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June 27, 2006

RECEIVED

VIA HAND DELIVERY

JUN 27 2006

PUBLIC SERVICE
COMMISSION

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

RE: In the Matter of the Investigation into the Membership of Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission System Operator
Case No. 2003-00266

Dear Ms. O'Donnell:

Enclosed please find and accept for filing the original and ten copies of the Response of Kentucky Utilities Company and Louisville Gas and Electric Company to The Midwest Independent System Operator, Inc.'s Application for Rehearing 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

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

JUN 27 2006

PUBLIC SERVICE
COMMISSION

In the Matter of:

INVESTIGATION INTO THE)
MEMBERSHIP OF LOUISVILLE)
GAS AND ELECTRIC COMPANY)
AND KENTUCKY UTILITIES)
COMPANY IN THE MIDWEST)
INDEPENDENT TRANSMISSION)
SYSTEM OPERATOR)

CASE NO. 2003-00266

**RESPONSE OF KENTUCKY UTILITIES COMPANY AND
LOUISVILLE GAS AND ELECTRIC COMPANY TO
THE MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC.'S
APPLICATION FOR REHEARING**

Kentucky Utilities Company and Louisville Gas and Electric Company (collectively, the “Companies”) hereby respond and object to the Midwest Independent Transmission System Operator, Inc.’s (MISO) June 23, 2006 Application for Rehearing of the Commission’s May 31, 2006 Order (“May 31 Order”). The Companies request that the Commission deny MISO’s Application. Through its Application, MISO requests the Commission to “reconsider and rehear matters decided in the 5/31/06 Order and then vacate the authorization to LG&E and KU to withdraw from the Midwest ISO” on essentially two grounds:

1. The burden of proof should be assigned to only the Companies, and the Companies’ evidence failed to meet this standard;¹ and
2. Rehearing should be granted to allow the introduction of new evidence of the operation of the MISO Day 2 market, since hearings took place almost a year ago in July 2005.²

¹ Application at 1-12.

² Application at 12-17.

Although the Companies demonstrate in detail in this response why neither argument provides a convincing reason to grant rehearing, there is a simple response to each:

Burden of Proof

The finding in the May 31 Order was that “the LG&E and KU analysis is more credible and it provides a more reasonable indication of the likely outcome of exiting MISO and pursuing the TORC option.”³ MISO attempts to attack this finding by devoting eleven pages of its Application to various arguments and strawman contentions in support of its ultimate assertion that the “burden of proof lies with LG&E and KU in this investigation.”⁴ Which party, if any, bore the burden of proof in this investigation, however, is not the defining issue.

The Commission, as the administrative trier of fact, has the exclusive province to pass on the credibility of the witnesses and the probative weight of the evidence, and has done so in the May 31 Order. The May 31 Order does not display the slightest prejudice to the Commission’s analysis of MISO’s evidence or any prejudgment in the analysis of the Companies’ evidence. MISO’s argument only serves to highlight its disagreement with the May 31 Order’s determination of the credibility of the evidence.

More Evidence

In September 2005, in reference to the evidence from the first three months of the Day 2 market, MISO said: “The results are in and the results are favorable,” “the favorable direction of results projected in the Midwest ISO modeling has been confirmed,” and “actual market data shows substantial benefits to LG&E.”⁵ The May 31 Order did not agree with MISO’s arguments on the meaning of this evidence, thus MISO asks the Commission to grant rehearing to take

³ May 31 Order at 17.

⁴ Application at 2-12.

⁵ Initial Post-Hearing Brief of the Midwest Independent Transmission System Operator, Inc., at 18-22 (September 6, 2005).

more evidence for the purpose of creating endless delay and re-litigation of issues the Commission has decided. The fact that more evidence of the operation of the MISO Day 2 market exists after the close of the hearing is not a compelling basis to grant rehearing in this investigation under KRS 278.400.

Noticeably absent from MISO's Application is any claim that the May 31 Order is unlawful or that any of the specific findings of fact in the May 31 Order on "Economic Issues," "Reliability," and "Regulatory Issues" are unreasonable or erroneous based on the record of evidence. Because MISO has not presented a compelling reason to rehear the case, MISO's motion should be denied.

I. The Commission Should Deny MISO's Application for Rehearing Because the Companies Did Not Have, But Did in Fact Carry, the Burden of Proof.

MISO's various assertions and contentions in support of its ultimate argument that the "burden of proof lies with LG&E and KU in this investigation"⁶ are not new -- MISO first made this claim in the investigation over two years ago.⁷ The Commission initiated this proceeding pursuant to its statutory authority in KRS Chapter 278 to conduct investigations, and no provision in Chapter 278 expressly assigns the burden of proof in investigations.

