COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

BIG RIVERS' ELECTRIC CORPORATION)
NOTICE OF INTENT TO REDUCE REVENUE) Case No. 2007-00111

ATTORNEY GENERAL'S MEMORANDUM OF LAW REGARDING LAWFULNESS OF RELEF PETITIONER SEEKS

Comes now the Attorney General, by and through his Office of Rate Intervention ["Attorney General"], and states as follows regarding the Public Service Commission's ["Commission" or "PSC"] *sua sponte* order dated August 21, 2007, which ordered the Attorney General to brief the lawfulness of the relief Big Rivers' Electric Corporation ["BREC"] seeks and whether in the instant action such relief can be granted pursuant to KRS 278.455, in light of the August 1, 2007 Opinion and Order entered by the Franklin Circuit Court in the matter of *Commonwealth of Kentucky, ex rel. Gregory D. Stumbo, Attorney General v. Public Service Comm'n. and Union Light, Heat & Power Co.*, Civil Action No. 06-CI-269 ["Opinion and Order"].

1. Commission Has Historically Granted Petitioner's Relief Under KRS 278.455

BREC initiated this petition to reduce its revenues in order to pass on to its members the cash flow benefits from a leveraged lease in 2000. The instant matter is the latest in a series of filings to follow-up on the Commission's Order dated August 30, 2000 in case no. 2000-382. In that case, BREC, pursuant to KRS 278.455 sought a rate reduction of $3.68 million per year based on the sale and

lease-back transaction that BREC undertook with regard to three of its operating units. That sale and lease back was approved in case nos. 99-450 and 2000-118. The sale and lease back yielded revenues of $64.0 million, which BREC paid to the Rural Utilities Service ["RUS"] for application on a new note with RUS. In return, RUS restructured the debt service schedule on the new note. That restructuring yielded BREC $3.68 million annually.

The Commission specifically found in 2000-382 that the reduction did not change the rate design in effect for BREC members, was allocated among and within consumer classes on a proportional basis, and otherwise met the requirements of KRS 278.455. On this basis, the Commission approved BREC's relief. Moreover, the Commission in a series of cases set forth in § 4 of BREC's petition in the instant matter has approved the same relief BREC sought in prior years.

In the instant matter, BREC has moved to incorporate the record from 2000-382 into the current case, and has indicated that all statutory requirements would continue to be satisfied to allow it to pass on this statutorily permissive rate reduction.

2. KRS 278.455 Provides Specific Context and Permission for Contemplated Relief

BREC seeks relief pursuant to KRS 278.455 to reduce its rates. Both by title and in its substantive language, this valid statute provides the specific relief which BREC seeks. Moreover, in no reported decision has anyone even brought a challenge to the lawfulness of this statute.

3. Franklin Circuit Court Opinion and Order Has No Applicability to Relief Sought by BREC

The Opinion and Order found that absent statutory authority for an interim review and surcharge, the cost of the Union Light, Heat & Power AMRP must be considered in the context of a rate case. [1] It further found that: (a) "The recovery of expenses in the interim between rate cases is a right not encompassed [in] the PSC's general power"[2]; (b) "there is no inherent authority to perform interim single-issue rate adjustments because such a mechanism would undermine the statutory scheme"[3]; and (c) "Outside a general rate case there is no context in which to consider any expense."[4]

Nowhere in the Opinion and Order is there any finding or holding that could in any manner be construed as precluding the relief BREC seeks in the instant matter. Rather, the Opinion and Order expressly states that: "Certainly the PSC can perform single issue interim review *when given* statutory authorization, including a standard by which to exercise their discretion."[5] Such is the case in the instant matter. BREC seeks relief pursuant to a valid statute to reduce its rates. As such, this matter falls entirely outside the scope of the Opinion and Order.

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[1] See Opinion and Order, p. 8.
[2] Id. at 6.
[3] Id.
[4] Id. at 7.
[5] Id. at 6 [emphasis added].

4. Conclusion

For the foregoing reasons, the relief sought by BREC in the above-styled action is lawful.

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601;

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Assistant Attorney General

COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION I
No. 06-CI-269

COMMONWEALTH OF KENTUCKY, ex rel.
GREGORY D. STUMBO, ATTORNEY GENERAL **PLAINTIFF**

v. **OPINION & ORDER**

KENTUCKY PUBLIC SERVICE COMMISSION
and
UNION LIGHT, HEAT AND POWER COMPANY **DEFENDANTS**

* * * * *

This action is before the Court for final resolution of the Attorney General's appeal of the final administrative order of the Public Service Commission (PSC), allowing Union Light, Heat and Power (Union) to adjust its rates to reflect pipeline replacement expenditures through an interim rate review, passing those costs on to its customers through a surcharge on its base rate.

