The PSC oversaw the closure of one such company during the biennium.



NATURAL GAS PRICES

The natural gas market underwent a fundamental transformation during the years 2000 to 2003. This shift first manifested itself in the summer of 2003, which saw wholesale natural gas prices reach record highs for the season.

The underlying reason for the market shift was the increased use of natural gas for electric generation, particularly to meet peak summer demand. This disrupted the previous pattern of seasonal price fluctuations, which saw prices rise during the colder months and decline in the summer.

This historical seasonal pattern made it possible for natural gas distribution companies, particularly those with their own storage facilities, to purchase gas at low prices in the summer and stockpile it for use during the heating season. When the less expensive stored gas was withdrawn during the winter months to meet consumer demand, it would have a moderating effect on overall prices passed on to consumers. This is because gas distribution companies are required to pass on wholesale costs to consumers on a dollar-for-dollar basis through the gas cost adjustment (GCA). The stored gas, when blended with gas purchased during the colder months, would bring down the average cost.

Gas prices did not experience the usual seasonal decline during the summer of 2003. Two factors were at work. Unusually cold weather in late winter of 2003 led to higher than normal late-season gas consumption that depleted stored reserves. As a result, the amount of gas in storage in the spring of 2003

was exceptionally low. This created unusually high demand from companies seeking to replenish gas stockpiles. These companies faced competition for gas from electric generating facilities. As a result, wholesale prices for natural gas during the summer of 2003, as measured by the benchmark price for delivery at the Henry Hub in Louisiana, were at roughly twice the level (\$6 to \$7 per 1,000 cubic feet) generally seen in recent years.

As a result, total retail gas costs were, on a per-volume basis, 30 to 40 percent higher during the 2003-2004 winter heating season than a year earlier. Due to robust demand, summer prices remained high during 2004, and the 2004-2005 heating season saw retail prices increase another 10 to 15 percent.

With demand running close to supply, the stage was set for extreme price volatility in the event of a supply disruption prior to or during the 2005-2006 heating season. Hurricanes Katrina (final landfall on August 29, 2005) and Rita (September 24, 2005) proved to be the perfect triggering events, as they both hit the portion of the Gulf Coast that supplies most of the natural gas used in Kentucky.

Hurricane Katrina's effects were felt mostly by the offshore production facilities along the Alabama and Louisiana coasts. Hurricane Rita did further damage to the offshore facilities, but also shut down much of the infrastructure that processes gas and sends it into the pipeline system to the Midwest and Northeast. The Henry Hub itself was flooded and shut down for a number of days.

At one point, about two-thirds of the production facilities and nearly all of the gas processing capacity was not operating. A month after Rita, natural gas production on the Gulf Coast was still at only half of capacity, with full recovery months away.

The result was an unprecedented price spike. Kentucky's five major natural gas distribution companies expect their wholesale cost in November to be, on average, \$12.95 per 1,000 cubic feet (mcf). That was up \$4.82 from an average of \$8.13 per mcf in November 2004. For an average Kentucky customer using 10 mcf per month, the wholesale cost increase meant a total monthly bill of \$155.25, up from \$107.56 a year earlier and an increase of 44 percent.

In response to the situation in the natural gas markets, the PSC again initiated a major information campaign to prepare consumers for higher heating costs. This effort began in the week following Hurricane Katrina. Shortly thereafter, the PSC convened a meeting with communication representatives of the five major LDCs and other interested state agencies to discuss a continuation of the coordinated communication efforts conducted the previous two years.

This outreach effort continued to focus on informing consumers of the reasons for higher wholesale natural gas prices, explaining to consumers the process by which gas rates are set and wholesale costs passed on through the GCA, providing consumers with advice on weatherization, even-payment plans and other means of reducing gas usage or coping

with higher gas costs, and informing low-income consumers about sources of assistance for bill payment and weatherization. As in the past, tools used to disseminate this information included news releases, media events focused on weatherization and placement of public service announcements on radio stations across Kentucky.



On October 27, 2005, the PSC conducted an online media briefing via a Webcast from its offices. The briefing began with a taped introduction from Governor Ernie Fletcher. Members of the media who were unable to attend in person could watch the Webcast and submit questions via e-mail. The Webcast also was archived and made available for viewing on a delayed basis.

Because of intense public interest, the PSC also conducted informational meetings for several organizations representing low-income consumers.

As an unseasonably warm heating season over much of the nation led to lowered demand, natural gas prices began to moderate in early 2006. As a result, the impact on consumers was much less severe than anticipated. Consumer inquiries to the PSC diminished after November and December.

The return to adequate production, combined with ample amounts of gas put into storage during the summer of 2006, pushed wholesale gas prices steadily downward over much of 2006. As the 2006-2007 heating season began, prices had returned to levels seen two years earlier.

Kentucky's five major natural gas distribution companies expected their wholesale cost at the start of the heating season to be, on average, \$8.65 per 1,000 cubic feet (mcf). That was down \$4.30 (33 percent) from an average of \$12.95 per mcf a year earlier. For an average Kentucky customer using 10 mcf per month, the wholesale monthly cost declined to \$116.35, down from \$158.12 a year earlier, a decrease of 26 percent.

The PSC renewed its education efforts prior to the 2006-2007 heating season, issuing news releases, conducting an online briefing and using radio public service announcements. Due to the moderation in natural gas prices, public interest and concern also diminished.

As the biennium ended, gas prices resumed their upward trend, though the rate of increase was somewhat slower than in previous years.

NATURAL GAS RATE CASES

UNION LIGHT, HEAT AND POWER COMPANY – GENERAL RATE ADJUSTMENT – Case No. 2005-00042

On February 25, 2005, Union Light, Heat and Power Company (ULH&P) filed an application to increase its revenue from gas operations by \$14,048,768, an increase of 10.79 percent. ULH&P also sought approval to continue its Advanced Main Replacement Program (AMRP) surcharge through 2011, approval to increase its bad check and reconnection charges, and approval to assume ownership of customer service lines at the time of installation.

(At the time ULH&P was a subsidiary of Cinergy Corp. In 2006, Cinergy Corp. would merge with Duke Energy Corp. and ULH&P would become Duke Energy Kentucky.)

In 2005, ULH&P had about 92,500 retail gas customers in Boone, Campbell, Gallatin, Grant, Kenton, and Pendleton counties.

The Kentucky Office of Attorney General was the sole intervenor in the case. A public hearing was held on August 15 and 16, 2005.

The PSC issued its final order in the case on December 22, 2005. ULH&P was granted a revenue increase of \$8.1 million - \$5.9 million less than requested. The rate change increased the monthly gas base rate for an average residential customer by \$4.19, or 10.3 percent.

The gas base rate increase covers only ULH&P's costs of distributing gas to its customers. The new rates increased the monthly customer charge from

\$8.30 to \$12. ULH&P had proposed a \$15 minimum charge. The customer charge is intended to cover those costs of providing service that are independent of the amount of gas a customer uses.

Under the new rate structure a monthly surcharge that had funded ULH&P's accelerated replacement of aging gas mains was folded into the gas base rates. The monthly surcharge had been \$3.29 per residential customer. The base rate (delivery charge) for gas increased from \$2.33 per 1,000 cubic feet to \$2.68 per thousand cubic feet.

Because ULH&P began charging its proposed rates on October 1, 2005, as permitted by law, the company had to refund to customers, with interest, the difference they paid between the implemented rates and the rates subsequently granted by the PSC.

In its order, the PSC cited several factors that led to a smaller increase than ULH&P had requested. They included:

- ◆ Granting a return on equity of 10.2 percent, rather than the 11.2 percent requested by ULH&P.
- ◆ Reducing by \$1.6 million the amount of depreciation expense requested by ULH&P for its natural gas facilities.
- ◆ Changing an adjustment factor used to balance out the effect of weather on gas consumption and hence utility revenues.
- ◆ Turning down a request by ULH&P to increase its

bad check charge from \$11 to \$20.

- ◆ Reducing the costs rate-payers bear for ULH&P's employee incentive plans.

The PSC order also:

- ◆ Approved a surcharge mechanism to pay for further gas main replacements, but said ULH&P could not file for the surcharge until March 2008.
- ◆ Allowed ULH&P to assume ownership of customer service lines that the company installs at no charge to the customer, including those that are replaced as new mains are installed. ULH&P will have responsibility for maintaining and repairing those service lines.

ULH&P's previous general rate increase was granted in January 2002.



