COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| THE APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR APPROVAL OF NEW RATE TARIFFS CONTAINING A MECHANISM FOR THE PASS-THROUGH OF MISO-RELATED REVENUES AND COSTS NOT ALREADY INCLUDED IN EXISTING BASE RATES | ) | CASE NO. 2004-00459 |
| THE APPLICATION OF KENTUCKY UTILITIES COMPANY FOR APPROVAL OF NEW RATE TARIFFS CONTAINING A MECHANISM FOR THE PASS-THROUGH OF MISO-RELATED REVENUES AND COSTS NOT ALREADY INCLUDED IN EXISTING BASE RATES | ) | CASE NO. 2004-00460 |

# O R D E R

On December 1, 2004, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") tendered for filing applications for approval of tariffs which are designed to pass through to their respective electric customers the net revenues and net expenses resulting from the wholesale energy market tariffs adopted by the Midwest Independent System Operator, Inc. ("MISO"). The proposed tariffs are to operate as monthly surcharges imposed upon all customers' bills and are to reflect only the MISO revenues and expenses that are not already included in existing base electric rates. The applications state that the actual charges or credits to customers'

bills will vary monthly, but the expectation is that the combined LG&E and KU customer billings will increase by $7 million annually.

By Order dated December 22, 2004, the Commission noted that LG&E and KU have requested approval of the MISO cost surcharges as "just and reasonable" and as "complements" to their existing rates, although they do not claim that their existing rates are not fair, just, and reasonable. The Commission further noted that the applications contain absolutely no financial information or exhibits to demonstrate that LG&E's or KU's existing rates are insufficient to allow full recovery of all MISO costs not already included in existing rates.

The December 22, 2004 Order raised the issue of whether the pending applications are actually attempts to obtain general adjustments in the existing rates of LG&E and KU without complying with the minimum filing requirements set forth in Administrative Regulation 807 KAR 5:001, Section 10. That Order established a schedule for the parties to file briefs on the issues of whether the Commission has the authority to consider the pending applications absent compliance with 807 KAR 5:001, Section 10, and whether the pending applications should be consolidated with the rehearing issues pending in LG&E's and KU's respective rate cases.[1]

Intervention was requested by and granted to the Office of the Attorney General ("AG") and Kentucky Industrial Utility Customers ("KIUC"). Each of those parties filed an initial brief and a reply brief, while LG&E and KU filed a response brief.

[1] Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company, and Case No. 2003-00434, An Adjustment of the Electric rates, Terms and Conditions of Kentucky Utilities Company.

The AG and KIUC argue that the pending applications are single-issue rate cases and that there is no statutory authority for the Commission to engage in single-issue rate-making. They both cite KRS 278.192, which requires a utility rate application to utilize either an historic test period or a forward-looking test period, and note that the pending applications do not utilize any test period. References are also made to Administrative Regulation 807 KAR 5:001, Section 10, which specifies the financial information that must be filed to support a rate application, and the absence of compliance by LG&E and KU with that regulation.

LG&E and KU argue that the Commission has broad implied authority to approve the proposed rate surcharges pursuant to KRS 278.030, which requires rates to be fair, just, and reasonable. They claim that the Commission has numerous times over the years exercised its authority to approve rate mechanisms to track costs such as fuel and purchased gas, which are similar to the request here to track MISO costs and revenues. LG&E and KU further claim that new rates can be filed and implemented pursuant to the Commission's regulation governing tariffs, 807 KAR 5:006, without the need to comply with the regulation applicable to rate adjustments, 807 KAR 5:001, Section 10. They also cite a number of prior Commission decisions which stated that applications for approval of new rate tariffs, as opposed to changes in existing rate tariffs, were not general adjustments in rates and need not comply with the filing requirements in 807 KAR 5:001, Section 10. Finally, LG&E and KU request alternative relief in the form of an accounting deferral to establish a regulatory asset/liability for the unrecovered MISO revenues and expenses in the event the Commission determines that the pending applications cannot be considered on their merits.

In his reply brief, the AG argues that the Commission cases cited by LG&E and KU should not now be relied upon because the Commission acted in excess of its implied authority in those cases and no court has considered the extent of the Commission's authority under KRS 278.030(1) to accept single-issue rate applications. The AG argues that LG&E and KU have failed to demonstrate that their existing rates are no longer fair, just, and reasonable due to the material financial impact of the unrecovered MISO revenues and expenses.

KIUC's reply brief argues that the Commission cases cited by LG&E and KU are not controlling precedent because they involved gas supply clauses or a profit-sharing provision, rather than the simple pass through of high costs and low revenues that will always result in higher charges to ratepayers.

