COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the matter of:

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

**Reply of the Attorney General to the Response of Louisville Gas and Electric Company and Kentucky Utilities Company to the Attorney General's Motion to Dismiss the Companies' request for MISO expense trackers.**

In their reply brief, LG&E and KU (the companies) have chronicled each of those gas cases in which the Commission has chosen to reject the AG's arguments concerning limits on its implied powers to engage in alternative rate making and single-issue rate making. Having exercised its implied power in those cases does not mean the Commission can or should do so here. First, no court has considered or addressed whether any of the chronicled Commission actions are valid exercises of implied power under KRS 278.030. Those actions create no precedent and should not be the basis on which to expand bad policy.[1] Furthermore, the chronicle ignores the overriding

[1] The Attorney General does not waive the contention the Commission is acting in excess of its statutory powers in engaging in single-issue ratemaking to increase rates between rate cases by addressing tariffs that affect the rates of all customers.

fact that the Companies have failed to demonstrate or prove that the MISO expenses and revenues will have a material financial impact on them, a central consideration in the determination of what constitutes a fair, just and reasonable rate. Therefore, there is no basis on which to allow the trackers.

**A. The Commission has correctly found that these single-issue tariffs do not comply with the requirements of 807 KAR 5:001. Further, these applications seek relief the Commission is not authorized to give.**

The Companies' response points that the Attorney General did not raise the issue of compliance with Section 10 of 807 KAR 5:001 in its previous challenges to the legality of single-issue ratemaking. While Section 10 did not appear to be relevant to performance based rate proposals within the context of gas supply clauses, it does serve to demonstrate even more strongly that a simple cost recovery single-issue rate case is illegal and beyond the authority of the Commission. Not only did the General Assembly enlarge on the type of test year that might be used by a utility to justify a general rate increase with the enactment of KRS 278.192 in the same legislative session in which it established both a single-issue cost recovery entitlement and process for environmental compliance costs in KRS 278.183 and an entitlement to and process for alternative rate making in KRS 278.516, it also left KRS 278.190 as the only express process by which the Commission could suspend rates to examine their reasonableness. It

linked the authorized period for a suspension of rates specifically to whether the application is based on an historic test year or a future test year, concepts only applicable in the context of a general rate increase. It also maintained the provision of KRS 278.190(2) that limits the ability of the Commission to allow rates to go into effect during the five or six month suspension period only if the Commission finds that the credit or the operations of the utility seeking the increase would be damaged or impaired absent early implementation of the requested rate.

This is a serious standard. It begs credulity to maintain that the General Assembly intended to impose differing standards of proof a utility must meet to get a requested increase based on what the utility calls its application. Under the approach espoused by the Companies, if the utility calls an application that is designed to increase revenues received for service provided an application for a general rate increase it must prove it is in financial crisis to get the increase implemented before the expiration of the suspension period,[2] but if it calls its application for an increase in revenues an adder or tracker tariff that operates in addition to previously set general base rates, it need not even show that the cost it

[2] Under KRS 278.190; 278.192 and 807 KAR Section 10 it must also demonstrate, as was pointed out in the Order entered in these cases, that the cost for which recovery is sought in an application for a general rate increase, has a material affect on the overall financial condition of the utility before the rate increase may be granted in due course, after the suspension period has expired.

is seeking to recover has a material impact on its overall financial condition in order to get the rate increase.

While the Companies might maintain that they are not seeking to implement these rates before the suspension period expires and that, therefore, it is not necessary to examine the requirements of KRS 278.190(2), that argument would miss the point. The point is that the utilities cannot and should not be able to change the standard of proof they must meet to get an increase in the amount they receive based simply on what they call their application for that increase. When the utility seeks to increase the overall amount paid by a consumer for electricity, the increased rates can go into effect early only when the utility is in a financial crisis[3] if the rate increase is sought by way of an application for a general rate increase and can go into effect at the end of the suspension period only if its material effect on the overall finances of the utility is such that is casues the new higher rate requested to be found reasonable.

Why would a utility that can seek as many single-issue cost recovery adder or tracker tariffs between general rate cases as it wants ever face the sort of financial crisis envisioned by KRS 278.190(2)? If it is not necessary to prove overall financial need for a single-issue tracker or adder tariff where it is necessary to prove overall financial need for a general increase in rates, why would

[3] The statutory definition requires a finding that the company's credit or operations will be materially impaired or damaged. KRS 278.190(2).

any utility ever seek an increase in their revenues by way of a general rate case?