FACTUAL BACKGROUND

Union undertook its Accelerated Mains Replacement Program (AMRP) to replace 150 miles of cast iron and bare steel mains over a ten year period. Based on the cost of this program, in its 2001 rate case, Union obtained approval for a tariff for the subsequent three years, the Rider AMRP. This tariff allowed Union to exact a surcharge on its base rate to offset the cost of investment in the mains replacement program. The surcharge encompassed the preceding year's net investment in the AMRP. This AMRP tariff was re-approved in Union's 2005 rate case, this time under the statutory authority of the newly-enacted KRS 278.509. This statutory AMRP has not yet been used to collect any surcharge.

KRS 278.509

KRS 278.509, enacted by the 2005 General Assembly, provides:

> Notwithstanding any other provision of law to the contrary, upon application by a regulated utility, the commission may allow recovery of costs for investment in natural gas pipeline replacement programs which are not recovered in the existing rates of a regulated utility. No recovery shall be allowed unless the costs shall have been deemed by the commission to be fair, just, and reasonable.

The PSC has claimed it possessed inherent authority to allow interim review prior to enactment of this statute. The newly enacted statutory grant of authority, KRS 278.509, supersedes any implied authority the PSC may have possessed under its existing statutory scheme. *See* South Cent. Bell Tel. Co. v. Util. Regulatory Comm., 637 S.W.2d 649 (Ky. 1982). Thus, this matter cannot be resolved without full analysis of KRS 278.509.

CONSTITUTIONALITY

Because the statute controls, its constitutionality must be addressed. The Kentucky Constitution Section 51 provides:

> No law enacted by the General Assembly shall relate to more than one subject, and that shall be expressed in the title, and no law shall be revised, amended, or the provisions thereof extended or conferred by reference to its title only, but so much thereof as is revised, amended, extended or conferred, shall be reenacted and published at length.

The Kentucky Supreme Court has said this provision is to be liberally construed, resolving doubt in favor of validity. Yeoman v. Commonwealth, 983 S.W.2d 459, 476 (Ky. 1998). This construction requires that a statute be upheld if it provides a "clue" about the contents. Id. However, the Court has also stated the title must be read as a whole to provide limits on what can be included in a single bill. McGuffey v. Hall, 557 S.W.2d 401 (Ky. 1977).

The Kentucky Supreme Court addressed this issue in Grayson County Bd. of Educ. v. Casey, 157 S.W.3d 201 (Ky. 2005), regarding a portion of the budget bill that authorized each board of education to allocate funds for indemnity insurance covering the negligence of school bus drivers. The Court found this provision was not sufficiently related to the budget bill's title: "AN ACT relating to appropriations providing financing for the operations, maintenance, support, and functioning of the government of the Commonwealth of Kentucky and its various officers, cabinets, departments, boards, commissions, institutions, subdivisions, agencies, and other state supported activities." The Court found the provision

did not appropriate any state funds or require the state to pay any judgment; thus, the provision was in violation of Section 51 of the Kentucky Constitution.

While the standard for compliance with Section 51 is minimal, it is not met in the present case. When read as a whole, the title "AN ACT relating to gas delivery systems and appliances" suggests the relevant gas delivery systems are those connecting to appliances within a structure. While Union's 150 miles of natural gas pipeline may fairly be said to deliver gas, the entirety of the title suggests a relationship between the items. Read in context, a reasonable person would expect the gas delivery system to be that which services the appliances. Further, Senate Floor Amendment (SFA) 1 to the legislation actually relates *only* to procedural requirements at the Public Service Commission for the recovery of investment in the main utility pipeline. *See* 2005 Ky. Acts, c. 148, sec. 2. While the pipeline might conceivably be considered a gas delivery system, the title of this bill gives no clue that the content is an amendment of PSC procedure for setting utility rates for "recovery of costs for investment in natural gas pipeline replacement programs."

Defendants argue that the General Assembly resolved the question of whether the subject amendment was germane to the bill, and they have provided the Court with the videotape of the proceedings on the Senate floor concerning this legislation. *See Exhibit A,* Brief of the Public Service Commission, 2/08/07 (Tape of Senate Floor Debate on House Bill 440, March 3, 2005). Indeed, the provision of the bill dealing with PSC ratemaking[1] was challenged in a point of order during the Senate debate. However, the ruling of the President of the Senate that SFA No. 1 was germane to the bill for purposes of the Senate Rules is not dispositive of the constitutional issue under Section 51.[2]

Determining constitutionality is the province of the judiciary. As our Supreme Court has ruled in addressing a similar question regarding a legislative determination of the validity of administrative

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1 2005 Ky. General Assembly, House Bill 440, Senate Floor Amendment (SFA) No. 1.

