

KENDRICK R. RIGGS

DIRECT DIAL 502-560-4222

DIRECT FAX 502-627-8722

kriggs@ogdenlaw.com

1700 PNC PLAZA  
500 WEST JEFFERSON STREET  
LOUISVILLE, KENTUCKY 40202-2874  
(502) 582-1601  
FAX (502) 581-9564  
www.ogdenlaw.com

September 13, 2005

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PUBLIC SERVICE  
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**VIA FACSIMILE (502) 564-7279**  
**AND FEDERAL EXPRESS**

Elizabeth O'Donnell  
Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, Kentucky 40601

**RE: *In the Matter of the Investigation Into the Membership of Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission System Operator***  
**Case No. 2003-00266**

Dear Ms. O'Donnell:

Enclosed please find and accept for filing the original and ten copies of Louisville Gas and Electric Company's and Kentucky Utilities Company's Reply Brief in the above-referenced matter. Please confirm your receipt of this filing by placing the stamp of your Office with the date received on the enclosed additional copies and return them to me in the enclosed self-addressed stamped envelope.

Should you have any questions or need any additional information, please contact me at your convenience.

Very truly yours,

Kendrick R. Riggs

KRR/ec  
Enclosures  
cc: Parties of Record

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**COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION**

SEP 14 2005

PUBLIC SERVICE  
COMMISSION

**In the Matter of:**

**INVESTIGATION INTO THE )  
MEMBERSHIP OF LOUISVILLE )  
GAS AND ELECTRIC COMPANY )  
AND KENTUCKY UTILITIES )      **CASE NO. 2003-00266**  
COMPANY IN THE MIDWEST )  
INDEPENDENT TRANSMISSION )  
SYSTEM OPERATOR, INC. )**

**JOINT POST-HEARING REPLY BRIEF  
OF LOUISVILLE GAS AND ELECTRIC COMPANY  
AND KENTUCKY UTILITIES COMPANY**

Kendrick R. Riggs  
W. Duncan Crosby III  
Ogden Newell & Welch PLLC  
1700 PNC Plaza  
500 West Jefferson Street  
Louisville, Kentucky 40202  
Telephone: (502) 582-1601

Elizabeth L. Cocanougher  
Senior Corporate Counsel  
LG&E Energy LLC  
220 West Main Street  
Post Office Box 32010  
Louisville, Kentucky 40232  
Telephone: (502) 627-4850

Counsel for Louisville Gas and Electric  
Company and Kentucky Utilities Company

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Table of Contents

	<u>Page</u>
I. Introduction.....	1
II. MISO’s “Day 2 Transmission Operations in a Nutshell” Tells the Commission Nothing of the Actual Performance of the Day 2 Markets and Therefore Is A Pure Distraction.....	3
III. MISO’s Brief Twists the Evidence and Misstates the Issues to Conceal the Failures of Its Case .....	5
A. The Outcome of this Investigation Does Not Turn on a Battle of the Computer Models But on the Commission’s Assessment of the Reasonableness of the Cost-Benefit Studies .....	5
B. MISO’s \$25 million “Actual Market Data” Figure Tells the Commission Nothing About the Companies’ Performance in the Day 2 Markets or Whether the Companies Would Have Been Better Off Having Already Exited MISO.....	12
C. The Companies’ Portrayal of Market Data Was Fair and Accurate .....	13
1. The \$2,407,000 Per Month in Uplift Costs is a Reasonable Value to Assess the Assumption in MISO’s Cost-Benefit Study.....	13
2. The Net Congestion Cost Figure of \$367,000 is a Reasonable Value to Assess the Assumption in MISO’s Cost-Benefit Study.....	14
3. The Companies’ Success in the Off-System Sales Market Was Not Predicted in MISO’s Cost-Benefit Study and is Not Attributable to the Companies’ MISO Membership .....	16
4. MISO’s Three Assertions Concerning the Revenue Sufficiency Guarantee are Selective and Misleading .....	16
D. So-called “Self-scheduling” Truly Does Not Allow the Companies to Serve Their Load as They Used to in Day 1 .....	17
E. MISO’s Assertions about Reliability Assessment Commitment and Revenue Sufficiency Guarantee Are Erroneous .....	19
F. MISO’s Purported Duty to Serve Contradicts its Past Assertions and Is Self-Serving .....	20
G. If the Companies are Able to Exit MISO, They Will in No Way Be “Free Riders” on the MISO Markets.....	21
IV. Day 2 Transmission Operations Have Done Nothing to Reduce the Economic Impact of Redispatch.....	23
A. MISO Day 2 Has Not Reduced Overall Curtailments .....	23
B. The Failure of MISO’s Much-Touted LMP-Based Congestion Management System to Adjust to Unit Outages Calls into Question MISO’s Claimed Reliability Benefit.....	26
V. MISO Day 2 Does Indeed Degrade the Commission’s Authority Over Retail Rates .....	27

Table of Contents  
(continued)

	<u>Page</u>
VI. The Companies' Litigation Concerning KRS 278.214 Did Not Implicate the Commission's Jurisdiction and Was Pursued to Protect the Companies' Native Load Customers .....	28
VII. Granting the Companies' Requested Relief and Participating in their Proceeding Before FERC Will Assure That an Alternative to MISO Membership That is Acceptable to the Commission Will Result.....	30
VIII. Conclusion .....	32

## **I. Introduction**

In its Initial Post-Hearing Brief, MISO attempts to distract the Commission from the question that is of ultimate import in this proceeding: Is the Companies' continued membership in MISO in the public interest?<sup>1</sup> MISO trots out an array of arguments and claims that the Companies have already refuted and that do not serve to illuminate questions concerning net benefits. The vast bulk of the arguments that MISO advances in its brief are: (1) based purely on theory, lacking any citation to the record of this proceeding; or (2) misconstructions of the evidence that is in the record, contortions of numbers that MISO uses in an attempt to divert the Commission from a simple fact: those results that the Companies have achieved in the Day 2 markets for which MISO plausibly has responsibility are, on the whole, worse than MISO predicted, and show that the Companies' prediction was and is likely correct that exiting MISO will produce net benefits for the Companies.

What is perhaps most notable about MISO's brief is the rhetoric it employs to attack the Companies and impugn the integrity of its officers, asserting that they have filed testimony that they "simply do not believe," and maligning it as "incredible as compared to their [the Companies' officers'] actions." MISO's makes these attacks notwithstanding the obvious tension between them and MISO's assertion it does not "stand in an adversarial role to [the Companies]."<sup>2</sup> The Commission should also take note of the clear contradiction between MISO's stated purpose for participating in this proceeding and its request at the conclusion of its brief. MISO asserted at hearing that its sole purpose for its participation in this case is to ensure the completeness and accuracy of the record.<sup>3</sup> Its witnesses have stated under oath that: (1) neither MISO nor any of its stakeholders get to vote on the Companies' business decision to seek

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<sup>1</sup> See KRS 278.218.

<sup>2</sup> MISO Brief at 5.

<sup>3</sup> I T.E. 29 ln. 23 - 30 ln. 3 (July 20, 2005).

exit from MISO;<sup>4</sup> (2) MISO respects the Companies' business decisions;<sup>5</sup> (3) MISO membership is voluntary<sup>6</sup>; and (4) MISO believes that the Companies' exit will have a "minimal impact" on MISO.<sup>7</sup> Yet in the conclusion of its brief, MISO "respectfully requests that the Commission close this investigation without ordering any change in the continued membership of LGE in the Midwest ISO."<sup>8</sup> MISO cannot have it all ways: either its sworn testimony and stated purpose are false, or the Commission should take MISO at its word and disregard MISO's recommendation concerning the proper resolution of this proceeding.

One attack that MISO makes in its brief deserves special attention, namely MISO's claim that the Companies' true motivation in this proceeding is to exit MISO so that it can "free ride" by transacting with the MISO markets without having to pay MISO's membership fees (i.e., tariff schedule costs).<sup>9</sup> This assertion leads to an absurdity: presumably, on MISO's reasoning, every non-MISO member that sells into or purchases from the Day 2 markets is a "free rider," which, to eliminate the problem, eventually would require all wholesale power traders in any way interconnected with MISO to become MISO members or require MISO to exclude all non-MISO members from Day 2 market participation.<sup>10</sup> Less abstractly, the "free rider" charge is an amazing one to level against the Companies, which: (1) were founding members of MISO and have paid the schedule fees required of them for years;<sup>11</sup> (2) acknowledge that they must pay an

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<sup>4</sup> I T.E. 25 ll. 11-14 (July 20, 2005).

<sup>5</sup> I T.E. 22 ll. 1-4 (July 20, 2005).

<sup>6</sup> I T.E. 22 ll. 6-8 (July 20, 2005).

<sup>7</sup> I T.E. 19-20 (July 20, 2005); Pre-filed Testimony of Paul W. Thompson (Sept. 29, 2004) at Exh. PWT-1.

<sup>8</sup> MISO Brief at 40.

<sup>9</sup> MISO Brief at 27-28.

<sup>10</sup> As the Companies point out herein, there is no reason that MISO should experience a free rider problem concerning non-MISO members, including the Companies (should they be allowed to exit). In economics, free rider problems occur when suppliers are unable to charge consumers for benefits the suppliers provide. In the case of non-MISO members that transact with the Day 2 markets, the simple way to avoid free riding is for MISO to charge transaction fees.

