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PUBLIC SERVICE
COMMISSION

Via Overnight Mail

November 1, 2007

Beth A. O'Donnell, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: Case No. 2006-00509 and 2006-00510

Dear Ms. O'Donnell:

Please find enclosed the original and twelve (12) copies of the PETITION FOR REHEARING OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. to be filed in the above-referenced matters. By copy of this letter, all parties listed on the Certificate of Service have been served.

Please place this document of file.

Very Truly Yours,



Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment

cc: Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by first-class postage prepaid mail, (unless otherwise noted) to all parties on the 1ST day of November, 2007.

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

IN THE MATTER OF:

AN EXAMINATION OF THE APPLICATION)
THE FUEL ADJUSTMENT CLAUSE OF)
LOUISVILLE GAS AND ELECTRIC COMPANY)
FROM NOVEMBER 1, 2004 TO OCTOBER 31, 2006)

CASE NO:
2006-00510

IN THE MATTER OF:

AN EXAMINATION OF THE APPLICATION)
THE FUEL ADJUSTMENT CLAUSE OF)
KENTUCKY UTILITIES COMPANY)
FROM NOVEMBER 1, 2004 TO OCTOBER 31, 2006)

CASE NO:
2006-00509

PETITION FOR REHEARING OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

Pursuant to KRS 278.400, Kentucky Industrial Utility Customers, Inc. ("KIUC") petitions the Kentucky Public Service Commission ("Commission") for Rehearing of its October 12, 2007 Order in Case Nos. 2006-00509 and 2006-00510. The Commission's reasoning in support of its Order is based on arguments that were not made by KIUC.

1. The Commission's Order Is Based On A Fundamental Misinterpretation Of KIUC's Argument.

In its October 12, 2007 Order the Commission rejected KIUC's recommendation that the Commission disallow specific fuel costs charged by the Louisville Gas & Electric Company and Kentucky Utilities Company (collectively "the Companies") through the fuel adjustment clause ("FAC"). However, the Commission's reasoning was based on an argument that was not made by KIUC in testimony, at hearing or in briefs. The Commission stated that KIUC argued that MISO "make whole" payments should be credited to customers through the FAC. The Commission then dismissed the argument falsely attributed to KIUC by holding that MISO "make whole" payments are not fuel-related and cannot be credited through the FAC. On page 3 of its Order the Commission states:

KIUC contends, for the hours in which KU received RSG Make Whole Payments, that MISO's dispatch orders caused KU to incur \$5.6 million in excessive, or improper, fuel costs, which were charged to ratepayers via the FAC. KIUC claims that KU received Make Whole Payments as compensation for over 90 percent of these excess fuel costs, and that KU should be required to refund to its ratepayers the amount it was compensated.

On page 7 the Commission holds:

Based on its review of the evidence, the Commission finds that KIUC's and the AG's arguments are not persuasive and that KU incurred no excessive or improper fuel costs during the 2-year review period ending October 31, 2006. In support of this finding, we provide the following discussion.

Most significantly, as KU states, RSG Make Whole Payments are not fuel related. They clearly do not conform to the definition of fuel costs included in the Commission's FAC regulation. Also, including Make Whole Payments in the FAC would be inconsistent with past Commission decisions in which it found: (1) that amounts held in escrow far excessive

fuel charges imposed by a fuel supplier were not fuel costs recoverable through the FAC; and (2) that damages awarded by courts for fraudulent utility fuel procurement practices, while fuel related, were not fuel costs recoverable through the FAC. Therefore, it would not be appropriate to require that items unrelated to fuel costs, such as RSG Make Whole Payments, be included in the calculation of KU's FAC. (emphasis added).

The Commission's Order is based on a false reading of KIUC's argument. KIUC never argued that RSG make-whole revenues should be included in the Companies' FAC calculation. In the pre-filed testimony of its expert witness, at hearing, and in its Initial Brief, KIUC argued that the Commission should disallow specific fuel costs charged by the Companies through the FAC, not that MISO "make whole" payments should be credited through the FAC.

KIUC explained that when the Companies were forced to dispatch power out of economic order for MISO reliability reasons the Companies recovered the associated excess fuel costs through the FAC and received "make-whole" payments from MISO in order to compensate the Companies for these excess fuel costs. KIUC was very clear that excess fuel costs should be disallowed, not that make-whole payments should be credited. KIUC explained through a simple example how excessive fuel costs were charged to ratepayers through the FAC:

"The Companies' recovery of improper fuel costs during the period at issue in this case is best understood by looking at a single hour in a sample month. KIUC Cross Exam Ex. 1 shows that for the hour ending 12:00 p.m. on August 30, 2006 MISO ordered KU to operate Paddy's Run Unit 13 (a gas fired combustion turbine) [footnote omitted] at 147 MW. The total fuel cost recovered through the FAC was \$10,255.03, [footnote omitted] or \$69.76/MWH. During the hour that KU was required to operate an expensive gas peaking unit the same amount of energy was available on the market for \$4,232.13, or \$28.79/MWH. [Footnote omitted]. Had KU bought market power rather than generate with expensive gas, ratepayers would have saved \$6,022.90. This is the precise amount for which KU

received a make-whole payment. [Footnote omitted]. This amount is an improper fuel expense.” (KIUC Brief at p. 6).

