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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE 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, Inc.	Case No. 2003-00266

Application for Rehearing of the

Midwest Independent Transmission System Operator, Inc.

Pursuant to KRS 278.400, the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") respectfully applies for rehearing of the final order in the above-captioned proceeding served by the Kentucky Public Service Commission ("Commission") on May 31, 2006 ("the 5/31/06 Order"). Midwest ISO requests that the Commission reconsider and rehear matters decided in the 5/31/06 Order and then vacate the authorization to Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities ("KU") to withdraw from the Midwest ISO.

1. **Proper construction and application of KRS 278.020(5) leads to the conclusion that no prior Commission approval was required for any LG&E/KU transfer of control of certain transmission facilities.**

In the 5/31/06 Order, the Commission found that, under KRS 278.020(5), LG&E and KU were required to obtain prior Commission approval of their membership in the Midwest ISO. This determination affects other aspects of the case such as the assignment of the burden of proof and the requirements of withdrawal from membership. Thus, the Commission errors in construing and applying the statute, in turn, spread to other aspects of the case. Upon rehearing, the Commission should find that no approval was required for LG&E's and KU's joining the

Midwest ISO or transferring to it certain functions, and that the burden of proof lies with LG&E and KU to justify their request to withdraw from the Midwest ISO.

a. KRS 278.020(5) regulates transfers of ownership or control over utility entities rather than their functions or assets.

KRS 278.020(5) states that "no person shall acquire or transfer ownership of, or control, or the right to control any utility ... without prior approval by the commission."[1] The Commission claims LG&E and KU were required under this statute to obtain permission for the transfer of any control of their transmission facilities to the Midwest ISO. It attempted to bring this transfer within the scope of KRS 278.020(5) by concluding that "LG&E and KU are ... generating utilities, transmission utilities, and distribution utilities"; as such, the transfer of control of one of these functions would be a transfer of a "utility." 5/31/06 Order at 4. This was an error. LG&E's and KU's vertical integration of multiple electric functions does not somehow make each corporation three distinct utilities. The Commission's construction is inconsistent with the plain language of the statute, the Commission's own findings, the tenets of statutory construction, and an earlier decision in an analogous situation. Properly construed and applied, "utility" refers to a single utility entity, not to each individual function.

In relevant part, KRS 278.010(3)(a) defines a "utility" as "any person" who meets certain qualifications, *i.e.*:

> Any person who owns, controls, operates, or manages any facility used or to be used for or in connection with:
>
> (a) The generation, production, transmission or distribution of electricity to or for the public, for compensation, for lights, heat, power, or other uses.

As the Commission contends, this language requires only that LG&E and KU execute one of these electric functions to qualify as a utility. There is no justification, however, for the

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[1] This provision was codified as KRS 278.020(4) until the 2004 amendments to KRS 278.020 — adding a new subsection (2) — when former subsection (4) became subsection (5).

Commission's reading of the statute as creating a separate utility for each function or capacity in which an entity performs. The statute's focus on "any person" is key. It clearly sets a utility equal to one "person," not one function. Participating in or adding additional functions does not create a new, distinct "person" and thus does not create a new, distinct utility. The Commission's holding that LG&E and KU constitute three separate utilities is contrary to the language of the statute.

Furthermore, the Commission expressly interprets KRS 278.010(3)(a) so that a utility "encompasses any person who owns, controls, operates, or manages a facility that is used to perform any one, or any combination, of the enumerated functions of generation, transmission, or distribution." 5/21/06 Order at 4 (emphasis omitted). From this, the Commission rationalizes that "both LG&E and KU satisfy the statutory definition of 'utility' with respect to <u>each</u> of the electric functions they perform ... LG&E and KU are thus generating utilities, transmission utilities, and distribution utilities." *Id.* This holding is at odds with the recognition that a single utility may encompass a "combination" of functions. No utility can consist of a "combination" of electric functions if each function is its own separate utility. LG&E and KU are each a single entity performing, in the words of the Commission itself, a "combination of the enumerated functions," and should be considered single utilities.

In fact, the Commission did so consider them when it described LG&E and KU as "vertically integrated." 5/31/06 Order at 2. By definition, to "integrate" means "to form, coordinate, or blend into a functioning or unified whole."[2] The very term used by the Commission in describing LG&E's and KU's corporate makeup thus indicates that several electric functions have been blended into one, unified utility. It is inconsistent then, that the

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[2] *Merriam-Webster Online Dictionary* <http://www.m-w.com/dictionary/integrate> (last visited Jun. 21, 2006).