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that LG&E and KU have proposed to implement rate surcharges to recover certain MISO-related revenues and expenses. For calendar year 2005 (annualized), LG&E and KU project that $7 million of additional revenue will be collected from ratepayers under the MISO surcharges.[2] On a per customer basis, LG&E and KU estimate the monthly impact to be an additional $0.20 for 1,000 kW usage.[3]

The proposed MISO surcharge tariffs are appended to the applications as Exhibits RMC-1 for LG&E and RMC-2 for KU. The texts of both surcharge tariffs state that, "The monthly amount computed under each of the rate schedules to which this mechanism is applicable shall be increased or decreased by the [MISO surcharge],"

[2] Direct Testimony of Kent W. Blake at 7.

[3] *Id.*

and that the MISO surcharge is applicable "[i]n all territory served," and is available "[t]o all Standard Rate Schedules and Pilot Programs." Thus, the MISO surcharges are intended as mandatory, not optional, rates and they are to be charged to every customer under every rate schedule.

The issue now before the Commission is whether the applications can be accepted as tariff filings or whether they must be dismissed as general adjustments in the existing rates, which do not comply with the minimum filing requirements set forth in 807 KAR 5:001, Section 10. By proposing to implement MISO surcharges, LG&E and KU are seeking to increase their combined revenues by $7 million annually by charging this surcharge rate to all existing customers. The statutory definition of "rate" is very broad and includes "any individual or joint fare, toll, charge, rental, or other compensation for service rendered or to be rendered by any utility…." KRS 278.010(12). The MISO surcharge is clearly a "rate," since it will obligate each customer to pay additional compensation for the service rendered by LG&E and KU. And since this new rate is to be charged to each customer in each existing rate class, the result will be that LG&E's and KU's existing rates will be adjusted by the addition of the MISO surcharge. Thus, the pending applications are proposing general adjustments in the existing rates of LG&E and KU. For the Commission to process those applications, LG&E and KU must satisfy the minimum filing requirements set forth in 807 KAR 5:001, Section 10.

By enacting KRS Chapter 278, the Kentucky General Assembly adopted a comprehensive scheme for regulating the rates and service of utilities. Every utility has the right, under KRS 278.030(1), to charge rates that are "fair, just and reasonable." If a

utility believes its existing rates are not fair, just, and reasonable, it has the right to file with the Commission new rates pursuant to KRS 278.180 and 278.190. When a utility chooses to file new rates that are to be charged to all existing customers, those new rates constitute a general adjustment in existing rates and the filing must be supported by all information specified in 807 KAR 5:001, Section 10.

Except as specifically provided for in KRS Chapter 278, no utility has the right to file an application to increase its existing rates absent compliance with 807 KAR 5:001, Section 10. This principle was affirmed by the Kentucky Supreme Court when it upheld the constitutionality of the environmental surcharge statute in *Kentucky Industrial Utility Customers v. Kentucky Utilities Co.*, Ky., 983 S.W.2d 493 (1998). That statute, enacted in 1992 as KRS 278.183, expressly authorized a utility to apply for a surcharge to recover qualifying environmental costs not already included in existing rates without having to either show that its existing rates are not fair, just, or reasonable or comply with the minimum filing requirements of 807 KAR 5:001, Section 10.

In discussing the rate-making procedure under KRS Chapter 278, the Supreme Court stated as follows:

> Prior to 1992, a utility could increase its rates only pursuant to the Fuel Adjustment Clause or as a general rate case. A general rate case pursuant to KRS 278.190 is a lengthy procedure in which a new base rate is approved only after thorough examination of all operations and costs by the PSC. In 1992, the General Assembly enacted the statute involved in this case [KRS 278.183] which allows utilities to use Kentucky coal and collect the costs of cleaning high sulfur coal. The effect is that the statute provides an alternate procedure to increasing the base rate by allowing utilities to recover the costs of environmental compliance by means of a surcharge rather than by opening a general rate case.

*Id.* at 496-497. The General Assembly has similarly authorized limited alternative procedures to a general rate case for a utility to recover certain specified costs, such as: wholesale increases in water and sewage costs (KRS 278.012); the Commission's annual assessment and consultant costs (KRS 278.130); and demand-side management costs (KRS 278.285). However, no such statutory authorization exists for the recovery of MISO costs absent a general rate case.

The Commission agrees in principle with the argument of LG&E and KU that, under KRS 278.030(1), we possess broad implied authority to adopt rate surcharges if they are found to be "fair, just and reasonable." However, absent specific statutory authorization, the Commission can only exercise its authority to adopt rate surcharges in the context of a general rate case.