<sup>11</sup> *In the Matter of: Investigation Into The Membership of Louisville Gas and Electric Co. and Kentucky Utilities Co. In the Midwest Independent Transmission System Operator, Inc.*, Case No. 2003-00266, Pre-filed Direct Testimony of Paul W. Thompson (9/22/2003) at 9-10, quoting *MISO Proposed Revisions to Open Access Tariff*, FERC Docket

exit fee to cover the Companies' share of MISO's outstanding capital obligations;<sup>12</sup> and (3) will pay whatever fees MISO charges all other non-MISO members to transact with the Day 2 markets.<sup>13</sup> Therefore, *contra* MISO's assertions,<sup>14</sup> the Companies will not free ride on the MISO markets should they be allowed to exit MISO, which exit the Companies have shown would be in the short-term and long-term public interest once a proper alternative is approved.<sup>15</sup>

## **II. MISO's "Day 2 Transmission Operations in a Nutshell" Tells the Commission Nothing of the Actual Performance of the Day 2 Markets and Therefore Is A Pure Distraction**

MISO spends nearly a third of its brief expounding upon the theory of the Day 2 markets and ignoring the cost-benefit analyses and evidence of actual Day 2 results that are in the record of this proceeding.<sup>16</sup> In particular, MISO avoids any discussion of the clear errors that the Companies have pointed out in four of MISO's five cost-benefit analyses, and fails to address the oddity that, notwithstanding that MISO has changed its assumptions dramatically among its various studies (primarily in response to the errors the Companies pointed out), they all predict roughly the same level of net benefits for the Companies.<sup>17</sup> The Commission, however, should

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No. ER02-2925-000 (9/24/2002), Transmittal Letter at 2; *In the Matter of: Investigation Into The Membership of Louisville Gas and Electric Co. and Kentucky Utilities Co. In the Midwest Independent Transmission System Operator, Inc.*, Case No. 2003-00266, Pre-filed Direct Testimony of Michael S. Beer (9/22/2003) at 2-4; *In the Matter of: Investigation Into The Membership of Louisville Gas and Electric Co. and Kentucky Utilities Co. In the Midwest Independent Transmission System Operator, Inc.*, Case No. 2003-00266, Pre-filed Rebuttal Testimony of Paul W. Thompson (2/9/2004) at 10. Please note that in all subsequent citations, unless otherwise noted the reader may assume that all pre-filed testimony citations are from the record of *In the Matter of: Investigation Into The Membership of Louisville Gas and Electric Co. and Kentucky Utilities Co. In the Midwest Independent Transmission System Operator, Inc.*, Case No. 2003-00266. A further convention that the Companies employ hereafter is to refer to pre-filed testimony solely by the name of the witness and the date on which the testimony was filed.

<sup>12</sup> See generally Joint Post-Hearing Brief of Louisville Gas and Electric Company and Kentucky Utilities Company (Apr. 26, 2004); Pre-filed Testimony of Paul W. Thompson at 15-16 (Sep. 22, 2003); II T.E. 158-65 (Feb. 26, 2004); Pre-filed Testimony of Paul W. Thompson at 6 ln. 16 - 7 ln. 15 (Jan 10, 2005).

<sup>13</sup> Pre-filed Testimony of Paul W. Thompson at 6 ln. 16 - 7 ln. 15 (Jan 10, 2005).

<sup>14</sup> MISO Brief at 27-28.

<sup>15</sup> See, e.g., Pre-filed Testimony of Mathew J. Morey (Sep. 29, 2004).

<sup>16</sup> MISO Brief at 5-17.

<sup>17</sup> See Pre-filed Testimony of Dr. Ronald R. McNamara (Dec. 29, 2003); Pre-filed Testimony of Dr. Ronald R. McNamara (Nov. 19, 2004); Pre-filed Testimony of Dr. Ronald R. McNamara (Jan. 20, 2005); Pre-filed Testimony of Dr. Ronald R. McNamara (Feb. 21, 2005); Pre-filed Testimony of Dr. Ronald R. McNamara (Mar. 3, 2005).

not be distracted by MISO's seeking refuge in abstract theory and unsupported assertions such as:

- “Day 2 transmission operations permit the Midwest ISO to coordinate the commitment and dispatch of resources so as to more reliably and cost-effectively operate the transmission system.”<sup>18</sup>
- “The TEMT's utilization of centralized, security-constrained economic dispatch ... is creating economic gains and improving reliability for the entire system.”<sup>19</sup>
- “[There] are clearly large operational, reliability, and market transparency benefits created by Midwest ISO's operation of LGE transmission facilities ... .”<sup>20</sup>

As the Companies have shown throughout this proceeding, the facts simply do not bear out these unfounded claims or MISO's theory as it applies to the Companies and their customers in Kentucky.

The Commission should reject MISO's assertion that the Companies need MISO's security-constrained economic dispatch to maintain system reliability.<sup>21</sup> MISO's witness acknowledged in live testimony that NERC does not rank reliability coordinators “good, better, or best,”<sup>22</sup> and MISO's brief states that MISO and PJM utilize TLR processes, not market-based congestion management, to handle loop flows between their respective systems, even though both systems use market-based redispatch inside their respective footprints;<sup>23</sup> this gives the lie to MISO's attempts to persuade the Commission that TLRs are inadequate to the task of maintaining transmission system reliability.

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<sup>18</sup> MISO Brief at 6.

<sup>19</sup> MISO Brief at 3-4.

<sup>20</sup> MISO Brief at 8.

<sup>21</sup> MISO Brief at 3-6.

<sup>22</sup> I T.E. 210 ll. 5-7 (July 20, 2005).

<sup>23</sup> MISO Brief at 28-29.



### **III. MISO's Brief Twists the Evidence and Misstates the Issues to Conceal the Failures of Its Case**

At pages 18 through 28 of its Brief, MISO asks the Commission to disregard its repeated failures in its case in favor of its old arguments which were fully rebutted long ago or selective interpretations of snippets of evidence from the operation of the Day-2 markets. The Commission should not be misled by these efforts.

#### **A. The Outcome of this Investigation Does Not Turn on a Battle of the Computer Models But on the Commission's Assessment of the Reasonableness of the Cost-Benefit Studies**

To distract the Commission from the failure of its own evidence, MISO erroneously asserts that this proceeding has been “characterized by dueling models.”<sup>24</sup> There is no issue with the PROMOD IV model verses the ProSym model *per se*; rather, as the Companies have pointed out, the issue is MISO's faulty model inputs and assumptions,<sup>25</sup> and the incredible results that MISO's repeated (and usually error-laden) analyses produced.<sup>26</sup>

MISO attempts to divert the Commission's attention from its multiple and flawed analyses first by repeating a criticism of the Companies' modeling that the Companies have already refuted. To be precise, MISO attacks the Companies' modeling of transmission, declaring: “The primary difference between Dr. McNamara's and LGE's models is the failure of LGE's models to represent the operation of the transmission system – the very issue which is the focus of this proceeding.”<sup>27</sup> Yet, as Mr. Sinclair explained in his supplemental rebuttal

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<sup>24</sup> MISO Brief at 18.

<sup>25</sup> MISO lays blame on the Companies for its flawed modeling inputs at pages 18-19 of its Brief, stating, “Dr. McNamara's initial modeling runs used input data which had been vetted by LGE for accuracy, but turned out to be in error.” The Commission's Order on this topic, in contrast, states unequivocally: “The Commission further finds that LG&E and KU are not responsible for the erroneous inputs utilized by MISO in its cost/benefit study.” *In the Matter of: Investigation into the Membership of Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission System Operator, Inc.*, Case No. 2003-00266, Order at 4 (Feb. 4, 2005).

<sup>26</sup> MISO Brief at 18.

<sup>27</sup> MISO Brief at 19.

testimony eight months ago and his additional supplemental rebuttal testimony five months ago, the Companies' models did indeed model transmission transfer capabilities between its system and those of TVA, MISO, and PJM.<sup>28</sup> Thus, this attack on the Companies' modeling is just as groundless today as it was when MISO first made it ten months ago.<sup>29</sup>

Having touted the benefits of its model *per se*, MISO then contradicts its own argument by asserting that "modeling does not provide precise point forecasts. It provides insights and directionally significant trends which can be compared to indicators of actual market operations."<sup>30</sup> This about-face change in position is nothing more than an effort to distract the Commission from the many well-documented errors of its numerous cost-benefit studies.

The issue before the Commission remains whether the results of the cost-benefit studies provide a reasonable basis to conclude that the Companies' continuing MISO membership is no longer in the public interest. Evaluating the reasonableness of the studies turns in part on examining the inputs used to generate the analysis and by checking against history the results that the analysis produces.<sup>31</sup> Unfortunately for MISO, an examination of the data in its cost-benefit studies reveal that the values of many of the key variables changed by orders of magnitude and the source of the claimed benefit of the In-MISO case relative to the TORC case changed from one study to the next, seriously undermining the credibility of MISO's latest analysis.

The first and most obvious change in the components of MISO's claimed net benefits of the In-MISO option occurred between MISO's very first cost-benefit analysis and those it filed

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<sup>28</sup> Additional Supplemental Rebuttal Testimony of David S. Sinclair at 2 (Apr. 1, 2005). *See also* Supplemental Rebuttal Testimony of David S. Sinclair at 4-8 (January 10, 2005) (concerning MISO's attacks on the Companies' modeling generally).

<sup>29</sup> Rebuttal Testimony of Dr. Ronald R. McNamara at 78-81 (Nov. 19, 2004). *See* Additional Supplemental Testimony of Dr. Ronald R. McNamara at 5 (Mar. 3, 2005).

<sup>30</sup> MISO Brief at 19.