The following three natural gas rate cases were filed during the 2005-2007 biennium, but were not concluded by June 30, 2007:

ATMOS ENERGY – GENERAL RATE ADJUSTMENT – Case No. 2006-00464

On December 28, 2006, Atmos Energy Corp. filed an application to increase annual revenue from gas distribution by \$10,405,936, or 4.6 percent. After deficiencies in the original application were corrected, the case was accepted as filed as of January 16, 2007. The Kentucky Office of Attorney General intervened in the case.

(Atmos and the Attorney General reached a settlement that was filed with the PSC on June 29, 2007. A public hearing on the settlement was held on July 10, 2007. On July 31, 2007, the PSC accepted a settlement granting Atmos a \$5.5 million (2.4 percent) increase in annual revenue from natural gas base rates. That was \$4.9 million less than Atmos had requested.

Residential natural gas customers saw only one change in their bills – an increase in the monthly customer charge from \$7.50 to \$9.35, an increase of about 3 percent given natural gas costs at the time. Other aspects of the settlement included the withdrawal by Atmos of a proposal to establish a mechanism that would adjust rates to maintain income if its customers use less natural gas and the resolution of a disagreement between Atmos and the Attorney General over how the company calculates depreciation of its facilities. Atmos' previous base rate increase came in December 1999.)

COLUMBIA GAS OF KENTUCKY – GENERAL RATE ADJUSTMENT – Case No. 2007-00008

On February 1, 2007, Columbia Gas of Kentucky filed an application to increase annual revenue from gas distribution by \$12,645,522, an increase of 7.99 percent. After deficiencies in the original application were corrected, the case was accepted as filed as of February 19, 2007. Intervening in the case were the Kentucky Office of Attorney General, the Lexington-Fayette Urban County Government, the Kentucky Industrial Utility Customers, Inc. and Interstate Gas Supply, Inc.

(Columbia and the other parties reached a settlement that was submitted to the PSC on August 10, 2007. A public hearing was held on August 14, 2007. On August 29, 2007, the PSC accepted the settlement, which granted Columbia an increase in annual revenue of \$7.25 million, or 4.6 percent. That was \$5.4 million less than Columbia had requested.

The settlement included not only a change in base rates, but also in Columbia's pricing structure. The monthly fixed customer charge increased from \$6.95 to \$9.30, and no longer included the cost of delivering the first 1,000 cubic feet (mcf) of gas used each month. The settlement left the volume-based delivery charge unchanged. For the average residential customer, the result was a \$2.35 increase in Columbia's monthly fixed charge and a shift of the \$1.87 delivery cost for the first 1,000 cubic feet of gas to the variable part of the bill, for an increase of \$4.22 per month.

Other aspects of the settlement included a commitment by Columbia to determine quickly whether it intended to continue the Columbia Choice program beyond March 31, 2009, an agreement on the accounting treatment for costs associated with Columbia's outsourcing of its customer call center and an agreement that the rate of return on equity would be 10.5 percent. Columbia's previous rate case, which was concluded in December 2002, resulted in a \$7.8 million decrease in annual operating revenue.)

DELTA NATURAL GAS – GENERAL RATE ADJUSTMENT – Case No. 2007-00089

On April 20, 2007, Delta Natural Gas Company, Inc. filed an application seeking an annual increase in gas revenues of \$5,641,650, an increase of 9.25 percent. The Kentucky Office of Attorney General intervened in the case.

(Delta and the Attorney General reached a settlement that was filed with the PSC on September 28, 2007. A public hearing on the settlement was held October 3, 2007. On October 19, 2007, the PSC accepted the settlement, which granted Delta an increase in annual revenue from natural gas base rates of \$3.92 million (6.4 percent) - \$1.72 million less than requested.

Under the settlement, residential natural gas customers saw the monthly fixed customer charge increase from \$10 to \$15.50. The \$5.50 increase was \$4.44 less than Delta had originally sought from the PSC. Delta serves about 37,300 customers in 23 counties in central and eastern Kentucky.)

**ZEBULON GAS ASSOCIATION –
ABANDONMENT – Case No.
2005-00424.**

On March 9, 2006, the PSC notified customers of the Zebulon Gas Association that the Pike County utility will begin disconnecting service on April 1, 2006. The PSC had been unable to find a qualified operator to take over the small company, which had fewer than 40 remaining customers and a debt of about \$300,000.

Jefferson Gas had been operating the Zebulon system under contract since 2001 and had notified the PSC that it was unwilling to continue as the operator. With no other party willing to assume operation of the system, the PSC said it had no option other than to close the utility.

Zebulon, which was incorporated in 1956, had a lengthy history of financial difficulty and regulatory non-compliance. In 1994, the PSC cited Zebulon Gas for failing to register as a utility, file annual reports and pay an annual assessment

In October 2000, Zebulon was \$379,000 in debt to its natural gas supplier, Columbia Gas Transmission Co. With the help of the PSC and Jefferson Gas, Zebulon was able to negotiate an agreement that reduced the debt to \$152,000 and set up a 20-year payment schedule.



When Jefferson took over operations, the Zebulon system was in need of repair. A 30-year, \$165,000 loan from the state Gas System Restoration Fund paid for the replacement of nearly all of the gas mains in the Zebulon system.

In September 2004, Jefferson notified the PSC that, because of ongoing financial losses, it intended to end its relationship with Zebulon at the end of October 2004, when its operating agreement with Zebulon expired. Jefferson subsequently agreed to continue operations on a month-to-month basis while the PSC searched for both a receiver for the system and for a new operator.

That search ultimately proved unsuccessful. A PSC investigation determined that Zebulon Gas had no active officers or directors and had lost its status as an active corporation. The PSC held a meeting in Zebulon to discuss the situation with the utility's customers in October 2005.

In November 2005, after a public hearing, the PSC found that Zebulon had abandoned the system and sought to place the utility under the direction of a court-appointed receiver. No entity willing to serve as a receiver was found, and the PSC filed a motion asking Franklin Circuit Court either to appoint a receiver or dismiss the proceeding.

With all options exhausted, Jefferson continued to operate Zebulon on a voluntary basis. It ceased supplying gas at the end of the winter heating season on March 31, 2006. Zebulon customers switched to propane or electric heat.



WATER AND SEWER ISSUES AND CASES

With 150 water utilities and 75 sewer utilities under its jurisdiction, the Kentucky Public Service Commission plays a major role in fostering access to safe and reliable water and wastewater services across Kentucky. As in the past, the PSC worked closely during the 2005-2007 biennium with the Kentucky Infrastructure Authority and the Kentucky Rural Water Association to assist smaller utilities in developing rate structures that provide adequate revenue for ongoing operations and maintenance as well as infrastructure expansion. The PSC provided rate case assistance to small numerous water and sewer utilities and continued to provide training for water system commissioners and personnel.

The two largest jurisdictional water utilities in Kentucky – Kentucky-American Water Co. and the Northern Kentucky Water District - both applied for rate adjustments during the biennium. Kentucky-American Water also sought and received PSC approval for a transfer of control via an initial public stock offering and transfer of a park property to the city of Lexington.

WATER SEMINARS

The PSC, in conjunction with the Kentucky Rural Water Association, conducted six seminars for water system personnel during the biennium. The seminars were held in various areas of the state in order to encourage attendance from all utilities. These seminars were offered to provide water utilities with information on how to file a rate case, rate design issues, cost of service studies, tariffs, legal issues and other necessary information. Utility response has indicated that the seminars have been of great benefit: the seminars will be continued for the foreseeable future.

KENTUCKY-AMERICAN WATER COMPANY CASES

TRANSFER OF CONTROL/ INITIAL PUBLIC OFFERING – Case No. 2006-00197

On June 5, 2006, RWE Aktiengesellschaft (RWE) submitted an application to transfer the control of the Kentucky-American Water Co. through a public sale of the stock of its parent company.

RWE acquired Kentucky-American Water in 2003 through its acquisition of American Water Works Co. RWE proposed to divest itself of American Water through an initial public offering (IPO) of stock held by Thames Water Aqua Holdings GmbH, the subsidiary through which RWE owned American Water Works. The complex transaction also involved the merger of Thames Water Aqua US Holdings, Inc., the American holding company, with American Water Works.

In seeking approval for the transaction, RWE stated it was divesting itself of its water operations in the United States and the United Kingdom in order to focus on its core business as an integrated electric and natural gas utility.

Prior to the 2002 acquisition by RWE, American Water was the largest publicly traded water utility in the United States. The proposed transaction was intended to restore it to that status.

Intervenors in the case were the Kentucky Attorney General's Office of Rate Intervention and Lexington-Fayette Urban County Government.



A public hearing on the proposed transfer and IPO was conducted on August 16, 2006.

The PSC issued an order approving the transaction in an order issued on April 16, 2007.