The Commission further finds that neither the arguments raised nor the Commission cases cited by LG&E and KU are controlling or persuasive. A utility's compliance with the Commission's tariff regulation, 807 KAR 5:006, does not obviate the need to comply with all other applicable regulations. Absent compliance by LG&E and KU with 807 KAR 5:001, the Commission has no evidence to determine whether the existing rates are fair, just, and reasonable, or whether the proposed rates are fair, just, and reasonable. Such a determination by the Commission of "fair, just and reasonable" rates is mandated by KRS 278.030(1). The expedited recovery of fuel costs under a fuel adjustment clause is specifically authorized by Administrative Regulation 807 KAR 5:056. An administrative regulation, once properly enacted, has the force of law. *See Union Light, Heat & Power Co. v. Public Service Comm'n.*, Ky., 271 S.W.2d 361, 366 (1954)("It is well established that the rules and regulations of an

administrative agency duly adopted pursuant to the powers delegated to it have the force and effect of law.") While most gas utilities have adopted gas cost adjustment clauses, LG&E and KU have cited no instance where such an ongoing clause was initiated outside of a general rate case where all the utility's revenues and expenses were subject to investigation and review.

Reliance by LG&E and KU on prior Commission cases involving incentive rates or performance-based tariffs is similarly misplaced. Those innovative rate proposals were adopted to provide the utility with an incentive to reduce its costs and pass some of the savings to ratepayers. Here, the LG&E and KU proposals are intended to substantially increase rates, not reduce them. The Commission does acknowledge that certain findings in Case Nos. 1999-00046[4] and 2001-00092[5] regarding our rate-making authority may be overly broad when viewed in light of the Supreme Court's decision in the above-cited *KIUC v. KU* case. To the extent that our prior findings are inconsistent with those of the Court, our findings must yield. However, the Commission also recognizes that Case No. 1999-00046 was ultimately consolidated into a general rate application, and that Case No. 2001-00092 was a general rate case application that complied with 807 KAR 5:001, Section 10. Thus, regardless of the findings therein on our statutory authority, the proposed rates were reviewed in conjunction with general rate cases.

[4] Case No. 1999-00046, Delta Natural Gas Company, Inc. For an Experimental Alternative Regulation Plan.

[5] Case No. 2001-00092, Adjustment of Gas Rates of The Union Light, Heat and Power Company.

In conclusion, the Commission finds that there is no statutory authority for LG&E and KU to apply for a rate surcharge which is limited to a single issue, i.e., MISO revenues and expenses, without demonstrating that their existing rates are insufficient.

By Orders dated June 30, 2004 in Case Nos. 2003-00433[6] and 2003-00434,[7] new electric rates were approved for LG&E and KU as being "fair, just and reasonable," which is the statutory standard for rates under KRS 278.030(1). Absent compliance by LG&E and KU with the filing requirements set forth in 807 KAR 5:001, Section 10, the record is devoid of the evidence necessary for the Commission to determine whether their existing rates are no longer "fair, just and reasonable," and, if they are not, the amount of rate relief needed. Consequently, the pending rate applications must be dismissed for failure to comply with the filing requirements set forth in 807 KAR 5:001, Section 10.

All parties have objected to the Commission's suggestion to incorporate these rate applications into the rehearing phase of last year's LG&E and KU rate cases, Case Nos. 2003-00433 and 2003-00434. The parties maintain that it would be improper and inappropriate to expand the scope of the existing issues in those cases to include the MISO rate surcharges. The Commission agrees and will not further pursue that suggestion.

Finally, as to the request by LG&E and KU for alternative relief in the form of accounting deferrals, the record is also devoid of any evidence to support those

[6] Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company.

[7] Case No. 2003-00434, An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company.

deferrals. In 2001, LG&E and KU filed a joint application for approval of accounting deferrals (i.e., cost capitalization and subsequent amortization) for over $200 million in expenses for a Workforce Transition Separation Program.[8] That application was supported by a showing that the estimated savings from the program would exceed the costs, and that the costs were more properly collected over an extended period of time to match the receipt of benefits by the ratepayers. In 1991, the Commission authorized LG&E to amortize, over a future period of time, some of its 1989 costs for an earlier workforce reduction. In authorizing that amortization, the Commission was persuaded by LG&E's showing of "the material nature of the costs, the future benefits of downsizing which should be available to the ratepayers and shareholders of LG&E, and the matching of those benefits with the costs."[9] Here, however, LG&E and KU have made no showing of net benefits, no showing that the costs are more properly recovered over some future period of time, no showing that the costs are of a material nature, and no showing that it has fully reflected the impact of the MISO energy market tariffs on off-system sales revenue. Consequently, their request for an accounting deferral should be denied. In the event that LG&E and KU chose to file a new application for an accounting deferral of MISO costs, the Commission will fully investigate and review that application on its merits.

[8] Case No. 2001-00169, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company For an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be Included in Earnings Sharing Mechanism Calculations.

[9] Case No. 1990-00158, Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company (Order dated September 30, 1991 at 14).

IT IS THEREFORE ORDERED that:

1. The applications by LG&E and KU to establish rate surcharges for the recovery of MISO revenues and expenses are dismissed.

2. The requests by LG&E and KU to establish accounting deferrals for certain MISO revenues and expenses are denied.

Done at Frankfort, Kentucky, this 15th day of April, 2005.

By the Commission

ATTEST:

Executive Director