<sup>31</sup> Additional Supplemental Rebuttal Testimony of David S. Sinclair at 3 (Apr. 1, 2005).

subsequently. Of the \$270.3 million in total net benefits that MISO's first cost-benefit study predicted the Companies would receive over the period 2005-2010, \$143.8 million thereof -- 53% of the total net benefit -- came from "merger benefits."<sup>32</sup> Because of the patent absurdity of MISO's claiming credit for efficiencies the Companies created through their merger, MISO has since abandoned "merger benefits" as a component of its claimed net benefits of the Companies' continued MISO participation. It is telling to note that, notwithstanding MISO's omission of the \$143.8 million of "merger benefits" in its subsequent cost-benefit analyses, MISO's later studies have all predicted annual net benefits of the In-MISO option that are within a few million dollars of that which MISO predicted in its first cost-benefit study, namely an annual net benefit of approximately \$45 million.<sup>33</sup> Other changes in the components of MISO's claimed net benefits of the In-MISO option from study to study are shown in the table on the next page:

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<sup>32</sup> See Pre-filed Testimony of Michael P. Holstein (Dec. 29, 2003).

<sup>33</sup> *Id.*

Overview of MISO Cost/Benefit Studies						
Savings / (Costs) of In-MISO Option vs. TORC Option						
All Figures Reflect TORC Option minus In-MISO Option						
Study Date	11/19/2004	% Total	2/21/2005	% Total	3/3/2005	% Total
<b>Costs of MISO Option</b>		Percent of Total Cost		Percent of Total Cost		Percent of Total Cost
RTO Admin	-14,150	87%	-14,150	84%	-14,150	83%
Uplift	-1,371	8%	-1,957	12%	-2,058	12%
A&G	-780	5%	-780	5%	-780	5%
<b>Total Costs of MISO Option</b>	<b>-16,301</b>	<b>100%</b>	<b>-16,887</b>	<b>100%</b>	<b>-16,988</b>	<b>100%</b>
<b>Benefits of MISO Option</b>		Percent of Total Benefit		Percent of Total Benefit		Percent of Total Benefit
Cost to serve Native Load	3,969	7%	9,992	14%	11,324	18%
Off-system Sales Margin	27,296	45%	15,903	22%	8,179	13%
Net Congestion Cost	22,834	38%	33,432	45%	24,517	39%
Transmission Revenues	6,092	10%	14,498	20%	19,223	30%
<b>Total Benefits of MISO Option</b>	<b>60,191</b>	<b>100%</b>	<b>73,825</b>	<b>100%</b>	<b>63,243</b>	<b>100%</b>
<b>Total Net Benefit of the MISO Option (Total Benefits minus Total Costs)</b>	<b>43,890</b>		<b>56,938</b>		<b>46,255</b>	
Notes						
1. Data from Exhibits RRM-Table 2, RRM-Table 2B, and RRM-Table 2C from the 11/19/04, 2/21/05, and 3/3/05 studies, respectively.						

Note that greater off-system sales margins for the In-MISO option accounted for 45% of the alleged annual gross benefits of the Companies' remaining in MISO in its November 19, 2004 study. In MISO's final, March 3, 2005 cost-benefit study, however, the In-MISO advantage of off-system sales margin had declined by a factor greater than three, making it roughly 13% of the

total annual gross benefits. Interestingly, the total savings of the In-MISO case relative to TORC remained virtually unchanged. This was achieved because the savings related to serving native load and increased transmission revenue in the In-MISO case relative to TORC inexplicably increased three-fold.

Thus, although the “directional trend” on the drivers of MISO’s supposed net benefits of the In-MISO option did not change, this comparison demonstrates how MISO has resorted to a number of ever changing dramatic and fundamentally different reasons to support its contention that there are net benefits of the Companies’ remaining in MISO relative to TORC. As was discussed at great length in Mr. Sinclair’s testimony, these changes in the fundamental rationale for the Companies’ MISO membership are indicative of MISO’s blind devotion to PROMOD IV results while at the same time ignoring results that do not comport with the historical and market data.<sup>34</sup> As has been repeatedly demonstrated, only the Companies’ cost-benefit study has produced results which compare favorably to “...indicators of actual market operations.”<sup>35</sup>

Finally, MISO erroneously asserts that three results of actual Day 2 operations “confirm[] key insights and indicators forecast in Midwest ISO modeling.”<sup>36</sup> The first result that MISO claims confirms the validity of its fifth and final cost-benefit analysis is that LMPs have at some hours been higher in the eastern portion of the Companies’ system than they are at the Companies’ load zone.<sup>37</sup> Assuming for the sake of argument that this is true, one wonders what might be its relevance or impact on MISO’s cost-benefit analysis, as MISO neglects to share this information.<sup>38</sup>

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<sup>34</sup> Pre-filed Testimony of David S. Sinclair (Jan. 10, 2005); Pre-filed Testimony of David S. Sinclair (Apr. 1, 2005).

<sup>35</sup> See, e.g., Pre-filed Testimony of Martyn Gallus (July 7, 2005).

<sup>36</sup> MISO Brief at 20.

<sup>37</sup> MISO Brief at 20.

<sup>38</sup> See MISO Brief at 20.

The second actual result that MISO highlights as supporting its study's credibility in fact provides it no support at all. MISO states: "Dr. McNamara's modeling reflected the fact that given regional security-constrained economic dispatch, LGE would be able to more fully use its transmission assets. This finding has been reflected in lower actual curtailments of LGE transactions since the start of the market."<sup>39</sup> This assertion simply is not true. According to MISO's exhibit introduced at hearing, MISO curtailed 15,731 MWh of imports to, and exports from, the Companies' system in April-June 2004 under TLR, but only curtailed 450 MWh on the Companies' system under TLR in April-June 2005.<sup>40</sup> What MISO's exhibit ignored was what the Companies demonstrated in their response to the Commission's post-hearing data request, namely that MISO curtailed a total of 18,830 MWh on the Companies' system during May-July 2005 under MISO's so-called "pre-emergency manual redispatch" procedures.<sup>41</sup> Additionally, MISO conveniently ignores the redispatch resulting from the LMP market that would have occurred under TLRs in the past. It therefore appears that the actual results of Day 2 operations "since the start of the market" do not in fact bear out MISO's study's prediction that the efficiency of the Companies' transmission system would increase. And no part of MISO's discussion or evidence on this topic addresses the relevant comparison, namely, what the Companies' curtailments would have been had they not been MISO members during April-June 2005; only such a comparison will yield the net increase or decrease in curtailments as between the TORC and In-MISO cases.

MISO's third actual result that it purports bolsters the credibility of the latest in its long line of troubled cost-benefit studies is: "The Midwest ISO's model forecast that LGE would be able to increase its off-system sales and obtain higher prices for its power within a large

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<sup>39</sup> MISO Brief at 20.

<sup>40</sup> MISO Re-direct Exhibit 1 (July 20, 2005).

<sup>41</sup> Companies' Response to Commission Staff's Post-Hearing Data Request No. 1 (Aug. 5, 2005).

integrated regional power market. That is exactly what has occurred. LGE has enjoyed large returns on its off-system sales in the first three months of the market . . .”<sup>42</sup> Yet again, MISO’s claim is false. Although both MISO’s and the Companies’ studies correctly predicted that the Companies would make greater volumes of off-system sales in the months of April and May 2005,<sup>43</sup> MISO’s study erroneously predicted that: (1) energy market prices would decrease, not increase (as they actually have);<sup>44</sup> and (2) the Companies would enjoy significantly lower off-system sales margins than they actually have.<sup>45</sup> The Companies’ study, on the other hand, produced far more accurate predictions of both energy prices and the Companies’ off-system sales margins than did MISO’s study,<sup>46</sup> so this actual result supports the credibility of the Companies’ study, not MISO’s.

In sum, the Companies’ recent strong performance in off-system sales is due primarily to: (1) high energy prices resulting from generally high fuel costs (but the Companies enjoy relatively low fuel costs due to relatively lower prices of coal than natural gas); and (2) lower native load demand than anticipated due to milder than normal weather in May.<sup>47</sup> Certainly MISO has provided no evidence that it or the Day 2 markets have had any impact on native load demand or the weather, had no role in securing the Companies’ low-cost fuel contracts, and has provided no empirical evidence to support any claim that it or the Day 2 markets are responsible for high energy prices (presumably MISO does not control fuel prices); indeed, MISO’s study

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<sup>42</sup> MISO Brief at 20.

<sup>43</sup> Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 9 Table 3.

<sup>44</sup> Pre-filed Testimony of David S. Sinclair (Apr. 1, 2005) at 16 Chart 1; Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 10 Table 4.

<sup>45</sup> Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 9 Table 3; Pre-filed Testimony of David S. Sinclair (Apr. 1, 2005) at 5 Table 1.

<sup>46</sup> Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 10 Table 4; Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 9 Table 3.

<sup>47</sup> Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 2-3.

predicted that energy prices would drop in Day 2.<sup>48</sup> Thus MISO has provided no reason at all to believe that the Companies would not have achieved the same or better off-system sales performance had they not been MISO members.

**B. MISO's \$25 million "Actual Market Data" Figure Tells the Commission Nothing About the Companies' Performance in the Day 2 Markets or Whether the Companies Would Have Been Better Off Having Already Exited MISO**

Just as nakedly as it did in live testimony before the Commission<sup>49</sup> -- with no support other than Dr. McNamara's word<sup>50</sup> -- MISO again presents the fact that the Companies received a \$25,090,000<sup>51</sup> net cash flow from MISO Day 2 settlements during April-June 2005 as evidence that "LGE will do quite well in the markets and that the long-term revenues therefrom will vastly eclipse the cost of membership in the Midwest ISO."<sup>52</sup> As Mr. Gallus pointed out in his live testimony and as the Companies noted in their recently filed brief, this is a ridiculous claim.<sup>53</sup> It is akin to a shopkeeper pulling the cash drawer out of the register and proclaiming, "A-ha! There's cash in here, so I must be in the black!" The \$25 million cash flow figure is utterly meaningless on its own because it tells the Commission nothing about what it cost to produce that cash, nor does it provide any indication of what the Companies' performance would have been had they not been in MISO during the same period, which is the key issue in this

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<sup>48</sup> Pre-filed Testimony of David S. Sinclair (Apr. 1, 2005) at 16 Chart 1.

