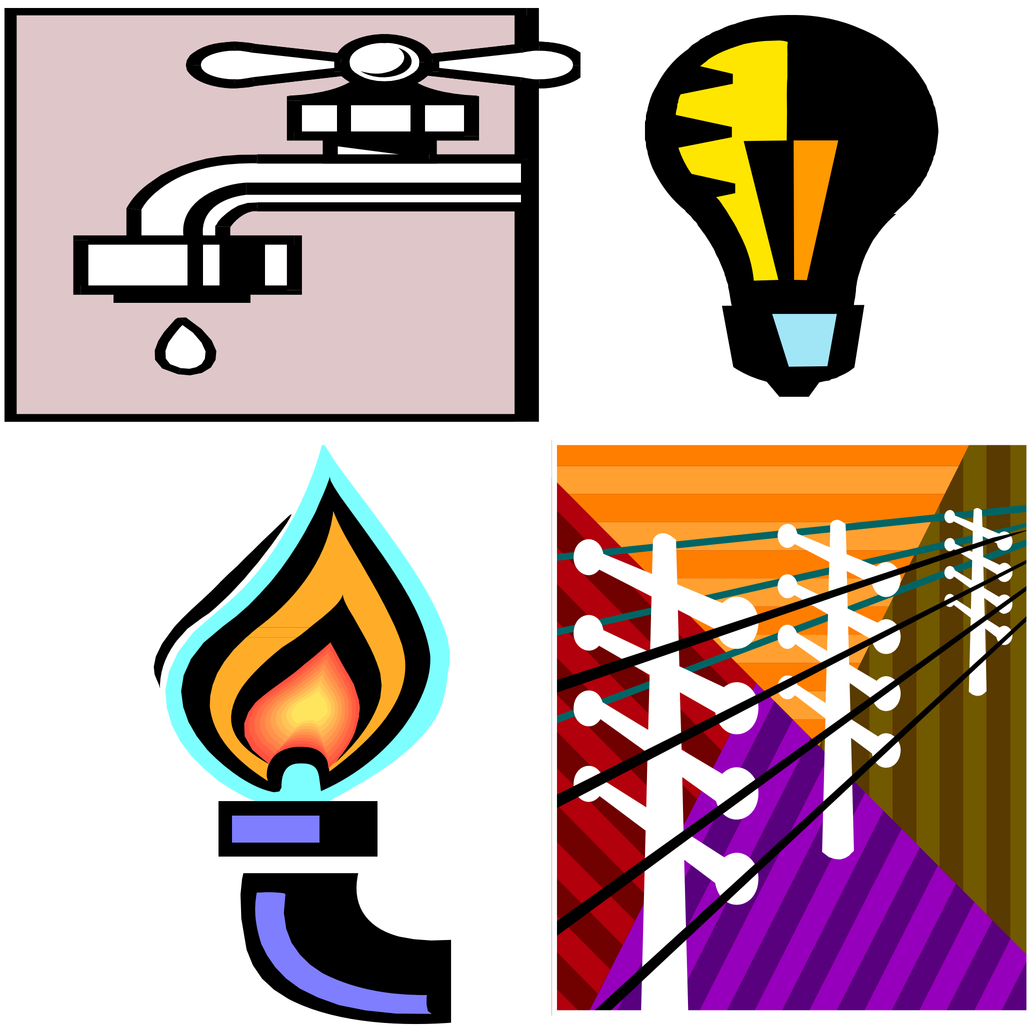
PSC

PUBLIC SERVICE COMMISSION OF KENTUCKY

BIENNIAL REPORT

JULY 1, 2003-
JUNE 30, 2005

ASSURING SAFE, RELIABLE UTILITY SERVICES FOR ALL KENTUCKIANS



Kentucky
UNBRIDLED SPIRIT™

Ernie Fletcher
Governor

Teresa J. Hill, Secretary
Environmental and Public
Protection Cabinet

Timothy J. LeDonne
Commissioner
Department of Public Protection

Commonwealth of Kentucky
Environmental and Public Protection Cabinet
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Mark David Goss
Chairman

John W. Clay
Vice Chairman

Caroline Pitt Clark
Commissioner

August 31, 2007

The Honorable Ernie Fletcher
Governor
Commonwealth of Kentucky
The Capitol
700 Capitol Avenue
Frankfort, Kentucky 40601

Dear Governor Fletcher:

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 35th Biennial Report. This report presents the activities, and accomplishments of the Public Service Commission from July 2003 through June 2005.

The mission of the Public Service Commission is to ensure that all citizens of the Commonwealth receive safe and adequate utility service at fair, just and reasonable rates.

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/	/S/	/S/
Mark David Goss Chairman	John W. Clay Vice Chairman	Caroline Pitt Clark Commissioner

PSC PUBLIC SERVICE COMMISSION OF KENTUCKY

The Kentucky Public Service Commission

Biennial Report
July 1, 2003-June 30,2005

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Kentucky UNBRIDLED SPIRIT™

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PUBLIC SERVICE
COMMISSION
OF KENTUCKY

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 Environmental and Public Protection Cabinet. Three appointed Commissioners who have quasi-legislative and quasi-judicial duties lead the Commission. It has a staff of about 110.

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, rural electric 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.

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.

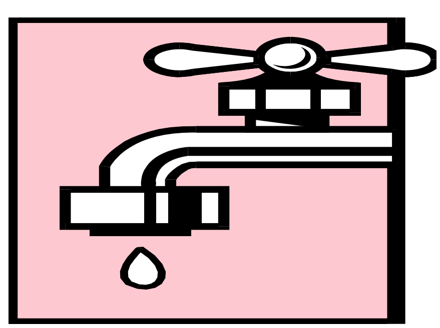
In 1987 sanitation districts were removed from Commission jurisdiction. In 1994, the Kentucky Supreme Court in the case of <u>Simpson County Water District v. City of Franklin, Kentucky</u>, Ky., 872 S.W.2d 460 (1994), concluded that the Commission retained jurisdiction to review the wholesale rates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

In 2002, the 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 Kentucky General Assembly also enacted legislation that generally removed state regulation over broadband services.






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 Mark David Goss, Vice Chairman John W. Clay and Commissioner Caroline Pitt Clark. Commissioner biographies begin on the following page.**

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 and two Staff Assistants who advise the three Commissioners on various issues.

Executive Director's Office

As Executive Director, **Elizabeth O'Donnell** serves as the chief administrative officer for the commission.

She is responsible for staff direction and coordination in implementing the programs and duties of the 110-member staff. Ms. O'Donnell is assisted by Robert Amato, 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.

Ms. O'Donnell joined the PSC in May 2004.

PSC Commissioners

Mark David Goss, Chairman

Governor Ernie Fletcher appointed Mark David Goss Chairman of the Kentucky Public Service Commission in February 2004, and reappointed him to a term expiring in June 2011.

Prior to joining the PSC, Chairman Goss was a partner with his father, Eugene Goss, in the law firm of Goss & Goss Attorneys in Harlan. He is the fourth generation of his family to practice law in that community. Chairman Goss' practice emphasis was in litigation. He routinely appeared in both state and federal courts, as well as before state and federal administrative agencies. He has made appellate appearances at the agency level and before the Kentucky Court of Appeals, the Kentucky Supreme Court and the U.S. Circuit Court of Appeals. He also has additional experience in banking law, criminal law, real estate law, probate law and corporate law.

Chairman Goss is a member of the Harlan County, Kentucky, Federal and Energy Bar Associations. He is admitted to practice in all Kentucky Courts, federal courts at the District and Circuit Court levels, as well as the Supreme Court of the United States.

Chairman Goss is a member of the board of directors of the National Association of Regulatory Utility Commissioners (NARUC), serves on NARUC's Electricity Committee and is chairman of the NARUC subcommittee on clean coal technology. He is past president of the Southeastern Association of Regulatory Utility Commissioners (SEARUC) and is on the board of directors of the Mid-Atlantic Conference of Regulatory Utility Commissioners (MACRUC). He also serves on the board of directors of the Organization of MISO (Midwest Independent System Operator) States (OMS) and is on the board of directors and executive committee of the Organization of PJM States, Inc. (OPSI).

Chairman Goss also is a member of the National Coal Council (NCC), which is the chief advisory panel on federal coal policy, and of the U.S. Environmental Protection Agency's Advanced Coal Technology Work Group.

Chairman Goss is active in promoting industrial development and education in his home community. He has served on the Harlan County Industrial Development Commission, the Harlan County Judicial Center Planning Committee, and as Chairman of the Buildings and Facilities Committee of the Harlan Independent School System. He is a member of the Board of Directors of the Bank of Harlan and is a Deacon of the Harlan Baptist Church.

Chairman Goss received his Juris Doctor degree from the University of Tennessee College of Law. He holds a Bachelor of Arts degree in Political Science from Transylvania University.

Chairman Goss and his wife Becky have two daughters, Elizabeth and Sarah. Elizabeth is a student at Furman University and Sarah attends High Point University.

John W. Clay, Vice Chairman

Governor Ernie Fletcher appointed John W. Clay as a member of the Kentucky Public Service Commission (PSC) on October 2, 2006, and designated him vice chairman on August 3, 2007. His term expires June 30, 2009.

Before joining the PSC, Vice Chairman Clay, a Certified Public Accountant, was deputy secretary of the Kentucky Environmental and Public Protection Cabinet. He previously served as executive director and chairman of the Alcohol Beverage Control Board in the Department of Public Protection.

Before entering state government, Vice Chairman Clay worked for many years in the beverage industry, most recently as director of finance for Southern Wine & Spirits of Kentucky Inc. and as secretary-treasurer of Crane Distributing Co., Inc. Vice Chairman Clay earlier was tax manager for a public accounting firm.

Vice Chairman Clay serves on the Committee on Water of the National Association of Regulatory Utility Commissioners (NARUC).

Vice Chairman Clay is a past member of the Kentucky State Board of Accountancy, serving one term as president, and is a current member of the American Institute of Certified Public Accountants. He is a member of the Kentucky Society of CPAs and serves on its Ethics Committee. Vice Chairman Clay serves on the Administration and Finance Committee of the National Association of State Boards of Accountancy.

Vice Chairman Clay is a graduate of Georgetown College, where he received a Bachelor of Arts degree in Business Administration. He completed additional accounting studies at the University of Kentucky.

Vice Chairman Clay and his wife D'Ann reside in Lexington.

Caroline Pitt Clark, Commissioner

Governor Ernie Fletcher appointed Caroline Pitt Clark as a member of the Kentucky Public Service Commission (PSC) on August 3, 2007, to complete an unexpired term. Her term expires June 30, 2008.

Before joining the PSC, Commissioner Clark was an attorney in the Louisville office of the law firm of Landrum & Shouse LLP, practicing in the areas of criminal defense and civil litigation.

Commissioner Clark is a member of the Louisville, Kentucky and American bar associations. She is admitted to practice in all Kentucky courts and federal courts at the District and Circuit Court levels in Kentucky and Indiana.

Commissioner Clark is a graduate of Centre College, where she received a Bachelor of Arts degree in Political Science. She received her Juris Doctor degree from the University of Kentucky College of Law.

Commissioner Clark resides in Louisville with her husband Justin and their daughters Charley and Georgia.

Other Commissioners who served during the biennium were:

W. Gregory Coker (2004-2006)	Teresa J. Hill (2005-2006)	Ellen C. Williams (2004-2005)
Martin J. Huelsmann (2003-2004)	Gary W. Gillis (2003-2004)	Robert C. Spurlin (2003-2004)

Division of Consumer Services

From July 2003 through June 2005, $1,228,062 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 9,062 informal complaints against utilities. These complaints are received by telephone, fax, letter, e-mail, and walk-ins. During this same period, the division received approximately 60,000 telephone calls from consumers seeking general information or wishing to file a complaint.

Many of these calls resulted in dollar savings to customers. From July 2003 through June 2005, $1,228,062 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 five 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 2003-2005 biennium, the Financial Analysis Division handled six major utility base rate cases.