Commission would essentially find LG&E and KU to each be at least three separate and distinct utilities.[3]

Moreover, it is a fundamental tenet of statutory construction "that a Statute should be construed, if possible, so that no part of it is meaningless or ineffectual." *Brooks v. Meyers,* 279 S.W.2d 764, 766 (Ky. 1955). On February 1, 2002, when the Commission has deemed that LG&E and KU transferred control of their transmission facilities to the Midwest ISO, KRS 278.020(5) prohibited the acquisition of control over "a utility" without Commission approval. Later, the legislature adopted KRS 278.218, which prohibited the transfer of ownership or control of certain "assets" to another person without such approval. Under the Commission's function-focused interpretation of what constitutes a "utility", KRS 278.020(5) regulated transfers of control of less than the whole "utility person."[4] This interpretation necessarily renders KRS 278.218 "meaningless" and "ineffectual," as transfers of less than the entire "utility" would already fall under KRS 278.020(5).

It is illogical to think that the legislature would adopt KRS 278.218, prohibiting the transfer of assets without prior Commission approval, if such transfers were already prohibited under KRS 278.020(5). "It must of course, be presumed that the Legislature is aware of the status of the law at the time of the enactment of a statute." *Commonwealth Dep't. of Banking*

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[3] The Commission's construction implies there would be additional LG&E "utilities" on the gas side of its business. *See* KRS 278.010(3)(b) and (c). Furthermore, the Commission's finding that "under the definition of 'utility' set forth in KRS 278.010(3)(a), LG&E and KU are no longer utilities with respect to the operations function of their respective transmission facilities," 5/31/06 Order at 6 (emphasis added), suggests that there could be multiple utilities within, *e.g.*, the transmission function based on ownership, control, operation, or management of a particular facility.

[4] At its limit, the Commission's atomization of "utility" would bring transfer of ownership or control of just about any fraction of a utility under KRS 278.020(5). By the Commission's logic, a single employee in charge of a single electric switch constitutes a "utility" as this employee is a "person who ... operates or manages" a "facility" used to generate, transmit, or distribute electricity.

and Securities v. Brown, 605 S.W.2d 497, 498 (Ky. 1980). If the General Assembly felt it necessary to enact KRS 278.218 to prevent the transfer of "ownership of or control, or the right to control" certain utility assets without the Commission's approval, it did so with the understanding that such transfers were not already subject to the prior-approval requirement under KRS 278.020(5). The addition of KRS 278.218 addressed transfers left unregulated because the term "utility" applies to an entire "person," not to the individual parts or functions of which it may be comprised.

Interestingly, when Kentucky Power Company sought approval from the Commission to transfer its transmission function to a regional transmission organization ("RTO"), the Commission considered this to be a transfer of assets, not of a "transmission utility." *Kentucky Power Co.,* Case No. 2002-047 (Ky.P.S.C. May 19, 2004) at 2. The transfer was granted by the Commission under the authority of KRS 278.218 without any mention of KRS 278.020(5) or its standard. *See id.* at 2, 10. The Commission clearly recognized in that *Kentucky Power* case that the transfer of a transmission function was a transfer with respect to assets and should be governed by KRS 278.218. *Id.* at 2. There is no reason for the Commission to hold any differently in the present matter. At most, LG&E and KU transferred control of transmission assets, not "transmission utilities."

b. LG&E and KU exaggerated the effect of the transfers to the Midwest ISO.

The Commission has also erred in basing its determination about the applicability of KRS 278.020(5) on the exaggerated view presented by LG&E and KU of the consequences of the limited functional control they transferred to the Midwest ISO. Nothing in the transfer/change of control statutes — KRS 278.020(5), 278.020(6), or 278.218 — suggests that the "control" in question is that of the Commission over the utility or that a "change in control" has occurred

whenever there are changes in the manner or outcomes of a utility's activities. Nonetheless, the Commission declares that the "degree of control which has been transferred ... is very significant, as noted by LG&E and KU in their explanation of how the transfer of transmission assets transforms aspects of what is presently retail service into wholesale transactions." 5/13/06 Order at 7-8. Contrary to that LG&E/KU "explanation," any transformative effect is independent of their membership in the Midwest ISO, and "reacquiring functional control of their transmission facilities," *id.* at 26 (Ordering¶ 1), will not reverse any transformation that has occurred.