<sup>49</sup> I T.E. 62 (July 20, 2005).

<sup>50</sup> It was the Companies, not MISO, that provided the settlement statement to support Dr. McNamara's number. *See* I T.E. 90 (July 20, 2005).

<sup>51</sup> At page 21 of its brief, MISO accurately states that the correct figure is \$25,090,000 -- the Companies made a \$50,000 computational error (in MISO's favor) in LG&E/KU Cross Exh. No. 4 by stating that the Companies' total Day 2 revenues came to \$25,140,000. In reference to this mistake, however, MISO erroneously states in footnote 81 on that same page, "LG&E/KU Cross Exh. No. 4 (attachment B hereto) contains a \$50 million computational error, showing a 'total charges/revenues' of \$25,140,000." What the exhibit actually lists are "Total Charges/Revenues" of "(25,140,[000])," which clearly means total revenues of \$25,140,000 (Mr. Gallus also explained this point in his live testimony). Thus, although the Companies acknowledge their computational error, it is not nearly as grievous as MISO states.

<sup>52</sup> MISO Brief at 21-22.

<sup>53</sup> I T.E. 234-38 (July 20, 2005); Companies' Brief (Sep. 7, 2005) at 16-17.



proceeding (aside from reliability issues) under KRS 278.218.<sup>54</sup> Therefore, contrary to MISO's assertion, this particular piece of actual data, taken on its own, provides absolutely no "directional indices [or] . . . objective measure[s] against which the assumption[s] underlying the models may be tested."<sup>55</sup>

### **C. The Companies' Portrayal of Market Data Was Fair and Accurate**

MISO complains for six and a half pages that "LGE's Portrayal of Market Data is Skewed, Incomplete and Misleading."<sup>56</sup> MISO's complaints however are based on a series of misleading arguments, twisted evidence and misstatements of the issues.

1. The \$2,407,000 Per Month in Uplift Costs is a Reasonable Value to Assess the Assumption in MISO's Cost-Benefit Study

MISO's first complains that the Companies pointed out that they paid MISO an average of \$2,407,000 per month in uplift costs during April-May 2005, far higher than MISO's (or the Companies') predicted amount, without noting the amounts the Companies received in Revenue Sufficiency Guarantee ("RSG") make-whole payments or over-collected losses ("OCL").<sup>57</sup> A few points suffice to refute this objection. First, neither MISO nor the Companies presented the "uplift cost" entries in their respective cost-benefit analyses as net figures,<sup>58</sup> so it is entirely appropriate to highlight the fact that in the first two months of Day 2 operations the Companies paid more than twice what MISO (and the Companies) projected the Companies would pay in uplift costs in a *year*,<sup>59</sup> the point being that both studies were dramatically off on this issue, and that reality is far less favorable to continued MISO participation. Second, with respect to RSG make-whole payments, as the Companies noted before, they have grouped these in with their off-

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<sup>54</sup> I T.E. 234-38 (July 20, 2005); Companies' Brief (Sep. 7, 2005) at 16-17.

<sup>55</sup> MISO Brief at 21-22.

<sup>56</sup> MISO Brief at 22-28.

<sup>57</sup> MISO Brief at 22-23.

<sup>58</sup> Pre-filed Testimony of Mathew J. Morey (Sep. 29, 2004); Pre-filed Testimony of Dr. Ronald R. McNamara (Mar. 3, 2005) Exh. RRM Table 2C.

<sup>59</sup> Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 5-6.

system sales revenues;<sup>60</sup> if MISO would prefer to reduce the Companies' off-system sales figure by the amount of the RSG make-whole payments the Companies have received and *only then* net the payments against uplift costs, the Companies have no objection. Third, with respect to over-collected losses: by definition, these are losses payments in excess of actual system losses that MISO collects as part of the LMP prices, so these rebates are most properly netted with LMP payments and revenues, not uplift costs.

2. The Net Congestion Cost Figure of \$367,000 is a Reasonable Value to Assess the Assumption in MISO's Cost-Benefit Study

MISO next complains that it has been unable to reconstruct the Companies' computation of its net congestion cost figure of \$367,000 for the months of April-May 2005.<sup>61</sup> Besides a citation to Mr. Gallus's testimony to support the \$367,000 net congestion cost figure, MISO provides no support for the remainder of its unsubstantiated complaint on this topic: the remainder of the paragraph is utterly devoid of citations.<sup>62</sup> The sources of all the information in Mr. Gallus's testimony are the books and records of the Companies.

Aside from not supporting this assertion, MISO does note that the Companies received \$6,111,000 in FTR revenues for the months of April, May and June 2005, a figure it presumably drew from LG&E/KU Cross Exh. No. 4.<sup>63</sup> Leaving aside the question of how the Companies derived their net congestion cost figure, the Commission should note that annualizing the \$6,111,000 figure creates annual FTR revenue of \$24,444,000 -- an amount that is not net of any congestion costs. This amount is only 35.5% of the annual FTR revenue that MISO's study

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<sup>60</sup> Companies' Brief (Sept. 7, 2005) at 15 n.46.

<sup>61</sup> MISO Brief at 23.

<sup>62</sup> MISO Brief at 23.

<sup>63</sup> MISO Brief at 23. *See* LG&E/KU Cross Exh. No. 4. Please note that the amounts shown in Exh. No. 4, though correct and accurate at the time presented, are subject to change due to MISO re-settlement processes, although they are not expected to change materially. *See* MISO Midwest Market Initiative, Business Practices Manual for Market Settlements, Manual No. 5, Version 7, available at: [http://www.midwestmarket.org/publish/Document/20f443\\_ffd16ced4b\\_-7e670a3207d2?rev=8](http://www.midwestmarket.org/publish/Document/20f443_ffd16ced4b_-7e670a3207d2?rev=8).

predicted the Companies would receive;<sup>64</sup> indeed, it is an amount that is only 55% of the annual *congestion costs* that MISO's study predicted the Companies would have to pay.<sup>65</sup> Therefore, the Companies' point that FTR revenues are markedly lower than MISO's study predicted,<sup>66</sup> remains valid.

MISO then complains that Mr. Gallus, "in improper sur-direct testimony" and "without support," noted that the \$25 million in cash flow<sup>67</sup> that the Companies from the Day 2 markets came at a cost, and that the cost of the off-system sales associated with that cash flow came to approximately \$24 million.<sup>68</sup> MISO's hypocrisy in making such a complaint is palpable: as the Companies note above, it was Dr. McNamara that improperly introduced the meaningless \$25 million figure into the record, and he did so utterly without support until the Companies, not MISO, produced a settlement statement exhibit to verify it.<sup>69</sup> Only later did Mr. Gallus have the opportunity to confront and address MISO's new evidence (i.e., the \$25 million cash flow figure) by noting the \$24 million OSS production cost number, a number the Companies subsequently substantiated in their response to a post-hearing data request.<sup>70</sup> MISO was provided the opportunity for further hearing on the Companies' post-hearing data response, and declined. The Commission afforded all parties full due process.

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<sup>64</sup> MISO's latest study predicted that the Companies would receive a total of \$68,944,818 in FTR revenues annually. Pre-filed Testimony of Dr. Ronald R. McNamara (Mar. 3, 2005) Exh. RRM Table 2C.

<sup>65</sup> MISO's latest study predicted that the Companies would pay a total of \$44,427,737 in congestion costs annually. Pre-filed Testimony of Dr. Ronald R. McNamara (Mar. 3, 2005) Exh. RRM Table 2C.

<sup>66</sup> See Pre-filed Testimony of Dr. Ronald R. McNamara (Mar. 3, 2005) Exh. RRM Table 2C.

<sup>67</sup> MISO again mischaracterizes the \$25 million as "LGE's net three-month gain from the Day 2 market . . ." MISO Brief at 23 (emphasis in original). The Companies cannot reiterate this point enough: the \$25 million figure is a *cash flow statement* concerning Day 2, nothing more. It most certainly is not a "net . . . gain."

<sup>68</sup> MISO Brief at 23; I T.E. 236 (July 20, 2005); Companies' Response to Commission Staff's Post-Hearing Data Request No. 2 (Aug. 5, 2005).

<sup>69</sup> The exhibit was LG&E/KU Cross Exh. No. 4. I T.E. 90 (July 20, 2005).

<sup>70</sup> Companies' Response to Commission Staff's Post-Hearing Data Request No. 2 (Aug. 5, 2005).

3. The Companies' Success in the Off-System Sales Market Was Not Predicted in MISO's Cost-Benefit Study and is Not Attributable to the Companies' MISO Membership

At pages 23-24 of its Brief, MISO then goes on, quite irrelevantly, to point out yet again that the Companies have indeed made reasonable margins on their off-system sales during April-June 2005,<sup>71</sup> asserting that if the Companies receive the same amounts of off-system sales margins for another nine months, then the Companies will receive "\$94,656,000 of pure profit . . . through participation in the Midwest ISO's Day 2 markets from off-system sales alone."<sup>72</sup> As the Companies discuss above, MISO has produced absolutely no evidence to support any claim that it is the Companies' participation in the Day 2 markets that has allowed the Companies to enjoy such off-system sales margins; rather, it is the Companies that have pointed out that non-MISO-related factors have been primarily responsible for the Companies' recent off-system sales success.<sup>73</sup> Indeed, MISO predicted that the Companies' margins would not be as robust as they have been, indicating that MISO's cost-benefit analysis is less credible than is the Companies, which did more accurately predict such margins for the Companies in the In-MISO scenario.<sup>74</sup> Thus, the fact of the Companies' recent healthy off-system sales margins does not help, but actually harms, MISO's case.

