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August 29, 2007

HAND DELIVERED

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, KY 40601

RE: Case No. 2006-00509 - An Examination of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company from November 1, 2004 Through October 31, 2006
and
Case No. 2006-00510 - An Examination of the Application of the Fuel Adjustment Clause of Louisville Gas and Electric Company from November 1, 2004 Through October 31, 2006

Dear Ms. O'Donnell:

Enclosed please find an original and ten copies for filing in each of the above-referenced cases.

Please indicate receipt of this filing by your office by placing a file stamp on the extra copy and returning to me via our runner.

Yours very truly,

Kendrick R. Riggs

KRR: jms
Enclosures

cc: Dennis G. Howard II w/ enclosures
Assistant Attorney General

David F. Boehm w/ enclosures
Michael L. Kurtz
Boehm Kurtz & Lowry

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF KENTUCKY UTILITIES COMPANY FROM NOVEMBER 1, 2004 THROUGH OCTOBER 31, 2006	)	**CASE NO. 2006-00509**
AN EXAMINATION OF THE APPLICATION OF THE FUEL ADJUSTMENT CLAUSE OF LOUISVILLE GAS AND ELECTRIC COMPANY FROM NOVEMBER 1, 2004 THROUGH OCTOBER 31, 2006	)	**CASE NO. 2006-00510**

JOINT RESPONSIVE MEMORANDUM OF LAW OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

* * * * *

> *[T]he PSC has many appropriate rate-making methodologies available to it, and it must have some discretion in choosing the best one for each situation . . . Again, we must look more to whether the result is fair, just and reasonable rather than at the particular methodology used to reach the result.*
>
> *- Kentucky Court of Appeals*[1]

A surcharge is not, in itself, unlawful or unreasonable.

- Kentucky Court of Appeals[2]

However, in the face of clearly settled law, this decision was issued earlier this month:

> *[T]his Court finds that the PSC may not allow a surcharge without specific statutory authorization.*
>
> *- Franklin Circuit Court*[3]

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[1] *National-Southwire Aluminum Co. v. Big Rivers Electric Corporation,* 785 S.W.2d 503, 516 (Ky. App. 1990) (affirming a Commission decision setting a fluctuating electricity rate for aluminum smelters based on the world price of aluminum).

[2] *Commonwealth ex rel Armstrong v. Public Service Comm'n,* 1985 Ky. App. LEXIS 709, 5-6 (Ky. App. 1985) (affirming a Commission decision setting a surcharge for several small gas companies for the purpose of retiring unpaid indebtedness) (unpublished, cited as persuasive, not binding, authority in accord with CR 76.28(4)(c)).

INTRODUCTION

The Commission has requested briefs that address the legality of the relief requested by Kentucky Utilities Company and Louisville Gas and Electric Company (the "Companies") in these proceedings under 807 KAR 5:056 (eff. 1982), the Commission's fuel adjustment clause ("FAC") regulation, in light of a statement contained in a non-final, unpublished opinion of a trial court that does not mention the fuel adjustment clause and that contradicts well-settled law as explained by Kentucky's appellate courts. The answer to the direct question is clear: the relief sought by the Companies is lawful. The answer to the implied question – the proper manner in which the Commission should fulfill its duty to comply with the law – is equally clear. Kentucky Supreme Court Rule 1.040(5) provides that the Kentucky Supreme Court and the Kentucky Court of Appeals establish binding standards of law in this state:

> (5) Conformity with precedents.
>
> On all questions of law the circuit and district courts are bound by and shall follow applicable precedents established in the opinions of the Supreme Court and its predecessor court and, when there are no such precedents, those established in the opinions of the Court of Appeals.

Ky. S.Ct. R. 1.040(5).

The standards of law set by the Kentucky Supreme Court and the Kentucky Court of Appeals bind the Commission. It is bound by law requiring it to set just and reasonable rates; by law instructing it that it is not the methodology used, but the result reached, that is controlling; by law instructing it that administrative regulations, including 807 KAR 5:056, have the force and effect of law; by KRS Chapter 13A, which requires certain procedures for repeal of an

[3] *Commonwealth ex rel Stumbo v. Public Service Comm'n,* No. 06-CI-269 (Fr. Cir. Ct., August 1, 2007) (rejecting a surcharge for recovery of gas pipeline replacement costs).

administrative regulation; by KRS 278.160, which requires filed rates, including the FAC, to be charged; and by the law of due process.

A Commission decision to apply unpublished *obiter dicta* of the Franklin Circuit Court, cited above and as advocated by the Attorney General, rather than all statutory, regulatory, and judicial law to the contrary, would be legal error and in derogation of its duty. The opinion applies neither to utilities that were nonparties to the case (such as the Companies) nor to rate mechanisms that were not the subject of the case (such as the FAC).

Because 807 KAR 5:056 is lawful and because the Companies have complied therewith during the two-year period under review, the Commission should grant the Companies their requested relief by: (1) approving the charges and credits the Companies applied through their FAC tariffs from November 1, 2004 through October 31, 2006; (2) incorporating into the Companies' electric base rates the proposed amounts of fuel; and (3) resetting the base period component of the Companies' FAC rate formulas to be 17.03 mills per kWh for LG&E and 25.91 mills per kWh for KU going forward.

ARGUMENT

I. THE FUEL ADJUSTMENT CLAUSE IS LAWFUL.

A. The Fuel Adjustment Clause is Statutorily Authorized.

1. The Fuel Adjustment Clause is Authorized by KRS 278.030.

The "Statutory Authority" designation appearing in the body of 807 KAR 5:056, as required by KRS Chapter 13A, specifies that its authorizing statute is KRS 278.030(1). KRS 278.030(1) requires rates to be fair, just, and reasonable. That authority is sufficient here. Kentucky statutes are to be construed liberally to effectuate the intent of the legislature.[4] Here, the legislative intent, explicitly stated, is that the Commission set "just and reasonable" rates. A

[4] KRS 446.080; *Hardin Co. Fiscal Ct. v. Hardin Co. Bd. of Health*, 899 S.W.2d 859 (Ky. App. 1995)

necessary corollary to the statutory directive is the delegation to the Commission of authority to determine the correct method needed to set that just and reasonable rate. One method chosen by the Commission is 807 KAR 5:056.

The Franklin Circuit Court's Opinion, which is currently on appeal, focused on KRS 278.190 as the sole means to change a rate absent a specific additional statutory procedure. The implication arising from this overly broad reading of the law is that 807 KAR 5:056, a specific procedure established by the Commission to set a rate, exists without statutory authority. However, the Franklin Circuit Court opinion does not include any examination of the language of KRS 278.180 and 278.190, both of which deal with procedures to change a rate or rates, and neither of which contains language limiting the Commission in the way the court indicated. The Court addressed only whether the Commission has something called "inherent authority" and concluded that it does not.[5]

To the extent the Franklin Circuit Court's rationale can be read to apply to the FAC regulation (and other interim rate adjustment mechanisms), the rationale is in error in at least three basic ways: [1] it fails to recognize that KRS 278.190 is a procedural statute rather than a substantive one; [2] it fails to recognize that KRS 278.190 is permissive rather than mandatory, stating that, when a "schedule stating new rates" (note the plural) is filed, "the commission may" suspend the schedule and institute additional procedures; and [3] it fails to take KRS 278.180 into account at all. KRS 278.180 allows a new rate (in the singular) to go into effect upon thirty days' notice and the filing of a tariff, indicating that the General Assembly fully anticipated, and provided a procedure for, creating, modifying, or terminating a rate or rate mechanism without

[5] As the Companies explain further in this brief, "inherent authority" is not a term used to describe legitimate powers of an administrative agency. "Necessarily implied" authority is the accurate term, and that term describes powers statutorily delegated to an agency that are not explicit but that are necessary to enable the agency to achieve the statutorily-mandated mission. Here, the statutorily-mandated mission is the establishment of just and reasonable rates. The necessarily implied power is choosing the means to establish those just and reasonable rates.

having to conduct full proceedings as set out in KRS 278.190. Indeed, KRS 278.180 is made a nullity by a ruling indicating that a full-blown rate case in which all costs and revenues are considered together is the sole way to change any rate.