The Commission focuses on the events on February 1, 2002, as effecting a change in control:

> [P]ursuant to the terms of a contractual agreement, LG&E and KU transferred operational control of their transmission facilities to MISO on February 1, 2002. .... The function of operating LG&E's and KU's transmission facilities was transferred to MISO, which now controls those facilities and uses them to transmit electric energy in interstate commerce. By providing this interstate transmission operations function, MISO's rates and terms of service are regulated by the FERC.

5/31/06 Order at 6. It is important to note that before <u>and</u> after February 1, 2002, the LG&E/KU transmission facilities were used to transmit electric energy in interstate commerce with the rates and terms of service regulated by FERC. Before the merger of LG&E and KU, both companies had rate schedules on file with FERC for the sale of power for resale. These sales were in interstate commerce. Their transmission systems were used to effectuate these sale whether the customer was in- or out-of-state. With the institution of general open-access requirements in 1996, LG&E and KU had to operate and offer their transmission assets on a non-discriminatory basis, treating "their own use of those transmission facilities under the same transmission tariffs they apply to others." *Kentucky Power Company v. Huelsmann*, 352 F.Supp.2d 777, 781 (E.D.

Ky. 2005) (describing the requirements of FERC Order 888, issued April 24, 1996). These aspects of LG&E/KU transmission service will not change under what is proposed in Case No. 05-471:[5] supervision will merely shift to Southwest Power Pool, Inc. ("SPP"), which will serve as an independent administrator of a LG&E/KU Open Access Transmission Tariff ("OATT") filed with FERC; their transmission system's use will have to be on a non-discriminatory basis. Indeed FERC, by Notice of Proposed Rulemaking, is considering reforms to such tariffs to further remove the potential for affiliate- or self-favoritism in transmission systems' use.

On December 1, 2001, the Midwest ISO became the reliability coordinator for LG&E, KU, and other transmission owner members, providing unbiased management and coordination of their operation of the individual systems within its regional footprint. LG&E and KU had previously received these services through American Electric Power, which was operating as a contractor for the East Central Area Reliability Council. This transfer was of "only limited control," authorizing the Midwest ISO "only to coordinate and evaluate transmission capacity and reliability functions, while LG&E and KU continue to own, staff, maintain, and operate their transmission assets." 5/31/06 Order at 6 (summarizing the LG&E/KU position). They have not "transferred operational control of their transmission assets," *id.* at 7, and there is no record evidence that they did.[6] Before <u>and</u> after December 1, 2001, the LG&E/KU transmission facilities were used to transmit electric energy in interstate commerce on a non-discriminatory basis with the rates and terms of service regulated by FERC. Long before they joined the Midwest ISO, the transmission systems of LG&E and KU were subject to a third-party reliability

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[5] *See* 3rd Am. Jt. Applic. at 7 (¶12), filed in Case No. 05-471 on June 14, 2006.

[6] The statement by LG&E/KU witness Mike Beer cited by the Commission, 5/31/06 Order at 7 n.4, does not support the Commission's conclusion. Mr. Beer specifically qualified his statement about the transfer of operational control on February 1, 2002, noting that he referred to such control "as we would define it today," 2/26/04 T.E. at 167:14-16. That definition was consistent with the LG&E/KU position that such control was limited.

coordinator, and they will be subject to a third-party reliability coordinator — the Tennessee Valley Authority ("TVA") is the proposed candidate — if they withdraw from Midwest ISO membership.

