SINCE 1898
OGDEN NEWELL & WELCH PLLC
ATTORNEYS FOR BUSINESS

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

KENDRICK R. RIGGS

DIRECT DIAL 502-560-4222
DIRECT FAX 502-627-8722

kriggs@ogdenlaw.com

January 31, 2005

VIA HAND DELIVERY

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

RE: ***In the Matter of 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

In the Matter of 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

Dear Ms. O'Donnell:

Enclosed please find and accept for filing two originals and five copies each of Louisville Gas and Electric Company's and Kentucky Utilities Company's Response 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

322130.1

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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**

In the Matter of:

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**

RESPONSE BRIEF OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY

I. INTRODUCTION

On December 1, 2004, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively, the "Companies") filed Applications for approval of new rate tariffs containing a mechanism for the pass-through of costs and revenues related to their membership in the Midwest Independent Transmission System Operator, Inc. ("MISO") which were not already included in existing base rates. These applications were filed pursuant to KRS 278.180, 807 KAR 5:001, Section 8, and 807 KAR 5:011, Sections 6 and 9.

The Companies propose to implement a rate mechanism to reflect the net costs and revenues associated with retail native load and not already included in existing rates associated with their participation in MISO's Day-Ahead and Real-Time energy markets, pursuant to MISO's Energy Market Tariff ("EMT"). The use of tracking mechanisms for the recovery of

MISO costs and revenues has been approved in at least three other jurisdictions. *Re Duquesne Light Co.*, Pennsylvania P.U.C., Docket No. P-00032071, 235 PUR4th 193, 2004 WL 1898487 (Aug. 19, 2004); *Re The Cincinnati Gas & Electric Co.*, Ohio P.U.C., Case Nos. 03-93-EL-ATA, *et al.*, 2004 WL 2309074 (Sept. 29, 2004); and *Re PSI Energy, Inc.*, Indiana Utility Regulatory Commission, Cause No. 42359 (May 18, 2004).

Following an informal conference on December 17, 2004, the Companies filed Amended Applications and a Stipulation and Recommendation between the Companies and the intervenors, the Office of the Attorney General ("AG") and Kentucky Industrial Utility Customers, Inc. ("KIUC"). The Public Service Commission ("Commission") entered an Order on December 22, 2004, observing:

> . . . that the Commission may lack authority to consider the MISO cost surcharges requested by LG&E and KU absent compliance with all filing requirements under 807 KAR 5:001, Section 10.

(Order, p. 5). The Commission established a briefing schedule on the issue of "whether the pending applications satisfy the minimum filing requirements." (Order, p. 6).

This brief is submitted in accordance with the Commission's Order of December 22, 2004, and supports the Companies' position that their Applications meet the minimum filing requirements and the requirements of 807 KAR 5:001, Section 10, are not applicable.

II. THE PROPOSED MISO TRACKER WOULD BE A TARIFF CHANGE, NOT A BASE RATE CHANGE

The AG and the KIUC argue that the Companies' proposed MISO tracker filing is an attempt to have the Commission engage in single-issue ratemaking without the requisite statutory authority and without making the relatively more extensive filing required in a base rate case under KRS 278.192 and 807 KAR 5:001, Section 10. The AG and the KIUC, however, overlook the Commission's broad implied authority under KRS 278.030 and clear Commission precedent

allowing the Commission to consider just this kind of filing without resort to a full-blown rate case, including the Delta Natural Gas case and the procedures under which the Companies' Fuel Adjustment Clauses and Gas Purchase Agreement clauses are altered.