However, which party, if any, bore the burden of proof in this investigation is not the defining issue. The Commission, as an administrative trier of fact, has the exclusive province to pass on the credibility of the witnesses and the weight of the evidence.⁸ As the trier of fact, the Commission weighed the evidence, decided what evidence was persuasive, what evidence was not credible, and based on this assessment, made findings of fact. It is clear from the May 31 Order that the Commission scrutinized all evidence in this proceeding. There is nothing in the

⁶ Application at 2 - 12

⁷ Reply Brief of Midwest Independent Transmission System Operator, Inc., May 10, 2004, pages 6-10.

⁸ *Energy Regulatory Commission v. Kentucky Power*, 605 S.W.2d 46, 50 (Ky. App. 1980).

May 31 Order to suggest the Commission held the Companies' evidence to a lesser standard of evaluation or MISO's evidence to an inappropriate standard of review. In fact, the only specific assertion of error claimed by MISO is the assertion, “[T]he LG&E/KU projection of net benefits from withdrawal was accepted despite a grossly underestimated exit fee.”⁹ Even if one assumes, despite evidence to the contrary that the Commission did not have an accurate exit fee estimate,¹⁰ the analysis in the May 31 Order nevertheless shows the Commission’s assessment of the Companies’ net benefit projections was independent of the consideration of the exit fee and its appropriate regulatory accounting.

The fundamental question that must be asked to determine whether a rehearing is necessary is whether there is any compelling reason to believe that the May 31 Order’s findings may be “unreasonable” or “unlawful” under KRS 278.410. MISO has presented none. The Kentucky Court of Appeals has held, “The term unreasonable can be applied to an administrative agency’s decision only when it is determined that the evidence presented leaves no room for difference of opinion among reasonable minds.”¹¹ The May 31 Order and its Dissenting Opinion demonstrate that the record of evidence leaves room for a difference of opinion among reasonable minds. There is no error in the May 31 Order’s analysis of the evidence; MISO’s quibble over what party bore the burden of proof makes no difference.

Even if the Commission made no formal assignment of the burden of proof to the Companies, the May 31 Order demonstrates that the Companies carried their burden

⁹ Application, page 12 and footnote 17 therein (selectively citing to pieces of evidence an effort to show there was no evidence in this record that the exit fee was \$41 million).

¹⁰ In fact, in testimony before the Commission a witness for the Companies stated that the Companies estimated the exit fee would be approximately \$40 million. II Transcript of Evidence 96 (July 21, 2005).

¹¹ *Energy Regulatory Commission v. Kentucky Power*, 605 S.W.2d 46, 50 (Ky. App. 1980), citing as authority *Thurman v. Meridian Mutual Ins. Co.*, Ky., 345 S.W.2d 635 (1961).

successfully. In all of its extended argument, MISO raises only three points in support of its assertion that the Companies did not successfully bear the burden. First, MISO states:

[T]he only effect of the Commission's *conclusion* that LG&E and KU should have obtained KRS 278.020(5) approval was to *prejudice* the question of whether the utilities should retain their Midwest ISO membership. Reasons given for the "significance" of the control transferred to the Midwest ISO reappear as "infringements" on the Commission's jurisdiction in the consideration of the merits of LG&E's and KU's request to withdraw.¹²

The May 31st Order contains no such conclusions; and MISO's accusation of "prejudice" as set out above is wholly unsupported by the May 31 Order; Nowhere therein does the Commission state that a reason for authorizing the Companies to exit MISO is that the Companies did not obtain the Commission's authorization to join. Thus this point lends no support to MISO's contention that the Companies did not successfully bear the burden of proof.

Second, MISO asserts that the Commission, in authorizing the Companies to exit MISO, relied upon evidence that "[fell] short of the quantification we have required in prior cases, such as the Kentucky Power/PJM case referenced above."¹³ The Companies respectfully point to the evidence that was used to support that decision. The May 19, 2004 Order in the Kentucky Power/PJM case¹⁴ ("Kentucky Power Order") gave as its evidentiary basis for granting Kentucky Power authority to join PJM (1) a stipulation supporting Kentucky Power between Kentucky Power, PJM, the AG¹⁵ and KIUC,¹⁶ and (2) a favorable cost-benefit analysis, which was based

¹² Application at 11, *citing* May 31 Order at 7-8 (emphasis added).

