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June 8, 2005

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PUBLIC SERVICE COMMISSION

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

RE: ***An Assessment of Kentucky's Electric Generation, Transmission and Distribution Needs***
Case No. 2005-00090

Dear Ms. O'Donnell

Enclosed please find and accept for filing Louisville Gas and Electric Company and Kentucky Utilities Company's Comments pursuant to the Commission's Order dated May 11, 2005 in the above mentioned docket.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

Kent W. Blake

Kent W. Blake

cc: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

RECEIVED
JUN 0 8 2005
PUBLIC SERVICE
COMMISSION

In the Matter of:

AN ASSESSMENT OF KENTUCKY'S ELECTRIC GENERATION, TRANSMISSION AND DISTRIBUTION NEEDS	))))	**ADM. CASE NO. 2005-00090**

COMMENTS OF
LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY

I. INTRODUCTION

On February 7, 2005, the Governor issued Executive Order 2005-121 directing the Kentucky Public Service Commission ("Commission"), in conjunction with the Commerce Cabinet and the Environmental and Public Protection Cabinet, to develop a Strategic Blueprint for the continued use and development of electric energy. In response to that directive, the Commission established this case by Order dated March 10, 2005. Pursuant to the Commission Order issued on May 11, 2005, in the captioned docket, Louisville Gas and Electric Company and Kentucky Utilities Company (collectively, "LG&E/KU" or "the Companies") file these comments. Specifically, the Commission requested that the Companies focus their comments in response to the following questions:

1. What additional information or data, if any, should the Commission consider in developing the Strategic Blueprint?

2. What are the top issues facing the electric power industry in Kentucky over the next 20 years?
3. What barriers exist, if any, to meeting future investment needs in electric power infrastructure in Kentucky?

The Companies appreciate the opportunity to present the following comments to the Commission for consideration in developing the Strategic Blueprint.

II. COMMENTS

A. <u>The Existing Regulatory Framework Has Historically Worked Well For Meeting The Needs Of All Stakeholders In The Electric Power Industry In The Commonwealth.</u>

The existing regulatory framework in Kentucky has served the Commonwealth well for many years. The balance of wise regulation and good utility practice has fostered a healthy electric utility environment. Electric rates for Kentucky consumers on the whole remain among the lowest in the country. The Companies have strong credit ratings, in part, because of the sound quality of regulation in Kentucky. The credit ratings, in turn, allow the Companies to achieve a lower cost of capital for customers. Customer satisfaction levels are high and the overall provision of safe and reliable electric service is intact. The Commission has successfully established, via its Orders, an appropriate balance between the interests of Kentucky customers and the utilities serving those customers. The establishment of just and reasonable electric base rates in periodic rate cases via the base rate case process has complemented the more timely cost recovery rate treatment allowed via the Environmental Cost Recovery and Fuel Adjustment Clause mechanisms. The Commission's balance between ratepayer and shareholder interests, through these ratemaking procedures, has historically addressed the economic development issues raised by the Governor in Executive Order 2005-121. However, as discussed below, the Commission should be encouraged to continue thinking forward into the 21^{st} Century and not rest on this historically solid regulatory framework.

B. <u>The Top Issues Facing The Electric Power Industry In Kentucky Are Infrastructure Development; Regulatory Certainty Needed For Infrastructure Investment; Jurisdictional Certainty; and The Dynamically Changing Industry</u>

1. Infrastructure Development

While the regulatory framework in Kentucky has worked well for many years, Kentucky must not become complacent. The landscape in the electric utility industry is changing, both nationally and in Kentucky. Load growth, aging facilities, environmental requirements, and energy policy-making present new challenges for the industry in the decades ahead. It is important for the Commonwealth to advance the current framework to address the top issues facing the electric power industry in Kentucky.

One top issue is the need for new generation and transmission facilities. Such facilities are ordinarily identified in the well-established Integrated Resource Planning ("IRP") process. These infrastructure enhancements may take many years to complete and will require significant financial investment. The Commonwealth must recognize that these new facilities are necessary for the continued provision of safe, reliable electric service in a manner that meets the needs of current and future electric consumers in Kentucky.

2. Regulatory Certainty

A potential barrier to meeting the future investment needs is the risk associated with the recovery of prudently-incurred costs. The balance of customer and service provider interests is better maintained if rate certainty for necessary infrastructure investments is increased.

As capital infrastructure and related costs to serve customers increase, they create downward pressure on a utility's earnings and its credit rating. If the only vehicle available for cost recovery is a base rate case, the utility incurring these costs is generally put in an "under-earning" position (not fully recovering its cost of operations) for a significant period of time. Assuming such a rate case results in the utility prospectively earning a fair, just and reasonable return, by definition, a utility will never fully recover its prudently incurred costs of providing service to its customers. This anachronism is often referred to as "regulatory lag." Regulatory lag should not be considered a cost of doing business in Kentucky for electric utilities.