The Division of Financial Analysis, headed by **Philip Cave,** consists of seven branches: the Electric and Gas Rate Design Branch, the Electric and Gas Revenue Requirements Branch, the Water, Sewer, and Telephone 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 is responsible for financial audits, management audits and accounting and financial matters.

Other responsibilities include analyzing and commenting on 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 tracking emerging issues and evaluating the potential impact 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 24 employees.

Division of Engineering

During the biennium, the Division of Engineering conducted 1,539 inspections and investigated 64 accidents.

The Division of Engineering, directed by **James Welch**, 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 deregulation 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 24 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 **David Samford.** It provides legal counsel to the Commission and the staff regarding the legal issues involved in jurisdiction, ratemaking, 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 11 attorneys and three support staff.

PSC Hearing — August 2007

From left: Vice Chairman John W. Clay,

Chairman Mark David Goss, Commissioner Caroline Pitt Clark

Filings Division

The Filings Division, directed by **Michael Burford**, 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. During the 2003-2005 biennium, the Division implemented a system that makes electronic copies of most paper filings available on the PSC Web site.

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

The webmaster keeps the PSC web page up to date and provides information to the public. Our 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 19 employees.

Commission administration

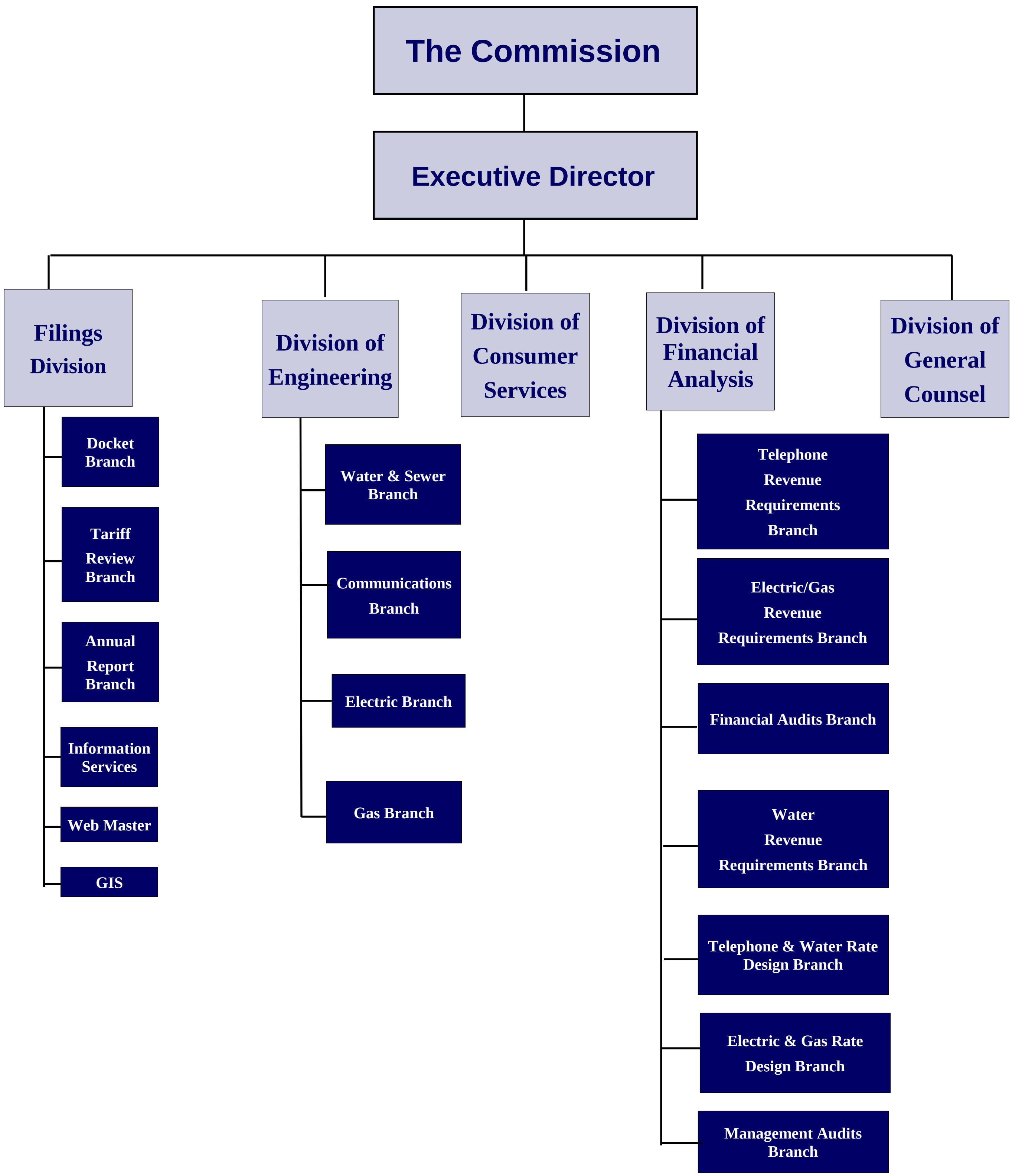
In 2003, the former Division of Administrative Services was consolidated within the Office of Executive Director. The principal function remains the production of and adherence to the Public Service Commission's biennial budget.

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.

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

PSC Organizational Chart



PSC PUBLIC SERVICE COMMISSION OF KENTUCKY

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

Mark David Goss, Chairman	201
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Division of Consumer Services

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Consumer Hotline	*1-800-772-4636*
	(1-800-PSC-INFO)

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Commission fax number: (502) 564-3460

Information Management

The PSC's web site offers a wealth of information toconsumers, 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.

A new feature added during the 2003-2005 biennium is information about major electric service disruptions. This information is available on the Web site as soon as it is filed by the affected utility.

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 may 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. This feature was added during the 2003-2005 biennium.

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. During the 2003-2005 biennium, this information was reorganized to make it more readily accessible to the public.

Forms needed by utilities are available for download direcrtly 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 1,000,000th visit in 2005

Using technology more effectively

The Public Service Commission took a number of steps during the 2003-2005 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 reduce the volume of paper produced by PSC proceedings. A major step in this direction came during the 2003-2005 with creation of 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 outage reporting system for electric utilities. Utilities use a secure Web portal to submit information about reportable outages. After an initial trial period, this information also was made available on the PSC Web site.

The PSC's internal operations also were significantly improved through more effective use of technology. An electronic case management system was implemented to track cases through the PSC system. It has improved workflow and timely processing of cases.

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.

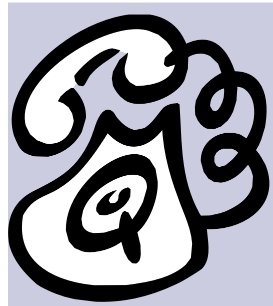
The Consumer Services staff assists in resolving a wide range of utility problems including improper termination of service, unauthorized or incorrect charges on utility bills, problems reading meters, customer deposits for utility services, poor quality of service and problems with delayed connection 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 2003-2005 Biennium

July 1, 2003 to June 30, 2004

	Telephone	Electric	Gas	Water	Sewer	Total
Billing	1018	260	97	97	3	1475
Slamming	136	0	0	0	0	136
Service	1152	140	27	89	4	1412
Disconnect	308	139	65	39	1	552
Other	688	280	103	106	3	1180
TOTALS	3302	819	292	331	11	4755

In the **1993-1995** period, the PSC received ***3,813*** consumer complaints. In the **2001-2003** biennium, ***9,347*** consumer complaints were received. The ***9,062*** complaints received in **2003-2005** represent the first decrease in the last six biennial periods.

July 1, 2004 to June 30, 2005

	Telephone	Electric	Gas	Water	Sewer	Total
Billing	899	327	124	109	4	1463
Slamming	110	0	0	0	0	110
Service	711	170	13	66	5	965
Disconnect	266	166	75	41	0	548
Other	649	341	92	133	6	1221
TOTALS	2635	1004	304	349	15	4307

Significant Cases and Issues

The 2003-2005 biennium was a period of change for the Kentucky Public Service Commission and the industries it regulates. The arrival of a new administration brought new leadership to the PSC. Changes in state law brought a significant new responsibility - certifying the construction of major electric transmission lines. The rising cost of natural gas posed challenges both in regulation and in communication with the public. A major electric blackout affecting some neighboring states prompted a comprehensive examination of Kentucky's transmission grid. The PSC participated in the formulation of a comprehensive energy policy for Kentucky, focusing on electric infrastructure needs. Rapid change continued in the telecommunications industry, including federal and state actions that affected the PSC's regulatory responsibilities. Significant cases coming before the PSC, included rate adjustment cases for several of Kentucky's largest utilities, certification of two new electric generation facilities and the first transmission line certificate cases. The Kentucky State Board on Electric Generation and Transmission Siting considered four applications during the biennium.

Electricity Issues and Cases

Infrastructure was the dominant electric issue during the biennium. The Kentucky Public Service (PSC) addressed infrastructure reliability at all levels, examined overall future electric infrastructure needs and considered a number of applications for construction of generation and transmission facilities.

In general, the studies concluded that Kentucky has a robust electric generation and transmission infrastructure, but needs to invest in additional capacity to meet projected needs. At the distribution system level, a number of issues were identified that require future study and possible action.

Assessments of reliability were prompted in part by several events that produced widespread disruptions of electric service. The PSC's review of utility response to the February 2003 ice storm was concluded in February 2004. Although the August 2004 blackout that affected a large portion of northeastern North America did not extend into Kentucky, it nonetheless prompted the PSC to initiate a review of transmission grid reliability in the state. A further review of both distribution and transmission reliability was undertaken during an administrative proceeding which assessed Kentucky's current and future electric infrastructure needs.

The 2004 Kentucky General Assembly enacted legislation that granted the PSC authority over the construction of high-voltage transmission lines. During the biennium, the PSC promulgated regulations to implement this legislation, completed consideration of the first application under the new statute and began its review of a number of other applications. The PSC also received several applications from jurisdictional utilities for the construction of new electric generation capacity.

Other matters coming before the PSC included the membership of utilities in regional transmission organizations, base rate adjustment requests from Kentucky's two largest electric utilities and other rate-related matters.

Strategic Blueprint and Electric Transmission Grid Reliability – Case No. 2005-00090

This administrative case was opened to develop a strategic blueprint for Kentucky's continued use and development of low-cost electric energy. In Executive Order 2005-121, issued Feb. 7, 2005, Governor Ernie Fletcher called on the Kentucky Public Service Commission to develop the plan as called for by the Commonwealth Energy Policy Task Force. The PSC's evaluation of Kentucky's electric transmission grid reliability was subsequently incorporated into the administrative case.

Following the Aug. 14, 2003, blackout that cut off electricity to much of Canada, the Northeast and the upper Midwest, the PSC ordered a study to determine the vulnerability of Kentucky's electric grid to widespread outages. Although the blackout did not affect Kentucky, it began in Ohio and extended to other nearby states.

The study was paid for by utilities in Kentucky and conducted by Commonwealth Associates, Inc., (CAI) an engineering consulting firm based in Jackson, Mich. Through their participation in the study, Kentucky's electric utilities were made aware of potential vulnerabilities in their systems.

CAI concluded that Kentucky's electric infrastructure is relatively resistant to the type of domino-effect outages that created the blackout. But the study identified a number of potential vulnerabilities. The PSC asked utilities in the state how they had or intend to address those situations.

CAI evaluated Kentucky's transmission grid to determine whether it is vulnerable to cascading outages of the kind that led to the 2003 blackout. The study used computer models to test what could occur under a variety of both likely and unusual operating conditions. Unusual operating conditions included multiple equipment failures and abnormally high power flows across Kentucky's system. Of the nearly 100,000 possible scenarios, fewer than 1,200 showed any possibility of creating widespread outages.

More than 1,000 of the potentially troublesome scenarios occurred under unusual operating conditions. Fewer than 150 approximated typical operating conditions.

The scenarios that have the greatest potential to cause problems, CAI found, involve the large-scale transfer of power through Kentucky from states north of Kentucky to states farther south. That finding paralleled the results of a 2001 PSC study that examined the adequacy of Kentucky's electric generation and transmission system.

