COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR APPROVAL OF NEW TARIFFS CONTAINING A MECHANISM FOR THE PASS-THROUGH OF MISO-RELATED REVENUES AND COSTS NOT ALREADY INCLUDE IN EXISTING BASE RATES	))))))	**CASE NO: 2004-0059**
THE APPLICATION OF KENTUCKY UTILITIES COMPANY FOR APPROVALOF NEW TARIFFS CONTAINING A MECHANISM FOR THE PASS-THROUGH OF MISO-RELATED REVENUES AND COSTS NOT ALREADY INCLUDE IN EXISTING BASE RATES	))))))	**CASE NO: 2004-00460**

BRIEF OF

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

I. INTRODUCTION

On December 1, 2004 Louisville Gas & Electric Company and Kentucky Utilities Company (collectively "the Companies" or "LG&E/KU") filed their Applications in the above-captioned matter requesting that the Kentucky Public Service Commission ("the Commission") approve tariffs containing new rate mechanisms to pass through revenues and expenses associated with the Midwest ISO's ("MISO") implementation of an energy market tariff. The

Office of the Attorney General ("AG") and Kentucky Industrial Utility Customers, Inc. ("KIUC") expressed concerns that the Companies' Application violates the prohibition against single-issue ratemaking, as well as the requirements for changing rates set out in 807 KAR 5:001, Section 10. After discussions with the Companies, the parties entered into a Stipulation agreeing to a schedule to brief the issues. On December 22, 2004 the Commission approved the Stipulation and ordered that intervenors file briefs on the above-mentioned issues and also to specifically address the additional issue of whether it is appropriate to consolidate the Company's MISO tracker request with Case Nos. 2003-00433 and 2003-00434, which are still pending before the Commission due to an investigation on allegations of collusion initiated by the AG. Pursuant to the Stipulation and the Commission's Order KIUC submits this brief.

II. THE COMPANIES' FILING IS AN ATTEMPT TO INCREASE RATES WITHOUT ENDURING A RATE CASE

a. The Companies' Proposal Violates The Statutory Framework For Ratemaking As An Attempt To Engage In Single-Issue Ratemaking.

The Companies' Application violates KRS 278.192, 807 KAR 5:001(10) and other related Sections setting out the procedure for changing electric rates. KRS 278.192 specifies the test year parameters and the establishment of rates on an all-in cost of service basis. That Section states in part:

> *"(1) For the purpose of justifying the reasonableness of a proposed general increase in rates, the commission shall allow a utility to utilize either an historical test period of twelve (12) consecutive calendar months, or a forward-looking test period corresponding to the first twelve (12) consecutive calendar months the proposed increase would be in effect after the maximum suspension provided in KRS 278.190(2)."*

Per KRS 278.192, the Companies are required to provide an accounting of all revenues and costs based on a test year in order for the Commission to determine whether a rate adjustment is appropriate given the totality of the Companies' financial circumstances. The Companies' Application violates this Section by failing to provide such an accounting and by basing their rate increase requests on a single expense.

The Companies' Application also violates 807 KAR 5:001(10). That Section mandates the requirements for changing rates and states that all applications requesting a rate adjustment be supported by:

> *"(a) A twelve (12) month historical test period which may include adjustments for known and measurable changes; or*
>
> *(b) A fully forecasted test period..."*

As mentioned above, the Companies' ignored the requirements contained in the KRS and KAR that their requests for a rates increase be supported by a twelve month test period and instead requested a rate increase based on a single cost item.

The Companies' Application completely ignores the statutory requirements for adjusting electric rates. The proposal is an attempt to rewrite the framework for ratemaking by converting it to real-time ratemaking for selected cost components. There is no justification for creating an alternative form of regulation whereby the Companies cherry-pick which components to include in their filing and which components to exclude. If the Companies wish to seek an increase in rates they should make a complete base rate filing and make any such filing on an all-in cost of service basis. The Commission should not allow this attempt to circumvent the ratepayer protections reflected in the statutes.

b. The Companies' Applications Are Counter To Clear Commission Policy Prohibiting Single-Issue Ratemaking.

In addition to running afoul of the statutory procedure for setting rates the Applications stand in contrast to clear Commission policy. The Commission has long held that it is improper to make changes to components of the revenue requirement in isolation, absent a unanimous settlement or a specific statute or regulation allowing a surcharge or tracker for certain costs. In Case No. 94-453 the Commission observed such strict adherence to the prohibition against single-issue ratemaking that it declined to establish a refund mechanism that would require Big Rivers Electric Cooperative ("BREC" or "Big Rivers") to refund damage awards it received from judicial proceedings involving fraud in its fuel contracts. That case was initiated by the Commission in an attempt to partially compensate BREC's customers for the detrimental affects of various acts of fraud committed in the process of procuring fuel for Big Rivers. The Commission directed BREC to refund certain fuel costs recovered by Big Rivers to its customers through the fuel adjustment clause ("FAC") in the aftermath of litigation involving its fuel procurement practices.[1] Despite the Commission's clear intention to pass what monies it could through to BREC's customers given the improprieties of Big Rivers and its fuel suppliers, the Commission carefully excluded items that did not meet the statutory criteria of "fuel cost" from being run though the FAC.[2] Because the damage awards could not be permissibly included in the FAC and passing these awards onto customers outside the context of the statutorily prescribed tracker such as the FAC or a base rate case violates the prohibition against single-issue ratemaking, BREC's customers could not directly recover these monies.[3] In refusing to