The distorted and exaggerated view promoted by LG&E and KU in this proceeding is that Midwest ISO membership or the start-up at the beginning of December 2001 and February 2002, respectively, of reliability coordination and access administration by the Midwest ISO effected a diminution in state jurisdiction over transmission. That is nonsense. Not only has there been no such diminution, but the Midwest ISO is not aware of any attempt to limit the Commission's authority over retail rates and services or to strip it of authority it once had.[7] LG&E and KU did attack KRS 278.214 as in conflict with and preempted by the Midwest ISO OATT and FERC Order 888, but were rebuffed on a demonstration by the Midwest ISO that "the curtailment provisions of the OATTs and those found in the Kentucky statute are complementary and sequential" and therefore "compliance with both is not impossible." *Kentucky Power*, 352 F.Supp.2d at 784.[8]

LG&E's and KU's greatest act of misdirection is to appear to "acknowledge" a non-existent shift in jurisdiction attributed to their own choice among options that were not inaugurated in the Midwest ISO's tariffs until well after February 1, 2002:

> LG&E and KU acknowledge that one major effect of the transfer to MISO is to sever the historic connection between their respective generation and the electric service provided to retail customers. The LG&E and KU generation used to serve

[7] The Commission continues to exercise authority over LG&E and KU fuel acquisition practices and their consumption and purchase power accounting relative to retail rates. If there had been a fundamental loss of jurisdiction over important components of retail rates, one might have expected to see termination of such mechanisms or at least challenges or investigations as to their continuing validity.

[8] Although it thus rejected the Supremacy Clause challenge to KRS 278.214, the federal district court held that the Kentucky statute violated the dormant Commerce Clause. 352 F.Supp.2d at 787.

> native load customers must now be scheduled or bid through the MISO energy market at wholesale rates that are not subject to the Commission's jurisdiction. The energy thus scheduled or bid is then resold by LG&E and KU to their native load customers. Consequently, as a result of the transfer of control to MISO, what had historically been a purely retail sale of power subject to our jurisdiction has been transformed into a wholesale sale of power that is beyond the scope of our jurisdiction.

5/31/06 Order at 8 (footnote omitted). The one citation for these purported facts is to LG&E/KU witness Mike Beer's opinions and dark warnings about the inauguration of the Day 2 market.[9] Self-scheduled generation is not "bid through the MISO energy market" and there is no settlement through the Midwest ISO at "wholesale rates that are not subject to the Commission's jurisdiction." LG&E and KU choose "to not 'self-schedule' their generation and load into the Day Ahead Market, ... attempting to reduce their costs by utilizing MISO's economic dispatch and purchasing power if it is bid into the market below their cost of production." 5/31/06 Order at 12. Thus, even if this represented a "transformation" from retail to wholesale sales, it is not a "major effect of the transfer" — it stems from an LG&E/KU choice and did not occur until after the transfer that took place on February 1, 2002. Furthermore, the tempting choice of bidding all generation through the energy market is not dependent on being a member and will be available to LG&E and KU even if they withdraw.

c. Application of KRS 278.020(5) is without consequence other than to prejudice consideration of the net benefits of continued membership in the Midwest ISO.

As is recognized by the Commission, the statute requires that there be Commission approval before the transfer takes place.

> The statute expressly prohibits the acquisition or transfer of control without prior approval by the Commission. Thus, there is an affirmative duty on the utility and

[9] The citation given is to 1/10/05 Supplemental Rebuttal Testimony of Michael S. Beer at 2-3 and 9-10. These topics were the subject of a Stipulation entered into by LG&E/KU and the Midwest ISO on December 7, 2004, and filed in the record of this proceeding.

> the acquirer to obtain Commission approval; there is no affirmative duty placed on the Commission to investigate whether a transfer of control has occurred. In any event, the Commission did initiate this present investigation in July 2003, approximately 18 months after the transfer occurred, to determine whether prior approval was needed.

5/31/06 Order at 9.[10] In a situation in which the requirement of prior approval was imposed by a Commission order rather than statute and the utility applied for approval only 2 days after taking the subject action, the Commission declined to retroactively affirm or ratify unlawful conduct:[11]

> Retroactive approval of [the utility's action] would only encourage utilities to enter into unauthorized transactions without obtaining the necessary regulatory approval and then present the transaction to the Commission as a *fait accompli.* Utilities that have failed to observe the law should not be excused from its requirements.

Nonetheless, it appears that — despite the conclusion that KRS 278.020(5) applied to the transfer of functional control to the Midwest ISO — LG&E and KU have been excused from its requirements[12] and the Commission has ratified conduct that it has found to be unlawful.