Kentucky's ability to meet its power needs is a major factor in protecting the state against outages, CAI concluded. The report notes that the international commission that examined the August 2003 blackout found that the presence of adequate generating capacity kept some areas from losing power as the blackout spread.

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.

Assessment of Electric Utility Response During the Ice Storm of February 2003

On Feb. 6, 2004, the PSC issued its evaluation of the response of electric utilities, both investor-owned companies and rural electric cooperatives, to the ice storm which had affected much of central and northeast Kentucky a year earlier. The PSC staff conducted the evaluation. The report's assessments were based on the staff's own observations and on information gathered from affected utilities and the communities they serve.

More than 250,000 customers lost power during the storm, which deposited several inches of ice on trees, utility poles and power lines. Some customers were without power for more than a week. Kentucky Utilities Co. (KU) suffered the greatest amount of damage, but several rural electric cooperatives experienced more severe service disruptions. The PSC concluded that, given the extent of the damage and outages, utilities generally did a good job of restoring service. However, the report notes some areas of concern and makes recommendations for improving disaster preparedness and response.

The reports key findings included:

1. The severity of the ice storm, as measured by the number of customer outages and damage to distribution facilities, was unprecedented on a statewide basis.

2. Trees or limbs falling onto distribution lines caused the majority of outages during the ice storm. More aggressive tree trimming would have had little effect in lessening the devastation.

3. The cost of the restoration stated by the utilities was approximately $22.5 million for KU and approximately $24.7 million for the other utilities combined. The majority of the electric cooperative expenses were eligible for federal disaster assistance reimbursement.

4. Some local government officials were concerned that they did not receive sufficient and/or timely information from the utilities during the ice storm and the subsequent power restoration process. Following the storm, the utilities made extensive efforts to improve their communications with government officials during outage periods.

5. A major point of public frustration in Central Kentucky was the difficulty in obtaining information about the progress of restoration in specific areas. There was no means available of conveying real-time information about restoration efforts. Utility Internet sites were of limited use to customers and news media reporters during the restoration process.

6. The assessment did not indicate that significant outages during the ice storm were attributable to the design or age of the distribution systems or to pre-existing conditions on the systems.

7. The assessment found no general discrimination among geographical areas by any of the utilities in their storm restoration efforts. However, it was noted that damage assessment in Woodford and Anderson counties was delayed due to KU's focus on Fayette County.

8. The utilities' restoration priorities – addressing safety-related situations, emergency services, and critical infrastructure needs – and then restoring service to the largest numbers of customers in the shortest period of time, were deemed appropriate by PSC staff.

9. Utility officials were careful to provide realistic assessments of when service would be restored. While this may not have been what frustrated customers wanted to hear, it forestalled the creation of unrealistic expectations.

10. Kentucky's electric utilities have emphasized safety precautions that should be taken around downed power lines. The message, which was emphasized from the outset during the ice storm, clearly has taken hold in the public consciousness, as evidenced by the absence of any injuries caused by downed lines.

11. There was a delay by KU in communicating the fact that property owners are responsible for repairs to property connections. It was learned that customers generally do not understand where the utility's responsibility ends and theirs begins.

12. Safety problems arose after the storm was over and power had been fully restored. The most serious problem – which led to two fatalities – was tree trimming or removal by untrained personnel or property owners themselves.

The report also made several recommendations. They included:

1. Utilities should make every effort to ensure that an adequate number of telephone lines are available to customers for incoming calls to the call centers, as well as having sufficient queue size for efficient management of the call volume imposed by major storms.

2. The addition of Spanish-speaking employees to customer service and public communication staffs should be considered.

3. Utilities should give additional attention to right-of-way maintenance and system inspections to maintain and improve system reliability. A proper balance must be attained between aesthetic benefits to the community and the risk of substantial societal costs associated with the types of major storms to which Kentucky is vulnerable.

4. Utilities should ensure that elected officials in all areas of their service territory have a means of access to information regarding storm restoration progress.

5. A storm preparedness position or contact employee should be established at each utility. This person should be responsible and accountable for establishing, reviewing and maintaining the utility's disaster preparedness and restoration procedures. This person should also make regular contact with the Kentucky Emergency Management offices in their territory. They could also serve collectively with their peers on a statewide disaster planning/ restoration task force.

6. Information about the customer's responsibility for repairs to property connections, and proper inspection of those repairs, should be a point of emphasis in initial communication efforts in future events that damage significant numbers of property connections. Improving customer education about their responsibility will help utilities restore power safely and decrease customer frustration.

7. Utilities should consider establishing "Restoration Information" Web sites that could convey the information about the status of restoration efforts in specific areas.

Membership of Kentucky Power Co. (American Electric Power Co.) in PJM Interconnection, Inc. – Case No. 2002-00475

On Dec. 19, 2002, Kentucky Power filed an application requesting approval to transfer functional control of its transmission assets to PJM Interconnection, Inc.

Kentucky Power is a unit of American Electric Power Company (AEP). It serves about 175,000 customers in eastern Kentucky. PJM, based in Pennsylvania, controls transmission facilities and operates a wholesale electric market in six states and the District of Columbia. It is one of several regional transmission organizations (RTOs) created as a result of industry restructuring overseen by the Federal Energy Regulatory Commission (FERC).

The Kentucky Office of Attorney General, Kentucky Industrial Utility Customers, Inc. (KIUC), and PJM requested and were granted intervention. A public hearing in the case was held on March 25, 2003. On July 17, 2003, the PSC issued an order denying Kentucky Power's application. The PSC said that the proposed transfer would not be in the public interest because it would impose costs on Kentucky Power ratepayers without providing demonstrable benefits.

Kentucky Power and PJM asked the PSC to reconsider its decision and allow new evidence to be presented. The PSC granted the request and allowed AEP to submit a new cost-benefit analysis that was specific to Kentucky.

Following the PSC's initial denial of Kentucky Power's entry into PJM, the FERC moved to override the state action (FERC Case

No. ER03-262-009). In November 2003, the FERC issued a preliminary finding that actions taken by the PSC and, separately, by Virginia had violated federal law by blocking AEP's membership in PJM.

On April 19, 2004, two days before the scheduled rehearing, and following the presentation of new evidence concerning the costs and benefits of Kentucky Power's membership in PJM, all parties to the case filed a stipulation with the PSC. The stipulation clarified how PJM's operating rules would mesh with Kentucky laws, particularly a statute that requires utilities in the state to give priority to the "native load" customers in their service territories in the event of an emergency on the transmission system that required power to be curtailed. The stipulation also affirmed the PSC's authority over Kentucky Power's retail rates.

On May 19, 2004, the PSC approved Kentucky Power's entry into PJM, noting that the stipulation's affirmation of PSC's authority, coupled with the voluntary nature of PJM's energy market for meeting Kentucky Power's native load energy requirements, provided adequate assurances that Kentucky Power's retail energy costs will continue to be fair, reasonable, and relatively stable over time, and not subject to market price variations.

The PSC subsequently sought to be dismissed from the FERC proceeding on the grounds that the order approving Kentucky Power's entry into PJM rendered moot the FERC action. On June 17, 2004, the FERC approved the settlement, closing the proceeding with respect to Kentucky.

Louisville Gas & Electric Co. and Kentucky Utilities Co. 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.)

Louisville Gas & Electric Co. and Kentucky Utilities Co. Applications for Base 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.

LG&E and KU are both subsidiaries of E.ON US. LG&E has about 384,000 electric customers in 16 counties in the Louisville area. KU serves about 477,000 customers in 77 Kentucky counties.

KU requested a $58.2 million annual electric revenue increase. KU's previous electric rate increase occurred in 1984, and had its rates reduced by PSC order in 2000. LG&E applied for a $63.7 million increase in annual electric revenue. LG&E previously was allowed to increase electric rates in 1990. But in 2000, LG&E's electric rates were lowered to pre-1990 levels.

On March 31, 2004, the PSC consolidated the rate increase cases with several other rate-related matters involving LG&E and KU. The most significant of these were reviews initiated by the PSC of the earnings-sharing mechanisms (ESM) for both utilities. Under the ESM, KU & LG&E customers shared in the profits and losses incurred by the two utilities. When profits exceeded certain levels, customers received a rebate representing a portion of the additional profits. When profits fell below a certain level, the customers were assessed a surcharge.

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.

An informal conference was held April 19, 2004, at the PSC offices in preparation for the hearing set for May 4, 2004. Negotiations began to settle the case. Further settlement negotiations were held April 29 and 30 at the PSC offices and those of the Kentucky Attorney General.

Hearings in the case began as scheduled on May 4, but were suspended to permit continued 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.

Key provisions of the settlement accepted by the PSC included an end to the ESM program for both LG&E and KU and the elimination of a variable rate structure under which LG&E's electric rates rose during the summer peak, when demand is highest, in order to encourage energy conservation.

The settlement agreement also established a program to assist low-income consumers in paying their utility bills. LG&E and KU were granted authority to impose a monthly assessment of 10 cents per residential meter. Implementation of the program was delayed to allow the PSC to review details of its administration in order to assure the program would operate efficiently.

On Sept. 30, 2004, the PSC authorized LG&E and KU to begin collecting the monthly fee, but directed that no funds be distributed until the utilities could adequately explain the differences between their two programs. The PSC granted its final approval for the programs on Nov. 24, 2004. In its order, the PSC registered its disappointment that LG&E's shareholders would not be contributing to the low-income assistance fund, but noted that it had no authority to compel a shareholder contribution.

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 re-opened 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.)

Electric Transmission Siting Law

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).

Prior to July 13, 2004, effective date of the transmission siting law, the PSC dealt with transmission line cases only in the infrequent instances in which questions were raised about unnecessarily duplicative facilities or in which complaints were filed. Two such instances occurred during the 2003-2005 biennium.

<u>East Kentucky Power Cooperative – Case No. 2003-00380</u>

In October 2003, after receiving a large number of inquiries from affected landowners, the PSC opened an inquiry (Case No. 2003-00380) into a plan by East Kentucky Power Cooperative to construct a 138-kilovolt transmission line from the Maysville area to Flemingsburg. The investigation focused on the question of whether building the proposed line on a new right-of-way would be an unnecessary duplication of facilities. The route for the new line generally paralleled existing transmission lines.

Kentucky Utilities Co. and Kentucky Power Co., both of which had facilities in the area that could be affected, were made intervenors in the case. They and others presented evidence about potential alternatives for meeting transmission needs in the area. In December 2003, the PSC concluded that EKPC had made a reasonable choice in its decision to construct the line and that the other options either were more costly or not as effective in rectifying insufficient transmission capacity.

<u>Louisville Gas and Electric Co. – Case No. 2004-00293</u>

In March 2004, officials of Louisville Gas and Electric Co. (LG&E) and several property owners met with PSC staff to discuss a planned LG&E transmission line in eastern Jefferson County. The landowners objected to the route chosen by LG&E and sought PSC assistance in having it changed. The PSC, at that time, had no jurisdiction in the matter and was able only to offer itself as a facilitator in discussions between the parties.

Subsequent to the passage of the transmission siting statute, the landowners filed a complaint with the PSC seeking enforcement of the statute with respect to the LG&E line in question. However, the PSC determined that LG&E had commenced construction of line prior to the effective date of the new statute. Therefore, the project preceded the statutory requirement and did not require a certificate, the PSC ruled in dismissing the complaint.

Transmission Line Cases

East Kentucky Power Cooperative – Case No. 2004-00320

The first application under the new statute was filed by EKPC to construct 6.3 miles of 161-kilovolt line to connect a new substation in the Little Mount area to an existing transmission line in the vicinity of Elk Creek. A public hearing was conducted in Taylorsville on March 3, 2005. No public comments were received at hearing or at the subsequent evidentiary hearing. The PSC granted a certificate for the project on March 30, 2005.

Big Rivers Electric Corp. – Case No. 2004-00365

Big Rivers Electric Corp. filed an application to construct 17.3 miles of 161-kilovolt line to connect to an existing line at a point about three miles west of Hardinsburg and extend to an existing substation northeast of Irvington. A local public hearing in the case was held Jan. 20, 2005, in Hardinsburg, at which several property owners voiced specific concerns about the line, notably issues regarding vegetation management in the right of way. At the subsequent evidentiary hearing on Jan. 31, Big Rivers committed itself to address the landowner concerns. The PSC, noting that Big Rivers had adequately considered other options, granted a certificate for the line on Feb. 28, 2004.