4. MISO's Three Assertions Concerning the Revenue Sufficiency Guarantee are Selective and Misleading

MISO makes three assertions concerning MISO's Revenue Sufficiency Guarantee ("RSG") and the Companies that are misleading. First, MISO states that the Companies cannot complain of high RSG distributions (i.e., RSG uplift costs) because the Companies received

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<sup>71</sup> See page 12, *supra*.

<sup>72</sup> MISO Brief at 23-24.

<sup>73</sup> Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 3.

<sup>74</sup> Pre-filed Testimony of Martyn Gallus (July 7, 2005) at 9 Table 3.

more in RSG make-whole payments than they paid out in RSG distributions.<sup>75</sup> Second, MISO asserts that the Companies cannot complain of high RSG distributions because “a substantial amount of ‘uplift’ experienced by the Midwest ISO was caused by forced outages in LGE’s system, the cost of which would have been fully borne by LGE but for the support of the Midwest ISO.”<sup>76</sup> Yet MISO also states: “RSG charges [distributions] are levied first on a localized basis in which a determination is made as to whether a local issue caused resources to be committed in the RAC [Reliability Assessment Commitment process], and then on a footprint-wide basis when no direct local issue can be identified as the cause of the resource commitment.”<sup>77</sup> It is this third point that undermines the other two. First, if MISO has indeed assessed RSG distributions on a localized basis (i.e., billed the utilities that create the need for units to be committed in the RAC process for the costs of those commitments), then the Companies certainly have “fully borne” the costs that their forced outages caused by paying localized RSG distributions.<sup>78</sup> Second, if the Companies have in fact “fully borne” whatever costs their unit outages have caused, then the Companies have every right to complain of paying additional amounts of RSG distributions to help subsidize reliability costs created by the actions of other MISO market participants, regardless of how much the Companies receive in RSG make-whole payments.

**D. So-called “Self-scheduling” Truly Does Not Allow the Companies to Serve Their Load as They Used to in Day 1**

MISO’s next set of old arguments attacks the Companies’ simple observation that they cannot serve their native load in Day 2 in the same way they did in Day 1, at least not without

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<sup>75</sup> MISO Brief at 22-23.

<sup>76</sup> MISO Brief at 22-23.

<sup>77</sup> MISO Brief at 12.

<sup>78</sup> MISO Brief at 12.

incurring significant financial penalties for so doing.<sup>79</sup> First, MISO makes the odd statement that the Companies have “conced[ed] that LGE may self-schedule and thus maintain the fictitious physical link between resources and customers . . . .”<sup>80</sup> With respect to so-called “self-scheduling,” the Companies do not challenge their ability under the TEMT to submit must-run generation schedules and become price takers; indeed, this is set out in the stipulation that the Companies and MISO filed in this proceeding.<sup>81</sup> But the important point about “self-scheduling” is that it absolutely does not enable the Companies to serve their load as they did in Day 1 or as they would after exit from MISO.<sup>82</sup> Instead, it merely allows the Companies to instruct MISO that the Companies will run certain generators at certain output levels for certain periods of time and will accept whatever LMP MISO assigns to those generators for those levels of output for those times, *regardless of LMPs*; this is what it means for the generators to be price-takers.<sup>83</sup> Submitting such price-taking, must-run schedules will sometimes result in sub-optimal economic outcomes for the Companies because by so doing the Companies forego the opportunity to acquire lower-cost power from the MISO-administered markets. For example, if the Companies self-scheduled a \$50/MWh unit and the LMP at that location turned out to be \$40/MWh, the Companies would have foregone the opportunity to acquire that cheaper, \$40/MWh power, to the detriment of the Companies and their customers. Thus, the Companies generally do not use “self-scheduling” and allow MISO to dispatch their units as part of the region-wide economic dispatch in order to ensure that potential economic energy purchasing opportunities are appropriately evaluated. However, although the Day 2 markets exist as a centrally-administered

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<sup>79</sup> II T.E. 15 ln. 23 – 16 ln. 7 (July 21, 2005); Pre-filed Testimony of Martyn Gallus (Jan. 10, 2005) at 11-12.

<sup>80</sup> MISO Brief at 25.

<sup>81</sup> LG&E/KU / MISO Stipulation ¶¶9, 12 & 18.

<sup>82</sup> II T.E. 15 ln. 23 – 16 ln. 7 (July 21, 2005); Pre-filed Testimony of Martyn Gallus (Jan. 10, 2005) at 11-12.

<sup>83</sup> See II T.E. 15 ln. 23 – 16 ln. 7 (July 21, 2005); Pre-filed Testimony of Martyn Gallus (Jan. 10, 2005) at 11-12; LG&E/KU / MISO Stipulation ¶¶9, 12 & 18.

power pool, regardless of whether the Companies are MISO members, the Companies' "playing the rules" of Day 2 emphatically does *not* mean that participating in the Day 2 markets as MISO members produces a superior economic outcome for the Companies as compared to the Companies being *outside* of MISO.<sup>84</sup>

**E. MISO's Assertions about Reliability Assessment Commitment and Revenue Sufficiency Guarantee Are Erroneous**

MISO makes two points that are in error about RSG and the Reliability Assessment Commitment ("RAC") process (by which MISO commits units to run for reliability purposes).<sup>85</sup> First, MISO points out that in Day 1 (and in the TORC scenario), the Companies had to pay their own start-up and no-load costs, whereas in Day 2 MISO assures that the Companies receive RSG make-whole payments for the start-up and no-load costs of the Companies' units that MISO commits in the RAC process.<sup>86</sup> What MISO neglects to mention is that RSG make-whole payments do not magically appear, but MISO collects them from market participants like the Companies through RSG distributions, which are socialized uplift costs.<sup>87</sup> Therefore, the real difference between the In-MISO and TORC options with respect to start-up and no-load costs is whether the Commission prefers that the Companies pay the costs of committing their own units for reliability -- in a manner controlled by the Companies -- or gamble that the net difference between MISO's RSG make-whole payments and RSG distributions will be consistently less than the Companies' internal commitment costs would be.

MISO's second point about RAC may well provide guidance to the Commission concerning which of the above two options it should prefer. MISO notes that its RAC process may well commit units out of economic merit order (i.e., MISO may commit higher-cost units

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<sup>84</sup> II T.E. 15-16 (July 21, 2005).

<sup>85</sup> MISO Brief at 25-27.

<sup>86</sup> MISO Brief at 25.

<sup>87</sup> *See, e.g.*, Pre-filed Testimony of Michael S. Beer (Sept. 29, 2004) at 6.

before it commits lower-cost units) for reliability purposes; MISO asserts that this behavior does not mean that the market is not working properly and that Mr. Gallus was mistaken to suggest that this commitment of higher-cost units ought to be reflected in LMP prices.<sup>88</sup> Although the Companies appreciate the need to maintain reliability by having adequate reserves to call upon if needed, MISO's apparent subscription to a "cost is no object" school of reliability commitment has resulted in unit commitments that several market participants, not just the Companies, have identified as strange and inefficient, particularly with respect to MISO's overly generous use of high-cost combustion turbines.<sup>89</sup> Furthermore, as Mr. Gallus testified, MISO's failure to figure the costs of high-cost RAC-committed units into LMPs has the effect of keeping LMPs artificially low, which likely had some part in why imports into the MISO footprint were uncharacteristically low in the first months of Day 2 operation.<sup>90</sup>

**F. MISO's Purported Duty to Serve Contradicts its Past Assertions and Is Self-Serving**

After trying to justify its odd dispatch of high-cost units ostensibly to maintain reliability, MISO claims that it "has a duty to maintain the reliability of the grid, which means ensuring that power flows to all load requirements."<sup>91</sup> This statement seems to be at odds with MISO's statement in an earlier response to a data request that it did not have a duty to serve load.<sup>92</sup>

On MISO's new assumption that it does indeed have a duty to serve, MISO smugly asserts that it has a "superior capability to requite this obligation," and claims that neither TVA nor SPP "would provide day-to-day and minute-to-minute services for transmission operations

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<sup>88</sup> MISO Brief at 26-27.

<sup>89</sup> See, e.g., In the Matter of: An Assessment of Kentucky's Electric Generation, Transmission and Distribution Needs, Case No. 2005-00090, Prepared Testimony of Roy M. Palk on Behalf of Eastern Kentucky Power Cooperative, Inc. (June 8, 2005) at 9 ll. 9-23.

<sup>90</sup> I T.E. 250-51 (July 20, 2005).

<sup>91</sup> MISO Brief at 27.

<sup>92</sup> MISO Response to Companies' Aug. 18, 2004 Data Request No. 38.



that are equivalent to what LGE receives from the Midwest ISO.”<sup>93</sup> First, MISO has admitted that all reliability coordinators, including MISO, TVA and SPP, are certified by NERC, and that NERC does not distinguish between reliability coordinators, ranking them “good,” “better,” or “best.”<sup>94</sup> Second, assuming for the sake of argument that MISO does provide some modicum of added reliability as compared to other reliability coordinators, there is no evidence in the record to support a belief that the benefit of that added reliability outweighs the costs necessary to achieve it, nor has even attempted to quantify the Day 2 reliability benefits it asserts it has provided the Companies.<sup>95</sup> Third and finally, with respect to MISO’s assertion that it has a “superior capability to requite this obligation [to serve load, assuming it has one],” MISO provides no empirical evidence support its claim, and MISO’s “superior capability” appears doubtful in view of what the Attorney General noted in his first brief: “MISO has had an unfortunate role in the August 2003 blackout.”<sup>96</sup>

**G. If the Companies are Able to Exit MISO, They Will in No Way Be “Free Riders” on the MISO Markets**

MISO insinuated as long ago as May 2004<sup>97</sup> that the Companies have an ulterior motive for arguing in favor of their exit from MISO, and in its Brief MISO finally makes explicit what it believes that motive to be: to exit MISO and “free ride” on the Day 2 markets by trading in them without having to pay MISO’s costs.<sup>98</sup> This suggestion is utterly without foundation and demonstrably false.