KRS 278.180 allows a utility to change "any rate" simply by filing a tariff and giving the commission only 30 days' notice. If the Commission does not suspend the rate, it may go into effect without any required detailed review. There is no requirement that all costs and revenues be considered before that rate is effective. There is no requirement that KRS 278.190 procedures be applied. Indeed, there is no reference to KRS 278.190 in KRS 278.180 *at all.* There are only the requirements that a tariff be filed and that a brief notice period be given.

Thus, the generally applicable *procedure* is supplied by KRS 278.180, although the Commission has the option to suspend the rates and to conduct a full investigation under KRS 278.190. However, the generally applicable *substance* of ratemaking is supplied by KRS 278.030, which requires the Commission to set "just and reasonable rates." The law is that the methodology used to establish those "just and reasonable" rates is a matter of Commission discretion.

In *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*,[6] the Court upheld as lawful separate variable rates for smelters based on the fluctuating price of world aluminum, an extraordinary basis for setting a utility rate, explaining at length why the Commission is, and must be, accorded discretion in finding ways to meet the "just and reasonable" statutory standard. Citing KRS 278.030(1) (requiring "fair, just and reasonable rates") and KRS 278.270 (requiring a "just and reasonable rate") as the statutes governing rate setting in Kentucky, the Court declared that the "ultimate resulting rate should be a more important consideration than

[6] 785 S.W.2d 503 (Ky. App. 1990).

some specific, mandated method for determining it,"[7] and that "the real goal for the PSC is to establish fair, just and reasonable rates. There is no litmus test for this and there is no single prescribed method to accomplish the goal."[8] Moreover, the Court explicitly rejected the argument that the Commission is not permitted to establish a variable rate, and held that the variable rate the Commission had established was not to be disturbed, as it was "fairly debatable as being sound and reasonable for all concerned."[9]

National-Southwire stands for the proposition that the Commission has extremely broad discretion in its choice of rate-setting methodology. Under *National-Southwire*, there can be no doubt that a formulaic rate such as the fuel adjustment clause meets the statutory standard, for 807 KAR 5:056 is an entirely reasonable way to assure that just and reasonable adjustments to rates are timely made, that customers do not overpay, and that a utility does not under- or over-recover. Even the Attorney General apparently so concedes, admitting that the fuel clause provides "rate stability for ratepayers."[10]

Indeed, Kentucky is not unusual in this regard: fuel adjustment clauses are employed across the nation, and courts have approved formulaic rates for various purposes. For example, the court in *Centerpoint Energy Entex v. Railroad Comm'n of Texas*,[11] upheld the operation of a purchased gas adjustment ("PGA") clause, holding that the "filed rate" is the *entire* rate schedule on file, including adjustment clauses. Accordingly, the court held that the commission had authority to conduct a prudence review of charges that had flowed through the PGA and order refunds. (The gas utility had claimed that such refunds would constitute improper retroactive ratemaking.) Although the court noted that, "as an administrative agency, the Commission may

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[7] *Id.* at 511.
[8] *Id.* at 513.
[9] *Id.* at 515.
[10] Attorney General Memorandum at 2.
[11] 208 S.W.2d 608 (Tex. App. 2006).

exercise only those powers that the legislature confers upon it ... [because] it has no inherent authority of its own," it concluded that the statutory authority conferred on the Commission was sufficient to support implementation of a PGA clause.[12] The term "rate," under Tex. Util. Code. Ann. § 101.003, was defined broadly to include not only "compensation," but also a "rule, regulation, practice, or contract affecting the compensation, tariff, charge, fare, toll, rental, or classification." Thus, the utility's entire schedule, together with its methodology for computing actual bills to be paid by gas customers, was the "filed rate."[13] The breadth of the Kentucky statute that defines "rate" fully supports the same finding, including not only "compensation," but also "any rule, regulation, practice, act, requirement or privilege in any way relating to such fare, toll, charge, rental, or other compensation, and any schedule or tariff or part of a schedule or tariff thereof."[14]

The statutory standard requires "just and reasonable" rates. 807 KAR 5:056 results in "just and reasonable rates." It is in compliance with the law, and it is well within the Commission's statutory authority. The relief sought by the Companies is lawful.

2. Administrative Agencies, Including the Commission, Possess Not Only Those Powers Explicitly Delegated to Them, But Also Those Powers Necessarily Implied by that Explicit Statutory Delegation.

As the court put it in *Ashland-Boyd County City-County Health Dept. v. Riggs*, "Powers of administrative boards and agencies are those conferred expressly or by necessary or fair implication.... It is a general principle of law that where the end is required, the appropriate means are implied."[15] Here, the end that is required is the establishment of a "just and

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[12] *Id.* at 615.
[13] *Id.* at 619.
[14] KRS 278.010(12). *See also Transwestern Pipeline Co. v. Federal Energy Regulatory Comm'n*, 897 F.2d 570, 578 (D.C. Cir. 1990) (FERC may approve a tariff containing a rate "formula" or "rule" instead of a specific number); Pierce, 97 Harv. L. Rev. at 349, n. 29 (rates may consist of fixed values and variable components).
[15] 252 S.W.2d 922, 923 (Ky. 1952).

reasonable rate." The choice of "means" to ensure that rate is left to the Commission, as the Court in *National-Southwire* held.

The court in *Public Service Comm'n v. Cities of Southgate and Highland Heights* did not address the Commission's power to set rates.[16] Nevertheless, the case illustrates the strength of the doctrine of necessarily implied power with relation to the important mission with which the General Assembly has entrusted the Commission. Faced with an argument that the Commission lacked jurisdiction to approve or to deny a transfer of ownership of a utility, as no statute expressly provided for such jurisdiction at that time, the Court held that such jurisdiction was necessarily implied:

> It is true that the governing statute, KRS Chapter 278, does not in express terms confer jurisdiction ... to pass upon sales of utility systems. However, ... the jurisdiction is *implied necessarily* from the statutory powers of the commission to regulate the service of utilities. KRS 278.040 .... The Public Service Commission is charged with responsibility, and vested with power, to see that the service of public utilities is adequate.[17]

Surely the Commission is charged with no less responsibility, and vested with no less power, to ensure that rates are fair, just, and reasonable.[18] After all, the Commission has been

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[16] 268 S.W.2d 19 (Ky. 1954).