The following transmission cases were filed during the biennium, but were not concluded until after June 30, 2005.

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)

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.)

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. (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. (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.)

Generating Facility Cases

In March 2005, East Kentucky Power Cooperative (EKPC) put into service its Gilbert Unit, the first coal-fired electric generating facility completed in Kentucky since 1990. The 268-megawatt unit, at EKPC's H.L. Spurlock Power Station in Mason County, also was the first in Kentucky to employ circulating fluidized bed technology, a combustion process that eliminates the need for costly flue-gas scrubbers and other emission controls.

Other generating facilities put into service during the biennium included gas-fired turbines at the Louisville Gas and Electric Co. (LG&E) Trimble County station and at EKPC's Smith Station in Clark County. EKPC also completed construction of three small gas turbines fueled by methane recovered from landfills.

The PSC also received applications for a number of new coal-burning generating facilities, but did not complete its reviews of these projects until after the end of the biennium.

<u>East Kentucky Power Cooperative – Case No. 2004-00423</u>

In October 2004, 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. (The PSC granted a certificate for the project in September 2005. EKPC commenced construction and, after Warren RECC decided it would not become a customer, was permitted to retain the certificate in order to satisfy other future demand.)

<u>Louisville Gas and Electric Co./ Kentucky Utilities Co. - Case No. 2004-00507</u>

In December 2004, Louisville Gas & Electric Co. (LG&E) and Kentucky Utilities Co. (KU) 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.

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.

(The PSC and the Siting Board both approved the project in November 2005.)

<u>East Kentucky Power Cooperative – Case No. 2005-00053</u>

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 in August 2006. 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 remaing three units.)

Union Light, Heat and Power Co. Acquisition of Generating Capacity – Case No. 2003-00252

On Dec. 5, 2003, the PSC approved a proposal by The Union Light, Heat and Power Co. (ULH&P) to purchase electric generating capacity from its parent company, The Cincinnati Gas & Electric Co. (CG&E). 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 transaction documents were submitted to the PSC in May 2006, following the merger of of Cinergy with Duke Energy Corp. The PSC gave its final approval in the case in February 2007.)

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. ULH&P serves about 128,000 electric customers in six Kentucky counties in the Cincinnati area.

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.

Other provisions in the order granted ULH&P waivers from state law prohibiting certain transactions between affiliated companies and from PSC regulations requiring another examination of power-supply options; outlined how certain financial aspects of the transaction would be treated on the company's books and are expected to be treated in future base rate proceedings and fuel adjustment clause proceedings before the PSC; and required that profits from any off-system power sales would, in ULH&P's next base rate case, be shared between ratepayers and shareholders, with the first $1 million credited to ratepayers and profits above $1 million shared equally by ratepayers and shareholders.

Union Light, Heat and Power Co. Economic Development Rates – Case No. 2004-00253

In an effort to promote economic development, The Union Light, Heat & Power Co. (ULH&P) proposed in June 2004 to offer discounted electric rates to customers who create jobs, particularly on old industrial sites (brownfields) or in urban redevelopment areas. The PSC approved the proposal on April 19, 2005, and commended ULH&P for its innovative approach to promoting and assisting economic development in Northern Kentucky. ULH&P serves about 128,000 electric customers in six Kentucky counties in the Cincinnati area.

While economic development rates have been allowed since 1990 through individual contracts between utilities and customers, this was the first time that the PSC permitted a utility to make such rates part of its published schedules of rates and services. Including the rates in its tariff would make it easier for customers to identify the utility as one that offers such economic incentives, ULH&P said in its request to the PSC.

The economic incentive programs set minimum qualifications for customers. Economic development customers must hire at least 25 new employees per 1,000 kilowatts of electric load and make a capital investment of at least $1 million per 1,000 kilowatts of load.

To qualify for the urban redevelopment incentive, a customer has to occupy an existing building of at least 25,000 square feet that has been vacant for at least two years. The brownfield redevelopment rate is available to customers who locate in a brownfield area as defined by Kentucky or federal law.

In all cases, customers receive service at a reduced rate for a specified period, and are required to take a certain level of service for a specified number of years. Specific terms are spelled out in individual contracts which must be approved by the PSC.

The Kentucky Office of Attorney General filed suit challenging the PSC decision. (The Franklin Circuit Court ruled in the PSC's favor in June 2006. The Attorney General appealed that ruling to the Kentucky Court of Appeals, which has not yet issued a decision the matter.)

Louisville Gas & Electric Co., Kentucky Utilities Co. and LG&E Energy – Focused Management Audit of Coal Purchasing Practices

In 2002, the PSC initiated a review of the purchase by Kentucky Utilities Co. (KU) in July 2001 of 102,000 tons of Polish coal. In January 2003, the PSC ruled, in Case No. 2000-00497B, that the purchase imposed unreasonable costs on KU's ratepayers. KU was ordered to refund a total of $673,000 to its customers. The PSC also ordered an independent audit of the fuel purchasing and management practices of KU and its sister company, Louisville Gas and Electric Co.

(LG&E), and their parent company, LG&E Energy (now E.ON US). The Liberty Consulting Group, an independent consulting firm headquartered in Quentin, Pa., performed the audit.

Results of the audit were made public on March 5, 2004. The audit identified 15 areas of improvement for the fuel purchasing and fuel management practices of KU and Louisville Gas and Electric Co. (LG&E). They included enhancing existing policies, operating procedures, and job descriptions; potential further separation of regulated and non-regulated affiliates; and enhancing the Fuels Department's handling and communication of information.

Liberty Consulting examined five primary aspects of the companies fuel acquisition and management: organization, staffing and controls; fuels planning; fuels acquisition; supply management; and affiliate relations. KU and LG&E received generally high marks in most areas of fuel procurement and management.

KU and LG&E were required to develop action plans to address the recommendations contained in the audit report. KU and LG&E also were required to file reports detailing the actions taken to comply with the audit recommendations. The reports were filed with the PSC every six months through March 2006.

The PSC routinely reviews coal purchases by regulated utilities. The reviews monitor how electric utility companies are applying the fuel adjustment clause. The fuel adjustment clause is governed by a regulation that permits utilities to adjust their electric rates to reflect fluctuations in the price of fuel burned to generate electricity.

Key audit findings included:

Fuels Department personnel have solid skills and sound experience in the coal area.

Fuel Procurement policies and procedures are too general and omit certain aspects of fuel procurement and management.

Necessary procedures related to fuel management dealings with the non-regulated affiliate, Western Kentucky Energy (WKE), do not exist and procurement functions for LG&E/KU and WKE are not sufficiently separated.

There is a sound process for analysis of coal bids and approval of coal procurement recommendations.

The Fuels Department has been effective integrating its fuel plans with corporate plans and in balancing risk and supply options.

There is a reasonable process for vendor selection and identifying acquisition needs and there is a satisfactory process for negotiating and renegotiating contracts. The Fuels Department administers coal contracts in a satisfactory manner and has an effective process for monitoring supplier performance.

The Fuels Department is properly interpreting the requirements for its monthly fuel adjustment clause filings and is submitting these filings in accordance with the applicable regulations.

Louisville Gas & Electric Co. and Kentucky Utilities Co. Environmental Surcharge Mechanisms – Case Nos. 2004-00421 (LG&E) and 2004-00426 (KU)

The PSC on June 20, 2005, approved 11 environmental improvement projects proposed by the Louisville Gas & Electric Co. (LG&E) and the Kentucky Utilities Co. (KU). The PSC said the proposed projects were reasonable and cost-effective means of complying with environmental requirements.

The projects were required in order for KU and LG&E to comply with new or revised government regulations, particularly U.S. Environmental Protection Agency (EPA) requirements to reduce air emissions from coal-fired power plants. The projects are to reduce the companies' sulfur dioxide emissions by at least 110,000 tons per year.

LG&E estimated its seven projects will cost a total of about $57 million. KU's four projects have an estimated cost of about $760 million.

Under Kentucky law, the utilities are allowed to recover their environmental compliance costs for coal-fired generating facilities through a surcharge on electric bills. The impact on individual electric bills will depend on actual construction costs, interest rates and other factors.

The projects included construction of scrubbers – devices that remove sulfur dioxide from boiler exhaust – at KU's E.W. Brown plant in Mercer County and Ghent plant in Carroll County, and improvements to scrubbers at LG&E's Cane Run and Trimble plants; improvements to ash handling and storage facilities at

KU's Brown and Ghent plants and at LG&E's Mill Creek and Cane Run plants in Jefferson County and Trimble plant in Trimble County; and purchases of emission allowances by both LG&E and KU. Allowances are credits used as offsets against a company's emissions.

The PSC noted that KU first considered the addition of at least one scrubber at Ghent in 1996. However, the company concluded at the time that it was less expensive to burn low-sulfur coal and purchase allowances in order to meet emission requirements. New EPA rules – announced in December 2003 and finalized in March 2005 – require companies to achieve substantial further reductions in sulfur dioxide emissions and tipped the scales in favor of constructing the new scrubber at Ghent.

Neither the the Kentucky Office of Attorney General nor the Kentucky Industrial Utility Customers, Inc., which intervened in the cases, opposed the projects proposed by LG&E and KU.

The new scrubbers at KU's Brown and Ghent plants will be the most expensive of the projects, with an estimated total cost of nearly $660 million. Three scrubbers will be built at the Ghent plant, each serving a single generating unit. A single scrubber at the Brown plant will serve three units. When completed by 2009, they will reduce annual sulfur dioxide emissions by 110,000 tons.

Scrubbers 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 modified or rejected three proposals made by LG&E and KU. The companies were allowed a return on equity of 10.5 percent, rather than 11 percent, as they had requested. They were ordered to exclude from their emission allowance inventories any allowances assigned to gas-fired generation. Any allowance trading between the utilities will have to reflect the cost of the allowances, rather than the market price.

East Kentucky Power Cooperative Environmental Surcharge Mechanism and Pass-Through for Member Cooperatives – Case Nos. 2004-00321 (EKPC) and 2004-00372

East Kentucky Power Cooperative (EKPC) proposed in September 2004 to initiate an environmental surcharge mechanism to cover the costs of pollution-control projects at several of its facilities. Several of the projects were either completed or under construction at the time of the application to the PSC. The proposed compliance plan had a total cost of nearly $224 million.

At the same time, each of EKPC's 16 member distribution cooperatives applied to the PSC for permission to pass on to their customers the portion of the EKPC surcharge that would be allocated to each cooperative. The cases were consolidated and intervention was granted to Kentucky Office of Attorney General and Gallatin Steel Co.

Under Kentucky law, the utilities are allowed to recover their environmental compliance costs for coal-fired generating facilities through a surcharge on electric bills. EKPC proposed to include the costs of emission controls on several gas-fired generating units.

The parties entered into settlement negotiations and in February 2005 presented a proposed settlement to the PSC. The PSC accepted the settlement on March 17, 2005.

The settlement excluded any costs associated with gas-fired generation. Other provisions in the settlement addressed the treatment of emission allowances, exclusion of certain revenues and inclusion of others in the monthly surcharge calculations and calculation of rates of return and depreciation. The specifics of the pass-through mechanism also were addressed. The PSC set an effective date for the pass-through of July 1, 2005.

Projects included in the settlement had a total cost of about $213 million. They included portions of the Gilbert Unit, a circulating fluidized bed combustion unit at the H.L. Spurlock station near Maysville, and units to reduce particulate and nitrogen oxide emissions from other coal-fired units at the Spurlock facility.

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.

During the 2003-2005 biennium, the Siting Board completed consideration of six cases and had one case pending as of June 30, 2005.

COMPLETED CASES

Kentucky Pioneer Energy

540 MW generating facility in Clark County

Case No. 2002-00312

In an application completed on Dec. 22, 2002, Kentucky Pioneer Energy LLC applied to build a 540- megawatt plant on a site near Trapp in Clark County. The proposed plant was to be on a site leased from the East Kentucky Power Cooperative (EKPC). It would sell electricity wholesale to EKPC and be fueled by synthetic gas produced on-site from a mixture of coal and refuse-derived fuel, created by processing municipal solid waste.