In the hours that the Companies were directed to dispatch generating units out of economic order, they were reimbursed for these excess fuel costs in the form of make-whole payments. These excess fuel costs should not have been charged to ratepayers in the FAC. On pages 5 and 6 of its Initial Brief KIUC stated:

In hours when the Companies were receiving make-whole compensation payments from MISO associated with native load, the Companies had a total of \$6,048,238 in excessive fuel costs, which they included in their respective FACs. These results are shown under the column “Excess Fuel Cost.” For \$5,584,489 of the excess fuel costs associated with MISO’s out of order dispatch instructions, the Companies received a corresponding RSG make-whole payment. This \$5,584,489 represents fuel costs that should not have been recovered from ratepayers through the FAC because the Companies were already being compensated for these costs through RSG make-whole payments.”

The Direct Testimony of KIUC expert witness Steve Baron was likewise clear that excess fuel costs should be disallowed, not that MISO make-whole payments should be credited.

“In hours when the Companies were receiving make whole payments from MISO that were associated with native load, the Companies incurred a total of \$6,048,238 in excessive fuel costs, which they charged to customers in their respective FACs (\$582,392 for LG&E and \$5,465,846 for KU).

My recommendation is to disallow the excess fuel costs charged by each Company, up to the amount of the RSG make whole payments received hourly by each Company. For KU, the disallowance would be \$5,075,553 and for LG&E the disallowance would be \$508,936.”

On pages 14 and 55 of his Direct Testimony Mr. Baron further explained:

“By the Companies own admission in its data responses, generation costs were included in the FAC charges of each Company that were in excess of market energy prices. On this basis, these costs were improper fuel expenses and should be disallowed. Because the Companies were required to operate these excess cost generating units pursuant to MISO dispatch instructions,

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As stated in our Initial Brief, Kentucky's FAC is by definition a single-issue ratemaking mechanism that deals with the single issue of fuel costs. The costs that KIUC argues should be disallowed in this two-year review of the FAC are the excessive fuel costs incurred by the Companies when they dispatched generating units out of order. The appropriate avenue for addressing these excessive fuel costs is through an adjustment to the FAC in this two-year review case. The Commission's FAC rules require the disallowance of improper fuel expenses during a two-year review case.

3. Orders Of The Commission Must Be Based On Appropriate Reasoning.

The Commission's Order must contain a clear explanation of its holding that addresses the arguments of the parties. The October 12, 2007 Order fails to address KIUC's arguments.

Judicial review of agency action entails an examination of the agency's reasoning process. The Supreme Court has declared that "*the generally applicable standards . . . require the reviewing court*" to determine that the agency's "*actual choice*" was not "*arbitrary [and] capricious.*" Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 415-16, 91 S.Ct. 814, 823, 28 L.Ed.2d 136 (1971). The agency must examine the relevant data and articulate a satisfactory explanation for its action including a "*rational connection between the facts found and the choice made.*" Walker Operating Co. v. FERC, 874 F.2d 1320, 1337 (1989) citing, Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168, 83 S.Ct. 239, 245-246, 9 L.Ed.2d 207 (1962). In reviewing an agency's explanation the Court must "*consider whether the decision was based on a*

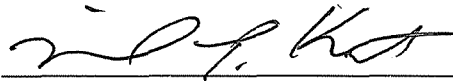
consideration of the relevant factors and whether there has been a clear error of judgment.” Walker, 1337.

The Commission decision was not based on a consideration of the relevant factors and it does not contain a rational connection between the facts found and the choice made. Instead, the Commission sets up a straw man with its mischaracterization of KIUC’s argument and then knocks its straw man down.

It is clear from the record that the Companies charged their customers excessive fuel costs at the same time that they were being reimbursed for the same fuel expense from MISO. The Commission should protect ratepayers from providing the Companies with a double recovery of its fuel costs by disallowing these excessive fuel costs in this two-year review case, or at the very least provide ratepayers with an appropriate explanation of why such protection is not warranted.

WHEREFORE, pursuant to KRS 278.400, KIUC respectfully requests that the Commission grant this Petition for Rehearing of the Commission's October 12, 2007 Order in the above-captioned matter.

Respectfully submitted,



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November 1, 2007