It is well established that administrative agencies in Kentucky, like the Commission, have broad implied authority from their express statutory powers. Kentucky CATV Association v. Volz, Ky.App., 675 S.W.2d 393, 397 (1983); National-Southwire Aluminum Co. v. Big Rivers Electric Corp., Ky.App., 785 S.W.2d 503 (1990); and South Central Bell Telephone Co. v. Public Service Commission, Ky.App., 702 S.W.2d 447, 453 (1985). In this case, the Commission's necessary and implied authority to approve the proposed rate mechanism in the filed tariffs stems from KRS 278.030. The Commission has exercised such authority repeatedly over the years to approve ratemaking clauses or trackers for the recovery of costs not already included in existing rates. The well established exercise of this authority is demonstrated through the longstanding and well-accepted operation of the fuel adjustment and gas supply clauses. Indeed, the Commission's implied authority is the basis for the Commission's enactment of the Uniform Fuel Adjustment Clause Regulation.[1]

There are significant similarities between the costs and revenues which are the subject of this proceeding and the costs which are the subjects of the fuel adjustment and gas supply clauses. The Financial Transmission Rights ("FTRs") available under the EMT are financial instruments whose value is determined based on Locational Marginal Pricing ("LMPs"). LMPs are set at both the source and sink locations of the market. FTRs and related congestion costs, therefore, are measured according to fluctuations of the market. LMP is, in effect, a market index. Thus, the FTRs and congestion costs are subject to market fluctuation and volatile

[1] 807 KAR 5:056

changes, and therefore are commodity-like in nature and comparable to changes in the price of coal and natural gas.

The Commission has recognized its ability to exercise this broad implied authority in several of its past orders. For example, in Delta Natural Gas, a case identical in all relevant respects to the case at hand, the Commission issued an Order that rejected the very same arguments that the AG and KIUC make in this case.[2] In the Delta Natural Gas case, Delta had filed a tariff containing a rate mechanism that Delta described as a "formula or plan for the automatic increase or decrease of Delta's rates and charges upon the occurrence of certain events."[3] More specifically, Delta filed new tariff sheets with the Commission containing a rate mechanism that proposed to add "three billing components to each customer's monthly bill, but would not change Delta's base rates."[4] The AG moved to dismiss Delta's filing on the ground that Delta was in substance proposing a "general adjustment of rates," thus requiring Delta to make a formal base rate adjustment application with all the financial data required for such a filing under the provisions of KRS 278.190, KRS 278.192, 807 KAR 5:001 and 807 KAR 5:011.[5] The Commission rejected the AG's argument, stating:

> Based upon its review of the proposed Alternative Regulation Plan and the pertinent provisions of KRS Chapter 278, the Commission finds that Delta's application is not a request for general rate adjustment, but a request for the establishment of a new rate. While Delta's proposal will create a mechanism that may result in additional charges assessed to Delta's customers and thus is a "rate,"[6] it will not alter the utility's existing general service rates. Administrative Regulation 807 KAR 5:001, Section 10, requires a utility to file an application only for a general rate adjustment in existing rates. It does not require an application for the assessment of a new charge or rate. Administrative Regulation 807 KAR 5:011, Sections 6 and 9, expressly permit a utility to amend its tariff by

---

[2] *In the Matter of Delta Natural Gas Co., Inc., Experimental Alternative Regulation Plan*, Case No. 99-046, Order (5/10/1999).
[3] Id. at 2.
[4] Id. at 1.
[5] Id.
[6] See KRS 278.010(12).

> filing revised rate schedules when such amendments do not involve a general adjustment of existing rates. Neither KRS 278.180 nor KRS 278.190 expressly requires the filing of a rate application. Previous applications for alternative regulation plans[7] were not required to meet the requirements of Administrative Regulation 807 KAR 5:001, Section 10.[8]

The General Assembly has not amended or otherwise modified any of the statutes the AG and KIUC cite in this case[9] since the Commission issued its Order in the Delta Natural Gas case on May 10, 1999, nor have there been any changes to the administrative regulations they cite.[10] Just as did Delta in Delta Natural Gas, the Companies are proposing a new billing component to each customer's monthly bill, but not one that changes the Companies' base rates. Thus, the Commission's reasoning is just as persuasive and controlling in this case as it was in Delta Natural Gas; the Commission should deny the AG's and KIUC's requests to dismiss the Companies' MISO tracker filings.