After conducting a local public hearing and a formal evidentiary hearing, the Siting Board on April 16, 2003, denied Kentucky Pioneer a construction certificate, ruling that the company had not met the standard – set by state law – that applicants demonstrate compliance with local planning and zoning regulations. The Siting Board rejected Kentucky Pioneer Energy's contention that it is exempt from local planning and zoning requirements. Kentucky Pioneer was given six months to demonstrate compliance.

Kentucky Pioneer petitioned for, and was granted, a rehearing for the purpose of presenting evidence of compliance. The hearing was held August 22, 2003. At that hearing, Kentucky Pioneer stated that it would submit itself to the entire local planning and zoning process in Clark County.

Kentucky Pioneer was granted a conditional certificate on Nov. 10, 2003, requiring that, prior to beginning construction, the company submit proof that the Winchester-Clark County Planning Commission approved the plant and that local authorities found the plant to be in compliance with all planning and zoning regulations. No such proof was ever submitted.

In a parallel proceeding, the Kentucky Public Service Commission on Jan. 30, 2003, opened a proceeding to determine whether EKPC had a continued need to purchase power from Kentucky Pioneer, given that EKPC had commenced construction of its own 268-megawatt generating facility. The purpose of the PSC proceeding was to determine whether there was an ongoing justification for the previously approved agreement for EKPC to purchase power from Kentucky Pioneer.

In an order issued June 23, 2003, the PSC ruled that the original basis for the power purchase agreement no longer existed and scheduled a hearing to examine whether the PSC should withdraw its approval of the agreement. At a hearing on Feb. 5, 2004, EKPC and Kentucky Pioneer requested that the matter be deferred until June 1, 2004, in order to allow Kentucky Pioneer to seek zoning approval, EKPC to reassess its power needs and both parties to renegotiate their agreement.

EKPC and Kentucky Pioneer were unable to reach a new agreement and, on Oct. 6, 2004, EKPC informed the PSC that it was exercising its option to terminate its agreement to purchase power from Kentucky Pioneer. On Oct. 18, 2004, the PSC withdrew its approval of the agreement, effectively ending the project.

Thoroughbred Generation

1,500 MW generating facility in Muhlenberg County

Case No. 2002-00150

On Aug. 4, 2002, Thoroughbred Generating Company, LLC, a subsidiary of Peabody Energy, applied to build a 1,500-megawatt power plant on a site east of Central City in Muhlenberg County. The plant, which would burn pulverized coal, would be located on a 4,100-acre site previously used for coal mining.

The Siting Board granted a permit to Thoroughbred on Dec. 5, 2003. The permit was conditioned on Thoroughbred obtaining interconnection agreements with neighboring utility companies that protect Kentucky ratepayers from sharing in the cost of the transmission lines needed for Thoroughbred to transmit electricity.

In imposing the condition, the Siting Board cited Kentucky law that requires independent power producers such as Thoroughbred to bear the costs of any improvements that must be made to the electric transmission system in order to maintain reliability under the increased loads created by their facilities. Thoroughbred was directed to negotiate and submit interconnection agreements with Big Rivers Electric Corp. and Kentucky Utilities Co.

(Thoroughbred and Big Rivers reached an interconnection agreement in late 2005. It was accepted by the Siting Board on May 17, 2006. To date, no agreement has been reached between Thoroughbred and Kentucky Utilities. Furthermore, still unresolved is a challenge to the air emissions permit granted to Thoroughbred by the Kentucky Division for Air Quality.)

Estill County Energy Partners

110 MW generating facility in Estill County

Case No. 2002-00172

On June 17, 2004, Estill County Energy Partners, LLC applied to build a 110-megawatt electric generating plant on a site near Irvine. The plant would be located on 28 acres of a 620-acre site previously used for coal preparation and would burn primarily waste coal now stockpiled at the site. The site contains enough fuel to last 25 to 30 years, the company said in its application.

The Siting Board conducted a local public hearing and a formal hearing in the matter, and, on Oct. 14, 2004, granted a certificate to Estill County Energy. The certificate was conditioned on resolution of a dispute over ownership of portions of the property.

Ownership of at least 100 acres of the property is in dispute. Fox Trot Properties, LLC, a company affiliated with Estill County Energy Partners, contends it owns the entire 620 acres. Contesting that claim are DLX, Inc., and a trust, both owned by the LaViers family, which established the coal processing facility in 1959. They claim ownership of a portion of the property Estill County Energy Partners is proposing to use, including an 80-acre tract of coal waste and the 28-acre proposed plant site.

Once the ownership issue is resolved, Fox Trot Properties and Estill County Energy Partners are to submit to the Siting Board proof of the right to use the property and an analysis of whether the original application would need to be amended. If necessary, the Siting Board would reopen the case to consider major changes.

(To date, Estill County Energy has not documented resolution of the property issue.)

Cincinnati Gas & Electric Co.

138 KV transmission line in Campbell County

Case No. 2004-00351

On Oct. 4, 2004, Cincinnati Gas & Electric Co. submitted an application for a 138 –kilovolt electric transmission line to connect CG&E's W.C. Beckjord Generating Station in southwestern Clermont County, Ohio, with the Silver Grove Substation in Campbell County, Kentucky. The Siting Board approved the application as submitted on Jan. 14, 2005.

The total length of the new line is approximately 6.5 miles, with 4.9 miles in Kentucky. It was built entirely within existing rights-of-way. The line fell within the purview of the Siting Board because it conveys power from a source unregulated by the Kentucky Public Service Commission.

DTE Wickliffe

13 MW generating facility in Ballard County

Case No. 2005-00108

DTE Wickliffe, LCC applied in April 2005 to construct a 13-megawatt plant located on the grounds of the Mead-Westvaco paper mill about a mile south of Wickliffe in Ballard County. Subsequent to the filing of the application, MeadWestvaco sold the paper mill to NewPage Corp. The plant was to have been powered by steam that the paper mill produces by burning wood wastes. Most of the electricity generated would have been sold back to the paper mill, with the remainder sold on the open, wholesale market.

On June 23, 2005, DTE Wickliffe asked to withdraw its application, citing unexpected difficulties in obtaining access to the electric transmission grid and its inability to resolve the issues in a time-frame meeting the Siting Board's procedural requirements. The Siting Board closed the case on June 24, 2005.

Westlake Energy

520 MW generating facility in Marshall County

Case No. 2002-00171

in May 2002, Westlake Energy Corp. filed a notice of intent to submit an application to construct a 520-megawatt generating plant in Calvert City in Marshall County. The facility was to be a combined cycle, natural gas-fired facility.

When Westlake did not submit an application, the Siting Board on July 9, 2004, issued an order asking Westlake to explain why the case should not be dismissed. Westlake asked for an extension until the spring of 2005, which the Siting Board granted. On April 8, 2005, Westlake submitted information indicating it would not be filing an application in the near future and raising no objection to the case being removed from the Siting Board docket. The case was dismissed on April 14, 2005.

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

Wholesale prices were the predominant natural gas issue during the biennium. In response to a major increase in natural gas prices, the Kentucky Public Service Commission, in conjunction with the major local distribution companies (LDCs), conducted an extensive effort to inform the public about the probability of higher home heating costs, the reasons for the increase and steps consumers could take to lessen the impact of higher gas costs. The PSC also considered proposals by major LDCs for hedging programs intended to reduce the volatility in the wholesale prices paid by the companies and passed on to consumers.

The PSC also completed consideration of rate adjustment requests filed by two of the five major LDCs. Also coming before the PSC during the biennium was the continuation of a customer choice program implemented by Columbia Gas of Kentucky.

Natural gas prices

The 2003-2005 biennium was a time of significant change in the natural gas market. Since deregulation of wholesale natural gas prices was completed in 1993, prices generally had followed a predictable seasonal pattern. They would rise during the winter, when home heating demand was high, and retreat in the summer as demand diminished. Sharp price increases occurred only at times when demand outstripped supply, as in the unusually cold winter of 2000-2001.

This seasonal pattern made it possible for natural gas distribution companies, particularly those with their own storage facilities, to purchase and stockpile gas during the summer, when prices were low. This less expensive gas could then be withdrawn during the winter months, when it was needed to meet consumer demand. Since 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 gas sold out of storage generally would bring down the overall price of gas sold during the heating season.

Market conditions changed in 2003, as gas prices did not fall substantially during the summer. A number of factors were at work. Unusually cold weather in late winter of 2003 led to higher than normal late-season gas consumption (with an accompanying price spike) 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. At the same time, the increased use of natural gas for electric generation, particularly to meet peak summer demand, was beginning to be felt in the marketplace. 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. This suggested substantially higher prices during the 2003-2004 winter heating season.

In response, the PSC convened a meeting with communication representatives of the five major LDCs and other interested state agencies to discuss development of a coordinated communication strategy that would prepare consumers for higher heating costs. The strategy focused 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. Tools used to disseminate this information included news releases, media briefings, media events focused on weatherization and placement of public service announcements on radio stations across Kentucky.

The communication effort proved effective. Although wholesale prices increased by about two-thirds from a year earlier (ranging from $7 to $10 per 1,000 cubic feet), and total retail gas costs increased by 30 to 40 percent, the level of concern among consumers appeared to be considerably lower than during earlier price spikes, notably during the winter of 2000-2001. The situation was mitigated considerably by unusually warm weather for much of the heating season; while consumers were paying more for gas, they were using less of it, thus lessening the effect of the higher prices.

Although the amount of natural gas in storage at the end of the 2003-2004 heating season had returned to typical levels, this did little to dampen the pressure on prices. Demand remained high due to an improving national economy and concomitant higher demand for gas for electric generation, while development of new gas supplies failed to keep pace. As a result, wholesale prices for the 2004-2005 heating season were forecasted to increase by an additional 20 to 30 percent, with retail costs up by another 10 to 15 percent.

The PSC determined that a continued public information campaign was necessary. The campaign used many of the same communication tools to reinforce the messages conveyed during the 2003-2004 heating season. One notable change was in the media briefing. Rather than conduct a series of briefings across the state, a single briefing was conducted from the PSC offices and made available via Webcast. Members of the media who were unable to attend in person could watch the Webcast and submit questions via e-mail. This change did not diminish media interest and made the briefing available to a wider audience. The Webcast also was archived and made available for viewing on a delayed basis.

As during the previous year, a relatively mild winter reduced demand and led to somewhat lower wholesale costs than anticipated, although they were somewhat (10 to 15 percent) higher than in 2003-2004. Consumer reaction was negligible. The PSC received relatively few complaints from ratepayers. However, the fundamental conditions in the market remained unchanged at the end of the biennium, creating the prospect of continued high wholesale prices that would be likely to increase sharply in the event of any substantial disruption of supply or sudden increase in demand.

Hedging programs and related matters

In response to higher-than-normal gas prices in 2000-2001, the PSC initiated an administrative case (Administrative Case No. 384) to examine the wholesale natural gas procurement practices of the five major LDCs and to consider steps the five companies could take to mitigate the volatility in the price they pay for wholesale natural gas and thus reduce volatility in retail prices. These mitigation measures fall generally within the category of “gas price hedging plans.” Hedging plans allow the utilities to undertake multiple procurement strategies in order to purchase gas at predetermined fixed prices, within agreed-upon upper and lower limits, or pursuant to contracts which give the utilities options to purchase gas at a specific price, with a utility having discretion to exercise such an option when market prices dictate that exercising the option is more economical than purchasing at market.

Following the conclusion of the administrative case in 2002, four of the five major LDCs implemented hedging plans, which were subject to annual review by the PSC. Hedging proved successful in reducing price volatility as intended. Although they were not intended to reduce overall gas costs, hedging programs did so in some instances. Whether a hedging program reduced or increased overall costs in a given time period depended on actual market prices during the period compared to the “hedged” prices of the gas purchased under the program.

