

Ernie Fletcher
Governor

Teresa J. Hill, Secretary
Environmental and Public
Protection Cabinet

Timothy J. LeDonne
Commissioner
Department of Public Protection

Lonnie E. Bellar
Vice President - State Regulation
Kentucky Utilities Company
220 West Main Street
P. O. Box 32010
Louisville, KY 40202



Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

Mark David Goss
Chairman

John W. Clay
Vice Chairman

Caroline Pitt Clark
Commissioner

November 26, 2007

RE: Case No. 2006-00509

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

A handwritten signature in black ink, appearing to read "Beth O'Donnell".

Beth O'Donnell
Executive Director

BOD/rs
Enclosure



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Honorable Elizabeth E. Blackford
Assistant Attorney General
Office of the Attorney General Utility & Rate Intervention Division
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204

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Honorable Michael L. Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
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Attorney at Law
Stoll Keenon Ogden, PLLC
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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION)
OF THE FUEL ADJUSTMENT CLAUSE OF) CASE NO. 2006-00509
KENTUCKY UTILITIES COMPANY FROM)
NOVEMBER 1, 2004 TO OCTOBER 31, 2006)

AN EXAMINATION OF THE APPLICATION)
OF THE FUEL ADJUSTMENT CLAUSE OF) CASE NO. 2006-00510
LOUISVILLE GAS AND ELECTRIC COMPANY)
FROM NOVEMBER 1, 2004 TO)
OCTOBER 31, 2006)

O R D E R

The Commission established these cases to review and evaluate the operation of the fuel adjustment clauses ("FAC") of Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively the "Companies") for the 2-year period ended October 31, 2006. Kentucky Industrial Utility Customers, Inc. ("KIUC") and the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention ("AG"), intervened. The Commission rendered its decisions in these proceedings on October 12, 2007. On November 2, 2007, KIUC petitioned for rehearing and, on November 9, 2007, the AG filed a notice of support for KIUC's rehearing request.

KIUC and the AG initially argued that KU incurred approximately \$5.1 million and LG&E incurred approximately \$400,000 in excess fuel costs and that these costs were improperly charged to ratepayers through the Companies' FACs. KIUC and the AG alleged that the Companies received compensation for their excess fuel costs from the

Midwest Independent System Operator (“MISO”) regional transmission organization¹ in the form of Revenue Sufficiency Guarantee (“RSG”) Make Whole Payments. KIUC argued that the Companies should be required to make refunds to their customers of the alleged excess fuel costs with interest. In its October 12, 2007 Orders, having considered the Intervenor’s arguments and the Companies’ counter arguments, the Commission found that no excess fuel costs were incurred and, therefore, no refunds were required.

KIUC’S REHEARING REQUEST

KIUC bases its rehearing request on the following arguments: (1) the Commission’s decisions reflect a fundamental misinterpretation of KIUC’s position; (2) the Commission’s conclusion that KIUC’s position violates the prohibition against single-issue rate-making is based on the misunderstanding that KIUC requested a crediting of Make Whole Payments through the Companies’ FACs; and (3) the Orders of the Commission are not based upon appropriate reasoning and, therefore, violate the “arbitrary and capricious” standard of review for administrative agencies.

KIUC claims that the Commission’s determination that all of the Companies’ fuel costs were reasonable is based on an incorrect reading of KIUC’s position. KIUC states that, in its pre-filed testimony, it argued that the Commission should disallow specific fuel costs charged by the Companies through their FACs, not that RSG Make Whole Payments should be credited through the FACs. KIUC quotes from page 7 of the October 12, 2007 Orders wherein the Commission concluded: “Therefore, it would not be appropriate to require that items unrelated to fuel costs, such as RSG Make Whole Payments, be included in the FAC.” KIUC claims that it never argued that RSG Make Whole Payments

¹ Although no longer members, from April 2005 through September 2006, LG&E and KU were members of MISO and operated under MISO’s “Day 2 Energy Markets.”

should be included in the Companies' FAC calculations. KIUC states that it was very clear in its position that excess fuel costs should be disallowed, not that Make Whole Payments should be credited.

KIUC contends that the Commission's conclusion that KIUC's position violates the prohibition against single-issue rate-making is likewise based on the misunderstanding that KIUC requested a crediting of Make Whole Payments through the FAC. As stated in its brief, KIUC agrees that the FAC is by definition a single-issue rate-making mechanism that deals with the single issue of fuel costs. KIUC states that the costs that it argues should be disallowed are the excess fuel costs incurred when the Companies dispatched their generating units out of economic order and that the appropriate venue for addressing excess fuel costs is through an adjustment to the Companies' FACs in these cases.

Finally, KIUC claims that the Commission's October 12, 2007 Order is not based on appropriate reasoning. KIUC argues that the Order fails to address KIUC's arguments and does not contain a rational connection between the facts found and the decision made.

THE COMPANIES' POSITION

On November 13, 2007, the Companies filed a joint response opposing KIUC's petition for rehearing. Therein, the Companies addressed each of the three arguments advanced by KIUC in its petition.