Prior to Delta Natural Gas, the Commission had exercised in at least three different cases the authority that the AG and KIUC now assert that the Commission does not have.[11] In those cases, one of which involved LG&E and all of which the Commission cited to support its authority in Delta Natural Gas, the Commission approved the gas companies' applications for

---

[7] See, e.g., Case No. 97-513, *Modification To Western Kentucky Gas Company, A Division of Atmos Energy Corporation (WKG) Gas Cost Adjustment To Incorporate An Experimental Performance-Based Ratemaking Mechanism (PBR)* (June 1, 1998); Case No. 97-171, *Modifications to Louisville Gas and Electric Company's Gas Supply Clause To Incorporate An Experimental Performance-Based Ratemaking Mechanism* (Sept. 30, 1997); Case No. 96-079, *The Tariff Filing Of Columbia Gas of Kentucky, Inc. To Implement Gas Cost Incentive Rate Mechanisms* (July 31, 1996). The AG participated in two of these proceedings and apparently did not object to the lack of any application meeting the requirements of Administrative Regulation 807 KAR 5:001, Section 10.

[8] Delta Natural Gas at 1-2 (emphasis and footnotes in the original).

[9] KRS 278.030; KRS 278.180; KRS 278.190; KRS 278.192; KRS 278.270.

[10] 807 KAR 5:001 Section 10; 807 KAR 5:011.

[11] See, e.g., Case No. 97-513, *Modification To Western Kentucky Gas Company, A Division of Atmos Energy Corporation (WKG) Gas Cost Adjustment To Incorporate An Experimental Performance-Based Ratemaking Mechanism (PBR)* (June 1, 1998); Case No. 97-171, *Modifications to Louisville Gas and Electric Company's Gas Supply Clause To Incorporate An Experimental Performance-Based Ratemaking Mechanism* (Sept. 30, 1997); Case No. 96-079, *The Tariff Filing Of Columbia Gas of Kentucky, Inc. To Implement Gas Cost Incentive Rate Mechanisms* (July 31, 1996). The AG participated in two of these proceedings and apparently did not object to the lack of any application meeting the requirements of Administrative Regulation 807 KAR 5:001, Section 10.

certain modifications to the companies' Gas Cost Adjustment clauses ("Gas Supply Clause" in the case of LG&E). After public hearings – but not base rate proceedings – the Commission ruled on the companies' rate mechanisms. The Commission has the same necessary and implied authority to hold hearings on the Companies' MISO tracker filings and rule thereon without any need for full rate case filings and schedules under 807 KAR 5:001, Section 10.

III. THERE IS AMPLE ADDITIONAL AUTHORITY TO SUPPORT THE COMMISSION'S IMPLIED AUTHORITY TO CONSIDER AND HOLD HEARINGS ON THE COMPANIES' MISO TRACKER FILINGS

The AG also argues that, in addition to the Commission' lack of express statutory authority to hear the Companies' MISO tracker case, the Commission lacks implied authority to do so as well. The AG states:

> KRS 278.192, which allows for the use of a future test year for the purposes of supporting a rate increase as well as an historic test year, was enacted by the General Assembly in 1992. That same year, the General Assembly enacted KRS 278.183, the environmental surcharge statute, which carved out certain environmental expenses for single-issue ratemaking. . . . The enactment of the two statutes in the same session indicates that the General Assembly meant that all changes to rates not specifically singled out for special single-issue treatment were to continue to be handled as had been done traditionally under the statutory scheme via a general rate case.[12]

There are two clear reasons why the AG's argument fails. First, as the AG notes, both KRS 278.192 and the environmental surcharge statute went into effect in 1992, well before Delta Natural Gas and the other three cases cited above in which the Commission determined that it did indeed have the authority to hear and approve utilities' tariff rate filings without the need for full compliance with the administrative regulations that govern base rate cases. Second, and more importantly, the Commission has already addressed the precise argument the AG makes above and found it to have no merit.