During the 2003-2005 biennium, financial hedging programs were in place at Atmos Energy Corp., Columbia Gas of Kentucky, Delta Natural Gas Co. and the Union Light, Heat and Power Co. (ULH&P).

Louisville Gas and Electric Co. (LG&E) did not engage in financial hedging. LG&E has considerable gas storage capacity within its system. It uses its ability to store gas in the summer and withdraw it during the heating season as both a physical hedge against price fluctuations and as a way to meet operational requirements during times of high demand. Atmos Energy and Delta Natural Gas also have significant on-system storage which functions both to complement their financial hedging programs and to meet operational requirements.

In an effort to more closely align its GCA with wholesale prices, ULH&P in October 2003 requested authority to adjust its GCA on a monthly, rather than quarterly, basis (Case No. 2003-00386). In its request, ULH&P cited the finding of the administrative case, which noted that market volatility often creates a lag between wholesale price changes when such changes are passed on to consumers through the GCA. The discrepancy is amplified by the fact that there is a six-month lag in the retrospective adjustment to reconcile actual wholesale costs with the projected costs as estimated in a quarterly GCA.

ULH&P stated that changing the GCA on a monthly basis would allow the utility to charge the customer a price that more closely reflects the wholesale cost by both reducing the duration of the forecast period and thus improving the accuracy of the GCA, and by allowing true-ups to occur on a shorter cycle. On Nov. 6, 2003, the PSC approved the request on a pilot basis, as requested by ULH&P.

None of the other major LDCs asked to switch from a quarterly to a monthly GCA, but several have on occasion sought monthly adjustments during periods of extreme price volatility in the wholesale natural gas market. The PSC has generally granted such requests.

Columbia Gas of Kentucky – Customer Choice Program – Case No. 2004-00462

On March 29, 2005, the PSC approved an extension of the program which permits customers of Columbia Gas of Kentucky to purchase their gas from a marketer rather than from Columbia. The Columbia Choice program was initiated on a pilot basis in 2000. Customers in the program pay Columbia Gas a system charge and delivery charge. Columbia Gas bills the customers the commodity charge on behalf of the marketer from whom they purchase their gas. Columbia Gas serves about 91,000 customers in central and eastern Kentucky.

By 2004, about 30 percent of Columbia's eligible customers were enrolled, purchasing their gas from one of two participating marketers. Columbia Gas estimated the program had saved those customers a total of $13.5 million over its first four years. Based on that initial experience, the PSC extended the Columbia Choice program through March 2009. The PSC also approved a request from Columbia Gas for a mechanism by which it shares certain costs savings with its customers.

Louisville Gas & Electric Co. – General Rates – Case No. 2003-00433

On Dec. 29, 2003, Louisville Gas & Electric Co. (LG&E) filed a request for an adjustment in its natural gas rates. (The application also sought an adjustment in LG&E's electric rates. That issue is addressed elsewhere in this report.)

LG&E requested an annual increase of $19.1 million in revenue from natural gas base rates. The rates cover LG&E's costs of operating and maintaining its natural gas distribution system and of delivering gas to its 312,000 natural gas customers, but do not include the cost of the gas itself. LG&E's previous gas base rate adjustment had occurred in 2000.

A number of parties were granted intervention in the case. They included the Kentucky Office of Attorney General, the Kentucky Industrial Utility Customers and other representatives of major industry, and the Kentucky Association for Community Action and other groups representing low-income ratepayers.

Settlement negotiations among the parties began in April 2004. By the time of the scheduled evidentiary hearing on May 4, 2004, the parties were sufficiently close to an agreement that the hearing was continued in order to permit continued discussion. An agreement was reached on May 5, 2004, on all issues regarding natural gas rates. The settlement was submitted to the PSC on May 12, 2004, and was the subject of testimony at the continuation of the hearing on that day.

The settlement granted LG&E an increase in annual revenue of $11.9 million, or 38 percent less than the company had requested. For an average customer using 7,300 cubic feet of gas per month, the increase would result in an increase in the monthly bill of $2.97 (4.3 percent), to $72.68 from $69.71. The settlement also included a monthly charge of 10 cents per meter, with the revenue going to a program to assist LG&E's low-income natural gas customers.

The PSC approved the settlement on June 30, 2004. However, it placed the 10-cent monthly surcharge in abeyance pending a PSC review of whether the program would be administered in an efficient manner. On Sept. 30, 2004, the PSC authorized LG&E to begin collecting the monthly fee, but directed that no funds be distributed until LG&E could adequately explain the differences between its program and the one established by Kentucky Utilities Co., which like LG&E is a subsidiary of EON.US.

The PSC granted its final approval for the program on Nov. 24, 2004. In its order, the PSC registered its disappointment that LG&E's shareholders would not be contributing to the low-income assistance fund, but noted that it had no authority to compel a shareholder contribution.

LG&E's program bases the level of assistance on a participant's income and energy usage. Eligibility is restricted to households with gross income no greater than 110 percent of federal poverty guidelines. Participants are required to take advantage of any available weatherization assistance.

The PSC ordered one change in a provision of the LG&E program that allows customers to use the subsidy to reduce past-due amounts. LG&E wanted a maximum of $1,500 in arrearage payments. The PSC reduced it to $700.

Delta Natural Gas Co. – General Rates – Case No. 2004-00067

Delta Natural Gas, which serves about 39,700 customers in eastern and central Kentucky, filed its base rate adjustment request on March 1, 2004. Delta's last general rate adjustment had been in December 1999.

Delta Gas sought an increase in annual revenue from base rates of $4.28 million, or 7.4 percent. The rates cover Delta's costs of operating and maintaining its natural gas distribution system and of delivering gas to its gas customers, but do not include the cost of the gas itself.

Full intervention in the case was granted to the Kentucky Office of Attorney General and the Lexington-Fayette Urban County Government. A public hearing was held Aug. 18, 2004. Delta Gas put its proposed rates into effect on Oct. 7, 2004.

On Nov. 10, 2004, the PSC issued its final order in the case, granting Delta Gas an increase in annual revenue of $2.76 million - $1.52 million less that the company requested. The average residential customer was projected to see an increase in the monthly bill of $5.02, or 6.6 percent.

Because Delta had put its proposed higher rates into effect prior to the PSC decision, the company was ordered to refund, with interest, the difference that customers had paid between the proposed rates and those granted by the PSC.

The PSC cited several factors in granting Delta less that the requested amount. They included granting a return on equity of 10.5 percent, rather than the 12.5 percent requested by Delta; reducing Delta's allowable depreciation expenses by a greater amount than the reduction proposed by Delta; not allowing Delta to charge ratepayers for employee bonuses, stock options and Christmas dinners and gifts given to its board of directors; disallowing the costs of employee gifts, social events, club memberships and expenses incurred by employee spouses; and not allowing Delta to charge ratepayers for the costs associated with a program to encourage consumers to purchase appliances that run on natural gas.

The PSC also ordered Delta to conduct a new depreciation study, either within five years or at the time of its next rate case, whichever is sooner; and file, with its next rate case, a thorough analysis and justification of the total compensation provided to its board of directors. The PSC recommended that the study be conducted by an outside party.

Water and Sewer Issues and Cases

During this biennium, the PSC has continued its efforts to expand access to water and sewer services throughout Kentucky. This has entailed working closely 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 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. In addition to these cases, the PSC also addressed issues such as fire protection tariffs and cross-connection policies for several utilities, provided rate case assistance to numerous water and sewer utilities and continued to provide training for water system commissioners and personnel.

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 different 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 relevant 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 - Rate Adjustment - Case No. 2004-00103

On April 30, 2004, Kentucky-American Water Company submitted a request to raise its annual revenues from water sales by about $6.62 million. Kentucky-American also proposed to increase annual revenue by an additional $672,000 through an account activation fee of $24 that reflects the cost of turning on service and establishing an account.

The PSC conducted an extensive investigation into the proposed increase and actively solicited public input in the case. A public meeting was held in Lexington on November 4, 2004, solely for the purpose of receiving public comments. The evidentiary hearing in the case was held November 8, 2004.

In an order issued February 28, 2005, the PSC granted Kentucky-American an annual increase in revenue from water sales of $3.61 million. The PSC also approved the account activation fee. The rate adjustment increased rates for the average residential customer by about 8.5 percent.

Because Kentucky-American chose to implement its proposed rates prior to the PSC's decision, it refunded with interest to its customers the difference between the proposed rates and the approved rates for the three months that the company's proposed rates were in effect.

In granting Kentucky-American a lower rate increase than requested, the PSC made the following adjustments:

Reduced to 10 percent the rate of return on equity, from the 11.2 percent the company had requested. The PSC determined that the lower level is reasonable and in line with the return on equity for similar water utilities.

Denied Kentucky-American's request to recover from customers more than $2.8 million the company had already spent on increased security in the wake of the Sept. 11, 2001, terrorist attacks. The company had agreed to absorb those costs as a condition of the Commission's approval in 2002 of the acquisition of Kentucky-American's parent company by RWE AG. The costs were incurred prior to the period used to calculate the new rates. Estimated future security costs were included in the new rates.

Denied Kentucky-American's request to recover its allocated share of the costs involved in the parent company's consolidation of all of its North American accounting, billing, payroll and other financial functions at a center in New Jersey and the centralization of its customer call centers in Illinois. The PSC ruled that Kentucky-American had failed to prove the costs were reasonable and necessary and to demonstrate the benefits, if any, to its ratepayers.

Rejected Kentucky-American's request to have ratepayers bear the costs of incentive compensation plans for its management, professional and technical employees. The PSC ruled that shareholders should bear the annual cost of about $229,000.

Denied Kentucky-American's request to include in its rate base $117,525 in annual business development costs on the grounds that they had not been justified.

Northern Kentucky Water District – Rate Adjustment – Case No. 2003-00224

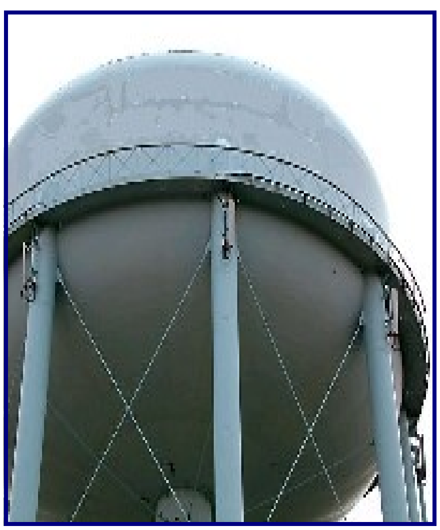
This case was the last in a series of proceedings under which the Northern Kentucky Water District equalized rates throughout its system following its creation from the merger of the Campbell and Kenton county water districts and the subsequent acquisition of several municipal water systems.

Northern Kentucky's application for an annual revenue increase of $2.2 million (originally $2.5 million) was accepted by the PSC on September 22, 2003. The proposed increase in part reflected the changes in income and costs associated with Northern Kentucky Water's acquisition of the water systems of the cities of Newport and Bromley. The district also proposed to equalize rates throughout its system.

After considering evidence in the matter and conducting a public hearing, the PSC on June 14, 2004, granted Northern Kentucky Water an increase of $1.5 million. The majority of the district's residential customers saw their rates rise by about 2 percent. However, rates for customers in Newport rose by about 36 percent as a result of the rate equalization. In addition to granting a rate increase, the PSC also permitted Northern Kentucky Water to issue $10.45 million in bonds for improvements throughout its system and authorized three major construction projects.

Water and Sewer Rate Case Assistance

The Commission staff continued to assist water and sewer utilities that requested help with the preparation of rate case applications. Staff assistance included determination of both revenue requirements and rate design. During the biennium, the Commission's staff assisted about 30 smaller utilities. In addition to the rate case assistance, staff has assisted numerous smaller utilities with the preparation of purchased water adjustment and/or non-recurring charge filings.



Telecommunications Issues and Cases

The telecommunications industry experienced rapid and sweeping changes during the biennium. The pace of technological advance has created a challenging environment for regulators. Emerging telecommunication technologies often do not fit within established regulatory schemes. Even the federal Telecommunications Act of 1996, which removed many regulatory constraints on voice and data services, did not anticipate the development of the newer alternatives to traditional telephone service, such as voice-over-Internet service.