¹³ May 31 Order, Dissent at 31, *quoted in* Application at 11.

¹⁴ *In the Matter of: Application of Kentucky Power Co. d/b/a American Electric Power for Approval, to the Extent Necessary, to Transfer Functional Control of Transmission Facilities Located in Kentucky to PJM Interconnection, L.L.C. Pursuant to KRS 278.218*, Case No. 2002-00475. Two months prior to the issuance of the May 19, 2004 Order on Reconsideration, the Administrative Law Judge for the Federal Energy Regulatory Commission issued his Initial Decision holding that American Electric Power should be exempted from the requirements of Virginia and Kentucky laws, rules or regulations to the extent required to consummate its timely integration into PJM. *See The New PJM Companies*, Docket No. ER03-262-009, Initial Decision (March 12, 2004).

¹⁵ Kentucky Office of the Attorney General by and through his Office of Rate Intervention.

on forward-looking projections.¹⁷ In this case, the May 31 Order found the Companies' cost-benefit analysis, which showed financial benefits to exiting MISO, to be based on more reasonable assumptions and therefore more convincing than MISO's.¹⁸ The Commission further found that a benefit of the Companies' MISO exit will be to regain jurisdiction over the Companies' continuing MISO membership, which has been compromised due to the doctrine of federal preemption.¹⁹ Moreover, the AG and KIUC have expressed their full support for the Companies' exit from MISO; the AG separately expressed support for exiting MISO in his brief in this proceeding more than two years ago.²⁰ Thus, the evidence supporting the Commission's May 31 Order authorizing the Companies to exit MISO is at least reasonable, if not more reasonable, as the evidence that was used to support the Kentucky Power Order.

The third and final point MISO offers in support of its erroneous assertion that the Companies did not carry their burden of proof is that the Commission did not weigh the evidence properly. MISO states:

Nonetheless, the Commission *scrutinized the benefit-cost studies* as if the Midwest ISO bore the burden of proof and made no note of patently unreasonable assumptions and inputs by LG&E and KU. For example, the LG&E/KU projection of net benefits from withdrawal was accepted despite a grossly underestimated exit fee.²¹

Here MISO makes an important admission, one that any honest reading of the May 31 Order compels: "the Commission scrutinized the cost-benefit studies." MISO does not claim that the Commission ignored the evidence that both MISO and the Companies presented, but rather

¹⁶ Kentucky Industrial Utility Customers, Inc.

¹⁷ Kentucky Power Order at 5-10.

¹⁸ May 31 Order at 16-17.

¹⁹ May 31 Order at 21-23.

²⁰ Brief of the AG at 2-4 (April 26, 2004).

²¹ Application at 12.(Emphasis added). MISO neglects to note that, in an exchange with Commissioner Coker, a witness for the Companies clarified that the then-current projection of the exit fee was approximately \$40 million, higher than the Companies' previous projection. See II T.E. 95-99 (July 21, 2006).

weighed it carefully -- “scrutinized” all of it -- and came to a conclusion MISO does not like. This appears to be the only basis for MISO’s assertion that the Commission examined the evidence “as if MISO bore the burden of proof,” since there is no such statement or other indication in the May 31 Order itself. And though it may displease MISO that the Commission found the Companies’ evidence more convincing than MISO’s, it certainly was and is in the Commission’s discretion and expertise to so find: “The administrative trier of fact has the exclusive province to pass on the credibility of the witnesses and the weight of the evidence.”²² Moreover, once an administrative body such as the Commission has weighed the evidence before it and reached a conclusion, it can be overturned as unreasonable “only when it is determined that the evidence presented leaves no room for difference of opinion among reasonable minds.”²³ Thus the Commission has properly examined the evidence in this case and reached a reasonable conclusion by authorizing the Companies to exit MISO.

II. MISO's Request Endlessly to Litigate the Investigation in Piecemeal Fashion Must be Rejected

The Commission will recall that MISO argued in September 2005 that the evidence from the first three months of the Day 2 market were “favorable,” asserting that “the favorable direction of results projected in the Midwest ISO modeling has been confirmed,” and contending that “actual market data shows substantial benefits to LG&E.”²⁴ The Companies rebutted these assertions.²⁵ After considering all the evidence, the Commission issued the May 31 Order, authorizing the Companies to exit MISO. Now, MISO asks the Commission to grant rehearing

²² *Energy Regulatory Com. v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. Ct. App. 1980).

²³ *Id.*

²⁴ Initial Post-Hearing Brief of the Midwest Independent System Operator, Inc, pages 18 -22 (September 6, 2005).