It is inconsistent for the Commission to conclude that the transfer by LG&E and KU was prohibited and nonetheless to authorize inclusion of Schedule 10 charges in existing rates[13] and establishment of both a regulatory liability for those charges and a regulatory asset for the

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[10] The Commission has consistently construed and applied the KRS 278.020(5) prohibition on "acquisition or transfer" to the acquirer as well as the transferor only if the acquirer is already a "utility" subject to Commission jurisdiction or will become one as a consequence of the acquisition. For example, the Commission does not require the Louisville and Jefferson County Metropolitan Sewer District to apply for or obtain KRS 278.020 approval for its acquisition of utilities or their assets. *See, e.g., Application of Lake Forest Disposal Systems, LLC etc.*, Case No. 04-094 (Ky.PSC June 10, 2004) at 1 & n.1, 6-7.

[11] *Compliance of Kentucky-American Water Company, etc.*, Case No. 02-277 (Ky.PSC May 19, 2006) at 4 (citing *Kenton County Water District No. 1*, Case No. 91-046 (Ky.PSC Nov. 8, 1991) at 4 ("As no purpose will be served by the post-execution approval of these documents, the Commission will not stamp its imprimatur upon these documents.")).

[12] The Commission has not subjected LG&E or KU to the administrative sanctions available under KRS 278.990(1) or stated any reason for forgoing such sanctions. *Cf.* Case No. 02-277 (Ky.PSC May 19, 2006) at 4-5 (explaining choice not to impose administrative sanctions).

[13] 5/31/06 Order at 24-25 (describing LG&E proposal) & n.19 (stating amounts of Schedule 10 costs included in base rates).

withdrawal fee imposed under the Transmission Owners' Agreement ("the exit fee").[14] The Midwest ISO reiterates its position that the responsibility for the exit fee and payments under its Schedules were lawfully and prudently undertaken by LG&E and KU and should be recoverable from their retail customers;[15] however, if the transfer to the Midwest ISO was unlawful then such consequent expenses and obligations cannot be recovered by LG&E and KU. Although the Commission "defers the rate-making disposition of these amounts until subsequent base rate cases," 5/31/06 Order at 15, it is unreasonable to establish a regulatory asset for which no recovery could possibly be had. Furthermore, LG&E and KU should not be permitted to continue to collect for Schedule 10 costs in their base rates; at the least, the regulatory liability to be established should include not only Schedule 10 costs which they are no longer incurring, but any and all Schedule 10 costs collected in base rates.

In fact, the 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.[16] Chairman Goss notes in his dissent that "the evidence relied on" by the majority in authorizing LG&E and KU to withdraw from membership "falls short of the quantification we have required in prior cases, such as the Kentucky Power/PJM case referenced above." 5/31/06 Order at 31. As the

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[14] *Id.* at 24-25. The exit fee reflects the responsibility for a share of all financial obligations incurred prior to the effective date of the withdrawal. *See* 12/29/03 M. Holstein Testimony 12:7-11.

[15] *See* Midwest ISO's Initial Post-Hearing Brief, filed 4/26/04, at 3; Midwest ISO's Reply Brief, filed 5/19/04, at 34-35; 12/29/03 M. Holstein Testimony 15:13-25.

[16] *Compare* 5/31/06 Order at 7-8 *with id.* at 20-23. Ironically, the Commission's construction of "utility" might lead to the very effects it erroneously connects with Midwest ISO membership.

applicants for a change in the *status quo*, LG&E and KU should have borne the burden of proof. *Energy Regulatory Commission v. Kentucky Power Company*, 605 S.W.2d 46, 50 (Ky. App. 1980); 5/31/06 Order at 28 (Chmn. Goss, dissenting). 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.[17]

2. Additional evidence not available at the former hearing requires a rehearing and reversal of the authorization to withdraw from the Midwest ISO.

In its 5/31/06 Order, the Commission concluded that "LG&E and KU should incur lower overall costs in the future by exiting MISO and pursuing the TORC option."[18] This conclusion reflects a studied attempt to divine future circumstances based upon the models and testimony presented by LG&E/KU and the Midwest ISO. In light of the evidence in the record and additional information not available at the former hearing in July 2005, the Midwest ISO continues to stand by its model, and hence respectfully disagrees with the conclusion of the majority. Moreover, it is only now that the requisite comparison under KRS 278.218 can be performed.