First, the Companies opine that the Commission's Orders correctly portray KIUC's position and correctly deny the premise on which that position depends: that RSG Make Whole Payments are fuel related. The Companies state that, through its testimony and brief, KIUC argues that the costs that should be disallowed are those that are excessive and for which the Companies received compensation via MISO Make Whole Payments.

The Companies also point to the Commission's conclusion that RSG Make Whole Payments are not fuel related and, therefore, are not pertinent to FAC considerations.

Secondly, the Companies state that there was no misunderstanding in the Commission's decisions regarding the matter of single-issue rate-making. Citing the Commission's conclusions that RSG Make Whole Payments are not fuel related, and that the single issue appropriately considered in FAC proceedings is fuel costs, the Companies state that including a single non-fuel revenue stream such as RSG Make Whole Payments in the FAC proceedings would, as our Orders state, constitute inappropriate single-issue rate-making.

Finally, the Companies state that the Commission's Orders are well-reasoned and easily satisfy the "arbitrary and capricious" standard of review for administrative agencies. The Commission's Orders indicate that it understood and articulated the facts in these proceedings and correctly concluded that RSG Make Whole Payments are not fuel related, according to the Companies. They go on to state that KIUC's claim that the Commission's Orders are "arbitrary and capricious" is utterly devoid of merit.

DISCUSSION AND DECISION

Based on the petition for rehearing of KIUC, the Companies' joint response thereto and being otherwise advised, the Commission finds no basis for granting rehearing of its decisions in these cases. Support for this finding is set forth in the following paragraphs.

The Commission neither misunderstood nor misstated KIUC's position in these proceedings. The first full paragraph on page 3 of the October 12, 2007 Orders clearly states KIUC's position, which, in summary, is (1) excess fuel costs were incurred due to MISO's dispatch orders and (2) the amount that should be returned to ratepayers is based

on the RSG Make Whole Payments received from MISO which the Companies received as compensation for these excess fuel costs.

The Commission does acknowledge the manner in which KIUC interchangeably referred to crediting excess fuel costs to customers in amounts based on the Companies' Make Whole Payments and crediting the Make Whole Payments themselves to customers through the Companies' FACs. As pointed out by the Companies, at the hearings on these cases, KIUC's witness stated that "up to the point of the excessive fuel costs, they should use the Make Whole Payments as an adjustment in the fuel clause." We also note that the beginning of the first full paragraph on page 2 of KIUC's brief reads as follows: "The issue in this case is whether the Companies charged any improper expenses through their FACs. But the sub-issue is who should receive credit for the make-whole payments: the E.ON shareholders who paid none of the excessive fuel costs, or ratepayers who paid all of the excessive fuel costs." (Emphasis added).

Another instance where KIUC blurred the distinction between whether it was advocating for excess fuel costs to be excluded from recovery through the Companies' FACs or for Make Whole Payments to be credited through the FACs is in the first paragraph on page 7 of its brief. That paragraph concludes with the sentence "But the Companies did act improperly when they kept for E.ON shareholders the \$5,584,489 in Make Whole payments when shareholders paid none of the excessive fuel costs." The clear implication of this statement is that the Companies should have passed the Make Whole Payments on to their ratepayers.

In its discussion of the Duke Energy Kentucky rate case settlement, on page 8 of its brief, referring to the schedule at the top of page 9, KIUC states "Duke Kentucky deducts

MISO Make-whole Payments directly from the Generation portion of its Fuel Costs Schedule in its FAC.” The last sentence in the first paragraph on page 9 reads “By approving this treatment of Duke Kentucky's Make Whole Payments, the Commission determined that MISO make-whole payments are related to fuel costs and can be credited to customers through a utility's FAC.” Although an inaccurate description of what was determined for Duke Energy Kentucky, this sentence clearly refers to crediting the Make Whole Payments themselves through a utility's FAC.

The last paragraph on page 9 of KIUC's brief furthers its discussion of the Duke Energy Kentucky settlement. KIUC argues that the Companies' FACs must conform to the Duke Energy Kentucky FAC, an FAC which provides for crediting the MISO Make Whole Payments themselves.

Having recounted what could be described as inconsistencies in KIUC's description of its position, we acknowledge that our Orders contained some similar inconsistencies, in their descriptions thereof. These have been noted in KIUC's petition. Regardless of those inconsistencies, however, the distinction now being made by KIUC was always recognized by the Commission and it is a distinction that is immaterial to the Commission's decisions in these cases -- those decisions being that Make Whole Payments are not fuel related. Therefore, it is improper to base any decision concerning an appropriate level of fuel costs, and recovery thereof through a utility's FAC, on such payments.

In closing, irrespective of the distinction between crediting Make Whole Payments to customers through the Companies' FACs or crediting excess fuel costs to customers through the FACs based on the level of Make Whole Payments received, our decisions

would be unchanged. Make Whole Payments are not fuel related and have no bearing on the appropriate level of fuel cost to be recovered from the Companies' ratepayers.

IT IS THEREFORE ORDERED that the Petition of KIUC for rehearing is denied.

Done at Frankfort, Kentucky, this 26th day of November, 2007.

By the Commission

Commissioner Clark Abstains

ATTEST:



Executive Director

Case No. 2006-00509
Case No. 2006-00510