With regard to necessary capital infrastructure investments discussed above, the Commonwealth can build upon the success of the existing regulatory framework by increasing the rate certainty associated with major investment in electric utility infrastructure. This could be accomplished by allowing utilities to fully recover their costs associated with investments pre-approved by the Commission under the existing Certificate of Public Convenience and Necessity ("CCN") process prescribed by KRS 278.020. Under the existing CCN process, utilities are required to demonstrate a need for the investment and that the proposed investment represents the least cost option for meeting that need. Once the utility meets this burden of proof, the Order issued granting the CCN merely allows the utility to proceed with construction at its own financial risk. Capital recovery is still at risk in future rate case proceedings.

It stands to reason that, after having met the requirements for obtaining a CCN, a utility and its creditors should be able to expect full recovery of its costs from the inception of construction activities. This would be coupled with Commission review of recovered costs to ensure that such costs were prudently incurred. Such a statutory modification would keep Kentucky in step with neighboring states -- including Indiana, West Virginia, Missouri, Wisconsin, and Kansas -- which are responding to the growing need for infrastructure investment by revising the regulatory cost-recovery framework. Such a statutory modification would be a significant step to removing risk to investment in Kentucky's electric infrastructure, while keeping rates as low as possible for Kentucky customers, building on the existing regulatory framework, and advancing the objectives of the Governor as outlined in his Executive Order.

3. Jurisdictional Certainty

The Commission currently enjoys regulatory oversight over all aspects of the provision of electric service to retail customers in the Commonwealth. However, there are Kentucky consumers who do not enjoy the benefits of this regulatory oversight, particularly the benefit of the low rates mentioned previously. Certain Kentucky consumers pay more than those end-use customers served by entities like LG&E/KU that are subject to the regulation of the Commission. This is a challenge to the economic development objectives of the Governor as outlined in his Executive Order.

Furthermore, certain aspects of the Commission's authority appear to be the victim of "jurisdictional creep" by other governmental agencies. The distinction between retail service subject to regulation by the Kentucky Public Service Commission and wholesale service subject to regulation by the Federal Energy Regulatory Commission ("FERC") blurs almost daily. Under the Federal Power Act, Congress has explicitly granted to the states authority over certain aspects of the electric utility industry. These include (but are not limited to) generation procurement and retail sales. Historically, generation dispatch and demand-side management have also been subject to state rather than federal authority. However, regional considerations, particularly via the advancement of Regional Transmission Organizations ("RTOs") and associated wholesale energy markets as well as currently pending federal legislation, have extended FERC's jurisdiction -- into these specific areas and others -- to an unprecedented extent. The Companies' specific concerns are a matter of record in the Commission's current investigation into their membership in a FERC-approved RTO.

Since LG&E/KU are currently members of a FERC-approved RTO, and since FERC retains authority over RTO business practices with which LG&E/KU must comport, the Companies are now subject to a form of regulation that is increasingly focused on regional issues rather than on those issues that primarily affect Kentucky stakeholders. This shift hinders the ability of this Commission to expressly and solely regulate aspects of the Companies' business with the interests of Kentucky stakeholders in mind.

The Commonwealth should take any and all necessary steps to ensure that "jurisdictional creep" does not in any way hinder the ability of the Kentucky Public Service Commission to regulate utilities in the Commonwealth in full accordance with Kentucky Revised Statutes Chapter 278 and consistent with the Federal Power Act. Encroachment of Commission authority over resource planning, retail transactions, demand response and generation dispatch will undoubtedly limit the ability of Kentucky electricity policy-makers to respond to the task of maintaining Kentucky's low-cost electricity advantage.

4. The Dynamically Changing Industry

The electric utility industry as it exists today looks very different than it did in decades past. From both regulatory and operational perspectives, the industry is in a state of unprecedented change. The emergence of competition in its many forms (including retail choice, independent power production, open transmission access, wholesale energy markets, and more), coupled with other contemporary energy policy-making initiatives, escalating environmental requirements, and technological advances, has introduced a wide array of complex issues never before contemplated in the electric utility industry. It is an exciting and challenging time for all electric utility stakeholders nationwide.

Kentucky is not immune from this dynamic, rapidly-evolving electric utility environment. In fact, it is more essential now than ever before that the Commonwealth be fully engaged in the evolutionary process that the industry is undergoing at present. The Commission and other energy policy-makers in the Commonwealth must closely monitor developing national trends and emerging programs. Along with the utilities, these entities must actively participate in the development of national and regional initiatives. The Commission must be encouraged to continue to collaborate with utilities and other stakeholders to stimulate discussion and facilitate more expansive insight into complex matters relevant to the electric utility industry in Kentucky. This will enable all of Kentucky's policy-makers, regulators and service providers to work to ensure that Kentuckians continue to benefit from safe, reliable, and low-cost energy in the decades ahead.

III. CONCLUSION

LG&E/KU respectfully request that the Commission consider the comments as outlined above for consideration in developing the Strategic Blueprint and/or for preparing further issuances in this docket.

Respectfully submitted,

Paul W. Thompson
Senior Vice President, Energy Services
LG&E Energy Services Inc. on behalf of
Louisville Gas and Electric Company and
Kentucky Utilities Company