During the biennium, Kentucky responded to these rapid changes both legislatively and administratively. In 2004, the Kentucky General Assembly enacted the Kentucky Broadband Act, which sought to promote the rapid deployment of broadband services within Kentucky by removing any regulatory impediments that might remain. The legislation addressed the limited role of the Kentucky Public Service Commission in regulating broadband services by clarifying that such services generally do not fall within the jurisdiction of the PSC.

Other telecommunication issues addressed by the PSC during the biennium included coin-operated telephone services, contract service arrangements, interconnection agreements, 211 information services and presumptive validity of tariffs.

Petition of BellSouth Public Communications, Inc. for Withdrawal from Provision of Payphone Service in Kentucky – Case No. 2003-00261 & Investigation Into the Need for Public Interest Payphones in Kentucky – Case 2003-00492

On July 2, 2003. BellSouth Public Communications, an affiliate of BellSouth Telecommunications, petitioned the Kentucky Public Service Commission for permission to withdraw from the payphone business in Kentucky. In its review of the BellSouth petition, the PSC determined that the availability of payphones in Kentucky was declining and that BellSouth and other incumbent local exchange carriers were not in uniform compliance with a state requirement to provide at least one payphone per local exchange. BellSouth also petitioned the PSC to be granted a deviation from the requirement. The Metro Human Needs Alliance, an intervenor in the case, raised concerns that allowing BellSouth to withdraw from the payphone market or granting BellSouth a deviation could lessen the availability of telephone service to low-income consumers.

In a order issued Dec. 24, 2003, the PSC granted BellSouth permission to withdraw from the payphone business, but ordered BellSouth and other incumbent local exchange carriers to continue providing at least one payphone per local exchange, either themselves or through a third party. In the same order, the PSC opened an investigation into the desirability of establishing a public interest payphone program in Kentucky.

A public interest payphone program allows a public agency, or a business or organization, with the sponsorship of a public agency, to petition to have a payphone placed on its property.

On Aug. 24, 2004, the PSC issued an order establishing a public interest payphone program in Kentucky and revoking the requirement for at least one payphone within each local exchange. The PSC said that the requirement was outmoded in light of the increased availability of wireless service and the opening of the payphone business to competition.

Kentucky's public interest payphone program is modeled on the program in Indiana. After an application is filed, the PSC staff will determine whether a phone is needed and, if one is, will contact payphone providers serving the area to offer them the opportunity to place a phone at the location. If no provider comes forward within 90 days, the PSC will move to fund a public interest payphone at the location.

No applications for public interest payphones meeting the established criteria have been filed to date in Kentucky.

Inquiry into Continued Assessment of Band Zone Charges by BellSouth Telecommunications, Inc. - Case No. 2003-00304

On June 29, 2004, the PSC ordered BellSouth Telecommunications, Inc. to phase out monthly "band zone" charges assessed to customers who live in the farther reaches of their telephone exchanges.

The band zone question was one of several issues included in the PSC's review of BellSouth's three-year Transition Regulatory Plan (TRP) for entry into a competitive telecommunications market. The review of band zone charges arose out of a complaint filed by a BellSouth customer and was incorporated into the review of the TRP.

The PSC denied BellSouth's request to raise basic phone rates in order to make up the revenue lost as a result of the elimination of band zone charges. Band zone charges were originally assessed many years ago to reflect the cost of extending service to more distant customers. At the time of the order, about 287,000 BellSouth customers paid band zone charges. The charges generated about $12 million in annual revenue for the company.

BellSouth was the last major telephone company in Kentucky which assessed band zone charges. The monthly charges were $1.30 for customers up to one mile outside the central base rate area for their exchange, $2.60 for customers one to two miles outside the base rate area, and $5.20 for customers more than two miles outside the base rate area. Under the PSC order, the $5.20 charge was reduced to $2.60 on August 1, 2004; the $2.60 charges dropped to $1.30 on August 1, 2005; and all band zone charges were to be eliminated on August 1, 2006.

The comprehensive review of the TRP, conducted independently for the PSC by Florida-based Vantage Consulting, Inc., found that BellSouth had met the objectives set out in the plan, and gone well beyond the plan objective in the expansion of broadband service. BellSouth asked the PSC to extend the plan for an indefinite period. The PSC agreed to make it permanent, subject to review in 2009.

Inquiry into the Use of Contract Service Arrangements by Telecommunication Carriers in Kentucky – Case No. 2002-00456

This case was the result of several earlier proceedings in which telecommunication providers brought complaints against BellSouth Telecommunications, inc., alleging that BellSouth, through its use of contract service arrangements (CSAs), was not providing equivalent rates and services to similarly situated customers. In both cases, the Kentucky Public Service Commission ruled in favor of the complaining providers.

In light of those cases, the PSC decided to review its earlier decision to permit BellSouth to file only a monthly summary of its CSAs, rather than the full text of CSAs themselves, as required by regulation. BellSouth had requested the deviation on the grounds that filing its many CSAs was unduly burdensome. In revisiting the issue, the PSC sought to determine whether relaxing the requirement to file CSAs had disadvantaged customers and other carriers by removing their ability to review the CSAs as filed.

Parties to the inquiry included BellSouth, Cincinnati Bell Telephone Co., ALLTEL Kentucky, Inc., the Kentucky Attorney General and a number of telecommunication providers, including several competitive local exchange carriers (CLECs).

Three central issues were considered by the PSC:

Whether telecommunication providers should be allowed to enter into CSAs that provide tariffed services at rates other than those filed in the tariff.

Whether it is permissible for a telecommunication provider to offer CSAs at differing rates to different customers, based in part on whether that customer has the opportunity to purchase the service from another provider.

Whether the manner in which incumbent local exchange carriers offer CSAs violates the rights of CLECs wishing to resell those services.

Telecommunication providers offered widely divergent views on these issues. ILECs opposed the mandatory filing of CSAs with the PSC. They said that CLECs and ILECs should be bound by the same rules regarding filing and disclosure of CSAs and also favored allowing the offering of differing contract terms to similarly situated customers in response to competition. Some CLECs argued that they should be exempted from filing their CSAs, while others had no objection to filing. CLECS generally agreed with ILECs that CSAs need not be uniform.

On April 29, 2005, the PSC issued its final order in this matter, ruling that BellSouth would no longer be exempt from the filing requirement for CSAs and that both ILECs and CLECs would be required to file CSAs within 20 days of their execution. CSAs would be effective upon their execution and carriers would be permitted to use CSAs in response to competition. The PSC also ruled that CSAs would be made public.

Petition of BellSouth Telecommunications, Inc. for Presumptive Validity of Tariff Filings – Case No. 2002-00276

In July 2002, BellSouth Telecommunications, Inc. petitioned the Kentucky Public Service Commission for an exemption from Kentucky statute that would have the effect of establishing the presumptive validity of tariffs for retail services filed with the PSC. Presumptive validity would allow tariffs to become effective immediately upon filing, rather than following a review of up to 30 days by the PSC.

After a full proceeding to consider the issues, the PSC initially denied BellSouth's petition on April 29, 2003. BellSouth requested reconsideration on the grounds that the PSC had relied on inaccurate information from the Federal Communications Commission (FCC) regarding the extent of retail competition in Kentucky. The PSC granted rehearing in order to give BellSouth an opportunity to provide countervailing evidence. Prior to the rehearing, the matter was delayed in order to permit the PSC to review issues related to the FCC's Triennial Review Order.

A hearing on reconsideration was conducted on Sept. 15, 2004. It considered BellSouth's revised proposal, which included:

- No changes to the filing procedures for stand-alone residential and commercial services.
- Tariffs for new services or rate increases would take effect 30 days after filing, subject to suspension by the PSC within the first 15 days after filing.
- Rate reductions would take effect on one day's notice to the PSC.

Promotional offerings would take effect with one day's notice to the PSC and the requirement for an "advance letter" filed 30 to 40 days in advance would be eliminated.

BellSouth argued that retail competition in Kentucky was sufficient to allow incumbent local exchange carriers (ILECs) greater flexibility to address the challenges posed by regulated and non-regulated competitors. Competitive local exchange carriers (CLECs) who were parties to the case countered that BellSouth remains the dominant provider within its service territory and should not be granted further advantage.

On April 28, 2005, the PSC issued a decision partially granting BellSouth's request. The PSC ruled that all tariffs submitted by both ILECs and CLECs would become effective within 15 days of filing but be subject to suspension or rejection by the PSC within the 15-day period. Promotional offerings would require only one day's notice to the PSC. The PSC noted that the availability of electronic filing had expedited the tariff submission and review process and thus justified reducing the waiting period from 30 days to 15 days. The PSC also noted that telecommunication providers retain the right to petition the PSC for expedited review periods of less than 15 days.

Investigation into the Assignment of Abbreviated N11 Dialing Codes – Administrative Case No. 343

On July 20, 2000, the Federal Communications Commission (FCC) established 211 as the abbreviated dialing code for community information and referral services. The information and referral number is intended to function as a one-call clearinghouse for people searching for government or community-based resources in areas such as social services, education, health care and other services.

The United Way of Kentucky subsequently petitioned the Kentucky Public Service Commission to become the statewide provider of 211 services.

United Way of Kentucky initially proposed a three-year plan to implement 211 services in Kentucky. United way proposed to first provide 211 services on a 24-hour-per-day basis in the metropolitan Louisville area and in the northern Kentucky portion of the Cincinnati metropolitan area. Services would be expanded throughout the state as resources became available. A review would be conducted after three years to assess United Way's progress.

On July 21, 2004, United Way of Kentucky provided the PSC with its three-year progress report. The report indicated that 211 services were in place in four counties near Cincinnati, were about to be implemented in seven counties in the Louisville area and were in the planning stages for the 12-county Lexington area. Together, those three areas contain about half of Kentucky's population.

Although United Way of Kentucky did not meet all of its original implementation goals, the PSC determined that substantial progress had been made and that United Way of Kentucky should be permitted to continue as the 211 provider. Therefore, in an order issued on Aug. 17, 2004, the PSC named United Way of Kentucky as the permanent administrator of 211 services in the state. United way of Kentucky was directed to provide annual updates on its progress in implementing the 211 system on a statewide basis.

Interconnection cases

During the biennium, the Kentucky Public Service Commission dealt with a number of cases related to the rates and terms under which incumbent local exchange carriers (ILECs) provide network access and services for resale to competitive local exchange carriers (CLECs). Interconnection cases are, by their nature, complex proceedings that address a multiplicity of issues. Many of the cases before the PSC during this biennium were further complicated by decisions made by the Federal Communications Commission (FCC) which changed the underlying rules governing interconnection agreements. In a number of instances, FCC decisions altered the course of pending cases or required the PSC to revisit recently concluded proceedings.

Among the noteworthy interconnection cases decided during this biennium were:

Case No. 2003-00115: Petition of SouthEast Telephone, Inc. for Arbitration of Certain Terms and Conditions of the Proposed Agreement with Kentucky ALLTEL, Inc., Pursuant to the Communications Act of 1934, as Amended by the Telecommunications Act of 1996.

Case No 2004-00044: Joint Petition for Arbitration of NewSouth Communications Corp.; Nuvox Communications, Inc.; KMC Telecom V, Inc.; KMC Telecom III LLC; and Xspedius Communications, LLC on Behalf of its Operating Subsidiaries Xspedius Management Co. Switched Services, LLC, Xspedius Management Co. of Lexington, LLC, and Xspedius Management Co. of Louisville, LLC, of an Interconnection Agreement with BellSouth Telecommunications, Inc. Pursuant to Section 252(b) of the Communications Act of 1934, as Amended.