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[1] Re Big Rivers Electric Corporation, Kentucky Public Service Commission Case No. 94-453, 1997 WL 152646 (Ky.P.S.C.) (1997) at 1.
[2] Id. at 3.
[3] Id.

take a results-oriented approach to applying the law, the Commission noted the importance of a strict application of the rule against single-issue ratemaking:

> "*Requiring BREC to implement its proposed refund mechanism is also counter to the rule against single-issue rate-making. Courts have generally held that regulatory commissions may not establish rates based on a single expense or revenue source.*[4]
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> ***
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> *The rule against single-issue ratemaking recognizes that the revenue formula is designed to determine the revenue requirement based on the aggregate costs and demand of the utility. Therefore, it would be improper to consider changes to components of the revenue requirement in isolation. Often times a change in one item of the revenue formula is offset by a corresponding change in another component of the formula.*[5]
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> ***
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> *A separate rate which requires the refund of litigation proceeds without examining BREC's other expenses and revenues may also have unintended policy consequences. A utility which incurs a significant expense in one area, but which is otherwise earning profits, may request a rate designed solely to recover the significant expense. If a utility can be ordered to refund particular revenues, it can also be authorized to collect a particular expense. While a refund of any litigation proceeds may be attractive in the short run, in the long run the precedent which it establishes may greatly disadvantage utility ratepayers.*"[6]

Given the Commission's history of rigorous observance to the letter of law concerning the proscription against single-issue ratemaking even when it results in failing to reimburse (outside of a rate case) customers for fraud on the part of a utility and its fuel suppliers, LG&E/KU's request to recover their MISO-related costs should be denied. The Companies' MISO costs are just one of numerous items that affect the Companies' earnings. It is inequitable and counter to Commission policy to allow the recovery of one item without reference to every other item.

[4] Id.
[5] Id.
[6] Id.

III. IT WOULD BE INEQUITABLE FOR THE COMPANIES' TO RECOVER MISO COSTS OUTSIDE OF A RATE CASE GIVEN THAT THEY UNILATERALLY ELECTED TO CANCEL THEIR EARNINGS SHARING MECHANISM

The Companies have unilaterally elected to discontinue their earnings sharing mechanism ("ESM") in favor of making rate adjustments through base rate filings. The Companies' apparently decided that they would be better served by getting 100% of their under-earnings through rate cases, rather then only a portion of their under-earnings on a real time, on-going basis through the ESM. If the ESM was not voided by the Companies, then the MISO costs that are the subject of this proceeding would have been partially recoverable immediately through the ESM. With this Application the Companies want to have their cake and eat it too. LG&E/KU should not be allowed to recover all of their test year under-earnings by voluntarily discontinuing the ESM in favor of rate cases, and then institute a MISO tracker to pick up their expenses after the conclusion of the case.

IV. IT IS INAPPROPRIATE TO CONSIDER THE COMPANIES' MISO COST RECOVERY REQUEST WITHIN THE CONTEXT OF CASE NOS. 2003-00433 AND 2003-00434.

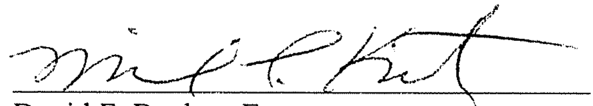
Case Nos. 2003-00433 and 2003-00434 considered revenues and expenses within the twelve month period ending September 30, 2003. The general rule regarding including revenues and expenses outside of the test year is that only known and measurable items incurred within a close proximity in time to the test period can be included. To open or reopen these cases would require new evidence, examinations and cross-examination concerning costs clearly outside the test period, whose nature, the Companies must concede are unknown, and indeed subject to

much dispute as between the Companies and MISO.[7] The dust around the Companies last rate case, stirred up by accusations by the AG and an attendant AG investigation has still not settled. To reopen the record of that case for additional hearings on additional and contested issues would serve no one well and KIUC therefore opposes that proposal.[8]

V. CONCLUSION

The Company's Application is an attempt to engage in unlawful single-issue ratemaking and circumvent Kentucky and Commission rules mandating that rate changes can only be made after a case considering all of the Companies' revenues and expenses. Further, the Companies' MISO expenses should not be included in the Companies last rate cases. If the Companies' wish to recover these expenses they should file a new base rate case.

Respectfully submitted,



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January 21, 2005

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[7] KPSC Case No. 2003-00266.

[8] It may seem to the Commission that the possibility of having the recovery of MISO costs heard in the context of the pending LG&E/KU rate case was raised first by KIUC in comments at a conference of the parties. This possibility was thrown out in a "brain storming" session. Upon careful reflection KIUC believes this is not a good idea for the reasons set forth above.