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[17] As noted in the 5/31/06 Order at 11 n.8, the LG&E/KU projection of 2005-2010 savings in excess of $65 million was based on an estimated exit fee of $24 million. The comparable Midwest ISO estimate was $38.2 million. *See* 12/29/03 M. Holstein Testimony 12:19. In its October 2004 Response to the Commission Staff's 10/13/14 Data Request No.1 (attached as Exhibit A), the Midwest ISO provided its then-current estimates of the exit fee for withdrawal at year-end 2005 ($40, 239,034), 2007 ($27,162,976), and 2009 (14,553,128).) Given that LG&E and KU used an estimate of $41 million in Case No. 05-471, *see* 11/18/05 M. Morey Testimony at 17:10-15, they grossly underestimated this cost of withdrawal in this proceeding.

[18] 5/31/06 Order at 26.

a. One year of actual data will show the net benefits of continued membership in the Midwest ISO after inauguration of the Day 2 market.

The Midwest ISO concurs with Chairman Goss that the Commission's action would be better informed by actual market experience.[19] It would also benefit from the results of associated inquiries by the Federal Energy Regulatory Commission ("FERC"). Inasmuch as there is no imperative for LG&E and KU to withdraw, the Midwest ISO respectfully requests that the Commission suspend its 5/31/06 Order pending presentation of one year of actual data from the market operations of the Midwest ISO. This information "could not with reasonable diligence have been offered to the Commission at the former hearings, KRS 278.400, and provides much needed context for a fully informed decision. The Commission found, and the Midwest ISO agrees, that economic models are predictive of trends as opposed to concrete portrayals of actual future outcomes.[20] Even as predictive devices, models are highly susceptible to subjective judgments concerning fundamental assumptions. In this case, there are two polestars against which modeled outcomes can be measured. The first is philosophical: whether it is more likely that a large, liquid competitive market will produce superior outcomes than an insular command-and-control industry structure. LG&E's and KU's own witness testified that, in the long run, Kentucky consumers would benefit from being a part of a market structure such as that operated by the Midwest ISO.[21]

The Midwest ISO again agrees with Chairman Goss that the debate over state verses regional interests has been overtaken by events.[22] It is simply impossible for a single state to

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[19] 5/31/06 Order at 32 (Chmn. Goss, dissenting).

[20] 5/31/06 Order at 16.

[21] 9/29/04 Supplemental Testimony of Martyn Gallus, Senior Vice President, Energy Marketing LG&E Energy LLC, at 3, 6, 7.

[22] 5/31/06 Order at 29-30 (Chmn. Goss, dissenting). *See also* 2006 Ky. Acts ch. 137 (HB 626) §1 (amending KRS 278.020(1) to provide that the Commission "when considering an

isolate itself from the flows of electrons through the Eastern Interconnect. *See Kentucky Power Co.*, 352 F.Supp.2d at 780 (discussing interconnectedness of electric power grids). Electrons respect the laws of physics and are nonplussed by state borders. The laws of economics favor efficiency and defy state attempts to preserve artificial benefits or exclude cost. In the context of what is *de facto* a regional market for electricity, Kentucky consumers are better served through a significant influence on regional affairs within the Midwest ISO and on national energy policy as a member of a Regional Transmission Organization.[23]

The second measurement is the objective one of actual experience. The parties were able to introduce only three months of actual experience with the Day 2 markets into the record.[24] The actual experience did not validate the predicted outcomes of either model, but then again it was for a short duration and reflected certain "learning curve" bias. The parties may argue about gross-versus-net, but the small sample of actual data available unambiguously showed that Kentucky consumers benefited from membership in the Midwest ISO.

Moreover, with experience, the Midwest ISO continues to rapidly develop. Every day, the Day 2 operations become more efficient. While the Midwest ISO was gaining experience in the early days, its real-time operators tended to err on the side of reliability with secondary regard to cost minimization. As a result, Revenue Sufficiency Guarantee ("RSG") costs were initially higher than the steady state predicted in the economic models; with experience, RSG costs are steadily decreasing. The Midwest ISO, in its monthly presentation of operating reports to its Advisory Committee and its Board of Directors has been quantifying this decrease in RSG.

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application for a certificate to construct an electric transmission line, may consider the interstate benefits expected to be achieved by the proposed construction or modification of electric transmission facilities in the Commonwealth"), § 2 (amending KRS 278.714(3) similarly).

[23] 5/31/06 Order at 29 (Chmn. Goss, dissenting).

[24] *Id.* at at 32.