[17] *Id.* at 21 (emphasis added).

[18] Kentucky cases upholding the doctrine of necessarily implied authority are legion. Examples include the following: *County of Harlan v. Appalachian Regional Healthcare, Inc.*, 85 S.W.3d 607, 611 (Ky. 2002) (Requiring the Harlan County jailer to take necessary steps to seek indigency determinations for medical treatment of inmates, although the statute did not expressly state that he had this duty, because "[t]he power granted by a statute is not limited to that which is expressly conferred but also includes that which is necessary to accomplish the things which are expressly authorized." The jailer thus had "a duty to take the necessary steps to seek an indigency" because otherwise the intent of the legislature to provide for medical treatment for indigents would be frustrated); *Chandler v. Strong*, 70 S.W.3d 405, 410 (Ky. 2002) (Attorney General had necessarily implied authority to view otherwise confidential records as part of a statutory mandate to investigate, because "[i]t is well recognized that a statute naturally carries with it all the powers necessary to its exercise." *Id.* at 410.); *Bd. of Educ. of Boyd Co. v. Trustees of Buena Vista School*, 76 S.W.2d 267, 268 (Ky. 1934) (the scope of a public officer's powers includes not only those expressly defined by statute, as "such statutes seldom, if ever, define with precise accuracy the full scope of such powers," but also those "supplemental and collateral" powers necessary to accomplish the statutory purpose of the office); *Humana of Kentucky, Inc. v. NKC Hospitals, Inc.*, 751 S.W.2d 369, 372-73 (Ky. 1988) ("...administrative agencies are held to possess the powers reasonably necessary and fairly appropriate to make effective the express powers granted to or duties imposed on them") (internal citations and quotations omitted); *Jefferson County v. Jefferson County Fiscal Court*, 192 S.W.2d 185 (Ky. 1946) (holding that the county court did, in fact, have authority

explicitly directed by the General Assembly to set "fair, just and reasonable" rates. It had not, at the time of *Southgate*, been explicitly directed to oversee utility transfers.

The breadth of discretion necessarily afforded to an administrative agency when it operates pursuant to the kind of general statutory standards given here – "fair, just and reasonable" – has been well described by the United States Supreme Court in upholding a Securities and Exchange Commission decision implementing a comparable standard: "fair and equitable:"

> The Commission's conclusion here rests squarely in that area where administrative judgments are entitled to the greatest amount of weight by appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process .... Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb.[19]

The same principle has been perhaps more memorably stated by a Kentucky Court, with direct reference to the Kentucky Public Service Commission:

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to spend money to pay commissioners to assist, and pay for newspaper publication, when it carried out its statutory duty to change precinct boundaries, even though no permission to spend the money was specifically given, because these powers were "necessarily implied" as part of the county court's statutory duties); *Dodge v. Jefferson County Board of Educ.*, 181 S.W.2d 406, 407 (Ky. 1944) (Deciding that School Board could set aside money for recreation for school age children, and explaining that "The power and authority granted by a statute is not always limited to that which is specifically conferred, but includes that which is necessarily implied as incident to the accomplishment of those things which are expressly authorized"); *Long v. Mayo,* 111 S.W.2d 633 (Ky. 1937) (Kentucky Highway department was authorized to issue bonds and purchase capital stock of bridge company to end public payment of tolls; the court found no express authority for such a procedure, *id.* at 638, but noted that "It is an accepted rule recognized often by this court that not only those powers expressly granted by the statute, but such powers as are necessarily or fairly implied in, or incident to, the accomplishment of the things which are expressly authorized to be done." *Id.* Accordingly, "the department of highways has the implied power to pay the railway company.... The only purpose of [the statute] was to abolish toll bridges.... The agreement attacked here by appellant is but a logical step for the accomplishment of that purpose." *Id.*); *Johnston v. Louisville,* 11 Bush 527, 74 Ky. 527 (Ky. 1875) (A municipal corporation possesses both express powers and those that are necessarily implied from, or incident to, those expressly granted).

[19] *Securities and Exchange Comm'n v. Chenery Corp.*, 332 U.S. 194, 209 (1947).

> We read the legislative mandate as directing us to keep our judicial fingers out of the ratemaking pie. [20]

It is ironic that the sole legal authority cited by the Attorney General in his Memorandum is *Boone County Water and Sewer District v. Public Service Commission.*[21] *Boone County* hardly supports the Attorney General's argument that the Commission has no authority other than that expressly conferred by statute. To the contrary: the court in *Boone County* said that the Commission has those powers that are "conferred expressly or by necessity or fair implication."[22] Moreover, *Boone County* concerned only whether the Commission had jurisdiction over a particular type of entity, in that case a sewage collection and transportation operation. The case did not concern the manner in which the Commission exercises jurisdiction it unquestionably has been given.

The relief sought by the Companies in these cases is lawful.

B. Established Law Cannot be Repealed by Implication

The Fuel Adjustment Clause is over twenty-five years old,[23] and the Commission's authority to implement the clause, as well as other formulaic rates and surcharges, has long been established. Kentucky courts have firmly established that long-established interpretations of law are entitled to respect.

> It is better that the law should remain permanent so far as judicial action is concerned, although settled originally upon doubtful principles, than that it should be subject to constant fluctuations according to the views and opinions which might be entertained by

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[20] *Commonwealth ex rel. Stephens v. South Central Bell Telephone Co.*, 545 S.W.2d 927, 931 (Ky. 1976).
[21] 949 S.W.2d 588 (Ky. 1997).
[22] *Id.* at 591.
[23] 807 KAR 5:056 was first effective on April 7, 1982. *See also* PSC Case No. 6877, Order (December 15, 1977) (Adopting with certain modifications the fuel adjustment clauses of the electric generation utilities and rejecting the proposal of the Attorney General to approve a separate purchase power clause); Memorandum to Hable D. Roberston, Regulations Compiler, Legislative Research Commission From Public Service Commission Re: Affirmative Consideration to Request for Modification of Proposed Uniform Fuel Adjustment Clause for Electrical Utilities (May 31, 1978).

> the court as constituted, at the time the same questions might at some subsequent time arise.[24]

The U.S. Supreme Court agrees: "[*Stare decisis*] permits society to presume that bedrock principles are founded in the law rather than in the proclivities of individuals, and thereby contributes to the integrity of our constitutional system of government."[25] In view of this venerable principle, the dicta in a sudden and isolated – and unreported – opinion by a circuit court, particularly when that opinion is not final and does not even mention the FAC, should not disturb that long-settled principle of law.

Nor may it simply be assumed that, since the General Assembly has enacted statutes that set particular rate making mechanisms, it meant also to limit by implication the Commission's long-standing discretion in rate-setting situations that do not implicate those mechanisms. There is no reason that the specific instruction to the Commission to permit a particular type of surcharge in, for example, KRS 278.183, should be interpreted to indicate that Commission authority in other areas has been affected in the least.[26] Legislative intent must be unmistakably clear before it may be presumed that settled law has been changed by an act of the legislature.[27] It is an understatement to say that there is no such clarity here.

The legislature is presumed to know the present state of the law, as well as the interpretations applied to the law, and to have acquiesced in those interpretations if it has taken

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[24] *Blankenship v. Bartleston & Co.*, 6 Ky. Op. 158 (1872).