However, the PSC conditioned its approval on the acceptance of a number of conditions intended to protect the company's customers from excessive costs or declining service as a result of the sale.

"In light of the lack of any significant benefit that the proposed transaction will bring to Kentucky-American ratepayers and the significant risk and uncer-

tainty that it will create, the proposed transaction is in the public interest only under the conditions" placed upon it by the PSC, the commission said in its order.

Because the management of both Kentucky-American and its parent company, American Water Works Co., were to remain substantially unchanged after the stock sale, the companies would retain the ability to provide reasonable service, the PSC said.

The PSC determined that the proposed transaction would have no immediate or direct effect upon Kentucky-American. None of its stock or debt was involved and no change in Kentucky-American's financial or management structure would occur as a direct result of the transaction.

But the commission also noted that the acquisition of large blocks of stock by one or more entities could give them control of the company and the ability to affect its management. The PSC noted that any person or entity acquiring 10 percent or more of the stock in American Water would be deemed under Kentucky law to have a controlling interest in the company and thus would be required to seek additional approval from the PSC.

Kentucky-American serves about 117,000 residential, commercial and industrial customers in Fayette and 11 other counties. The company also sells water to five municipal water systems and three water districts. It was incorporated in 1882 as the Lexington Water Company.

American Water owns and operates water and sewer systems serving about 10 million people in 23 states. It also manages water or sewer systems serving 5 million people in 18 states and three Canadian provinces.

Among the conditions the PSC placed on its approval of the IPO are:

- The costs of the IPO will not be passed on to Kentucky-American or its rate-payers.
- American Water and Kentucky-American will maintain water quality, water supply and water service and Kentucky-American customers will not experience any decline in water service as a result of the IPO.
- Non-management and union employee positions will be maintained for at least a year after the IPO. Kentucky-American's top managers also will be allowed to continue in their current jobs for up to a year.
- At least 40 percent of Kentucky-American's board of directors will be non-employees drawn from within the company's service area.
- Kentucky-American will continue to support economic development efforts and maintain its current level of social and charitable activities and contributions.
- Kentucky-American's headquarters will remain in Lexington.
- ◆ RWE will replenish American Water's pension fund to restore it to the level that existed when RWE acquired the company.

KENTUCKY RIVER WITHDRAWAL FEE – Case No. 2006-00154

Since 1994, the Kentucky-American Water Co. has been paying a fee to the Kentucky River Authority (KRA), to compensate the KRA for its operation and maintenance of the locks and dams on the Kentucky River. Kentucky-American Water draws its supply from the impoundment behind one of the dams.

Kentucky-American was authorized by the PSC in Case No. 1992-00452 to pass the fees on to customers in the form of a line-item charge based on each customer's water consumption.

The PSC approved an initial methodology for calculating the customer fee in 1994 (Case No. 1994-00194). The fee rate was to be calculated on an annual basis, with over- or under-recovery amounts dealt with in subsequent general rate cases. The methodology was revised in 2000 (Case No. 2000-120) to include the over- or under-recovery amounts as an adjustment to the following year's withdrawal fee rate.

However, when Kentucky-American Water filed a fee revision in 2006, the PSC discovered that the fee had not been updated since November 2000. As a result, Kentucky-American had overcollected a total of \$502,571.58 from its customers over a five-year period.

In an order issued on February 12, 2007, the PSC ordered Kentucky-American Water to refund the overcharges by reducing the fee for a 12-month period. Kentucky-American was told to lower the fee from about 5.5 cents per 1,000 gallons to 0.113 cents per 1,000 gallons until March 31, 2008. For an average residential customer using 5,000 gallons per month, the lowered fee amounted to a refund of about \$3.10.

The PSC also ordered Kentucky-American to change the way it passes the withdrawal fee on to customers. In order to prevent future accumulation of overcharges, the PSC ordered Kentucky-American to adjust the fee on an annual basis to reflect changes in the amount it pays the KRA. Kentucky-American had been permitted to forego annual adjustments if there were only "immaterial"



discrepancies between the amount paid to the KRA and the amount collected from customers.

Kentucky-American conceded that at least three adjustments have been required since 2001.

“Kentucky-American’s failure to make these adjustments strongly suggests the need for greater supervision of its assessment and collection of the KRA withdrawal fee,” the PSC said in its order.

The PSC also noted that the fees paid by Kentucky-American to the KRA had remained relatively stable for a number of years. Therefore, the possibility of incorporating the fee into Kentucky-American’s general rates, rather than allowing it continue as a separate item, would be considered in the company’s next fully adjudicated general rate case.

(Both of Kentucky-American Water’s subsequent general rate cases were settled and not fully adjudicated. The question of the withdrawal fee was not addressed in either settlement and thus did not come before the PSC in connection with those proceedings. At the time it accepted the settlement in the second rate case (Case No. 2008-00427), the PSC stated its intention to examine the withdrawal fee in a separate proceeding (Case No. 2009-00124) to determine whether the fee should be treated as an ongoing cost and thus incorporated into base rates. That proceeding is in progress.)



JACOBSON PARK TRANSFER – Case No. 2005-00214

Since 1968, the city of Lexington has leased Jacobson Park from the Kentucky-American Water Co. The 386-acre park includes a reservoir used by the water company and a local golf course.

In 2002, when it approved the acquisition of Kentucky-American’s parent company by RWE AG, a German utility holding company, the PSC required that any transfer of control of the park be approved by the Commission in order to protect the interests of the citizens of Lexington and Fayette County.

In 2005, Kentucky-American and the Lexington-Fayette Urban County Government (LFUCG) agreed to terms for a transfer of the park. Kentucky-American subsequently filed an application to transfer control of the park to the city.

On April 28, 2006, the PSC approved the transfer, saying it complied with the conditions it set forth in allowing the sale of the water company. Ownership of the park will be handed over to the LFUCG on Jan. 2, 2011.

GENERAL RATE ADJUSTMENT – Case No. 2007-00143

On April 30, 2007, Kentucky-American Water Co. filed an application for a general rate adjustment, seeking to increase annual revenue by about \$11 million, or about 21 percent.

Intervention was granted to the Kentucky Office of Attorney General, the Lexington-Fayette Urban County Government, the Kentucky Industrial Utility Customers Inc. and the Community Action Council for Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc.

(Following negotiations among all the parties, a proposed settlement was presented to the PSC on September 14, 2007. The settlement granted Kentucky-American an increase in annual revenue of about \$8 million, or 15 percent. A hearing on the proposed settlement was held on September 18, 2007. On November 29, 2007, the PSC issued an order accepting the settlement.)

NEW WATER TREATMENT FACILITY IN OWEN COUNTY AND PIPELINE TO FAYETTE COUNTY – Case No. 2007-00134

Citing a long-standing need for an additional source of raw water supply, Kentucky-American Water Co. on March 30, 2007, submitted an application to construct a new water treatment facility, with a capacity of 20 million gallons per day, on the Kentucky River in Owen County. The plant would be connected to the Lexington-area water system via a 31-mile pipeline that would pass through Owen, Franklin, Scott and Fayette counties.

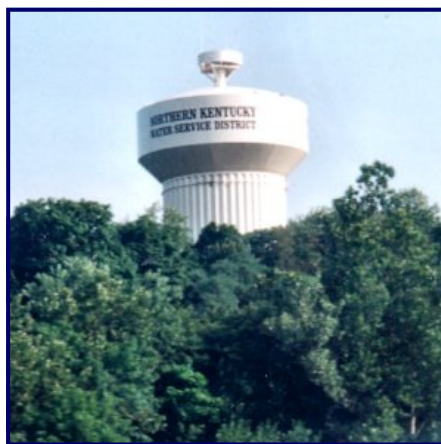
Intervention in the case was granted to the Louisville Water Company, the Bluegrass Water Supply Commission, the Kentucky River Authority, Lexington-Fayette Urban County Government, Kentucky Industrial Utility Customers, Citizens for Alternative Water Solutions and the Kentucky Office of Attorney General.

(The PSC conducted public meetings in the case in September 2007 in Owenton, Frankfort and Lexington. The initial formal evidentiary hearing was conducted in November 2007. Following the hearing, the PSC requested additional information from certain parties. A second evidentiary hearing was held in March 2008. The PSC granted a certificate of public convenience and necessity for the proposed facilities on April 25, 2008.)

OTHER WATER UTILITY CASES

NORTHERN KENTUCKY WATER DISTRICT – GENERAL RATE ADJUSTMENT – Case No. 2005-00148

Northern Kentucky Water District was formed through a series of mergers involving water districts in Campbell and Kenton counties in 1997 and the subsequent absorption of municipal water companies in Newport, Bromley and Taylor Mill.