[12] AG's Brief at 2.

In the Union Light, Heat and Power case,[13] Union sought to have the Commission approve a tracker for the costs Union incurred to replace its aging cast iron and bare steel gas mains, which tracker was intended to prevent Union from having to return to the Commission frequently for new base rate cases as it incurred main replacement costs.[14] The AG objected to Union's proposed tracker primarily on two grounds: (1) Union did not include a future test-year filing with its tracker request and (2) the Commission lacked authority to rule on the tracker, which the AG characterized as "single-issue ratemaking," because the General Assembly would not have enacted KRS 278.183 (the environmental surcharge statute) had the Commission already possessed the authority to conduct single-issue ratemakings.[15] The Commission found no merit in either of the AG's objections, stating with respect to the AG's first objection that KRS 278.192 merely provided an applicant the option to tender an historical or forward-looking test period to demonstrate the reasonableness of the applicant's proposed rates.[16] With respect to the AG's second objection and assertion that the Commission must lack authority to conduct single-issue ratemakings in light of the environmental surcharge statute, the Commission noted that KRS 278.183 required the Commission to allow utilities current recovery of their costs of complying with the Federal Clean Air Act.[17] Therefore, rather than granting the Commission a new power to consider and pass upon "single-issue ratemakings" such as Union's tracker, the Commission held that the environmental surcharge statute actually served only to place a limit on the Commission's authority to deny such recovery. The Commission observed:

> It [the Commission] believes the General Assembly intended prior to 1992 and after 1992 for the Commission to have broad implied

---

[13] Case No. 2001-00092, *Adjustment of Gas Rates of the Union Light, Heat and Power Company*, Order (1/31/2002).
[14] Id. at 71-73.
[15] Id. at 74-75.
[16] Id. at 74-75.
[17] Id. at 75-76.

> and discretionary authority to establish fair, just and reasonable rates. . . . Contrary to what the AG suggests, this statute [KRS 278.183] was not enacted to grant the Commission authority it did not already have."[18]

In short, the Commission held in Union Light, Heat and Power that it continues to have broad implied authority to hear and act upon applications concerning tariff rate issues, such as the Companies' proposed MISO tracker. Therefore, the requirements of KRS 270.192 do not restrict the Commission's authority to consider and approve tracker filings separate and apart from base rate proceedings. KIUC's contention thus should be rejected.

The Commission's implied authority to accept, hear and act upon the Companies' MISO tracker filing is also supported by the existence of, and hearing procedures for, the Fuel Adjustment Clauses and the Gas Cost Adjustment/Gas Supply Clauses. Although there is an administrative regulation that governs Fuel Adjustment Clauses,[19] the only statutory authority under which the regulation was promulgated is KRS 278.030, which provides the Commission the general power to ensure that utilities' rates are fair, just and reasonable. There is no statute that specifically authorizes the Commission to promulgate regulations concerning, or hear and decide applications requesting, the creation or modification of Fuel Adjustment Clauses. With respect to Gas Cost Adjustment/Gas Supply Clauses, there is neither a statute nor an administrative regulation that provides the Commission any express authority to hear or decide applications concerning the establishment of, or modifications to, such Clauses. Because there is no dispute that the Commission may hear and decide Fuel Adjustment Clause and Gas Cost Adjustment Clauses or that such clauses are reasonable rate mechanisms, there is little reason to doubt that the Commission may hear and rule upon the Companies' MISO tracker filing.

---

[18] Id. at 75-76.
[19] 807 KAR 5:056.