First, such a motive would provide the Companies no impetus to dispute MISO’s cost-benefit analysis. MISO’s cost-benefit analysis claims to show that the Companies will enjoy

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<sup>93</sup> MISO Brief at 27.

<sup>94</sup> I T.E. 210 ll. 5-7 (July 20, 2005).

<sup>95</sup> I T.E. 210-11 (July 20, 2005).

<sup>96</sup> Attorney General’s Brief (April 2004) at 3.

<sup>97</sup> See MISO Reply Brief (May 10, 2004) at 6-7.

<sup>98</sup> MISO Brief at 27-28.

tens of millions of dollars in net benefits annually if they remain in MISO as compared to becoming “free riders” outside of MISO.<sup>99</sup> Thus, if the Companies found MISO’s cost-benefit analysis credible, then even if the Companies had an inclination toward “free ridership,” it would be against the Companies’ economic interests to pursue exit.

Second, the Companies have paid MISO’s tariff costs for years, and do not dispute that if they are allowed to exit MISO, they will have to pay an exit fee to do so.<sup>100</sup> The purpose of the exit fee is for the Companies to pay their load-ratio share of MISO’s outstanding capital obligations, precisely so as not to allow an exiting member to profit by leaving MISO’s remaining stakeholders with greater capital obligations.<sup>101</sup> After paying the exit fee, it simply will not be credible to construe the Companies as “free riders” on the Day 2 markets, as they will have paid their share of the capital costs to create those markets.

Third, MISO has not disparaged other non-MISO entities that transact in the Day 2 markets as “free riders”; one wonders why MISO has singled out the Companies for special derision. Indeed, presumably such entities provide MISO members the benefit of providing a broader market into which MISO entities can sell their power and from which MISO entities can purchase power when it is economic to do so. Certainly it is true that MISO must recover its costs of performing the functions it performs; MISO does so by assessing Schedule 16 and 17 charges as appropriate to all those who participate in the FTR, Day-Ahead and Real-time

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<sup>99</sup> Pre-filed Testimony of Dr. Ronald R. McNamara (Mar. 3, 2005) Exh. RRM Table 2C.

<sup>100</sup> See generally Joint Post-Hearing Brief of Louisville Gas and Electric Company and Kentucky Utilities Company (Apr. 26, 2004); Pre-filed Testimony of Paul W. Thompson at 15-16 (Sep. 22, 2003); II T.E. 158-65 (Feb. 26, 2004); Pre-filed Testimony of Paul W. Thompson at 6 ln. 16 - 7 ln. 15 (Jan 10, 2005).

<sup>101</sup> See generally Joint Post-Hearing Brief of Louisville Gas and Electric Company and Kentucky Utilities Company (Apr. 26, 2004); Pre-filed Testimony of Paul W. Thompson at 15-16 (Sep. 22, 2003); II T.E. 158-65 (Feb. 26, 2004); Pre-filed Testimony of Paul W. Thompson at 6 ln. 16 - 7 ln. 15 (Jan 10, 2005). MISO also states that remaining the Companies’ remaining in MISO will result in the benefit that the Companies will not have to pay an exit fee. MISO Brief at 4. But given that the exit fee merely represents amounts that the Companies would have paid as part of their MISO schedule charges had they remained members, the exit fee should constitute neither a benefit nor a detriment to either the In-MISO or TORC scenario in the long term.

markets without regard to whether the participant resides within the MISO footprint.<sup>102</sup> The Companies have already stated in this proceeding that although they anticipate being able to transact with the Day 2 markets at the MISO border, they certainly expect to pay the same transaction fees MISO charges everyone else.<sup>103</sup> Thus, if the Companies are allowed to exit MISO and transact with the Day 2 markets thereafter, they will be “free riders” only insofar as all other non-MISO entities that transact with MISO are “free riders,” and it will be MISO’s fault for not setting appropriate transaction fees that will create “free ridership,” not any action of the Companies; moreover, the Companies will be the only “free rider” to have paid tens of millions of dollars in capital costs to establish the Day 2 markets.

As the Companies showed previously, it is only MISO, not the Companies, that has a stake in providing the Commission with anything other than the unalloyed truth in this proceeding.<sup>104</sup> MISO’s attempt at pinning on the Companies an ulterior motive was doomed to fail before it began simply because, as Mr. Gallus stated in live testimony, the Companies are in the business of earning a profit; if MISO truly could provide the benefits it claims and not detract from the Companies’ ability to fulfill their obligation to serve load, the Companies would be MISO’s biggest supporters. Because the Companies are convinced that MISO cannot produce net benefits and that exit will not have a detrimental effect on reliability,<sup>105</sup> the Companies continue to seek exit and ask that the Commission grant the relief they request herein.

#### **IV. Day 2 Transmission Operations Have Done Nothing to Reduce the Economic Impact of Redispatch**

##### **A. MISO Day 2 Has Not Reduced Overall Curtailments**

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<sup>102</sup> TEMT Schedule 16, second revised sheet 993 and Schedule 17 substitute second revised sheets 1000-1001, available at: <http://www.midwestiso.org/emt/docs/Schedules.pdf> (last viewed on Sept. 13, 2005).

<sup>103</sup> Pre-filed Testimony of Marytn Gallus (Jan 10, 2005) at 16; TEMT Schedule 16, second revised sheet 993 and Schedule 17 substitute second revised sheets 1000-1001, available at: <http://www.midwestiso.org/emt/docs/Schedules.pdf> (last viewed on Sept. 13, 2005).

<sup>104</sup> Companies’ Brief (Sept. 7, 2005) at 22-23.

<sup>105</sup> Pre-filed Testimony of Mark S. Johnson (Sept. 29, 2004) at 2-3.

MISO attempts to characterize the Companies' testimony that MISO posted 147 TLRs in May 2005<sup>106</sup> as "misleading and fails to account for the drastic change in the economic effects of TLRs in Day 2."<sup>107</sup> It is difficult to see how the Companies' testimony could possibly be misleading. It has been MISO, not the Companies, that has called TLRs "blunt and inefficient"<sup>108</sup> and has stated that its goal is to eliminate TLRs entirely in Day 2;<sup>109</sup> the Companies have merely pointed out that MISO has not achieved that goal.

With respect to the economic effects of TLR calls on the Companies' system in Day 2, MISO describes as "devastating[]" Mr. Harszy's testimony that MISO curtailed a total of 15,731 MWh of the Companies' transactions under TLR during April-June 2004, but curtailed only 450 MWh under TLR during April-June 2005, which TLR curtailment reduction Mr. Harszy suggested could "explain[] LGE's phenomenal off-system sales experience over the first three months" of Day 2.<sup>110</sup> These assertions by MISO ignore what the Companies discussed above, namely MISO redispatched over 18,000 MWh of the Companies' generation during May-July 2005,<sup>111</sup> which significantly exceeds the amount of MWh of transactions MISO curtailed on the Companies' system under TLR procedures during April-June 2004.<sup>112</sup> Thus, given that MISO appears to have curtailed more MWh of the Companies' transactions in Day 2 than in Day 1, even without counting the amount of redispatch that occurs as a natural outcome of LMP-based economic dispatch, Mr. Harszy's testimony is "devastating[]" only to MISO as the Companies have shown to be baseless his economic assertion that reduced TLRs may have contributed to the Companies' off-system sales performance.

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<sup>106</sup> Pre-filed Testimony of Mark S. Johnson (July 7, 2005) at 3.

<sup>107</sup> MISO Brief at 28.

<sup>108</sup> MISO Brief at 14.

<sup>109</sup> *See, e.g.*, Midwest ISO Annual Report (LG&E/KU Cross Exh. No. 1) at 14.

<sup>110</sup> MISO Brief at 29-30.

<sup>111</sup> Companies' Response to Commission Staff's Post-Hearing Data Request No. 1 (Aug. 5, 2005).

<sup>112</sup> MISO Re-direct Exhibit 1 (July 20, 2005).

With respect to the TLRs that MISO continues to call, it justifies its continued use of “blunt and inefficient”<sup>113</sup> TLRs by stating that it called “most of the May 2005 TLRs” in order to control PJM loop flows, and notes that “[t]he enforcement mechanism under the JOA [Joint Operating Agreement between MISO and PJM] is the issuance of TLRs to keep flows within prescribed allocations.”<sup>114</sup> One wonders how MISO and PJM will be able to “keep flows within prescribed allocations” with “blunt and inefficient” instruments like TLRs, as to which MISO asserts, “[i]t is difficult to accurately predict the effect of curtailing transactions on a specific transmission facility or ‘flowgate’ that is approaching its operating limit,” and which “often require 30 to 60 minutes to implement.”<sup>115</sup> Indeed, MISO goes on in its brief to suggest that TVA or SPP would be inadequate reliability coordinators for the Companies because they would have to rely “exclusively” on TLRs to maintain reliability.<sup>116</sup> But given that PJM and MISO -- both market-based dispatchers of their respective systems and both of which MISO considers equally well-equipped to provide “superior” reliability coordination services<sup>117</sup> -- have elected to use TLRs to control flows between them, perhaps TLRs are not so “blunt and inefficient” after all, thus TVA and SPP would indeed provide the Companies reliability coordination services comparable to MISO.