2 The Court also notes that Legislative Record indicates that the sponsor of Senate Floor Amendment No. 1 also filed a title amendment to House Bill 440 (Senate Floor Amendment No.2). However, the title amendment was never called for a vote or adopted. It is not clear that this title defect could have been cured with a title amendment, but clearly the title to the bill as passed is defective under Section 51 of the Constitution.

regulations, "[i]t requires no citation of authority to state unequivocally that such a determination is a judicial matter and is within the purview of the judiciary." Legislative Research Comm'n v. Brown, 664 S.W.2d 907, 919 (Ky. 1984).

The legislature cannot be the final judge of the questions concerning the constitutionality of its own acts. *See, e.g.,* Rose v. Council for Better Educ., Inc., 790 S.W.2d 186 (Ky. 1989). Just as it would infringe upon the separation of powers enjoyed by the legislature under Sections 27 and 28 of the Constitution for the Court to interfere with the legislature's exercise of discretion, it would violate the separation of powers for the Court to abdicate its duty to pass on the question of constitutionality. Id. While the ruling of the President of Senate on the legislative point of order is entitled to respect and due consideration, it is not dispositive of the constitutional issue presented here. The ruling of the President of the Senate may have conclusively decided the issue of whether the amendment to the Bill was germane under the Rules of the Senate (thus, making a vote on the SFA No. 1 in order under the Senate Rules), but it is not conclusive on the issue of whether the SFA No. 1 complied with Section 51 of the Constitution.

Similarly, legislative discussion regarding the content of the act does not cure the constitutional defect where the title of the act is not sufficient to inform a reasonable person of the general content and subject matter of the legislation. Just as legislators are entitled to know what they are voting for, the public is entitled to notice that its rights may be affected by a proposed amendment.

The Constitution provides that an act cannot relate to more than one subject. As enacted, the provisions of this act include amendments to two vastly different subjects that are codified in statutes that have no common thread or relationship. *See* KRS 278.509 and KRS 234.175. Those statutes are not interconnected or related in any way. The latter chapter is entitled "Liquefied Petroleum Gas and Other Flammable Liquids," while the subject provision is contained in the chapter entitled "Public Service Commission." This utter lack of commonality or reasonable relationship further demonstrates that the two sections of the bill are unrelated.

The rule in Hayden's case is further supports the finding that the two subjects of House Bill 440 are unrelated. Courts are required to construe statutes by examining the plain language of the statute and by consideration of the problem the statute was intended to remedy. City of Bowling Green v. Board of Ed. of Bowling Green Indep. Sch. Dist., 443 S.W.2d 243 (Ky. 1969); Kentucky Indus. Util. Customers, Inc. v. Kentucky Utilities Co., 983 S.W.2d 493, 500 (Ky. 1998). When looking at the act in relationship to the problem it was intended to address, it is apparent that these provisions are not related. Problems relating to design, installation, and maintenance of gas-consuming appliances have nothing to do with ratemaking procedures of the PSC. Solving the problem of how Union is to recover its pipeline investment has no effect on the problem of unlicensed persons maintaining or installing gas-consuming appliances and other components of a gas delivery system.

INHERENT AUTHORITY

The Court has observed "a claim that an agency has 'inherent authority' may be problematic in light of the general principle of agency law that 'administrative agencies are creatures of statutes and must find within the statute warrant for the exercise of any authority which they claim.'" Fankhauser v. Cobb, 163 S.W.3d 389 (Ky. 2005), citing Dept. for Natural Res. v. Stearns Coal and Lumber Co., 563 S.W.2d 471, 473 (Ky. 1978). The PSC claims authority implied under KRS 278.030 and KRS 278.040, regarding the setting of reasonable rates, to perform an interim review on a single cost. These statutes give the PSC authority to regulate utilities and set rates that are "fair, just, and reasonable."

The fact KRS 278.509 was enacted suggests that the existing authority of the PSC did not allow interim hearings on single issues. Similarly, in KRS 278.183, the legislature created an interim review mechanism for the environmental surcharge. It is a well known rule of construction that legislation should not be construed to lack meaning, but rather that the legislature intends to do something by its action. White v. Commonwealth, 178 S.W.3d 470 (Ky. 2006); Aubrey v. Office of Attorney Gen., 994 S.W.2d 416 (Ky.App. 1998). While the legislature may speak to clarify existing authority, enactment of prior interim review statutes supports the construction that the legislature is creating new authority.