[25] *Vasquez v. Hillery*, 474 U.S. 254, 265-66 (1986). In *Warren v. Spurlock's Adm'r*, 292 Ky. 668, 670 (Ky. 1943), Kentucky's highest court further explained the importance of this maxim, holding that a consistently applied statutory construction that the legislature had accepted for thirty years "must be regarded as the equivalent of a specific expression therein so far as contract rights acquired under it are concerned. The policy involved in this case was issued under that interpretation and it became in effect a part of it. *The court is not persuaded that its construction of the statutes is unsound; but even if it were otherwise the rule of stare decisis would constrain us to adhere to it."*(Emphasis added.)

[26] By the same reasoning, one could conclude that, since the General Assembly has set specific timeframes for certain actions (for example, in KRS 278.020(6) [utility transfers]; KRS 278.260(2) [notice of hearing]), the Commission is thereby rendered powerless to set, by regulation or order, timeframes for other actions.

[27] *Northern Kentucky Port Authority, Inc. v. Cornett,* 700 S.W.2d 392 (Ky. 1985); *Lee v. Forman,* 60 Ky. 114 (1860).

no legislative action in response.[28] As the court in *Leadingham* succinctly put it, "if the General Assembly had a contrary intention [to an existing construction of law] ... it has had ample opportunity to amend the statute, but has not done so."[29] That is precisely the case here. Presumably the legislature has known for decades that a fuel adjustment clause regulation exists, stating on its face that it is authorized by KRS 278.030; yet the legislature has made no move to alter it. Presumably the legislature also has known about such cases as *National-Southwire*, which uphold broad Commission discretion in choosing rate-setting methodology under KRS 278.030; yet the legislature has made no move to amend that interpretation of law either. Finally, KRS 278.180 remains on the books, permitting the Commission to order a change of a single rate, or to permit a change of a rate upon the filing of a tariff by a utility, *to go into effect in thirty days*. It is unquestionable that a full-scale rate case in which all costs and revenues are considered together cannot possibly take place in 30 days. Yet again, the General Assembly has not seen fit to repeal or even to modify KRS 278.180 to state that "no change shall be made by any utility in any rate *except by means of a general rate case*."

In *Leadingham*, the court concluded that the legislature's presumed knowledge of standards set by the Kentucky Supreme Court for review of cases brought under KRS 401.020 established that the legislature intended to leave that legal standard in place, particularly as the statute had remained unchanged "for more than ten years" following the interpretation in question.[30] Here, the subject regulation has existed for more than twice that length of time, carrying on its face the assertion that the statutory authority for its promulgation is KRS 278.030,

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[28] *See, e.g., Leadingham v. Smith,* 56 S.W.3d 420, 426 (Ky. App. 2001); *McChesney v. Hager*, 104 S.W. 714 (Ky. 1907)(legislative acquiescence of Supreme Court's longstanding statutory construction required adherence to that interpretation). *City of Louisville v. Louisville Water Co.,* 49 S.W. 766 (Ky. 1899) (water company's practical construction of its charter acquiesced in by the city for 30 years would be adopted even if the legislative meaning were doubtful).

[29] *Id.* at 426.

[30] 56 S.W.3d at 426.

which requires the Commission to set "just and reasonable" rates. Here, *National-Southwire*, holding that the Commission has extremely broad discretion in choosing a method by which a "just and reasonable" rate may be set, has been on the books for over sixteen years. The legislature presumably is aware of both, yet has made no move to disturb either one.

The FAC is lawful, and there is no justification for disturbing its just and reasonable operation and effect in this case.

C. An Administrative Regulation Has the Force and Effect of Law.

The Commission has questioned the legality of its own fuel adjustment clause regulation, a regulation that is over twenty-five years old and that is an integral part of the settled utility law of this state. However, as Kentucky's highest court explained in *Union Light, Heat & Power Co. v. Public Service Comm'n*, "It is well established that the rules and regulations of an administrative agency duly adopted pursuant to the powers delegated to it have the force and effect of law."[31] In *Union Light*, the court declared that the utility "was, and is, as much bound by these rules and regulations as if they were statutes enacted by the Legislature."[32]

An administrative agency is bound by its own regulations just as certainly as the regulated community is so bound.[33] An agency is prohibited by statute even from modifying a regulation by any means other than repeal or amendment through the statutory promulgation process, *see* KRS 13A, much less simply refusing to comply with it:

> (1) An administrative body shall not by internal policy, memorandum, or other form of action:
>
> (a) Modify a statute or administrative regulation;
>
> (b) Expand upon or limit a statute or administrative regulation; and

[31] 271 S.W.2d 361, 366 (Ky. 1954).
[32] *Id.* at 365.
[33] *Shearer v. Dailey*, 312 Ky. 226, 226 S.W.2d 955 (1950); *Hagan v. Farris*, 807 S.W.2d 488 (Ky. 1991).

> (c) Except as authorized by the Constitution of the United States, the Constitution of Kentucky or a statute, expand or limit a right guaranteed by the Constitution of the United States, the Constitution of Kentucky, a statute, or an administrative regulation.[34]

The Kentucky Supreme Court in *Hagan* demonstrated, moreover, how seriously the Courts take the right of regulated entities to rely upon an agency's longstanding construction of its own regulations: the Court held that, even though the agency in question had actually misinterpreted its own regulation, a licensee was entitled to rely upon that misinterpretation because it was "decades old" and "consistent." Citing *Barnes v. Dept. of Revenue*,[35] for the proposition that "[a] construction of a law or regulation by officers of an agency continued without interruption for a long period of time is entitled to controlling weight," the Hagan Court declared that, because of the licensee's reliance on the misinterpretation, "it would be unfair and unjust" to overrule the agency and to deprive the licensee of rights it had obtained under that misinterpretation.[36]

The Commission's administration of 807 KAR 5:056 also is "decades old" and "consistent." However, unlike the regulation at issue in *Hagan*, 807 KAR 5:056 has been interpreted properly. Consequently, there is even more reason not to punish those who have relied upon it for decades than there was to protect the licensee in *Hagan*. There is, and can be, no dispute that 807 KAR 5:056 has been in effect since 1982. There is, and can be, no dispute that regulated entities such as the Companies have relied upon it. There is, and can be, no dispute that the Commission has long interpreted the regulation and its ratemaking actions under other

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[34] KRS 13A.130(1). *See also* KRS 13A.310 (providing, *inter alia*, that a regulation "cannot be withdrawn" or "suspended," but must be repealed "by promulgation of an administrative regulation" entitled "Repeal of (state number of administrative regulation to be repealed)").
[35] 575 S.W.2d 169 (Ky. 1978)
[36] 807 S.W.2d at 490.

enabling law to be lawful, reasonable, and otherwise legitimate - an interpretation that is entitled to great deference.[37]

The Commission's longstanding interpretation of its authority to set formulaic and/or individual rates when necessary, and to promulgate such regulations as 807 KAR 5:056 (1982) (FAC regulation) and 807 KAR 5:011, Section 10 (1984) (the nonrecurring charge regulation, by which a utility may change a single rate outside a general rate procedure) is entitled to that deference.

In contrast, neither the statutes nor the caselaw permit the Commission suddenly to abrogate the regulation in the manner it seems to contemplate. The relief sought by the Companies in these cases is lawful.