Given that MISO and PJM control their respective loop flows between their systems, MISO’s claim that the Companies’ “would be overwhelmed by PJM-related loop flows” if the Companies’ exit MISO is grossly overstated and again misconstrues testimony, this time the testimony of MISO’s own witness.<sup>118</sup> Mr. Harszy testified that the Companies’ system “*could* be

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<sup>113</sup> MISO Brief at 14.

<sup>114</sup> MISO Brief at 15.

<sup>115</sup> MISO Brief at 14-15.

<sup>116</sup> MISO Brief at 31.

<sup>117</sup> MISO Brief at 7-8, 39.

<sup>118</sup> MISO Brief at 29.

overwhelmed by PJM-related loop flows,” not that they *would* be, and admitted that he knew of no evidence or analysis to support his assertion of the possibility.<sup>119</sup> MISO’s misquoting of testimony aside, although MISO might no longer “have obligation or reason to enforce the JOA to eliminate loop flows affecting LGE” if the Companies exit MISO,<sup>120</sup> MISO would still be bound by NERC Version 0 Reliability Coordinator standards to request TLRs on the Companies’ system if MISO observes conditions that warrant such calls, and MISO would remain obliged to honor any TLRs that the Companies’ new Reliability Coordinator called.<sup>121</sup> There is therefore little reason for the Commission to believe that the Companies’ system will be “overrun” with PJM loop flows if the Commission ultimately gives the Companies authority to exit MISO.

**B. The Failure of MISO’s Much-Touted LMP-Based Congestion Management System to Adjust to Unit Outages Calls into Question MISO’s Claimed Reliability Benefit**

MISO’s final claim with respect to TLRs is that the Companies’ forced outages at the Brown generating station caused MISO to have to call TLRs on the Companies’ system, and that, had Brown been in service, MISO could have managed congestion through LMP-based dispatch.<sup>122</sup> MISO then states: “LGE should not, therefore, be heard to criticize the Midwest ISO for taking action to alleviate a reliability problem of its own making.”<sup>123</sup> Again, the Companies have not criticized MISO for its use of TLRs, but only pointed out that MISO has stated in the past that it will eliminate “blunt and inefficient” TLRs in Day 2 but has yet to do so.<sup>124</sup> And it seems odd that MISO’s much-touted LMP-based redispatch, which MISO has reminded the

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<sup>119</sup> I T.E. 159-60 (July 20, 2005); Pre-filed Testimony of Roger C. Harszy (July 7, 2005) at 3.

<sup>120</sup> MISO Brief at 29. Presumably MISO would recognize the applicability of the existing PJM-TVA-MISO Joint Operating Agreement if the Companies obtain reliability coordination services from MISO, PJM, or TVA.

<sup>121</sup> See, e.g., NERC Version Standard 0 Standards IRO-003-0, IRO-006-1, available at [http://www.nerc.com/~filez/standards/Reliability\\_Standards.html#Interconnection\\_Reliability\\_Operations\\_and\\_Coordination](http://www.nerc.com/~filez/standards/Reliability_Standards.html#Interconnection_Reliability_Operations_and_Coordination) (last viewed on Sept. 13, 2005).

<sup>122</sup> MISO Brief at 29.

<sup>123</sup> MISO Brief at 29.

<sup>124</sup> See, e.g., Midwest ISO Annual Report (LG&E/KU Cross Exh. No. 1) at 14; MISO Brief at 14.

Commission time and again gets updated every five minutes, should be thrown so out of kilter by the forced outage of a generating station, even a large one like Brown.<sup>125</sup> Not only is it odd that MISO's dispatch apparently cannot adjust to such a contingency, it is in direct contradiction to what MISO stated over a year ago:

**REQUEST [from the Companies to MISO]:**

47. In the proposed Day 2 Market, how long does the MISO SCED take to correctively redispatch once a constraint has been entered into the SCED algorithm?

**RESPONSE:**

Up to the next five-minute interval when the SCED is calculated.<sup>126</sup>

Thus it appears that, yet again, the reality of the Day 2 markets and Security-Constrained Economic Dispatch falls short of the theory that MISO propounded before market start-up, and which it continues to propound today.

**V. MISO Day 2 Does Indeed Degrade the Commission's Authority Over Retail Rates**

MISO again tries to convince the Commission that Day 2 has not affected the Commission's authority over retail rates.<sup>127</sup> As the Companies have discussed at length before, this claim is simply false.<sup>128</sup> In MISO Day 2, the Companies must purchase all of the energy needed to serve native load from MISO in FERC-regulated wholesale transactions, and all of the Companies' sales into the MISO footprint also are FERC-regulated wholesale transactions.<sup>129</sup>

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<sup>125</sup> See, e.g., MISO Brief at 16. Given the duration of the episodes of MISO's "pre-emergency" manual redispatch of the Companies' system (one episode lasted over eleven and a half hours, and twenty-eight episodes lasted longer than one hour), it appears that MISO's LMP-based redispatch has had real difficulty adjusting LMPs to provide for the proper dispatch configuration in anything like the ten to fifteen minute timeframe MISO has asserted such adjustment requires. Companies' Response to Commission Staff's Post-Hearing Data Request No. 1 (Aug. 5, 2005).

<sup>126</sup> MISO Response to the Companies' Aug. 18, 2004 Data Request No. 47.

<sup>127</sup> MISO Brief at 35.

<sup>128</sup> Companies' Brief (Sept. 7, 2005) at 28-30.

<sup>129</sup> LG&E/KU Cross Exh. No. 5.

As the Commission itself has stated, it has no authority to deny rate recovery of costs a utility incurs under a FERC-approved tariff like the TEMT.<sup>130</sup> In view of all these facts, MISO's attempt to tell the Commission that it has lost no authority because it still has jurisdiction to set retail rates is disingenuous; Day 2 has increased the population of the universe of MISO-related costs as to which the Commission has acknowledged it may not deny the Companies recovery through retail rates.

#### **VI. The Companies' Litigation Concerning KRS 278.214 Did Not Implicate the Commission's Jurisdiction and Was Pursued to Protect the Companies' Native Load Customers**

MISO tries to portray itself as a defender of this Commission's prerogatives because it opposed the Companies' position in the Companies' challenge to the constitutional validity of KRS 278.214, Kentucky's curtailment priority statute.<sup>131</sup> In that proceeding before the federal district court for the eastern district of Kentucky, the Companies advanced two arguments for the constitutional invalidity of KRS 278.214, neither of which is inconsistent with the Companies' position in this case, and neither of which trenches upon the Commission's jurisdiction. The Companies' first argument was that KRS 278.214 (which required the Companies, should the need arise, to shed all other load before shedding their Kentucky native load) was irreconcilable with the requirements of FERC Order No. 888 and the MISO OATT, which appeared to require the Companies to shed load pro rata, without preference for native load customers.<sup>132</sup> Because the Companies believed that, should the need to shed load arise, the Companies could not follow both sets of legal requirements, they argued that the federal law preempted KRS 278.214.<sup>133</sup>

Although the court ultimately held that, on MISO's reading of the federal requirements, the state

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<sup>130</sup> In the Matter of: Application of the Union Light, Heat and Power Company to Adjust Electric Rates, Case No. 91-370, Order, (May 26 1992) at 4.

<sup>131</sup> MISO Brief at 36-37. The litigation culminated in a reported decision, *Kentucky Power Co. v. Huelsmann*, 352 F.Supp.2d 777 (E.D.Ky. 2005).

<sup>132</sup> *Kentucky Power Co.* at 783-84.

<sup>133</sup> *Kentucky Power Co.* at 783-84.



and federal law was not in irreconcilable conflict, it clearly acknowledged that the Companies' reading of the two sets of requirements was plausible and their concerns well-founded when it stated: "[t]hese two laws are seemingly irreconcilable."<sup>134</sup> The Companies' seeking to determine what the precise legal requirements are that will have to govern their conduct in the event load shedding becomes necessary can hardly be construed as challenging the Commission's jurisdiction; it was simply a proactive exercise in preventing the Companies from running afoul of the law by determining what the law is.

It is the Companies' second argument that MISO claims shows that the Companies "simply do not believe" that "Kentucky customers [should have] preferred rights of access, over out-of-state consumers, to the low cost generation in Kentucky."<sup>135</sup> MISO's claim misconstrues what the Companies actually argued, which is that all of the Companies' native load customers – all of whom the Companies have a duty to serve – should have the same preferred status as being the last load shed should the need arise, regardless of whether those customers reside in Kentucky, Virginia or Tennessee.<sup>136</sup> The court agreed with the Companies.<sup>137</sup> Nothing about the Companies' position in that case is inconsistent with the Companies' testimony that the MISO Day 2 markets require the Companies to offer their low-cost generation to the entire MISO footprint rather than give the Companies' native load customers – the vast bulk of whom reside in Kentucky – preferred access to those low-cost resources as the Companies did in Day

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<sup>134</sup> *Kentucky Power Co.* at 784.

<sup>135</sup> MISO Brief at 37.

<sup>136</sup> *Kentucky Power Co.* at 784-86.

<sup>137</sup> *Kentucky Power Co.* at 786.

<sup>138</sup> *See, e.g.*, Pre-filed Testimony of Michael S. Beer (Sept. 29, 2004) at 8-9. The Commission is well aware that the Companies have native load obligations in Virginia and Tennessee, and that under the Companies' pre-MISO joint dispatch, the benefits of joint dispatch flowed proportionally to all of their native load customers, including those outside Kentucky.