Northern Kentucky Water has 78,000 retail customers in Campbell and Kenton counties and provides wholesale water service to the Pendleton County and Bullock Pen water districts and to the city of Walton.

Through a series of rate cases in 2003 and 2004, water rates were equalized for all customers except those in Taylor Mill, who were the newest in the district.

This case, in which Northern Kentucky Water proposed to increase revenue by \$3.4 million (10 percent), was the final step in equalizing rates across the entire district. The completed application was received on July 1, 2005. A hearing was held on

February 28, 2006, with the Kentucky Office of Attorney General as the sole intervenor.

On April 28, 2006, the PSC granted Northern Kentucky Water an annual revenue increase of \$2.3 million. With the increase, Northern Kentucky Water's annual revenues from water sales were projected to increase by 6.8 percent, to \$36.3 million.

The rate increase raised the quarterly bill for the average Northern Kentucky Water residential customer (18,000 gallons/quarter usage) from \$78.65 to \$83.70, an increase of \$5.02, or 6.4 percent.

The PSC also authorized Northern Kentucky Water to issue \$29 million in bonds for projects to improve and expand its system.

The PSC denied a number of revisions Northern Kentucky Water proposed to its rules and conditions of service, including changes in the areas of fire protection and meter location. The Commission also ordered the district to clarify the language pertaining to matters such as service charges and leak adjustments.

SANDY VALLEY WATER DISTRICT – TRANSFER OF CONTROL – Case No. 2006-00327

On September 22, 2006, the PSC accepted the application of Sandy Valley Water District, Southern Water and Sewer District and the city of Pikeville to transfer Sandy Valley water's assets and customers to Southern Water and Pikeville. Southern Water also proposed to assume certain portions of Sandy Valley's debt obligations.

The Kentucky Office of Attorney General was the only intervenor in the case. It notified the PSC that it did not object to the proposed transfer, did not intend to conduct discovery and did not desire a hearing in the case.

The PSC conducted a public meeting in Betsy Lane on January 11, 2007, to receive public comment on the proposed transfer.

The PSC approved the transaction on January 22, 2007. The PSC found that Pikeville and the Southern Water and Sewer District had shown, as required by Kentucky law, that they have the technical, managerial and financial capability to operate the Sandy Valley system.

The PSC also determined that the transfer, with conditions attached, would be in the public interest, noting that the transaction included a planned extension of sewers into an area that had no centralized wastewater treatment facilities.

At the time of the transfer Sandy Valley, which was headquartered in Betsy Layne, had 2,335 retail customers in Floyd (1,133) and Pike (1,202) counties. Southern Water served about 6,160 retail water customers in Floyd and Knott counties. Pikeville had about 3,200 retail water customers.

Under the transfer, Southern Water took over Sandy Valley's customers in Floyd County, while Sandy Valley customers in Pike County were absorbed by the city of Pikeville.

The PSC placed a number of conditions on its approval, including:

- ◆ Pikeville and Southern Water were to establish an office in the current Sandy Valley service

area to receive payments and answer customer questions and complaints.

- ◆ Sandy Valley's employees as of Jan. 1, 2006, were to remain in their current jobs, at no less than their current rates of pay, for at least one year.
- ◆ Rates for current Sandy Valley customers were frozen for at least one year, as specified in an interlocal agreement entered into on Jan. 1, 2006, by Sandy Valley, Southern Water, Pikeville and Floyd County Fiscal Court.

Additionally, the PSC incorporated into its order other provisions of the interlocal agreement relating to the assumptions of Sandy Valley's debt, allocations of its assets and construction of a sewer system. The PSC determined that Sandy Valley Water District and Southern Water and Sewer District had properly entered into the interlocal agreement.

MARTIN COUNTY WATER DISTRICT – MANAGEMENT AND OPERATIONS AUDIT – Case No. 2006-00303

On June 27, 2006, the PSC ordered a comprehensive audit of the operation and management of the Martin County Water District. The PSC said the investigation was intended “not only to identify the existing deficiencies in Martin District's management and operation but to identify possible solutions to those deficiencies and possible courses of action to improve the quality of service.”

State law requires a utility to bear the cost of a management audit. Because of Martin County Water's financial condition, the cost of the audit could impose a hardship on the utility and its customers, the PSC noted. Therefore, the PSC obtained an alternative source of funding for the audit. The Kentucky Division of Water has agreed to provide a grant to cover nearly the entire cost of the audit.

This was the second PSC investigation of Martin County Water in four years. The district, which is based in Inez and serves about 3,400 customers, had been the subject of PSC concern since 1997, when PSC reviews and inspections found problems with recordkeeping, maintenance and system reliability. In April 2002, equipment failures led to a system-wide water shortage and triggered a PSC staff investigation into Martin County Water's financial stability and ability to provide adequate service.

The 2002 investigation had uncovered a number of issues, including inadequate financial controls, system unreliability due to insufficient maintenance and deteriorating equipment, and persistent problems with water loss from leaking lines and overflowing storage tanks.

By late 2003, Martin County Water agreed to take a series of actions to remedy the problems identified by the PSC staff. Martin County Water also contracted with American Water Services, a private firm, to manage the district's operations.

In ordering the audit, the PSC noted that “while Martin District has made some progress” since late 2003, the progress “has been slow and unsteady.” Martin County Water had yet to meet many of the conditions set forth

in the agreement, was two years behind in filing annual reports with the PSC and had terminated the agreement with American Water Services and resumed full responsibility for operating the system.

In light of the ongoing problems, a new investigation and a management audit were necessary, the PSC said.

The audit findings were released on April 19, 2007.

The independent audit by the Barrington-Wellesley Group Inc., an independent consulting firm, found that Martin County Water has made significant progress in recent years, but still requires substantial improvements in a number of key areas, including operational reliability, financial stability and customer service.

Martin County Water had not adjusted rates since 1996, leading to concerns that the district's revenue was insufficient to support adequate and reasonable service. The district also had undergone numerous changes in the composition of its board of commissioners and management staff.

The audit was a comprehensive review of Martin County Water's operations and management. While the audit recognized the district's achievements over the previous three years, it noted room for significant further progress. The audit identified five areas of particular concern:

- ◆ Reducing water loss and strengthening the reliability of the treatment and distribution systems.
- ◆ Establishing a formal system for planning and funding capital improvements.

- ◆ Strengthening meter reading and bill collection.
- ◆ Redefining and formalizing the roles of the district board and managers.
- ◆ Finding additional revenue in order to provide adequate staffing and meet operational goals.

The audit report contained 37 findings, including:

- ◆ MCWD generally delivers water of adequate quality, although concerns remain about levels of organic compounds.
- ◆ Delivery of water is generally reliable, although the system remains vulnerable to disruptions.
- ◆ Although MCWD has significantly reduced water loss from the system, it remains excessively high.
- ◆ MCWD has improved its treatment and distribution infrastructure to address PSC concerns, but continues to have a backlog of work in its distribution system.
- ◆ The capital program has focused on system expansion over water loss reduction. Water loss should be the top capital priority.
- ◆ Current rates are significantly below those of surrounding water utilities. Even with a planned rate increase, rates will not be sufficient to fully fund all needed activities.
- ◆ Customer service procedures are adequate and effective, with the exception that requests for new service from existing wa-

ter lines are not completed promptly.

- ◆ Procedures to identify theft are incomplete.
- ◆ Procedures to collect past due accounts are inadequate.
- ◆ Meter reading controls are inadequate, but misread and unread meters do not appear to have contributed noticeably to the water loss problem.
- ◆ The roles and responsibilities of the general manager and the board of commissioners are not clearly defined.
- ◆ MCWD is current in filing its required regulatory reports and has updated its policies and procedures.

Martin County Water was required to develop action plans to address the findings of the audit report. MCWD also was required to inform the PSC of the actions taken in response to the audit findings.



WOOD CREEK WATER DISTRICT AND CITY OF LIVINGSTON – Case No. 2006-00184

On May 2, 2006, officials of the Wood Creek Water District notified the PSC that they intended to discontinue water service to the Livingston Water Works because the city owed the district at least \$9,000 in unpaid bills. The PSC subsequently ordered Wood Creek to continue service until the matter could be heard by the Commission.

In deciding to prohibit the cutoff, the PSC cited not only the dangers posed by the loss of water to fire hydrants in Livingston, but also the fact that a loss of water service would prevent the city's sewer system from functioning properly, creating a risk to public health and the environment.