D. The Fuel Adjustment Clause Regulation is Accepted by Kentucky Appellate Courts Without Any Question as to Its Legality.

The fuel adjustment clause is so integral to utility law in Kentucky that its existence, function, and effect is simply a given in legal rationales that directly concern other rate issues. For example, the Kentucky Supreme Court in *Kentucky Indus. Utility Customers, Inc. v. Kentucky Utilities Co.*,[38] upheld the environmental surcharge statute, KRS 278.183, in part because of the legitimacy of Kentucky's FAC. The legitimacy of the FAC, which – like the environmental surcharge – also appears as a surcharge on customer bills and is handled in separate rate proceedings, was discussed as follows by the Court:

> By comparison, separate rate proceedings for fuel adjustment expenses have been upheld in many jurisdictions. *See Norfolk v. Virginia Electric and Power*, 197 Va. 505, 90 S.E.2d 140, 11 PUR3d 438 (1955); *City of Chicago v. Illinois Commerce Comm'n*,

[37] *Com. ex rel Beshear v. Kentucky Utilities Co.*, 648 S.W.2d 535, 537 (Ky. App. 1982) ("Great deference is always given to an administrative agency in the interpretation of a statute which is within its specific province."). *See also Logan County v. Apex Env'tal*, 2005 WL 2045810 (Ky. App. 2005) ("As a general matter the courts give deference to an agency interpretation of its own regulations and the statutes underlying them.").
[38] 983 S.W.2d 493, 498 (Ky. 1998).

> 13 Ill.2d 607, 150 N.E.2d 776, 24 PUR3d 334 (Ill.1958), as examples.[39]

Similarly, in *Kentucky Power Co. v. Energy Regulatory Comm'n*,[40] the Court affirmed an order of the Franklin Circuit Court that had required the Commission to set a surcharge to enable a utility to recover the shortfall resulting from a change in the fuel adjustment clause formula. As in *Kentucky Indus. Utility Customers*, the existence and use of the fuel adjustment clause is expressly recognized by the Court. The controversy in both of these cases lay elsewhere: there was no argument concerning the legality of the long-accepted fuel adjustment clause.

The relief requested by the Companies in these cases is lawful.

II. THE FILED RATE DOCTRINE AND THE PROHIBITION AGAINST RETROACTIVE RATEMAKING PROHIBIT THE COMMISSION FROM ISSUING A REFUND ORDER IN THESE PROCEEDINGS.

Regardless of the Franklin Circuit Court's recent Order and Opinion, the filed rate doctrine and the prohibition against retroactive ratemaking strictly prohibit the Commission from ordering the refund of any of the Companies' FAC revenues for any reason other than non-compliance with the Companies' FAC tariffs.[41] In a 2007 Kentucky Court of Appeals case to which the Commission was a party, *Cincinnati Bell Tel. Co. v. Ky. P.S.C.*,[42] the court set forth the most comprehensive exposition to date of the filed rate doctrine in Kentucky. The court stated:

> [The filed rate] doctrine in essence stands for the proposition that when the legislature has established a comprehensive ratemaking scheme, the filed rate defines the legal relationship between the regulated utility and its customer with respect to the rate that the

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[39] *Id.* at 498.
[40] 623 S.W.2d 904 (Ky. 1981).
[41] 807 KAR 5:056(12) provides the standard by which the Commission may examine and disallow recovered fuel costs in two-year review proceedings such as these: "Every two (2) years following the initial effective date of each utility's fuel clause the commission in a public hearing will review and evaluate past operations of the clause, disallow improper expenses and to the extent appropriate reestablish the fuel clause charge in accordance with subsection (2) of this section."
[42] 223 S.W.3d 829 (Ky. App. 2007).

> customer is obligated to pay and that the utility is authorized to collect.[43]

The court went on to state, "While the doctrine has not been applied by name in Kentucky, its underlying principles are incorporated and recognized in both our statutory and our case law."[44] The statutes the court cited as embodying the filed rate doctrine in Kentucky are directly applicable to the Companies' FACs and their recovery thereunder, making that recovery lawful and prohibiting any disallowance or refund thereof except where the Companies did not comply with their FAC tariffs.

The first statute the appellate court cited in *Cincinnati Bell* is KRS 278.160,[45] which provides that utilities must collect from their customers the rates set out in their duly filed rate schedules, and that customers must likewise pay the rates set out in those schedules. The statute states:

> (1) Under rules prescribed by the commission, each utility shall file with the commission, within such time and in such form as the commission designates, schedules showing all rates and conditions for service established by it and collected or enforced....
>
> (2) No utility shall charge, demand, collect, or receive from any person a greater or less compensation for any service rendered or to be rendered than that prescribed in its filed schedules, and no person shall receive any service from any utility for a compensation greater or less than that prescribed in such schedules.

For the period under review in these proceedings, November 1, 2004, through October 31, 2006, the Companies had in place properly filed and approved FACs, as evidenced by the Commission's orders approving them.[46] Furthermore, there is no question that the Companies'

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[43] *Id.* at 837 (citing *Big Rivers Elec. Corp. v. Thorpe*, 921 F. Supp. 460 (W.D. Ky. 1996)).
[44] *Id.* (citing *Boone County Sand & Gravel Co. v. Owen County Rural Elec. Coop. Corp.*, 779 S.W.2d 224 (Ky. App. 1989)).
[45] *See id.* at 838.
[46] *See In the Matter of An Examination Of The Application Of The Fuel Adjustment Clause Of Kentucky Utilities Company From November 1, 2002 Through October 31, 2004,* Case No. 2004-00465, Order (May 25, 2005); *In the*

FACs are "filed schedules" of the kind contemplated by the statute.[47] Thus, pursuant to KRS 278.160(2), the Companies had an unambiguous legal obligation not to "charge, demand, collect, or receive from any person a greater or less compensation for any service rendered or to be rendered that that prescribed in its filed schedules ...." Likewise, each of the Companies' customers had an unambiguous legal obligation not to "receive any service from any utility for a compensation greater or less than that prescribed in such schedules."[48] Indeed, the Kentucky Court of Appeals has held that even when a utility negligently under-bills a customer for service, KRS 278.160(2) obliges the utility to collect the amount due pursuant to the utility's filed tariffs, just as the statute obliges the customer to pay that amount.[49] It would therefore be flatly contrary to the terms of KRS 278.160(2) for the Commission to order the Companies to refund any amounts collected under their FACs for any reason other than the Companies' failure to comply with the terms of their FACs.

The conclusion that the Commission may not order the Companies to refund their FAC revenues collected during the period under review save for non-compliance with their tariffs

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Matter of An Examination Of The Application Of The Fuel Adjustment Clause Of Louisville Gas and Electric Company From November 1, 2002 Through October 31, 2004, Case No. 2004-00466, Order (May 25, 2005); *In the Matter of Adjustment Of The Electric Rates, Terms and Conditions of Kentucky Utilities Company*, Case No. 2003-00434, Order (June 30, 2004); *In the Matter of Adjustment Of The Electric Rates, Terms and Conditions of Louisville Gas and Electric Company*, Case No. 2003-00433, Order (June 30, 2004).