²⁵ *See, e.g.*, Supplemental Additional Direct Testimony of Martyn Gallus (July 7, 2005); I T.E. 231-238 (July 20, 2005).

to take more evidence of the MISO Day 2 operations for the purpose of creating endless delay and relitigating the issues decided in the May 31 Order.

A. Simply because evidence now exists that could not have been offered at the July 2005 hearing does not provide any basis for determining whether to grant a rehearing under KRS 278.400.

In its second argument, MISO invites the Commission to reopen its three-year investigation to take further evidence on the operation of the Day 2 market. The Commission, however, apparently considered this possibility but chose not to do so.²⁶ Moreover, the mere fact that additional evidence now exists that could not with reasonable diligence have been offered at the July 2005 hearing is not a reason for granting rehearing. The statute governing rehearing, KRS 278.400, restricts what evidence can be offered if a rehearing is granted – namely, that only evidence which could not with reasonable diligence have been presented at hearing can be offered at a rehearing. This evidentiary guideline, however, is not the standard for determining whether a rehearing should be granted. It does not provide a bootstrap that the losing party may use to ask for a *de novo* hearing following the issuance of a final order. There will always be new evidence of the operations of the MISO Day 2 market, and that new evidence -- whether it is data or the latest accord reached between the RTOs -- will be subject to debate and conflicting interpretation.²⁷ In reviewing the circumstances under which Public Service Commission cases should be remanded, Kentucky's highest court made a public policy pronouncement directly applicable to this case:

Public policy dictates that these actions not be unnecessarily prolonged. ... [I]f changes in the general economic situation should be permitted to be classed as newly-discovered evidence, there would never be an end to a public utility case. The Public Service Commission necessarily must base its decision and actions on the

²⁶ Compare May 31 Order, pages 16-17 with Dissenting Opinion, pages 32-33.

²⁷ The Dissenting Opinion also acknowledges that “the first year of the market would not produce enough information to estimate the long-run benefits of membership to the Companies.” Dissenting Opinion, page 32.

economic conditions existing at the time a case is before it, and it is not in the public interest that a case be prolonged indefinitely by allowing a reconsideration whenever there is a fluctuation in price levels.²⁸

The record in this three-year investigation is one of the most extensive and comprehensive ever compiled by the Commission. It provided the Commission with a complete and thorough basis on which to make an informed decision. MISO has failed to offer any compelling reason why the record should be reopened to continue the lengthy debate.

Furthermore, tendering the report marked as Exhibit B to the Application for Rehearing is clearly an unauthorized filing under KRS 278.400. The Commission's long-standing interpretation of KRS 278.400 prohibits the offering of evidence until such time as the Commission has decided to grant rehearing.²⁹ As the Commission explained, "There are obvious reasons for this interpretation, including fairness to the parties. Testimony should not be filed until it is certain that there will be a rehearing, otherwise the record would potentially include testimony upon which a witness had not been cross-examined . . . [I]n the future the Commission's Secretary will not accept testimony or affidavits such as these for filing and any such documents which are inadvertently accepted for filing and later discovered will be ordered stricken."³⁰ Clearly MISO is engaging in impermissible conduct by attempting to introduce just enough information to tempt the Commission into believing that MISO might now have a solid case to present. It is attempting to pull its Application for Rehearing up by improper evidentiary bootstraps. The Companies cannot respond to the document without violating the Commission's policy on such unauthorized filings and joining the debate MISO would welcome to facilitate its

²⁸ *Stephens v. Kentucky Utilities Company*, 569 S.W.2d 155, 158 (Ky. 1978), quoting *Kentucky Utilities Co. v. Public Service Com'n*, 252 S.W.2d 885, 897 (Ky. 1952).

²⁹ *In the Matter of: An Investigation Of Toll and Access Charge Pricing and Toll Settlement Agreements For Telephone Utilities Pursuant to Changes To Be Effective January 1, 1984*, Case No. 8838, Order on Rehearing-Unauthorized Filings (February 4, 1985).

³⁰ *Id.*

own objectives of delay and further litigation. Absent further action, the evidence remains untested. Fundamental fairness requires this improper evidence be stricken and otherwise ignored.