As shown on the most recent such report (attached as Exhibit B),[25] the amounts have decreased substantially — beginning in December 2005 — to a fraction of what they had been earlier in 2005. This, and other evidence of its type, could be introduced if market experience to date is to be considered by the Commission.

Simultaneously, the effective scope of the Midwest ISO's market is steadily increasing. The transitory phases of the integration of the markets of the Midwest ISO and PJM have come to a close. A member of the Midwest ISO can now sell electricity to PJM markets (and vice-versa) without bearing pancaked transmission rates or having the market burdened by Seams Elimination Cost Adjustments. The Midwest ISO and PJM have in place reciprocal rights that allow them to resolve congestion on an economic basis as opposed to the blunt instrument of Transmission Loading Relief ("TLR") directives. The Midwest ISO's members, including LG&E and KU, share these developments, and such success and benefits are not available to outside parties.

The majority opinion suggests that LG&E's and KU's economic success as members of the Midwest ISO have been overstated.[26] The Midwest ISO respectfully submits that actual experience shows that more efficient and seamless markets will consistently improve the off-system sales experience of LG&E and KU, and a review of additional data will support such a conclusion. As Chairman Mark Goss notes:[27]

> If a full year's worth of market data were analyzed using both LG&E's, KU's and MISO's models, it would be possible to test their validity more accurately. While the first year of the market would not produce enough information to estimate the long-run benefits of membership to the Companies, it would have

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[25] Since Exhibit B could not have been available at the time of the last hearing date, it serves as an important example of the type of evidence that Midwest ISO could not with reasonable diligence offer at the former hearing.

[26] 5/31/06 Order at 17.

[27] 5/31/06 Order at 32-33 (Chmn. Goss, dissenting).

> shown which model had higher predictability and therefore greater certainty. With both the relatively small net benefits predicted by the Companies and the incredibly large estimated net cost predicted by the MISO models, this rough analysis could have made our decision much more informed. Moreover, it would have been easy to reopen the record for the limited purpose of receiving a full year's worth of market data.

This analysis goes to the heart of a request for rehearing under KRS 278.400. Additional evidence is now available to the Commission that could not have been previously offered. This evidence must be considered by the Commission in order to reach a fully informed decision.

b. LG&E and KU are pursuing an alternative different from the option on which the 5/31/06 Order is based, requiring a rehearing to compare the requested alternative with the *status quo*.

The additional evidence discussed above must also be considered in light of the LG&E's and KU's known plans following the proposed withdrawal from Midwest ISO. The Commission's approval for LG&E and KU to leave Midwest ISO in this matter is based on their plan to take back all operating functions from Midwest ISO and subsequently contract out reliability coordination services ("the TORC option").[28] However, it appears from LG&E and KU's filings in PSC Case No. 2005-00471 that the TORC option is no longer what LG&E and KU plan to do.[29] The current plan involves transferring control of LG&E's and KU's transmission facilities from Midwest ISO to LG&E and KU for the purpose terminating their membership in the Midwest ISO and control to TVA to the extent necessary for it to act as their Reliability Coordinator, and to SPP to the extent necessary for it to administer the OATT as an Independent Transmission Organization. This differs from the scenario reviewed by the Commission in the 5/31/06 Order in the use of SPP and the costs associated with using a third-party tariff administrator.

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[28] 5/31/06 Order at 17.

[29] 6/2/06 Stipulation of Facts, filed in Case No. 2005-00471, at 2-3.

The first concrete and specific information about what LG&E and KU proposed to do upon withdrawal from the Midwest ISO came with the late 2005 applications to FERC and the Commission. Their proposal has continued to be filled in and modified in the following months,[30] and several matters and issues remain subject to change.[31] No sensible comparison between the *status quo* and the requested alternative has been possible until LG&E and KU specified the alternative. Now, with a full year of market data, the tests required under KRS 278.218 can be performed and the relative merits can be assessed.

Finally, the Midwest ISO is unaware of any prejudice that will be occasioned to LG&E and KU or to Kentucky ratepayers if finality about withdrawal awaits receipt of the empirical evidence discussed above. Importantly, as Chairman Goss noted, Kentucky ratepayers will receive a benefit by delaying withdrawal because, to date, LG&E and KU have found it more cost effective to serve their native load through the Midwest ISO markets as opposed to dedicating LG&E and KU-owned resources to this function.[32] With a great deal in the balance, definitive proofs tested with actual data are better than sheer prognostications and speculation — and a rehearing of these issues is needed.