Livingston, which has about 195 customers on its water system, had repeatedly fallen behind in payments to Wood Creek over a two-year period. Wood Creek provides Livingston with about 18 million gallons of water per year.

Livingston's water bills had accumulated, reaching about \$17,000 before the city made several partial payments.

Cutting off water to Livingston also would interrupt service to 33 customers of the Eastern Rockcastle Water Association. Livingston resells water to Eastern Rockcastle, thus placing Livingston within the PSC's jurisdiction.

The PSC issued administrative subpoenas to Livingston officials to provide the PSC with payment records and other documents and to appear at a hearing which was held on May 22, 2006.

During a recess in the hearing, Wood Creek and Livingston reached a settlement. The terms of this settlement were documented in a PSC order issued on May 25, 2006. On May 31, 2006, Wood Creek advised the PSC that Livingston had failed to make payment as promised. Wood Creek issued a second notice of intent to terminate service.

On June 2, 2006, the PSC set another hearing for June 13, 2006. However, on June 9, 2006, Wood Creek advised the PSC that Livingston had paid the outstanding indebtedness. The PSC dismissed the case on September 7, 2006, saying the matter had been resolved.



TELECOMMUNICATION ISSUES AND CASES 2005-2007

The restructuring of the telecommunication industry accelerated during the 2005-2007 biennium as consumers increasingly moved away from reliance on traditional landline telephone services and switched to wireless, phone-over-cable or Internet-based technologies. These shifts in turn altered the economics of the industry, leading to consolidations or realignments among telecommunication providers.

That trend was evident in Kentucky during the biennium. The state's largest incumbent local exchange carrier (ILEC) was part of a merger of two regional telecommunications companies. Kentucky's second-largest ILEC was spun off by its parent company, which was becoming a wireless-only carrier.

These two transfer of control cases, and the consideration of a new area code in western Kentucky, were the most significant telecommunication matters to come before the Kentucky Public Service Commission during the biennium. The PSC continued to address routine telecommunication issues, including interconnection agreements, disputes between telecommunication companies and certification of cell towers in areas without local planning and zoning authorities.

However, legislation enacted during the 2006 Kentucky General Assembly curtailed the PSC's remaining authority over retail rates and services. The new law permits larger telephone utilities to elect to operate

under a price regulation plan that caps basic phone service rates for five years from the time of election. At the end of the five-year period, the basic rates are no longer subject to PSC jurisdiction.

Smaller telephone companies electing alternative regulation are subject to a one-year price cap and annual increases thereafter that are tied to the rate of inflation. The statute also removes tariff filing requirement for all telephone companies for all but basic local service and in-state long-distance service.

The PSC retained jurisdiction over complaints related to basic telephone service and complaints related to unauthorized switching of a customer's telephone service, or "slamming." The 2006 statute returned to PSC jurisdiction – from the Kentucky office of attorney general – enforcement of truth-in-billing regulations and prohibitions against billing for services not specifically authorized by a customer, or "cramming."

Large telephone companies in Kentucky quickly chose to operate under the alternative regulation permitted by the 2006 statute. Most companies also chose to withdraw existing tariffs and not file new tariffs as permitted by the statute.

JOINT APPLICATION FOR APPROVAL OF THE INDIRECT TRANSFER OF CONTROL RELATING TO THE MERGER OF AT&T INC. AND BELL SOUTH CORPORATION – Case No. 2006-00136

On March 31, 2006, BellSouth Corporation and AT&T, Inc. filed a joint application to merge through the acquisition of BellSouth stock by AT&T. The companies said that the merger would benefit consumers by uniting the ownership of Cingular Wireless, currently a joint venture of AT&T and BellSouth, under a single entity; by integrating BellSouth's local network with the AT&T backbone; and through substantial savings in costs of operations.

BellSouth and AT&T also said the merger will speed their deployment of broadband services in rural areas of Kentucky. The applicants also argued that the merger would not harm competition in Kentucky because the companies do not compete in Kentucky.

During the proceedings before the PSC, AT&T and BellSouth also agreed to certain principles. They include capping rates for basic local service for five years, maintaining local charitable and eco-

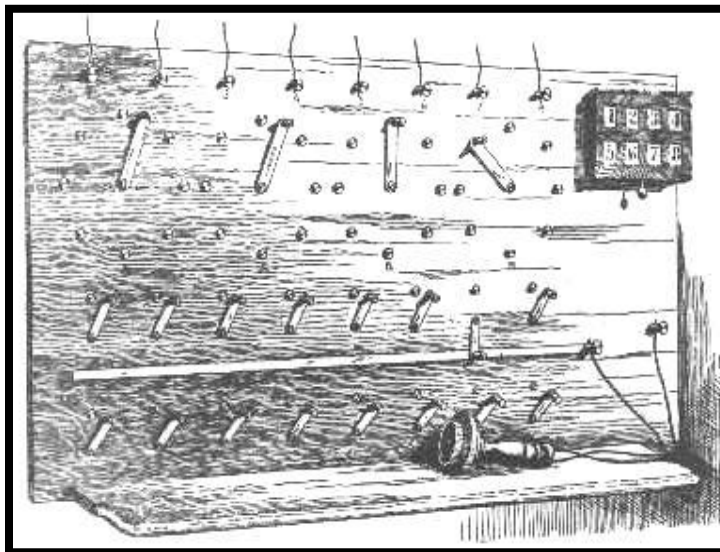
nomie development activities, adhering to labor agreements in place at the time of the merger and notifying the PSC prior to closing any facilities in the state.

The PSC approved the merger on July 25, 2006. The PSC imposed certain conditions on the transaction, including that the merger have no immediate effect on rates, terms and conditions of services provided in Kentucky and that a state headquarters be maintained in Kentucky.

Existing agreements with local phone service providers that purchase services will remain in effect following the merger. When the merger was completed, BellSouth began operating under the name AT&T.

AT&T was formerly SBC, a regional telephone company which grew out of the Southwestern Bell Co. SBC took on the AT&T in 2005 when it acquired AT&T Corp., which was primarily a long-distance telephone service provider. Cingular had previously acquired AT&T Wireless.

AT&T is headquartered in San Antonio. Cingular's headquarters remained in Atlanta after the merger, as did a regional headquarters for operations in the nine states once served by BellSouth.



APPLICATION FOR APPROVAL OF THE TRANSFER OF CONTROL OF ALLTEL KENTUCKY, INC. AND KENTUCKY ALLTEL, INC. – Case No. 2005-00534

On December 22, 2005, Alltel Communications, Inc. asked the Kentucky Public Service Commission to approve the transfer of its two Kentucky subsidiaries to VALOR Communications Group as part of the larger merger of Alltel's landline operations with VALOR to create Windstream Communications.

At the time, the two Kentucky subsidiaries had more than 540,000 customers in 48 counties, mostly in Lexington and surrounding areas. The company also serves Elizabethtown, Somerset, Ashland, Hazard and Shepherdsville.

The PSC approved the transfer of control on May 23, 2006, after determining that Windstream has the technical, managerial and financial ability to provide reasonable service to Alltel's Kentucky landline customers. After the spin-off of its landline operations, Alltel became a wireless-only carrier.

The PSC placed certain conditions on the merger in order to ensure that it is in the public interest. Most of the conditions are intended to protect Kentucky ratepayers from bearing any of the costs or debt associated with the transaction.

In addition to the conditions related to the cost of the merger, other conditions placed by the PSC on the transaction include that:

- ◆ The headquarters of the Kentucky operating companies remain in Kentucky.

- ◆ The quality of service be maintained.
- ◆ Windstream continue to invest in deploying high-speed Internet service in its Kentucky service territory.

After the merger was finalized, Alltel's two operating divisions in Kentucky became Windstream Kentucky (Shepherdsville area) and Kentucky Windstream (all other areas).

The overall merger included Alltel's landline operations in 15 states, as well as the company's competitive local telephone service and long-distance operations. Valor, headquartered in Irving, Texas, had about 530,000 landline customers in 260 mostly rural communities in Arkansas, Texas, Oklahoma and New Mexico. The merged company has about 3.4 million customers. It is headquartered in central Arkansas.

The merger was the third transfer of the Alltel landline system in Kentucky in seven years. Alltel acquired the system from Verizon in 2002. Verizon purchased the system from GTE in 1999.

CHANGES TO THE FUNDING FORMULA FOR THE TELECOMMUNICATIONS ACCESS PROGRAM (TAP) AND THE TELECOMMUNICATION RELAY SERVICE (TRS) PROGRAM

On May 31, 2006, the Kentucky Public Service Commission approved a revised funding formula to increase the availability of telecommunications equipment for the deaf and hard of hearing while reducing the overall surcharge assessed on all telephone customers in Kentucky.