[47] *See* KRS 278.010(12): "'Rate' means any individual or joint fare, toll, charge, rental, or other compensation for service rendered or to be rendered by any utility, and any rule, regulation, practice, act, requirement, or privilege in any way relating to such fare, toll, charge, rental, or other compensation, and any schedule or tariff or part of a schedule or tariff thereof"; *Centerpoint Energy Entex v. Railroad Comm'n of Texas,* 208 S.W.3d 608 (Tex. App., 2006)(upholding the operation of a purchased gas adjustment clause on the grounds that the "filed rate" is the *entire* rate schedule on file, including adjustment clauses). *See also Transwestern Pipeline Co. v. Federal Energy Regulatory Comm'n,* 897 F.2d 570, 578 (D.C. Cir. 1990) (FERC may approve a tariff containing a rate "formula" or "rule" instead of a specific number); Pierce, 97 Harv. L. Rev. at 349, n. 29 (rates may consist of fixed values and variable components).

[48] KRS 278.160(2).

[49] *See Boone County Sand & Gravel Co. v. Owen County Rural Elec. Coop. Corp.*, 779 S.W.2d 224, 226 (Ky. App. 1989) ("In light of the applicable Kentucky statute [KRS 278.160(2)] and the decisions cited, we fail to perceive any valid basis for finding that the equitable defense of estoppel may be invoked by a customer in Kentucky to defeat the claim of a utility to recover the amount of an underbilling.").

finds further support in the second statute the Kentucky Court of Appeals cited in *Cincinnati Bell*,[50] KRS 278.390, which states:

> Every order entered by the commission shall continue in force until the expiration of the time, if any, named by the commission in the order, or until revoked or modified by the commission, unless the order is suspended, or vacated in whole or in part, by order of decree of a court of competent jurisdiction.

In *Cincinnati Bell*, the court noted that the Subscriber Line Charge ("SLC") that BellSouth had charged to payphone providers was included in the rates the Commission approved for BellSouth in January 1999.[51] The court further noted that, though the Federal Communications Commission had ruled in 2002 that such charges could lead to over-recovery for phone utilities like BellSouth, the Kentucky Public Service Commission did not alter or otherwise affect BellSouth's rates until May 2003.[52] Even though there was little doubt that the SLC resulted in BellSouth recovering more than its costs and was, therefore, improper, the court applied the filed rate doctrine, stating:

> Under the requirements of the statutes, the rate that the PSC authorized BellSouth to charge payphone service providers remained in full force and effect until the Commission modified it by its order of May 2003. Consequently, as a matter of law, BellSouth was never overpaid; no credits accrued; and no refunds were owed.[53]

Precisely the same analysis applies to, and the same result is appropriate in, these proceedings. At no time during the two-year periods under review did the Commission or any court revoke, modify, suspend, or vacate, in whole or in part, the Commission's orders approving the FACs pursuant to which Companies recovered fuel costs.[54] Therefore, because KRS 278.390

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[50] 223 S.W.2d at 838.
[51] *Id.* at 839.
[52] *Id.*
[53] *Id.* at 839.
[54] In fact, the Commission issue six separate orders approving the charges and credits in the Companies' respective six-month review proceedings pursuant to 807 KAR 5:056 Section 1(11).

makes it plain that the Commission's FAC orders remained "in full force and effect" during the entire period under review, and because KRS 278.160(2) required the Companies to collect revenues pursuant to their FAC tariffs and also obliged customers to pay the same, as a matter of law, the Companies were never overpaid, no credits accrued, and no refunds are owed.[55]

Continuing with the Kentucky Court of Appeals' *Cincinnati Bell* analysis, the third and fourth statutes the court cited, KRS 278.180(1) and KRS 278.270, show that the Commission may alter a filed rate only prospectively.[56] KRS 278.180(1) states:

> Except as provided in subsection (2) of this section, no change shall be made by any utility in any rate except upon thirty (30) days' notice to the commission, stating plainly the changes proposed to be made and the time when the changed rate will go into effect.... *The commission may order a rate change only after giving an identical notice to the utility* ....[57]

And KRS 278.270 states:

> Whenever the commission, upon its own motion or upon complaint as provided in KRS 278.260, and after a hearing had upon reasonable notice, finds that any rate is unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation of any of the provisions of this chapter, the commission shall by order prescribe a just and reasonable rate *to be followed in the future.*[58]

The court found that the obvious thrust of these statutes is that the Commission may alter filed rates only prospectively, not retroactively: "In light of the General Assembly's comprehensive ratemaking scheme, including only a narrowly defined circumstance under which refunds can be ordered, the filed rate can only be lawfully altered prospectively."[59] The Commission itself has recognized the prohibition against retroactive ratemaking: "Rates are final until this Commission

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[55] The only lawful adjustments the Companies billings under their FAC tariffs the Commission can make are disallowances for improper expenses pursuant to 807 KAR 5:056 Section 1(12).
[56] *Id.* at 839.
[57] Emphasis added.
[58] Emphasis added.
[59] 223 S.W.2d at 839.

modifies them. They may not lawfully be changed and refunded based upon issues that were unknown at the time that they were set."[60]

In sum, the weight of multiple statutes, the binding precedent of an unambiguous and recent Kentucky Court of Appeals opinion, and the Commission's own words is overwhelmingly heavy, and their dictate is clear: the Companies were and are entitled and obligated to collect revenues pursuant to their duly filed and approved FAC tariffs. Thus, any order requiring the Companies to refund revenues collected pursuant to their FAC tariffs for any reason other than non-compliance with those tariffs and the Uniform Fuel Adjustment Clause Regulation 807 KAR 5:056 Section 1(12) would constitute impermissible retroactive ratemaking. This same weight of statutory and appellate authority binds even the Franklin Circuit Court,[61] just as it binds this Commission. There is therefore no doubt that the Companies' requested relief in this proceeding is entirely lawful.

III. THE COMPANIES' PROCEDURAL DUE PROCESS RIGHTS PROHIBIT THE COMMISSION FROM ENTERING AN ORDER IN THIS PROCEEDING EITHER SUSPENDING THE COMPANIES' FAC TARIFFS OR CONDITIONING THEM SUBJECT TO REFUND.

The Commission may not prospectively suspend, or condition subject to refund, the Companies' collections under their FAC tariffs because such actions would violate the Companies' procedural due process rights. As shown in Argument II, KRS 278.160(2) and KRS 278.390 entitle and obligate utilities to collect revenues from customers pursuant to their properly filed and Commission-approved tariffs. This is a statutorily created property right, and Kentucky's highest court has stated: "[C]onstitutional due process requires a fair and open

[60] *In the Matter of Deregulation of Local Exchange Companies' Payphone Service*, Admin. Case No. 361, Order at 3 (May 1, 2003).
[61] *See, e.g.*, Ky. S.Ct. R. 1.040(5).

hearing as prerequisite to an order reducing rates of a public utility."[62] For the reasons stated below, the Commission has not afforded the Companies the kind of fair and open hearing that any suspension or conditioning subject to refund of the Companies' FAC tariffs would require.