**VII. Granting the Companies' Requested Relief and Participating in their Proceeding Before FERC Will Assure That an Alternative to MISO Membership That is Acceptable to the Commission Will Result**

Rather than make substantive arguments for the Companies' continued MISO membership, MISO spends the last part of its brief attempting to convince the Commission that: (1) there are insuperable federal regulatory obstacles to the Companies' exit from MISO;<sup>139</sup> (2) the Companies have not presented the Commission with a viable alternative to MISO;<sup>140</sup> and (3) because no other RTO membership is preferable to MISO membership, the Companies should remain MISO members.<sup>141</sup> These assertions are easily rebutted: (1) as the Companies noted in their recent brief, there is a new chairman of FERC, which chairman has expressed a greater willingness to consider alternatives to ISOs/RTOs;<sup>142</sup> (2) the Companies have indeed presented a viable alternative to MISO participation in terms of economic viability and assurance of continued reliability, which is TORC; and (3) simply because MISO may be the economically preferable RTO should the Companies be required to remain in an RTO does not mean that it is the preferable option, period – as the Companies have demonstrated, TORC is economically preferable to any RTO membership the Companies have studied in this proceeding.<sup>143</sup>

MISO's point concerning possible revocation of the Companies' market-based rates deserves further consideration, however, only because MISO seriously misconstrues both the Companies' testimony and the FERC order it cites concerning Duke Energy.<sup>144</sup> First, MISO's mischaracterization of Mr. Beer's testimony as stating that "there is no risk that FERC would rescind [the Companies'] market-based rate certification" is so severe as to approach being an

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<sup>139</sup> MISO Brief at 31-34, 37.

<sup>140</sup> MISO Brief at 37-38.

<sup>141</sup> MISO Brief at 38-40.

<sup>142</sup> Companies' Brief (Sept. 7, 2005) at 30-31.

<sup>143</sup> Pre-filed Testimony of Mathew J. Morey (Sept. 29, 2004). The Companies' cost benefit analysis identified SPP RTO membership as more cost effective than remaining in MISO, though considerably less cost effective than TORC.

<sup>144</sup> See MISO Brief at 33-34.

outright lie.<sup>145</sup> The Companies, and Mr. Beer specifically, have acknowledged throughout this proceeding that FERC might seek to revoke the Companies' market-based rate authority as a condition of exit from MISO.<sup>146</sup> The specific testimony to which MISO's brief cites and of which it paints an utterly false picture reads:

Q. . . . Has FERC provided any indication that it intends to revoke the Companies' market-based rate authority?

A. No. Although FERC has stated that it may revoke the market-based rate authorities of entities that do not join RTOs, there are many utilities (e.g., Duke and Southern Company) that are not members of RTOs but nonetheless retain their market-based rate authority.<sup>147</sup>

On any fair reading, Mr. Beer's testimony does not state that "there is no risk" concerning the Companies' market-based rate authority; it clearly states that FERC has provided no indication of an intent to revoke such authority while acknowledging that "FERC has stated that it may revoke the market-based rate authorities of entities that do not join RTOs."<sup>148</sup> Moreover, Mr. Beer had an extended discussion under cross-examination during the recent hearing in this proceeding during which he made it clear that it was possible that FERC might make a revocation of the Companies' market-based rate authority in its control area a condition of exiting MISO, and discussed how the Companies might react to such a condition.<sup>149</sup>

Second, MISO misconstrues one of the "relevant events [that has] transpired" since Mr. Beer filed the above-quoted testimony in April 2005, namely what MISO claims was FERC's revocation of Duke Energy's market-based rate authority.<sup>150</sup> In fact, FERC revoked Duke's

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<sup>145</sup> MISO Brief at 33.

<sup>146</sup> *See, e.g.*, Pre-filed Testimony of Michael S. Beer (Sept. 22, 2003) at 6-7.

<sup>147</sup> Pre-filed Testimony of Michael S. Beer (Apr. 1, 2005) at 7 ll. 9-14.

<sup>148</sup> Pre-filed Testimony of Michael S. Beer (Apr. 1, 2005) at 7 ll. 9-14.

<sup>149</sup> II T.E. 71-76 (July 21, 2005).

<sup>150</sup> MISO Brief at 33.

market-based rate authority *in its own control area only*.<sup>151</sup> This revocation will have no impact on Duke's ability to make off-system sales at market-based rates.<sup>152</sup> In fact, two of North Carolina's municipal power agencies that recently moved for intervention in the Duke proceeding at FERC have argued that Duke's inability to sell at market-based rates in the Duke control area has resulted in Duke channeling all of its wholesale power sales outside of the Duke control area (where Duke retains the ability to sell at market-based rates), stating, "[I]ronically, the very same remedy that the Commission selected to protect customers from unjust and unreasonable rates actually threatens to produce exactly that harm."<sup>153</sup>

The Commission should not be deceived: all of these arguments amount to MISO's saying, "Don't even consider the possibility of the Companies exiting MISO because FERC will not let them out." In other words, MISO is attempting to convince the Commission to abandon its statutory duty to protect the public interest under KRS 278.218 because there is a chance that FERC will not allow the Companies to exit MISO. The Commission should decline MISO's invitation and protect the public interest.

### **VIII. Conclusion**

None of the already-refuted arguments and claims that MISO presents in its brief change the fact that the Companies have presented the Commission with credible evidence that at least one viable alternative to MISO membership exists – TORC – that is economically preferable to MISO membership and will ensure that the Companies' excellent reliability record remains excellent. The Companies do not deny that FERC could attach conditions to their MISO exit

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<sup>151</sup> *Duke Power* ¶ 61,506 (2005) at ¶4.

<sup>152</sup> *Duke Power* ¶ 61,506 (2005) at ¶4; *Duke Power Company* (FERC Docket Nos. ER96-110-016, EL05-4-000, ER05-1272-000), Motion to Intervene and Protest by North Carolina Municipal Power Agency Number 1 and Piedmont Municipal Power Agency (Aug. 29, 2005) at 5.

<sup>153</sup> *Duke Power Company* (FERC Docket Nos. ER96-110-016, EL05-4-000, ER05-1272-000), Motion to Intervene and Protest by North Carolina Municipal Power Agency Number 1 and Piedmont Municipal Power Agency (Aug. 29, 2005) at 5.

that would render any such exit detrimental to the public interest,<sup>154</sup> but the mere existence of this possibility ought not be sufficient to cause the Commission to deny the Companies' requested relief and thereby foreclose any opportunity to further the public interest.

Again, the Companies respectfully request that the Commission grant them only the following relief in this proceeding:

Entry of an order by November 1, 2005 that:

(1) finds that (a) the costs of MISO's Day 2 markets exceed the benefits they provide (if any) and (b) the Companies' continued MISO membership is not in the public interest because the Companies can likely obtain comparable reliability coordination and other services from another provider or other providers at lower cost and risk levels;

(2) requires the Companies to continue pursuing FERC authority to exit MISO, and to formulate an alternative to MISO membership that is acceptable to FERC, and ultimately to this Commission;

(3) authorizes the Companies to establish a regulatory asset for the amount of the exit fee which must be paid to MISO pursuant to Section 5 of the MISO Transmission Owners Agreement ("TO Agreement"); and

(4) closes this investigation.

As the Companies noted in their recent brief,<sup>155</sup> in this request for relief the Companies are not asking the Commission to approve the transfer of the operational control of their transmission assets back to them, or to any other entity. Instead, the Companies are asking this Commission to determine that such a transfer would be in the public interest and to assist the FERC in

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<sup>154</sup> See, e.g., Pre-filed Testimony of Michael S. Beer (Sept. 22, 2003) at 6-7.

<sup>155</sup> Companies' Brief (Sept. 7, 2005) at 4.

determining an approach that would be acceptable to both commissions. The Companies will then return to this Commission for approval under KRS 278.218 for the requisite authority to implement the proposed alternative operating arrangement.

Dated: September 13, 2005

Respectfully submitted,



Kendrick R. Riggs  
W. Duncan Crosby III  
OGDEN NEWELL & WELCH PLLC  
1700 PNC Plaza  
500 West Jefferson Street  
Louisville, Kentucky 40202  
Telephone: (502) 582-1601

Elizabeth L. Cocanougher  
Senior Corporate Counsel  
LG&E Energy LLC  
220 West Main Street  
Post Office Box 32010  
Louisville, Kentucky 40232  
Telephone: (502) 627-4850

Counsel for Louisville Gas and Electric  
Company and Kentucky Utilities Company

**CERTIFICATE OF SERVICE**

I hereby certify that a true copy of the foregoing Joint Post-Hearing Reply Brief was submitted by facsimile transmission to the Office of the Executive Director of the Kentucky Public Service Commission, the original and ten copies of the Joint Post-Hearing Reply Brief are being dispatched for next day delivery by an overnight courier service, and that a true copy of the foregoing brief was served via U.S. mail, first-class, postage prepaid, this 13th day of September 2005, upon the following persons:

Katherine K. Yunker  
Benjamin D. Allen  
Yunker & Associates  
Post Office Box 21784  
Lexington, Kentucky 40522-1784

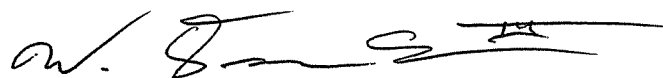
James C. Holsclaw  
Stephen G. Kozey  
Midwest ISO  
701 City Center Drive  
Carmel, Indiana 46032

Elizabeth E. Blackford  
Assistant Attorney General  
Office of the Attorney General  
Utility & Rate Intervention Office  
1024 Capital Center Drive, Suite 200  
Frankfort, Kentucky 40601-8204

David F. Boehm  
Michael L. Kurtz  
Boehm, Kurtz & Lowry  
36 East Seventh Street, Suite 1510  
Cincinnati, Ohio 45202

Stephen L. Teichler  
1667 K Street, N.W., Suite 700  
Washington, DC 20006-1608

Richard G. Raff  
Staff Counsel  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, Kentucky 40601



Counsel for Louisville Gas and Electric  
Company and Kentucky Utilities Company