WHEREFORE, the Midwest ISO respectfully requests that the Commission 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.

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[30] *See, e.g.*, 2nd Am. Jt. Applic. at 7 (¶14), filed in Case No. 2005-00471 on February 3, 2006; 4/13/06 FERC compliance filing, filed in Case No. 05-471, at 4-9.

[31] For example, at FERC, applications for rehearing remain unaddressed the terms of withdrawal may be altered in any order on rehearing, the treatment of the exit fee and Schedule 10 costs in base rates may be modified, and the scope of LG&E's and KU's market-based rate authority is in doubt. LG&E and KU have indicated that resolution of the last issue is critical to their withdrawal decision.

[32] 5/31/06 Order at 30 (Chmn. Goss, dissenting).

Respectfully submitted,

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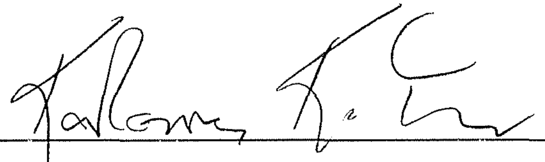
BY: 

ATTORNEYS FOR MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC.

CERTIFICATE OF FILING AND SERVICE

I hereby certify that on the 23rd day of June, 2006, the original and ten (10) copies of this Application for Rehearing were hand-delivered for filing with the Commission, an electronic copy was e-mailed to counsel of record, and a copy was mailed, first-class and postage-prepaid, to:

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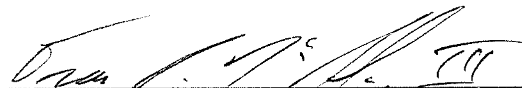

Attorney for Midwest Independent
Transmission System Operator, Inc.

REQUEST:

1. What is the current calculation of the total exit fee if Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities ("KU") withdraw from MISO? Provide all details to support the calculation.

RESPONSE:

The exit fee for LGE/KU was calculated for three different years: 2005, 2007, and 2009. This was done to illustrate that the exit fee declines over time as the Midwest ISO's total obligations are paid off. The exit fee for each of these years is as follows:

2005: $40,239,034

2007: $27,162,976

2009: $14,553,128

The details underlying these figures are provided in the form of a spreadsheet showing the calculations themselves (attached as Exhibit 1 to this response), as well as the financial reports from which the exit fee spreadsheet input data were taken (attached as Exhibit 2).

Witness: Michael Holstein

Exhibit A

Revenue Sufficiency Guarantee

Revenue Sufficiency Guarantee
$ millions

Day-Ahead

	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
RSG ($ millions)	4.3	5.7	6.6	5.3	4.1	2.7	3.8	7.6	8.0	4.6	2.9	4.8	2.6
Gas Prices in $/MMBtu	6.46	7.10	7.45	9.18	10.99	12.32	9.02	12.65	8.38	7.26	6.37	6.72	6.00
Revenue Sufficiency Guarantee Normalized for Fuel Price*	4.7	5.7	6.3	4.1	2.6	1.5	3.0	4.2	6.7	4.5	3.2	5.1	3.1

2005 (May–Dec) 2006 (Jan–May)

Real-Time

	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
RSG ($ millions)	29.4	67.9	45.1	59.3	67.4	53.1	41.1	60.4	16.2	14.2	14.1	9.9	7.8
Gas Prices in $/MMBtu	6.46	7.10	7.45	9.18	10.99	12.32	9.02	12.65	8.38	7.26	6.37	6.72	6.00
Revenue Sufficiency Guarantee Normalized for Fuel Price*	32.2	67.6	42.8	45.7	43.4	30.5	32.2	33.8	13.7	13.8	15.6	10.4	9.2

2005 (May–Dec) 2006 (Jan–May)

Revenue Sufficiency Guarantee
$/MWh

2006

	Jan	Feb	Mar	Apr	May	YTD
Low	1.43	0.34	0.89	1.69	0.45	0.34
High	8.68	8.58	6.06	3.29	2.35	8.68
Average	3.72	3.75	3.23	2.45	1.38	2.91

* RSG Normalized using gas price at Market start (04/2005) of $7.07

Exhibit B