One of the requirements for a fair and open hearing that satisfies procedural due process requirements is adequate notice of what rights and issues will be at stake in the hearing: "For more than a century the central meaning of procedural due process has been clear: Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified."[63] In *Utility Regulatory Com. v. Kentucky Water Service Co.*, the Kentucky Court of Appeals said:

> Due process requires, at a minimum, that persons forced to settle their claims of right and duty through the judicial process be given a meaningful opportunity to be heard. ... It has been said that no hearing in the constitutional sense exists where a party does not know what evidence is considered and is not given an opportunity to test, explain or refute.[64]

In that case, Kentucky Water Service Co. had applied to the Commission for a rate increase.[65] Part of the utility's calculation of the increase involved an accounting treatment that the Commission had traditionally accepted.[66] In this case, however, the Commission, subsequent to

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[62] *Mayfield Gas Co. v. Public Service Com.*, 259 S.W.2d 8, 10 (Ky. 1953). Also, the Fourteenth Amendment to the Constitution states in relevant part: "nor shall any State deprive any person of life, liberty, or property, without due process of law[.]" In *Bd. of Regents of State Colleges et al. v. Roth*, 408 U.S. 561, 564 (1972), the Court stated:

> To have a property interest in a benefit, a person clearly must ... have a legitimate claim of entitlement to it. ... It is a purpose of the constitutional right to a hearing to provide an opportunity for a person to vindicate those claims.
>
> Property interests ... are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law – rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.

[63] *Harbin v. Commonwealth*, 121 S.W.3d 191, 195 (Ky. 2003) (quoting *Fuentes v. Shevin*, 407 U.S. 67, 80, 92 S. Ct. 1983, 1994, 32 L. Ed. 2d 556 (1972)). *See also Storm v. Mullins*, 199 S.W.3d 156, 162 (Ky. 2006) ("Ordinarily, notice and an opportunity to be heard are the basic requirements of due process.").

[64] *Utility Regulatory Com. v. Kentucky Water Service Co.*, 642 S.W.2d 591, 593 (Ky. App. 1982).

[65] *Id.* at 592.

[66] *Id.* at 593.

the hearings already held, determined to utilize a different accounting treatment.[67] The Commission therefore denied the utility an increase in the full amount requested without providing the utility a hearing concerning the Commission's use of the different accounting treatment.[68] The Kentucky Court of Appeals held that the utility had a due process right to a hearing concerning the accounting issue: "The company had no opportunity for a hearing to examine staff members performing the calculations, or to present oral arguments or evidence as to the propriety of the action prior to the issuance of the order."[69] The application of these requirements to these proceedings is clear: the Commission may make changes to the Companies' FAC tariffs only to the extent that the Commission put the Companies on notice of, and gave the Companies a fair and open hearing concerning, the potential changes.

In these proceedings, the only notices the Companies received were orders dated December 18, 2006, which opened these proceedings. The orders required the Companies to appear before the Commission and "submit [themselves] to examination on the *application* of [their] fuel adjustment clause[s] from November 1, 2004 to October 31, 2006."[70] The hearing already held in these proceedings addressed only the operation of the Companies' FAC tariffs and the propriety of the Companies' collections thereunder. Thus, the Companies have neither received adequate notice of, nor have they had a fair and open hearing upon, any prospective suspension or conditioning subject to refund of revenues to be collected under their FAC tariffs.

Further, concerning the Companies' right to adequate notice, KRS 278.180(1) requires a minimum of thirty days' notice prior to any change in the Companies' rates:

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[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *In the Matter of an Examination of the Application of the Fuel Adjustment Clause of Kentucky Utilities Company from November 1, 2004 through October 31, 2006*, Case No. 2006-00509, Order at 1 (Dec. 18. 2006); *In the Matter of an Examination of the Application of the Fuel Adjustment Clause of Louisville Gas and Electric Company from November 1, 2004 through October 31, 2006*, Case No. 2006-00509, Order at 1 (Dec. 18. 2006) (emphasis added).

> Except as provided in subsection (2) of this section, no change shall be made by any utility in any rate except upon thirty (30) days' notice to the commission, stating plainly the changes proposed to be made and the time when the changed rate will go into effect. ... *The commission may order a rate change only after giving an identical notice to the utility.* ...[71]

The Commission's regulation concerning the necessary procedure for "Change or Withdrawal of Rate Schedules Administrative Regulations," 807 KAR 5:011 Section 6, explicitly acknowledges the need for the Commission to comply with KRS 278.180:

> (1) No tariff, or any provision thereof, may be changed, cancelled or withdrawn except upon such terms and conditions as the commission may impose and in compliance with KRS 278.180 and Sections 6 and 9 of this administrative regulation.

To date, the Commission has not provided the Companies notice of its intent to change any of the Companies' rates, including the terms of the Companies' FAC tariffs. If the Commission issued an order altering the Companies' FAC tariffs in any way without notice, it would be a clear violation of KRS 278.180(1), 807 KAR 5:011 Section 6, and the Companies' procedural due process rights.

Turning to the Companies' due process right to a hearing before a reduction in their rates, in the context of reviewing a Commission order reducing a gas utility's rates, Kentucky's highest court stated: "a 'formal hearing' was considered as analogous to a common law hearing and held to include: (1) the right to seasonably know the charges; (2) the right to meet such charges by competent evidence; and (3) the right to be heard by counsel upon the probative force of the evidence adduced by both sides, and upon the law applicable thereto."[72] In that case, the court ultimately held the Commission's order reducing the gas company's rates was constitutionally

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[71] Emphasis added.

[72] *Mayfield Gas Co. v. Public Service Com.*, 259 S.W.2d 8, 10-11 (Ky. 1953) (quoting a Wisconsin opinion).

infirm because the Commission had not held a full hearing in the matter.[73] Instead, the Commission had heard only two witnesses on one day of hearing and continued the hearing until a later date, yet prior to that date the Commission entered its order reducing the utility's rates.[74] The court held that a complete hearing is a constitutional requirement; a partial hearing addressing only some of the issues involved was not sufficient.[75] Likewise, in these proceedings there has been no hearing to address suspending or conditioning subject to refund the Companies' FAC revenues. Thus, the Commission cannot enter such an order because there has not been a hearing sufficient to satisfy the Companies procedural due process rights.

In sum, the statutes, regulation, and cases discussed above show that the Commission simply cannot order the Companies to suspend or condition subject to refund their FAC collections because to do so would violate the Companies' statutory and constitutional due process rights. The Commission has provided the Companies no adequate notice that it plans to alter the Companies' FAC tariffs in any such way, nor has it provided the Companies a constitutionally sufficient opportunity to be heard; indeed, without adequate notice of the Commission's planned action, it is not possible for the Companies to have had a constitutionally adequate hearing. The hearing already held in these proceedings addressed only the operation of the Companies' FAC tariffs and the propriety of the Companies' collections thereunder, all topics of which the Commission gave the Companies notice through their orders in these proceedings dated December 18, 2006. These notices and hearing were not sufficient, however, for the Commission to enter an order other than one addressing exclusively the Companies' application of their FACs for the two-year period under review.

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[73] *Id.* at 11.
[74] *Id.*
[75] *Id.*

IV. THE FRANKLIN CIRCUIT COURT'S OPINION HAS NO BINDING, PRECEDENTIAL EFFECT ON ANY OF THE COMMISSION'S PROCEEDINGS CONCERNING SURCHARGES OR RATE ADJUSTMENTS OTHER THAN THE SPECIFIC AMRP RIDER ADDRESSED IN THE CIRCUIT COURT'S OPINION AND ORDER.

