

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LOUISVILLE GAS)	
AND ELECTRIC COMPANY AND KENTUCKY)	
UTILITIES COMPANY TO TRANSFER)	CASE NO. 2005-00471
FUNCTIONAL CONTROL OF THEIR)	
TRANSMISSION FACILITIES)	

O R D E R

INTRODUCTION

On November 18, 2005, Louisville Gas and Electric Company and Kentucky Utilities Company (jointly “Applicants”) filed a joint application requesting authority to transfer the functional control of certain transmission facilities from the Midwest Independent Transmission System Operator, Inc. (“MISO”) to the Applicants; and to the Tennessee Valley Authority (“TVA”), to the extent necessary for TVA to act as the Reliability Coordinator (“RC”) and to the Southwest Power Pool, Inc. (“SPP”), to the extent necessary for SPP to act as the Independent Transmission Organization (“ITO”). On February 3, 2006, Applicants filed an amended application including final RC and ITO agreements with TVA and SPP, respectively. By Order dated February 23, 2006, the Commission accepted the February 3, 2006 amended application.

On November 30, 2005, Kentucky Industrial Utility Customers, Inc. (“KIUC”) moved for intervention. On December 12, 2005, the Attorney General filed a similar motion. Both motions were granted by Orders dated June 23, 2006. On December 1,

2005, MISO moved for full intervention; that motion was renewed on June 19, 2006. By separate Order issued today, those motions were denied.

On December 22, 2005, the Commission ordered that this docket be held in abeyance pending a final decision in Case No. 2003-00266.¹ That Order was reinforced by an Order dated January 26, 2006, denying the Applicants' motion for an informal conference. On March 17, 2006, the Federal Energy Regulatory Commission ("FERC") issued an order conditionally approving Applicants' request to withdraw from MISO.² On May 31, 2006, this Commission issued an Order in Case No. 2003-00266 similarly authorizing the Applicants to withdraw.

On June 2, 2006, the Applicants, KIUC, and the Attorney General filed a stipulation in this case ("Stipulation"). By Order dated June 13, 2006, the Commission initiated an investigation and set for hearing the accounting and rate-making provisions of that Stipulation. In response to that Order, Applicants filed motions for reconsideration, an informal conference, and both Third and Fourth Amended Joint Applications. With the passage of time and the filing of these later amended applications, the motions for reconsideration and for an informal conference are now moot, but the Commission accepts the amended applications. In the Fourth Amended Joint Application, the Applicants have withdrawn the accounting and rate-making provisions of the Stipulation that the Commission had set for hearing, therefore leaving

¹ Case No. 2003-00266, Investigation Into the Membership of Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission System Operator, Inc. MISO, the AG, and KIUC are all parties in this case.

² *In re Louisville Gas and Electric Company*, 114 FERC ¶ 61,282 ("FERC Order").

for consideration only the originally requested authorization to transfer functional control of their transmission system to TVA and SPP as previously described.

JURISDICTION

The threshold issue is whether the contemplated transfer falls within the scope of the Commission's statutory jurisdiction. Applicants say "it is not clear whether obtaining reliability coordination or ITO services constitutes a transfer of control of utility assets of the kind governed by KRS 278.218." They conclude, however, that they "do not believe that such transactions should fall under the ambit of KRS 278.218."³ We find that a transfer of operational control of transmission assets, as proposed here by the Applicants, falls within the scope of the Commission's jurisdiction and requires pre-approval from the Commission.

The applicable statute reads:

278.218 Approval of commission for change in ownership or control of assets owned by utility.

(1) No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars (\$1,000,000) or more and:

(a) The assets are to be transferred by the utility for reasons other than obsolescence; or

(b) The assets will continue to be used to provide the same or similar service to the utility or its customers.

(2) The commission shall grant its approval if the transaction is for a proper purpose and is consistent with the public interest.

The record of this case and Case No. 2003-00266 plainly detail the nature of the proposed transfer of operational control. In our May 31, 2006 final Order in Case

³ Fourth Amended Joint Application, Paragraph 20, p. 9.

No. 2003-00266, we found that the Applicants violated Kentucky law by failing to obtain Commission approval when they joined and turned over operational control of their transmission facilities to MISO. The decision that MISO controlled or had the right to control Applicants' transmission function was pursuant to KRS 278.020(5), a statute of significantly more limited scope than the more recently enacted KRS 278.218. Under KRS 278.218, a transfer of assets alone is sufficient to require Commission approval.

That the relief sought by the Applicants is for a transfer of operational control is reinforced by the findings and conclusions of the March 17, 2006 FERC Order, which specifically relied on the Applicants' proposals to substitute TVA and SPP for MISO in operational control of the transmission system. For example, in Paragraph 139, FERC stated, "The operational independence that Applicants state that they vest in SPP is a critical element in our consideration of Applicants' proposal to withdraw from [MISO]." Thus, while Applicants may claim that the transfer of control of their transmission system is less complete under the proposed arrangement than was the case when they were members of MISO, they do not have permission to resume control of their system as they had before joining MISO. The conditions of the FERC Order clearly would not allow such a result. Based on the proposed operations of the transmission assets as described in the application in this case, the Commission finds that, together, TVA and SPP will "control" the operations of the Applicants' transmission system, as that term is used in KRS 278.218, once they fully transfer the system operations from MISO to TVA and SPP. The Commission therefore has jurisdiction to consider this application, and our approval is necessary under Kentucky law before control may be transferred to TVA and SPP.