B. A rehearing is not required to rule on the Companies' application in Case No 2005-00471.

MISO finally argues that a rehearing should be granted for the purpose, in effect, of ruling on the Companies' application in Case No. 2005-00471, contending that the evidence from the operations of the Day 2 markets since the close of the record almost a year ago should be used to evaluate the proposed service contracts with the Tennessee Valley Authority ("TVA") and Southwest Power Pool, Inc. ("SPP"). The subject of the investigation in the instant action, however, is whether the Companies' continued membership in the MISO is in the public interest. The May 31 Order concluded it was not and authorized the Companies to withdraw. MISO's interest in comparing the TVA and SPP contracts with its own operations is a red herring. The Commission's May 31 Order granted the Companies authority to exit MISO, so comparisons to it are not relevant to analysis of the TVA and SPP contracts.

MISO's true objective is evident when it alleges, "Now, with a full year of market data, the tests required under KRS 278.218 can be performed and the relative merits assessed."³¹ The proper purpose and public interest elements of KRS 278.218(2) are not so narrowly defined as MISO contends, and do not require the strict type of examination that MISO now asserts is necessary. The Commission has found that the Companies' reacquisition of the functional control of their transmission system is for a proper purpose and is consistent with the public interest based on the extensive record developed in this investigation. This conclusion places the Commission in a position where it may now determine whether to extend jurisdiction over the

³¹ Application at 17.

TVA and SPP contracts, and if so, whether such contracts are for a proper purpose and consistent with the public interest in a separate proceeding. However, contrary to MISO's assertions, the "public interest" standard is not defined by MISO's operations as some *de jure* standard of the public interest. Rather, the public interest standard is far broader and more encompassing than MISO's assertion, and includes jurisdictional and other regulatory issues of concern to the Commission, the Companies and their customers. MISO's contention is simply one more request to relitigate the matters decided by the Commission.

Conclusion

After nearly three years of proceedings, the Commission ended its investigation into the Companies' MISO membership in Case No. 2003-00266 on May 31, 2006, authorizing the Companies to exit MISO. MISO now seeks to complicate this proceeding through its Application for Rehearing in order to relitigate the Commission's determination to authorize the Companies' exit from MISO. It should be denied. MISO's Application has presented no compelling cause to believe that the May 31 Order's findings may be "unreasonable" or "unlawful" under KRS 278.410. The evidence of record fully supports the Commission's May 31 Order authorizing the Companies to withdraw from MISO. Relitigating these same issues after the May 31 Order will be acutely prejudicial to LG&E and KU's substantive due process rights.³² The Companies firmly believe, and the AG and KIUC agree, that the time has arrived for the Companies to withdraw from MISO.

Contrary to MISO's assertions that "there is no imperative for LG&E and KU to withdraw,"³³ time is of the essence. As the Commission is aware, the Companies and MISO have

³² The Companies have a due process right to have this litigation conclude in a timely manner. *Kentucky Power Co. v. Energy Regulatory Com.*, 623 S.W.2d 904, 908 (Ky. 1981)("Even a public utility has some rights, one of which is the right to a final determination of its claim within a reasonable time and in accordance with due process.")

³³ Application at 13.

established an agreed methodology for calculating the MISO exit fee and procedures to effect the Companies' operational exit from MISO.³⁴ On June 14, 2006, the Companies submitted to MISO schedules informing MISO that it should not include the Companies' generation and transmission facilities in the Day 2 market models for the quarter beginning September 1, 2006. The Companies may rescind this request no later than close of business on July 7, 2006, if they wish to remain participants in MISO's security constrained economic dispatch operations after August 31, 2006.³⁵ The Companies will rescind this request if necessary, but they, along with the AG and KIUC, believe it is in the Companies' and their customers' best interest to complete the Companies' exit from MISO.

For these reasons, the Companies request the Commission issue an order denying MISO's Application for Rehearing by July 6, 2006.

³⁴ See Amended Application (February 3, 2006) for the agreement concerning methodology for calculation of Exit Fee between the Companies and MISO; see June 5, 2006 Joint Letter from MISO and the Companies to FERC concerning agreed upon procedures for effecting the operational withdrawal from MISO (copy distributed the attendees at the June 7, 2006 Informal Conference at the KPSC).

³⁵ The next opportunity will not occur until September 15, 2006 when the Companies can submit their schedules to MISO in order to achieve a complete operational withdrawal on December 1, 2006.

Dated: June 27, 2006

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kendrick R. Riggs", is written over a horizontal line.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that an original and ten copies of this Response was hand delivered on the 27th day of June 2006 to Elizabeth O'Donnell, Executive Director, Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601, and that a copy of this motion was mailed to:

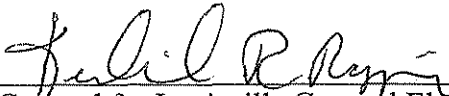
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