Statistics:

Cases Filed and Orders Issued During the Biennium

Type of Case Filed	Number
Abandonment	2
Accounting Deferral	3
Administrative	1
Complaints – Rates	38
Complaints – Rates, Service	15
Complaints – Service	51
Construct	42
Construct—Cell Site—No Local P&Z Comm.	63
Construct, Finance, 278.023	17
Construct, Finance, Rates, 278.023	20
Construct, Financing	11
Construct, Rates, Financing	2
Construct, Rates 278.023	1
Construct, 278.023	2
Contracts	6
Declaratory Order	4
Demand-Side Management	15
Deviation	45
Electronic Case	7
Financing	54
Franchises	30
Initial Operations	2
Initial Operations—Rates	2
Integrated Resource Plan	2
Interconnection Agreement	50
Investigation—Rates	1
Investigation — Rates, Service	3
Investigation – Service	30
Other	31
Rates – ARF	19
Rates – FAC	66
Rates – General	19
Rates – NRC	28
Rates – PGA	195
Rates – PWA	55
Surcharge	26
Tariffs	84
Territory/Boundary	4
Transfer/Sale/Purchase/Merger	17
Wholesale Rate Adjustment	9
Total Cases filed during biennium	**1,072**

Type of Orders Issued	Number
Amended/Correction/Omission	27
Complaints – Rates	11
Complaints – Rates, Service	2
Complaints – Service	34
Construct	35
Construct—Cell Site—No Local P&Z	52
Construct—Uniform Application	2
Construct, Finance, 278.023	17
Construct, Finance, Rates, 278.023	19
Construct, Financing	15
Construct, Rates, Financing	5
Construct, 278.023	2
Contracts	8
Declaratory Order	4
Demand-Side Management	16
Deviation	48
Financing	52
Franchises	31
Hearing/Procedural/Informational	820
Initial Operations	2
Integrated Resource Plan	3
Interconnection Agreement	41
Investigation - Rates	5
Investigation — Rates, Service	2
Investigation – Service	25
Motions	519
Operate, Rates	2
Other	18
Rates – ARF	21
Rates – FAC	83
Rates – General	21
Rates – NRC	38
Rates – PGA	194
Rates – PWA	55
Rehearing	33
Show Cause	5
Staff Reports	32
Surcharge	24
Tariffs	93
Territory/Boundary	4
Transfer/Sale/Purchase/Merger	22
Total Orders issued during biennium	**2,432**

Statistics: Cases Filed and Orders Issued During the Biennium Listed by Utility Type

Utility Type	Number
Investor-Owned Electric	142
Rural Electric Cooperatives	142
Gas Distribution Utilities	252
Intrastate Gas Pipelines	17
Gas – Safety Only	3
Cellular Companies	70
Local Exchange Carriers	74
Competitive Local Exchange Carriers	41
Long Distance Carriers	23
Operator Service Providers	2
COCOTs (Pay Phones)	4
Privately-Owned Water Companies	14
Water Districts	208
Water Associations	30
Municipal Water Utilities	10
Sewer	40
Total Cases filed during biennium	**1,072**

Utility Type	Number
Investor-Owned Electric	530
Rural Electric Cooperatives	424
Gas Distribution Utilities	357
Intrastate Gas Pipelines	30
Gas – Safety Only	8
Cellular Companies	101
Local Exchange Carriers	185
Competitive Local Exchange Carriers	84
Long Distance Carriers	77
Operator Service Providers	7
COCOT (Pay phones)	13
Privately-Owned Water Companies	66
Water Districts	343
Water Associations	70
Municipal Water Utilities	27
Sewer	110
Total Orders issued during biennium	**2,432**

Statistics: Cases Filed and Orders Issued During the Biennium

For Electric Utilities

Type of Case Filed	Number
Accounting Deferral	2
Complaints – Rates	20
Complaints – Rates , Service	4
Complaints – Service	10
Construct	19
Contracts	5
Declaratory Order	1
Demand-Side Management	13
Deviation	14
Electronic Case	4
Financing	22
Franchises	13
Integrated Resource Plan	2
Investigation – Rates	2
Investigation – Service	12
Rates – FAC	66
Rates – General	4
Rates – Reduction	1
Surcharge	23
Tariffs	35
Territory/Boundary	3
Transfer/Sale/Purchase/Merger	2
Transmission Line Certificate	7
Total Cases filed during biennium	**284**

Type of Orders Issued	Number
Amended/Correction/Omission	10
Complaints – Rates	2
Complaints – Service	4
Construct	16
Contracts	5
Declaratory Order	1
Demand-Side Management	13
Deviation	16
Financing	22
Franchises	12
Hearing/Procedural/Informational	398
Integrated Resource Plan	3
Investigation – Rates	2
Investigation—Rates, Service	1
Investigation – Service	11
Motions	259
Other	9
Rates—ARF	2
Rates – FAC	83
Rates – General	6
Rehearing	11
Show Cause	1
Surcharge	23
Tariffs	38
Territory/Boundary	4
Transfer/Sale/Purchase/Merger	2
Total Orders issued during biennium	**954**

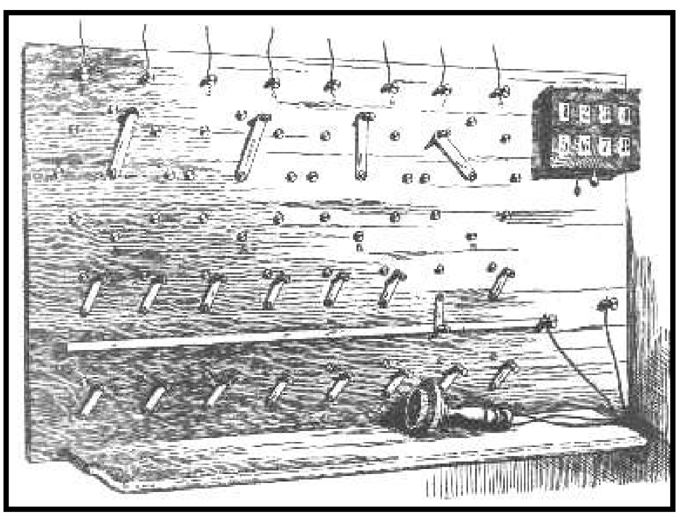
Statistics: Cases Filed and Orders Issued During the Biennium For Gas Utilities

Type of Case Filed	Number
Acoounting Deferral	1
Complaints — Rates	2
Complaints — Rates, Service	3
Complaints — Service	4
Construct	3
Declaratory Order	1
Demand-Side Management	3
Deviation	10
Financing	9
Franchises	11
Investigation — Rates	1
Investigation—Rates, Service	1
Investigation — Service	4
Other	1
Rates — General	3
Rates -– PGA	195
Tariffs	17
Transfer/Sale/Purchase/Merger	2
Weather Normalization Adjustment	1
Total Cases filed during biennium	**272**

Type of Orders Issued	Number
Amended/Correction/Omission	8
Complaints — Rates	1
Complaints — Rates, Service	1
Complaints — Service	2
Construct	2
Demand-Side Management	3
Deviation	13
Financing	8
Franchises	11
Hearing/Procedural/Informational	74
Investigation — Rates	1
Investigation — Rates,Service	1
Investigation — Service	6
Motions	32
Other	1
Rates — ARF	1
Rates — General	2
Rates -– PGA	194
Rehearing	3
Show Cause	3
Staff Reports	3
Surcharge	1
Tariffs	22
Transfer/Sale/Purchase/Merger	2
Total Orders issued during biennium	**395**

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

Type of Case Filed	Number
Administrative	1
Arbitration	18
Complaints — Rates	14
Complaints — Rates, Service	6
Complaints—Service	30
Construct Cell Site — No P&Z Commission	63
Deviation	3
Electronic Case	2
Franchise	6
Interconnection Agreement	32
Investigation – Service	13
Monitoring Compliance	2
Other	1
Price Regulation Plan	1
Tariffs	14
Telecommunications Act of 1996	8
Total Cases filed during biennium	**214**



Type of Orders Issued	Number
Arbitration	10
Complaints – Rates	7
Complaints – Rates, Service	1
Complaints – Service	24
Construct Cell Site — No P&Z Commission	52
Construct Cell Site — Uniform Application	2
Deviation	2
Franchise	8
Hearing/Procedural/Informational	208
Interconnection Agreement	29
Investigation – Service	1
Monitoring Compliance	2
Motions	96
Other	2
Price Regulation Plan	1
Rehearing	9
Tariffs	12
Telecommunications Act of 1996	2
Total Orders issued during biennium	**467**

Statistics: Cases Filed and Orders Issued During the Biennium

For Water Utilities

Type of Case Filed	Number
Abandonment	1
Complaints – Rates	2
Complaint—Rates, Service	2
Complaints – Service	6
Construct	18
Construct, Finance, 278.023	15
Construct, Finance, Rates, 278.023	17
Construct, Financing	9
Construct, Rates, Financing	2
Construct, Rates 278.023	1
Construct, 278.023	1
Contracts	1
Declaratory Order	2
Deviation	18
Electronic Case	1
Financing	23
Initial Operations	1
Investigation – Service	1
Rates – ARF	10
Rates – General	12
Rates – NRC	26
Rates – PWA	55
Surcharge	3
Tariffs	17
Territory/Boundary	1
Transfer/Sale/Purchase/Merger	6
Wholesale Rate Adjustment	11
Total Cases filed during biennium	**262**

Type of Orders Issued	Number
Amended/Correction/Omission	9
Complaints – Rates	1
Complaints – Service	4
Construct	16
Construct, 278.023	1
Construct, Finance - 278.023	15
Construct, Finance, Rates - 278.023	17
Construct, Financing	13
Construct, Rates, Financing	5
Contracts	3
Declaratory Order	3
Deviation	18
Financing	22
Hearing/Procedural/Informational	96
Investigation – Rates	2
Investigation – Service	7
Monitoring Compliance	2
Motions	96
Rates – ARF	11
Rates – General	13
Rates – NRC	26
Rates – PWA	55
Rehearing	8
Show Cause	1
Staff Reports	23
Suspension	14
Tariffs	19
Transfer/Sale/Purchase/Merger	4
Total Orders issued during biennium	**506**

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

Type of Case Filed	Number
Abandonment	1
Complaints—Service	1
Construct	2
Construct, Finance, Rates - 278.023	3
Construct, Finance - 278.023	2
Construct, Finance	2
Construct - 278.023	1
Initial Operations	1
Initial Operations—Rates	1
Rates- ARF	8
Rates—NRC	2
Tariffs	1
Transfer/Sale/Purchase/Merger	13
Total Cases filed during biennium	**40**

Type of Orders Issued	Number
Construct	1
Construct, Finance - 278.023	2
Construct - 278.023	1
Construct, Finance, Rates - 278.023	2
Construct, Finance	2
Hearing/Procedural/Informational	29
Initial Operations	2
Motions	36
Operate, Rates	2
Rates - ARF	7
Rates - NRC	2
Rehearing	2
Tariffs	2
Transfer/Sale/Purchase/Merger	14
Total Orders issued during biennium	**110**

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, 2004
(All amounts rounded to the nearest $100)

General Fund:		
	Regular Appropriation	$11,752,100
	Continuing Appropriation	$ 2,777,800
	Total	$14,529,100
Agency Fund:		
	Siting Board Fees , receipts for Law Books, CDs, Tapes, etc.	$ 242,700
Federal Funds:		
	Gas Pipeline Safety Program	$ 269,100
	Grand Total	$15,041,700

Total of expenditures by Kentucky PSC as of Fiscal Year Ended June 30, 2004
(Rounded to the nearest $100)

TOTAL $ 9,458,000

Comparison of Expenditures

	FY04	FY05
Budget	$13,033,400	$12,427,700
Personnel	$7,436,400	$7,360,400
Operating	$2,021,600	$2,031,500

Summary of Receipts by Kentucky PSC as of Fiscal Year Ended June 30, 2005
(All amounts rounded to the nearest $100)

General Fund:		
	Regular Appropriation	$11,154,100
	Continuing Appropriation	$ 1,807,400
	Total	$12,961,500
Agency Fund:		
	Siting Board Fees , receipts for Law Books, CDs, Tapes, etc.	$ 245,800
Federal Funds:		
	Gas Pipeline Safety Program	$ 272,100
	Grand Total	$13,479,400

Total of expenditures by Kentucky PSC as of Fiscal Year Ended June 30, 2005
(Rounded to the nearest $100)

TOTAL $9,391,900

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*