DISCUSSION

Based on the Commission's May 31, 2006 Order in Case No. 2003-00266, which approved the Applicants' request to withdraw from MISO, the sole remaining issue here is whether we should approve the Applicants' proposed transfer of functional control of their transmission facilities to SPP and TVA. Pursuant to KRS 278.218(2), the Commission will approve this application if "it is for a proper purpose and is consistent with the public interest." The public interest in this case encompasses both network reliability and the cost of electric service, two issues addressed in the application. The Commission notes that, under the remaining terms of the Stipulation, all parties to this case agree that the application should be approved.

Network reliability is ensured through an RC working under guidelines established and monitored by the North American Reliability Coordinator ("NERC"). It is common practice for electric utilities to contract with NERC-certified RCs in proximity to the applicants' control area. The Applicants, through a competitive process, selected TVA as its RC. In selecting TVA, Applicants maintain that the reliability of the transmission system will be maintained and the costs of doing so can be kept to a minimum. Prior to joining MISO, this function was performed for the company by American Electric Power Service Corporation, another adjacent electric utility.

TVA, as an electric utility with substantial operational experience in the power industry, demonstrates a core competency to handle reliability coordination issues in the region. TVA already acts as the RC for Big Rivers Electric Corporation and East Kentucky Power Cooperative, Inc., systems that adjoin the Applicants' system. Once TVA becomes the RC, it will manage a Reliability Area that encompasses most of

Kentucky. TVA's expertise with the region generally is seen as a substantial benefit for Kentucky consumers. In addition, TVA meets all of the criteria regarding independent operation and fulfilled the numerous requirements the Applicants included in their selection process.

Applicants state that TVA's bid to perform the functions of RC is at a reasonable rate that would be economically beneficial to the Applicants' retail customers. Also, TVA has in place a currently operational seams agreement with MISO and PJM, which will free the Applicants from developing individual seams agreements with each adjacent control area.

The Applicants selected SPP as its ITO using essentially the same factors as they used to select an RC. The Applicants wanted assurance that the ITO was competent and willing to perform the duties required of it, viewing the provision of these unbundled services as mutually beneficial for the Applicants and SPP's existing membership. SPP currently has in place the personnel and infrastructure needed to perform the transmission function duties and, most importantly, has substantial experience in transmission operations.

The ITO will conduct all transmission scheduling (including calculation of available transmission capacity and awarding of transmission service to customers), administer the Applicants' Open Access Transmission Tariff ("OATT") and Open Access Same-time Information System ("OASIS") (including the responsibility to update and post information to ensure compliance with all FERC OASIS-related regulation) and control all generation interconnection determinations, among other functions.

Further, the ITO provides a mechanism for Applicants to retain the benefits of their vertically integrated utility model (rate stability and least-cost integrated planning of generation and transmission investments) while also gaining the market benefits of open-access wholesale competition (and assurance to market participants that transmission will be run by an independent party). It allows the Applicants, as low-cost vertically integrated utilities, to continue the planning and operating activities that have made them low-cost, it provides the non-discriminatory transmission access that is essential to wholesale competition, and it keeps the costs of transmission and coordination services low.

The ITO will be the single point of contact for transmission customers seeking to schedule non-discriminatory transactions on the Applicants' system and will make all decisions relating to allocation of transmission service to customers. The ITO will further evaluate all transmission service requests, including requests for network service and existing point-to-point service agreements. The ITO will maintain all of the appropriate documentation associated with transmission determinations and be the coordinator for all transactions into, out of, and through the Applicants' transmission system.

The ITO will also conduct all System Impact Studies and Facilities Studies as may be required under the OATT when transmission service is requested. The ITO has the option of coordinating with the Applicants or RC personnel to the extent that it needs assistance in performing such studies. Further, the ITO and RC will exchange information and cooperate to ensure that both entities can perform its assigned functions.

The Commission finds that Applicants' selection of TVA as their RC and SPP as their ITO is reasonable and appropriate. The Commission further finds that transmission operations under this arrangement will maintain a high degree of reliability at a reasonable cost.

The Commission notes one remaining uncertainty with regard to this application. FERC is currently investigating the Applicants' authority to sell power at market-based rates in Docket No. ER06-1046. A loss or substantial diminution in that authority would raise new issues that we have not considered in this case. In their Fourth Amended Application at 8, Applicants suggested, "The Commission may want to consider issuing a final order in this proceeding conditioned upon the receipt of a statement from the [Applicants] that the scope of any FERC-approved market-based rate authority for the [Applicants] to be effective upon exit from MISO will not result in a material diminution of the market-based rate authority the [Applicants] already possess or that which the [Applicants] proposed in" Docket No. ER06-1046. The Commission finds that this Order should be so conditioned.

Based on the application, as amended, the prefiled testimony, the Stipulation, and the record as a whole, the Commission finds that transfer of the operations of the Applicants' transmission system to the extent explained in the application to TVA as RC and SPP as ITO is for a proper purpose and is consistent with the public interest. The requested authority should therefore be granted.

IT IS THEREFORE ORDERED that:

1. Applicants' motions to file their Third and Fourth Amended Joint Applications are granted.

2. Subject to the condition stated in this Order with regard to FERC's ruling on the Applicants' market-based rate authority, the Applicants' request to transfer functional control of their transmission facilities to TVA and SPP as described in the application and this Order is granted.

Done at Frankfort, Kentucky, this 6th day of July, 2006.

By the Commission

ATTEST:


Executive Director