As permitted by the 2006 Kentucky General Assembly, the PSC increased the monthly surcharge for the Telecommunications Access Program (TAP), from one cent per telephone access line per month to two cents per month. At the same time, the PSC reduced the monthly surcharge for Telecommunication Relay Service (TRS) from nine cents per month to seven cents per month, thus reducing the overall surcharge from 10 cents per month to nine cents per month.

The TAP fund, formerly known as the Telecommunications Devices for the Deaf Distribution Program (TDD) fund, is used to provide specialized devices that enable the deaf and hard of hearing to communicate via the telephone. These devices, which are provided at no cost to the user, include amplified telephones, captioned phones and other equipment.

The TRS program enables those persons with specialized devices to communicate with those who do not have such equipment. Together, TAP and TRS allow full access to the telephone system for the deaf and hard of hearing.

Kentucky is home to about 400,000 of the 28 million Americans who are deaf or hard of hearing.

The reallocation of the TAP/TRS surcharge was intended to channel funding to where it is most needed.

Annual payments into the TDD fund had been about \$265,000. With the change, the TAP fund collections increased to about \$500,000 each year. TRS fund annual revenue declined from about \$2.2 million to about \$1.7 million. Because per-minute charges for using the TRS system has declined, as has usage, the

lower amount was sufficient to maintain service.

At the time, the the surcharge was assessed on landline service only.

(The PSC in February 2009 extended both the TRS and TAP surcharges to wireless phones. The TAP surcharge, which is set by statute, remained at two cents per line. The TRS surcharge declined to two cents per line, from seven cents. The total surcharge declined to four cents from nine cents.)

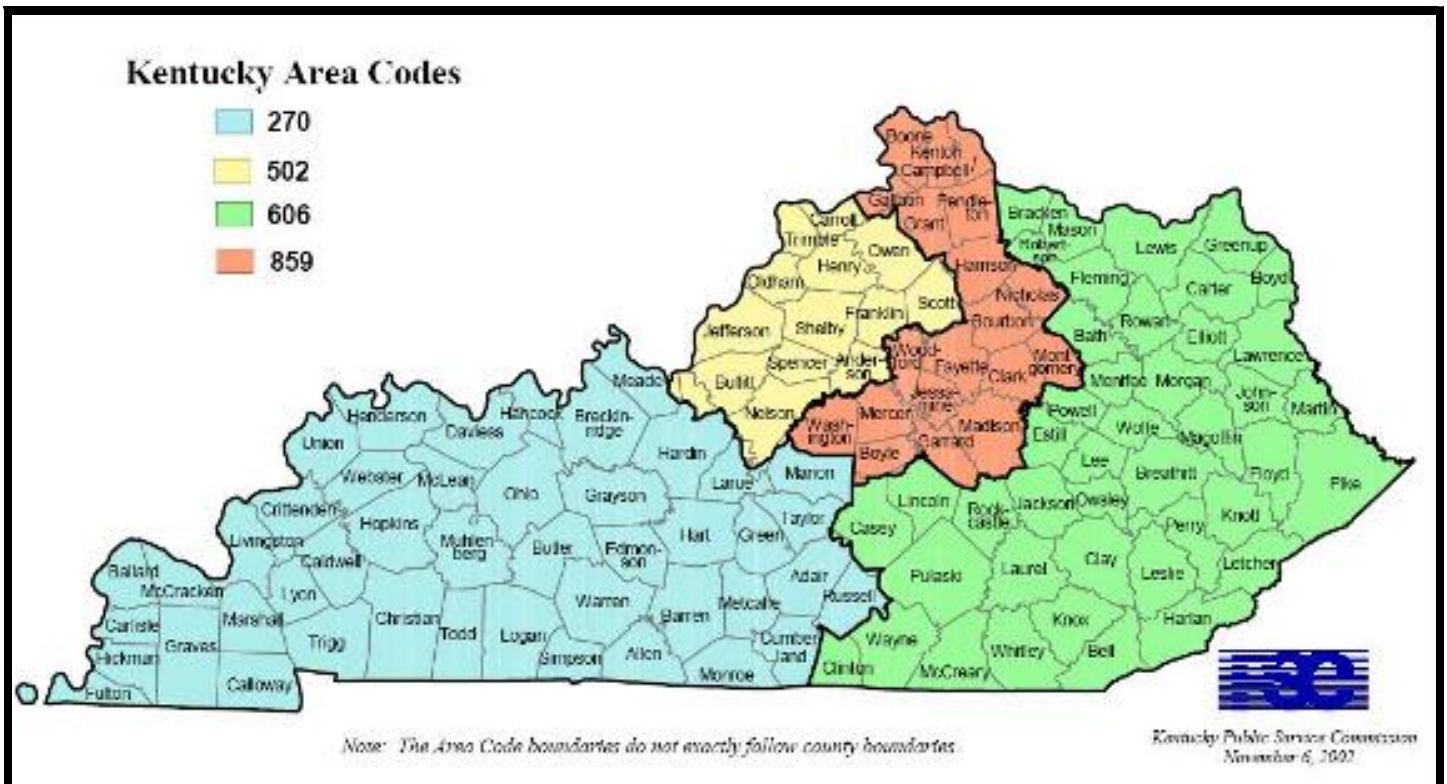
THE APPLICATION OF NANPA ON BEHALF OF THE KENTUCKY TELECOMMUNICATIONS INDUSTRY FOR APPROVAL OF NPA RELIEF PLAN FOR THE 270 NPA, AND NUMBER CONSERVATION MEASURES WITHIN KENTUCKY – Case No. 2006-00357

On July 17, 2006, the Kentucky Public Service Commission opened a proceeding to examine possible solutions to an anticipated shortage of available telephone numbers in area Code 270.

Subsequently, on August 31, 2006, the PSC received formal notification from the North American Numbering Plan Administrator (NANPA) that the supply of available telephone numbers in Area Code 270 would be exhausted by the fourth quarter of 2007. NANPA requested that the PSC initiate a proceeding to create a new area code in the current Area Code 270 territory.

The PSC examined both options for establishing a new area code – a geographic split and an overlay. Kentucky has historically created new area codes through splits. The overlay option, which creates a new area code in the same geographic area as an existing code, has been used mostly in major metropolitan areas. Creation of an overlay imposes 10-digit dialing for local calls.

In October and November of 2006, the PSC conducted public meetings in Bowling Green, Elizabethtown, Henderson, Hopkinsville, Owensboro and Paducah to receive public comment on the creation of a new area code. In addition to seeking input on the split-versus-overlay question, the PSC sought opinions on various split options. Most of the comments received, both at the meetings and through other means, favored a split.



On May 31, 2007, the PSC decided to split area code 270, with the eastern portion retaining the current area code. The PSC said that the western portion of area code 270, which includes the cities of Henderson, Hopkinsville, Madisonville, Murray and Paducah, would be assigned a new area code. Cities remaining in area code 270 include Bowling Green, Columbia, Glasgow, Elizabethtown and Owensboro. The decision on where to retain area code 270 was made “on the basis of greatest population density and areas of fastest growth,” the PSC said.

In deciding where to draw the line splitting area code 270, the PSC considered local calling areas, telephone company service boundaries and other technical issues, as well as public input. The boundary selected was preferred by both the telecommunications industry and members of the public who commented on the issue.

In its order, the PSC noted that further area code splits in Kentucky were likely to prove impractical, signaling that future area

codes would have to be created through overlays.

Two weeks after the PSC decision, NANPA designated the new area code with the number 364.

Mandatory use of the new area code originally was to take effect on October 1, 2008, with a transition period during which either area code 364 or area code 270 could be used in the affected area to begin by April 1, 2008.