When taken to its logical conclusion, the utilities assertion is that the general rate case process imposes greater burdens of proof on utilities than does the process for single-issue trackers or adders. If that is true, why would the General Assembly only enact an express comprehensive statutory scheme to deal with applications for a general increase in rates - a scheme that would not be used because it would be harder for the utility to get the desired rate increase by this process than it would be under single-issue ratemaking? Why too would the General Assembly remain entirely silent about what would surely be the preferred means of increasing revenues, the single-issue cost recovery tariff? Why would the General Assembly leave the entire process of single-issue rate recovery to occur without statutory guidelines when it did specify the entitlement to and the process for recovery of environmental costs, for alternative rates, and for purchased water adjustments and a few other designated costs?

It begs credulity to maintain that the General Assembly enacted a complete express statutory scheme dealing with an application for a general adjustment in rates, but that it gave the Commission equally broad power, an implied power, that allows a company to utilize a different and lesser standard of proof with reference to single-issue rate requests. It begs credulity to maintain that the General

Assembly left that power to be exercised with no statutory scheme to guide the process, particularly when it also designated the process and burdens of proof for the environmental surcharge and alternative ratemaking for small telephones, the two areas of single-issue and alternative rate making the General Assembly has addressed.

Simply put, the General Assembly has not done so and the Commission should continue to disallow these single-issue cost tariffs because they are illegal. Furthermore, as the Commission found in its December 2004 Order, even if the Commission assumes that is does have the implied power to permit single-issue tariffs it should not do so in the absence of proof by the utility that this single increased expense has created an overall financial need for an increase in rates. To find otherwise would constitute a departure from the General Assembly's requirement for a demonstration of financial need as set out in KRS 278.190 and KRS 278.192, and as required by 807 KAR 5:001 Section 10.

**B. These single-issue cost tariffs differ from the Union Light Rider AMRP, the gas supply clause PBRs and the Delta alternative rate filing. They are not fuel adjustment clause cases or gas supply clause cases.**

Obviously, these tariffs differ from the gas supply clause PBRs as the utilities do not propose them as performance based rates. Actions taken by the Commission with reference to performance based rates are not a precedent for relief sought under a cost tariff.

Likewise, they differ from the Delta Natural Gas filing in Case No. 99-046 as they are not proposed here as alternative rate making. Instead they are posited simply as single-issue cost recovery. Two things are worthy of note with reference to the Delta filing cited by the companies. One, Delta's proposal was not adopted. Two, in its order of December 2004 in the case now at issue, the Commission has found these are applications for a general adjustment of existing rates and has discussed its reasoning for that finding at length. Nothing that was done in Delta demonstrates any error in the Commission's reasoning in this case.

Assuming arguendo that the Union Light Heat and Power Company single-issue cost recovery tariff is a legal exercise of the Commission's implied authority, it still constitutes no precedent for the relief sought here. First, the Rider AMRP was proposed in the context of a rate case with allegations and proof sufficient to convince the Commission that the cost to be recovered by the tariff would have a severe and material impact on the Company's ability to have an opportunity to earn a fair return, a fact neither alleged nor proven here. Second, in each filing to increase the amount recovered under the Rider AMRP, the company has filed an application that to some extent complies with the requirements of 807 KAR 5:001 Section 10 and has sought deviations from full compliance filing. In each of its AMRP orders, the Commission has commented on the material impact

of the expense on the Company. No compliance with Section 10 of 807 KAR 5:001 has been offered by the Companies here. The Commission would have no basis on which to make like findings.

The Companies also urge the Commission to grant relief here because they do grant relief in fuel adjustment clauses and gas supply clause cases. Obviously, these are not gas supply or fuel adjustment clause cases. Assuming arguendo that fuel adjustment clause and gas supply clause relief is a legal exercise of an implied power, it remains distinguishable from the relief sought here because those types of cases gained acceptance on a nationwide basis due to the historically demonstrated material impact the wildly volatile fuel and gas costs were having on the overall financial wellbeing of the utilities. See, Southern California Edison Company v. Public Utilities Commission, 144 Cal. Rptr. 905, 576 P.2d. 945 at 954 (1978) (the commission employs adjustment clauses when it encounters an item of expense or revenue which tends to vary abnormally in comparison to he utility's other financial data); Re Mountain States Telephone and Telegraph Company, 100 PUR4th 20 at 50 (Colorado Public Utilities Commission, February 10, 1989)(the cost adjustment concept had its origin as early as 1923...The overall justification for adjustment clauses was to effect timely rate changes in response to rapidly increased costs beyond the control of gas utilities.)

**C. The Commission should refuse to grant the requested relief here as it refused to grant Union Light's request for an increase in purchased power costs in Case No. 91-370.**

While this case is neither a gas supply case[4], a fuel adjustment clause case, an alternative rate case,[5] nor a case that established a tariff within a rate case,[6] the Companies try to bring it within the ambit of any or all of the Commission's forays into single-issue rate making. Instead, this is a case where the cost recovery sought is more akin to the cost recovery denied in Union Light Heat and Power's Case No. 91-370.