Statutory creation of a mechanism for interim review of a cost would be unnecessary if the PSC possessed such implied authority inherently.

Upon review of KRS 278.183, the environmental surcharge, the Court noted the statute "creates a new right" and characterized that right as the ability to recover expenses "without filing a general rate case." Kentucky Indus. Util. Customers, Inc., 983 S.W.2d at 500. The PSC argued that KRS 278.509 would be a nullity if it did not provide for interim rate increases because KRS 278.030 already allows rate increases through a general rate case. That is exactly so. KRS 278.509 would likewise have been a nullity if the PSC possessed inherent authority for interim review. Rather, the recovery of expenses in the interim between rate cases is a right not encompassed the PSC's general power.

PSC argued that this case was distinguishable from the environmental surcharge statute because the Rider AMRP was approved during a rate case. However, that position would allow the PSC, through a rate case, to grant itself new authority to hear an issue as an interim review. Ratemaking is a legislative function and the PSC may only act to the extent authority has been delegated to it. See Id. at 497.

Finally, there is no inherent authority to perform interim single-issue rate adjustments because such a mechanism would undermine the statutory scheme. Certainly the PSC can perform single issue interim review when given statutory authorization, including a standard by which to exercise their discretion. However, finding the PSC to have authority to review any single expenditure outside the context of a rate case would create a means to circumvent the general rate case mechanism created by KRS 278.190.

Utilities regulated by the PSC are now confronting the problem of the aging infrastructure required to deliver services to the public. Water and sewer lines, telephone lines, and the electric grid are all part of the aging infrastructure of regulated utilities throughout Kentucky. If this Court acquiesces in the exercise of power by the PSC to review such large and capital intensive infrastructure replacement projects outside the context of a general rate case under some vague theory of "inherent

power," it could create an exception to the requirement for utilities to have their rates approved in a general rate case that would swallow the rule.

Outside a general rate case there is no context in which to consider any expense. Without context, almost any expenditure can be justified and made to appear reasonable. A utility could bring all of its expenditures as interim expenses, evade rate case review, and deprive the public of the overall picture of its financial condition. The end result would be that consumers could unfairly bear the entire burden of infrastructure replacement, even when there are offsetting savings from new technologies, increased efficiencies, market conditions, or other developments that increase the return of investment of the utility. Those offsetting considerations can only be fully developed and considered in the context of a general rate case in which the utility company is required to justify its rates, taking into consideration all income and all expenses.

The PSC contends that the Rider AMRP is a mechanism for changing rates and that the fact the mechanism was approved during a general rate case renders it valid. The PSC created a formula for reasonableness of the tariff Union would seek on a yearly basis. PSC asserts the formula itself is a rate set during the rate case and that the determination that the formula is reasonable necessarily includes the determination that the amount recovered yearly pursuant to the formula is reasonable.

The Kentucky Supreme Court indicated that failure to consider an expense in context does not render it inherently unreasonable. Kentucky Indus. Util. Customers, Inc., 983 S.W.2d at 498. Certainly it is established that the surcharge mechanism itself is not impermissible. However, the environmental surcharge statute was held to be constitutional. This is a critical distinction from the current case. It is not questioned that the legislature, pursuant to its authority to regulate the utility rates, may allow a surcharge. Rather, this Court finds the PSC may not allow a surcharge without specific statutory authorization.

Requiring that any charge, absent statutory authorization, be considered within a rate case does not deprive the utility of anything. Union may still recover this cost by bringing a rate case and

justifying the rate increase as part of its overall financial picture. Union is not deprived of a profit. The opportunity to have a return on investment is rolled into the base rate and Union is entitled to ask for an increase in the rate if additional costs deprive them of this profit opportunity.

CONCLUSION

Absent statutory authority for an interim review and surcharge, the cost of the AMRP must be considered in the context of a rate case. The additional issue the Plaintiff raised regarding whether return on investment is properly included as a cost in a surcharge for the AMRP is mooted by this determination. Within a rate case, the PSC will consider this program in the full context of the operations of Union, including all expenses and Union's opportunity to earn a return on investment, in setting a fair, just and reasonable base rate.

Accordingly, the final administrative order of the Public Service Commission in this action is REVERSED and this action is REMANDED to the Public Service Commission for further proceedings not inconsistent with this judgment. This is a final and appealable order and there is no just cause for delay.

So ORDERED this 31ST day of July 2007.

PHILLIP J. SHEPHERD, JUDGE
Franklin Circuit Court, Division I

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