However, the start date for the new area code was postponed almost immediately to July 1, 2008. The postponement was the result of the Federal Communication Commission’s (FCC) decision – also on May 31, 2007 – to grant the PSC’s request for a change in the way telephone numbers are allocated to telecommunication providers by NANPA. The FCC decision allowed the PSC to require a procedure known as “number pooling,”

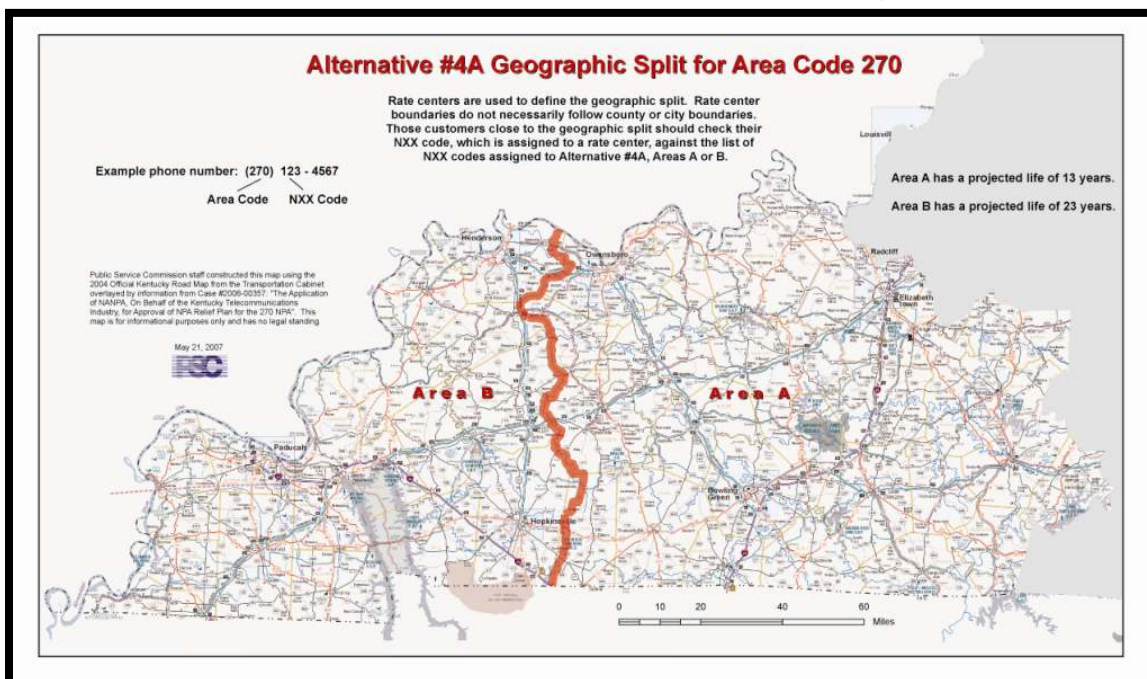
With number pooling, most numbers are assigned to telecommunication providers in blocks of 1,000, known as NXX-X blocks, rather than blocks of 10,000

known as NXX codes. A company may not need to use all of the numbers in a code or block. The use of the smaller groupings reduces the quantity of numbers that are assigned but unused.

Area code number exhaustion occurs when there are no number blocks remaining to be assigned. Therefore, mandating number allocation in smaller blocks can extend the life of an area code.

In order the initial postponement, the PSC anticipated that the switch to number pooling could free up thousands of unused telephone numbers. It ordered telephone companies to provide an assessment of whether further postponements would be necessary.

(That proved to be the case. The increased availability of new numbers, combined with lower demand due to a slowing economy, prompted three more postponements in two years as NANPA revised its projections for number exhaustion. The start date was reset for January 2009, then to April 2010, and again to Jan. 1, 2012. About two million numbers are now available in area code 270.)





Statistics:

Cases Filed and Orders Issued During the Biennium — Listed by type

Type of Case Filed	Number
Accounting Deferral	2
Administrative	2
Appointment of Commissioner	4
Arbitration	54
Complaints – Rates	23
Complaints – Rates, Service	9
Complaints – Service	41
Construct	43
Construct—Cell Site—No Local P&Z Comm.	84
Construct, Finance, 278.023	11
Construct, Finance, Rates, 278.023	23
Construct, Financing	5
Construct, Rates, Financing	3
Contracts	16
Demand-Side Management	11
Depreciation Methodology	3
Deviation	24
Farm Tap—Rate Adjustment	4
Financing	47
Franchises	22
Initial Operations	2
Integrated Resource Plan	4
Interconnection Agreement	14
Investigation—Rates	3
Investigation — Rates, Service	3
Investigation – Service	44
Merchant Plant	1
Other	7
Rates – ARF	16
Rates – FAC	81
Rates – General	34
Rates – NRC	44
Rates – PGA	189
Rates – PWA	61
Rates—Flow-through	16
Rates—278.023	1
Refinancing	4
Revenue Reduction	3
Surcharge	6
Surcharge—Environmental	9
Tariffs	52
Telecommunications Act of 1996	9
Territory/Boundary	6
Training or certification	17
Transfer/Sale/Purchase/Merger	20
Transmission line certificate	7
Wholesale Rate Adjustment	15
Total Cases filed during biennium	1,100

Type of Orders Issued	Number
Abandonment	2
Administrative	6
Arbitration	47
Complaints – Rates	29
Complaints – Rates, Service	8
Complaints – Service	32
Construct	49
Construct—Cell Site—No Local P&Z	87
Construct—Uniform Application	1
Construct, Finance, 278.023	11
Construct, Finance, Rates, 278.023	20
Construct, Financing	6
Construct, Rates, Financing	3
Contracts	16
Declaratory Order	2
Demand-Side Management	10
Deviation	43
Financing	44
Franchises	23
Hearing/Procedural/Informational	771
Initial Operations	1
Integrated Resource Plan	3
Interconnection Agreement	13
Investigation — Rates, Service	2
Investigation – Service	44
Merchant Power Plant	2
Motions	443
Other	45
Rates – ARF	15
Rates – FAC	61
Rates – General	28
Rates – NRC	38
Rates – PGA	186
Rates – PWA	58
Rates—Other	17
Show Cause	9
Staff Reports	27
Surcharge	12
Tariffs	52
Telecommunications Act of 1996	13
Territory/Boundary	5
Transfer/Sale/Purchase/Merger	22
Transmission Line Certificates	7
Total Orders issued during biennium	2,343

Statistics: Cases Filed and Orders Issued During the Biennium

Listed by Utility Type

Utility Type	Number of Cases	Utility Type	Number of Orders
Investor-Owned Electric	108	Investor-Owned Electric	421
Rural Electric Cooperatives	167	Rural Electric Cooperatives	369
Gas Distribution Utilities	231	Gas Distribution Utilities	325
Intrastate Gas Pipelines	25	Intrastate Gas Pipelines	54
Gas – Safety Only	2	Gas – Safety Only	7
Wireless Companies	101	Wireless Companies	168
Local Exchange Carriers	99	Local Exchange Carriers	256
Competitive Local Exchange Carriers	31	Competitive Local Exchange Carriers	81
Long Distance Carriers	14	Long Distance Carriers	50
Operator Service Providers	6	Operator Service Providers	10
COCOTs (Pay Phones)	6	COCOT (Pay phones)	16
Privately-Owned Water Companies	20	Privately-Owned Water Companies	82
Water Districts	217	Water Districts	390
Water Associations	35	Water Associations	65
Municipal Water Utilities	17	Municipal Water Utilities	65
Sewer	26	Sewer	88
Total Cases filed during biennium	1,105	Total Orders issued during biennium	2,447

Statistics: Cases Filed and Orders Issued During the Biennium For Electric Utilities

Type of Case Filed	Number	Type of Orders Issued	Number
Accounting Deferral	2	Accounting Deferral	3
Administrative	1	Administrative Case	3
Complaints – Rates	5	Complaints – Rates	13
Complaints – Rates , Service	1	Complaints – Service	10
Complaints – Service	11	Complaint—Rates, Service	2
Construct	17	Construct	25
Contracts	12	Contracts	13
Declaratory Order	1	Declaratory Order	1
Demand-Side Management	11	Demand-Side Management	10
Deviation	5	Deviation	8
Financing	20	Financing	19
Franchises	9	Franchises	10
Integrated Resource Plan	4	Hearing/Procedural/Informational	357
Interconnect	1	Integrated Resource Plan	3
Investigation – Rates	2	Interconnection	1
Investigation – Service	17	Investigation—Rates, Service	1
Merchant Plant	1	Investigation – Service	20
Other	3	Merchant Plant	1
Rates – FAC	81	Motions	180
Rates—Flow-through	13	Other	8
Rates – General	10	Rates – FAC	61
Rates—NRC	3	Rates – General	10
Rates – Reduction	3	Rates—NRC	4
Surcharge	9	Show Cause	5
Tariffs	18	Surcharge	8
Territory/Boundary	5	Tariffs	14
Transfer/Sale/Purchase/Merger	3	Territory/Boundary	4
Transmission Line Certificate	7	Transfer/Sale/Purchase/Merger	4
Transmission Line Certificate	7	Transmission Line Certificate	7
Total Cases filed during biennium	280		