In Case No. 91-370, Union Light sought a general rate increase primarily driven by the anticipated approval by FERC of an increase in Union's purchased power cost.[7] The new purchase power agreement between Union and CG&E had not gone into effect when the rate case was filed, but was expected to go into effect before the suspension period for the consideration of the case was ended. First, Union sought to be allowed to increase its rates to accommodate the anticipated increase when it occurred under KRS 278.190(2). This was not allowed as Union was unable to show when the

[4] All of the performance based rate cases chronicled by the Companies have been raised in the context of gas supply clauses.
[5] Regardless of what Delta's alternative rate proposal in Case No. 99-046 actually was, it styled itself an alternative rate making proposal. Here, the request is simply for cost recovery of an expense outside of a general rate case and makes no pretense of being alternative rate making.
[6] Union Light Heat and Power sought and received approval for the AMRP Rider in general rate case number 2002-00092.
[7] Union bought all of its power from its parent CG&E.

FERC approved rate would go into effect or what the rate would be when it did so.[8]

Then, Union filed a petition to be allowed to record on its books as a deferred debit the increase in purchased power expense allowed by the FERC during the suspension period for the Kentucky rate case.[9] The Commission treated this request for relief as related to its earlier denial of the request to allow interim rate relief and as a request for that relief under KRS 278.190(2).

The requested relief was denied by Order dated April 17, 1992, because ULH&P failed to meet its statutory burden to show entitlement. In so holding, the Commission noted, at page 8, that the proposal to create the accounting deferral tended to demonstrate that incurring and paying the monthly increases in the purchased power expenses did not have an adverse impact on the short term cash flow of the utility. The same situation is present here. In seeking permission in the alternative to create a deferral, the Companies are demonstrating that the expense is not having a material financial impact on their cash flow.

Finally, after Union's case was duly heard and an Order granting prospective rate relief was granted, Union sought reconsideration to allow it to recover the three months of expenses it had borne when the newly approved FERC rate did become effective during the suspension period for the

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[8] *In the Matter of: Application of the Union Light, Heat and Power Company to Adjust Electric Rates*, Case No. 91-370, Order of December 17, 1991.

[9] Id., Order dated February 13, 1992.

Kentucky case. Again, the Commission denied the requested relief, this time for reasons related to notice and retroactive ratemaking. Significantly however, the Commission reiterated that the simple fact that an increase in expenses is related to a FERC approved cost does not mean that added retail rate recovery is appropriate saying:

> Despite our inability to investigate the reasonableness of CG&E's FERC-filed rate, we can exercise our discretion under KRS 278.190(2) to suspend ULH&P's proposed rates and conduct an investigation of ULH&P's overall financial condition to determine if other expenses have decreased or economies have been achieved. See Narrangansett Electric Company v. Burke, 119 R.I. 559, 381 A.2d 1358 (1977) cert denied, 435 U.S. 972 (1978). In such a situation, the increased FERC-filed rate may properly be off-set with other changes in revenues or expense, potentially resulting in no increase to retail customers.[10]

Absent any proof concerning the financial impact of the FERC-approved MISO expenses, there is no basis on which to either allow a single-issue increase in rates to recover those expenses or an accounting deferral to permit later rate recovery in the next general rate case.

**D. The MISO expenses are not appropriate for deferral.**

In their response, the Companies proposed that accounting deferrals be created for expenses and revenues generated by the FERC-approved MISO tariff to be considered in the next rate case. As stated above, absent any indication that a rate increase (or decrease) would be rendered appropriate because of the material financial

[10] Id., Order of May 26, 1992, p. 4.

impact these expenses might have on the overall finances of the utility, there is no reason to grant what is tantamount to interim rate relief for those expenses. While deferrals may be appropriate under FASB 71 for expenses having a material impact on the utility,[11] no such impact has been demonstrated here. The request for deferrals should be denied.

**Conclusion**

For the foregoing reasons, the Companies Applications for MISO-related rate recovery should be dismissed.

Respectfully submitted

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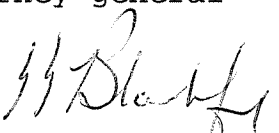

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[11] See, In the Matter of: Application of Kentucky-American Water Company to Increase it Rates, Case No. 2000-120, pp. 22-24 where the Commission discussed and disapproved Kentucky American's practice with reference to immaterial deferred expenses.

NOTICE OF FILING AND CERTIFICATION OF SERVICE

I hereby give notice that I have filed the original and ten true copies of the foregoing with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 this the 7th day of February, 2005, and certify that this same day I have served the parties by mailing a true copy, postage prepaid, to the following:

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