IV. THE COMPANIES DID NOT UNILATERALLY TERMINATE THEIR EARNINGS SHARING MECHANISM, BUT ENDED IT THROUGH A UNANIMOUS SETTLEMENT TO WHICH THE AG AND KIUC WERE PARTIES

The KIUC asserts that "[t]he Companies have unilaterally elected to discontinue their earnings sharing mechanism ("ESM") in favor of making rate adjustments through base rate filings."[20] The KIUC goes on to argue that it would be inequitable for the Commission to allow the Companies "to have their cake and eat it, too," by ending the ESM while having the MISO tracker because, had the ESM remained in place, the Companies could have recovered a part of whatever MISO Day 2 expense they incur through the ESM.[21] Both of the KIUC's points are in error.

First, the KIUC misstates the facts concerning the termination of the ESM. The Commission approved ending the ESM in its June 30, 2004, rate case Orders because it found reasonable the unanimous settlement agreement that was negotiated and agreed by all parties to the rate cases, including the KIUC and the AG, and which included termination of the ESM.[22] Therefore, the KIUC's claim that the Companies "unilaterally" terminated the ESM is simply incorrect.

Second, there is nothing inequitable about the Companies' proposed rate mechanisms. As demonstrated in their Applications, the tracking mechanisms, if approved, will not recover costs or reflect revenues already included in existing rates. Because the costs and revenues associated with the Day-Ahead and Real-Time energy markets under MISO's EMT were not incurred by the Companies during the test period ending September 30, 2003, the additional net costs or revenues will necessarily affect the Companies' overall rate of return. Contrary to

---

[20] KIUC Brief at 6.
[21] Id.
[22] LG&E Rate Case Order at 5-7.

KIUC's assertion, approval of the tracking mechanisms will allow LG&E's and KU's current base electric rates to remain fair, just and reasonable.

The Companies' Fuel Adjustment and Gas Purchase Adjustment Clauses are well-known and long-standing examples of the kind of rate-making mechanisms that the KIUC now calls "inequitable." Because there is no principled difference between the Fuel Adjustment and Gas Purchase Adjustment Clauses and the proposed MISO tracker – all seek to have the customer share in the risks and rewards of volatile costs and revenue items – the Commission should find that the KIUC's equitable argument in this case deserves no weight.

V. THE MISO TRACKER CASES SHOULD NOT BE CONSOLIDATED WITH THE PENDING RATE CASES; DEFERRAL ACCOUNTING IS AN OPTION

A. These Cases Should Not Be Consolidated With The Companies' Current Rate Cases

The AG and KIUC rightly argue that the MISO tracker should NOT be incorporated into the currently reopened rate case proceedings in Case Nos. 2003-00433 and 2003-00434.[23] As the AG and KIUC point out, the test year the Companies utilized in the rate cases ended on September 30, 2003, well in advance of the beginning of MISO's Day 2 markets - now scheduled to be on April 1, 2005. For these reasons, the Companies agree with the AG and KIUC that it would be inappropriate to combine the Companies' MISO tracker filings with the rate case proceedings.

[23] KIUC Brief at 6-7; AG Brief at 3-4.

B. Establishing A Deferral Is An Alternative

In the alternative, the Companies request the Commission approve the deferral of their net costs and revenues not already included in existing rates as a regulatory asset/liability until their next base rate case filings.

VI. CONCLUSION

For these reasons, the Companies request the Commission issue an order determining that the requirements of 807 KAR 5:001, Section 10, are not applicable to their Applications and that the Commission's investigations of these tariff filings may proceed forthwith. In the alternative, the Companies request that the Commission approve the deferral of these new net costs and revenues not already included in existing rates as a regulatory asset/liability, the recovery of which would be provided for in the Companies' next base rate case.

Dated: January 31, 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 Attorney
Louisville Gas and Electric Company
220 West Main Street
Post Office Box 32010
Louisville, Kentucky 40232
Telephone: (502) 627-4850

Counsel for Louisville Gas and
Electric Company

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Response Brief was served on the following persons on the 31st day of January 2005, U.S. mail, postage prepaid:

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

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

Counsel for Louisville Gas and
Electric Company