Total Orders issued during biennium **806**



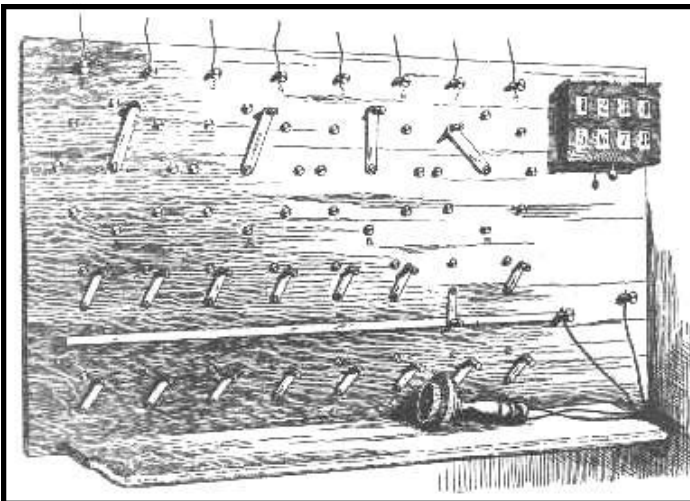
Statistics: Cases Filed and Orders Issued During the Biennium For Gas Utilities

Type of Case Filed	Number	Type of Orders Issued	Number
Accounting Deferral	1	Abandonment	1
Complaints — Rates	2	Accounting Deferral	1
Complaints — Rates, Service	1	Complaints — Rates	4
Complaints — Service	5	Complaints — Rates, Service	2
Construct	2	Complaints — Service	6
Contracts	1	Construct	5
Demand-Side Management	1	Contracts	1
Deviation	2	Demand-Side Management	1
Financing	15	Deviation	4
Franchises	13	Financing	13
Investigation—Rates, Service	1	Franchises	13
Investigation — Service	5	Hearing/Procedural/Informational	85
Other	7	Investigation — Rates, Service	1
Rates—ARF	4	Investigation — Service	6
Rates—Farm Tap	4	Motions	82
Rates — General	3	Other	7
Rates — PGA	189	Rates — ARF	4
Rates—NRC	2	Rates—Farm Tap	4
Tariffs	19	Rates — General	2
Transfer/Sale/Purchase/Merger	5	Rates — PGA	186
Weather Normalization Adjustment	1	Rates—NRC	2
		Show Cause	2
Total Cases filed during biennium	283	Staff Reports	2
		Surcharge	1
		Tariffs	18
		Transfer/Sale/Purchase/Merger	5
		Weather Normalization Adjustment	1
		Total Orders issued during biennium	459



Statistics: Cases Filed and Orders Issued During the Biennium For Telecommunications Utilities

Type of Case Filed	Number	Type of Orders Issued	Number
Administrative	1	Administrative	3
Arbitration	54	Arbitration	47
Complaints — Rates	15	Complaints – Rates	11
Complaints — Rates, Service	6	Complaints – Rates, Service	3
Complaints—Service	18	Complaints – Service	11
Construct	1	Construct	1
Construct Cell Site — No P&Z Commission	84	Construct Cell Site — No P&Z Commission	86
Deviation	2	Construct Cell Site — Uniform Application	1
Financing	1	Deviation	1
Franchise	1	Financing	1
Interconnection Agreement	13	Franchise	1
Investigation – Service	15	Hearing/Procedural/Informational	189
Investigation, Service, Rates	1	Interconnection Agreement	13
Price Regulation Plan	1	Investigation – Service	12
Tariffs	3	Motions	92
Telecommunications Act of 1996	9	Other	12
Transfer, Sale, Merger	2	Price Regulation Plan	1
		Tariffs	6
Total Cases filed during biennium	227	Telecommunications Act of 1996	13
		Transfer, Sale, Merger	1
		Total Orders issued during biennium	506



Statistics: Cases Filed and Orders Issued During the Biennium For Water Utilities

Type of Case Filed	Number	Type of Orders Issued	Number
Appointment of Commissioners	4	Appointment of Commissioners	2
Complaints – Rates	3	Complaints – Rates	4
Complaint—Rates, Service	1	Complaint—Rates, Service	1
Complaints – Service	11	Complaints – Service	9
Construct	21	Construct	19
Construct, Finance, 278.023	11	Construct, 278.023	1
Construct, Finance, Rates, 278.023	23	Construct, Finance - 278.023	11
Construct, Financing	5	Construct, Finance, Rates - 278.023	20
Construct, Rates, Financing	3	Construct, Financing	6
Construct, Rates 278.023	1	Construct, Rates, Financing	3
Contracts	3	Contracts	2
Deviation	15	Deviation	29
Financing	20	Financing	15
Initial Operations	1	Hearing/Procedural/Informational	169
Investigation—Rates	2	Investigation – Service	4
Investigation—Rates, Service	2	Monitoring Compliance	2
Investigation – Service	5	Motions	92
Other	20	Other	22
Rates – ARF	7	Rates – ARF	5
Rates – General	20	Rates – General	16
Rates – NRC	39	Rates – NRC	33
Rates – PWA	61	Rates – PWA	58
Surcharge	4	Show Cause	2
Tariffs	20	Staff Reports	20
Territory/Boundary	1	Suspension	7
Transfer/Sale/Purchase/Merger	6	Tariffs	18
Wholesale Rate Adjustment	13	Territory/Boundary	1
		Transfer/Sale/Purchase/Merger	4
		Wholesale Rates	13
Total Cases filed during biennium	321		

Total Orders issued during biennium 592



Statistics: Cases Filed and Orders Issued During the Biennium For Sewer Utilities

Type of Case Filed	Number	Type of Orders Issued	Number
Construct	2	Abandonment	1
Construct, Finance, Rates - 278.023	1	Complaint—Service	1
Construct, Finance - 278.023	2	Construct	1
Finance	2	Construct, Finance - 278.023	2
Initial Operations	2	Construct, Finance, Rates - 278.023	2
Investigation—Rates	1	Deviation	1
Investigation—Service	1	Financing	1
Other	3	Hearing/Procedural/Informational	27
Rates	1	Initial Operations	1
Rates- ARF	5	Investigation—Service	2
Rates—NRC	2	Motions	31
Tariffs	1	Rates - ARF	6
Transfer/Sale/Purchase/Merger	7	Rates - NRC	2
		Staff Reports	5
Total Cases filed during biennium	30	Surcharges	2
		Tariffs	1
		Transfer/Sale/Purchase/Merger	7
		Total Orders issued during biennium	94

The information on the preceding pages offers a picture of the operation of the Public Service Commission. Utility annual report statistics and graphs are available on the PSC web site at psc.ky.gov

Summary of Receipts and Expenditures

Summary of Receipts by Kentucky PSC as of Fiscal Year Ended June 30, 2006 (All amounts rounded to the nearest \$100)

General Fund:	
Regular Appropriation	\$ 11,568,600
Continuing Appropriation	\$ 2,261,700
Total	\$ 13,830,300
Agency Fund:	
Siting Board Fees , receipts for Law Books, CDs, Tapes, etc.	\$ 512,800
Federal Funds:	
Gas Pipeline Safety Program	\$ 200,800
Grand Total	\$ 14,543,900

**Total of expenditures by Kentucky PSC as of Fiscal Year Ended June 30, 2006
(Rounded to the nearest \$100)**

TOTAL \$ 9,160,300

Summary of Receipts by Kentucky PSC as of Fiscal Year Ended June 30, 2007 (All amounts rounded to the nearest \$100)

General Fund:	
Regular Appropriation	\$ 12,684,800
Continuing Appropriation	\$
Total	\$ 12,684,800
Agency Fund:	
Siting Board Fees , receipts for Law Books, CDs, Tapes, etc.	\$ 239,400
Federal Funds:	
Gas Pipeline Safety Program	\$ 182,900
Grand Total	\$ 13,107,000

Comparison of Expenditures

	FY06	FY07
Budget	\$ 8,739,200	\$ 11,890,800
Personnel	\$ 7,422,400	\$ 8,036,200
Operating	\$ 1,099,900	\$ 1,960,500

**Total of expenditures by Kentucky PSC as of Fiscal Year Ended June 30, 2007
(Rounded to the nearest \$100)**

TOTAL \$ 10,673,700

Kentucky Public Service Commission Accommodations for Individuals with Disabilities

The Public Service Commission provides, upon request, reasonable accommodations and services necessary to afford an individual with a disability an equal opportunity to participate in all services, programs and activities. To request materials in an alternative format, contact the PSC at 502-564-3940. Persons with hearing or speech impairments can contact the agency by using the Kentucky Relay Service, a toll-free telecommunication device for the deaf (TDD). For voice to TDD, call 1/800-648-6057. For TDD to voice, call 1/800-648-6056.

You can e-mail the PSC at psc.consumer.inquiries@ky.gov



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