The Franklin Circuit Court's Opinion and Order is not binding precedent in this proceeding. Indeed, that unreported decision of a trial court – which is presently on appeal – has no precedential value whatsoever under established Kentucky procedural rules and case law. Moreover, the Circuit Court decision concerned only AMRPs and therefore could not be binding precedent as to the Companies' FAC tariffs, or the Commission's FAC regulation, 807 KAR 5:056, all of which are plainly within the Commission's authority under well settled appellate precedents. Accordingly, the Opinion and Order is not even persuasive authority, much less binding precedent, in this proceeding.

A. The Franklin Circuit Court's Opinion and Order is not Binding Precedent in This Proceeding.

Because a circuit court is not a court of record, its unpublished decisions cannot have the effect of *stare decisis*. The Kentucky Rules make clear that an unpublished opinion of the circuit court has *no* binding precedential force in any proceeding other than the specific case in which it was issued, even if that opinion is not appealed. Under the Rules of the Supreme Court, only the opinions of the Kentucky Supreme Court and the Court of Appeals are deemed to have precedential force:

> On all questions of law the circuit and district courts are bound by and shall follow applicable precedents established in the opinions of the Supreme Court and its predecessor court and, when there are no such precedents, those established in the opinions of the Court of Appeals.[76]

[76] SCR 1.040(5).

The Rules of Civil Procedure clearly prohibit citing to an unpublished circuit court opinion as binding precedent. CR 76.28(4)(c) expressly states that such opinions "*shall not be cited* or used *as binding precedent* in any other case in any court of this state."[77] And tribunals may impose sanctions for filing briefs that fail to conform with rules regarding citation to authority.[78] This ban applies with even more force where, as here, the circuit court decision is on appeal.

The precedents that bind the Commission in this proceeding are the reported Kentucky appellate decisions discussed in Arguments I and II above. As those cases squarely hold, the legislature has delegated to the Commission plenary authority to regulate utility rates.[79] The regulation authorizing the fuel adjustment charge at issue in this proceeding is clearly a valid exercise of the Commission's statutory authority.[80]

The unpublished Opinion and Order of the Franklin Circuit Court relating only to the validity of the Duke Rider AMRP simply does not trump these published precedents of the Commonwealth's highest court. Plainly, the Circuit Court Opinion and Order lacks any precedential authority in this proceeding.[81]

B. A Judgment Reaches Only the Issue to be Decided in the Case Before the Court. Accordingly, Even if the Franklin Circuit Court's Decision Were

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[77] CR 76.28(4)(c) (emphasis added). Under recent amendments to CR 76.28, in very limited circumstances, unpublished Kentucky *appellate* decisions may cited , albeit only for consideration – not for precedential value. *Id.* Any citation to circuit court opinions – as precedent or for consideration – is still prohibited.

[78] *Jones v. Commonwealth*, 593 S.W.2d 869 (Ky. App. 1979).

[79] *National Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 516 (Ky. App. 1990).

[80] *Homestead Nursing Home v. Parker*, 86 S.W.2d 424, 426 (Ky. App. 1999) ("Although our review of the Board's statutory interpretations is less differential than our review of its factual determinations, nevertheless, *an administrative agency's construction of its statutory mandate*, particularly its construction of its own regulations, is entitled to respect and *is not to be overturned on appeal unless clearly erroneous*.") (emphasis added); *Hagan v. Farris*, 807 S.W.2d 488, 490 (Ky. 1991) ("A construction of a law or regulation by officers of an agency without interruption for a long period of time is entitled to controlling weight.").

[81] In its August 24 filing with the Commission, the Attorney General tacitly recognized the need to provide this court with binding precedent to support his request that fuel adjustment clauses be set aside, citing *Boone County Water and Sewer District v. Public Service Commission,* 949 S.W.2d 588 (Ky. 1997) in addition to the Circuit Court's opinion, to support his claim that the Commission lacks the power to authorize fuel adjustment clauses. While a published precedent, that case is inapposite. The specific issue in that case was the Commission's authority to regulate sanitation districts. The court did not address the Commission's authority to approve fuel adjustment clauses. That case in no way requires this Commission to invalidate any fuel adjustment clause, nor does it call into question the Commission's own fuel adjustment regulation

Upheld on Appeal, Its Opinion Has No Precedential or Preclusive Effect Beyond the Specific AMRP at Issue in the Duke Proceeding.

Well-established law narrowly limits the legal effect of a judgment to the parties and facts of that specific case. Accordingly, the Franklin Circuit Court's general statements regarding the Commission's ratemaking authority in an opinion deciding a case where the only question presented was the validity of the Duke Rider AMRP amount to nothing more than *dicta*. Even if the opinion were affirmed on appeal, the Court's decision would not be binding on the Commission as to anything other than AMRP Riders. The lower court's general verbiage as to the Commission's authority to make interim rate adjustments would remain nothing more than *dicta*. Thus, nothing in the Circuit Court's decision binds the Commission to rescind its fuel adjustment clause regulation or any fuel adjustment clause.

It is black-letter law that the precedential effect of a court's holding is limited to the resolution of the specific issue presented in that case. Broad statements of law in an opinion that extend beyond the legal issue presented in a case are mere *obiter dicta* and are not binding on the Commission or future courts:

> It is a maxim not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decisions.[82]

[82] *Cohens v. Virginia*, 6 Wheat. 264, 5 L.Ed. 257 (1821). *Accord, Louisville Water Co. v. Weis*, 25 Ky. L. Rptr. 808, 76 S.W. 356 (1903) (quoting *Cohens*). *See also Matthews v. Ward*, 350 S.W.2d 500, 501 (Ky. 1961) (following *Cohens* and recognizing that general statements of law concerning an agency's legal authority are mere non-binding *dictum* that do not control the outcome of cases that may present similar questions about agency authority, but address different agency actions).

Indeed, Kentucky's highest court is reluctant to give collateral estoppel effect even where a final decision of a circuit court resolved the identical question of law in a very similar case involving the same parties.[83]

In *U.S. v. Mendoza*,[84] the U.S. Supreme Court made clear that an administrative agency is not bound by collateral estoppel from a former judgment limiting its authority in future cases. The Court determined that "[a] rule allowing nonmutual collateral estoppel against the Government in such cases would substantially thwart the development of important questions of law by freezing the first final decision rendered on a particular legal issue."[85] Accordingly, it is the general rule that an administrative agency has no obligation to apply the decision of a lower court beyond the confines of the specific case in which that decision was announced.[86]

In the Duke proceeding, the only issue was the Commission's authority to approve Duke's proposed Rider AMRP. Accordingly, the Circuit Court's decision in the Duke proceeding has no binding effect on this Commission with regard to cases involving fuel adjustment clauses. These clauses have been approved by the Kentucky Supreme Court. They are authorized by the Commission's lawfully promulgated administrative regulation, which has the full force and effect of law.[87] Cloaking the Circuit Court's non-final judgment with any sort of binding or preclusive effect beyond the scope of the Duke Rider AMRP proceeding itself would not only be contrary to established Kentucky law, but also would wreak havoc on

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[83] *Ward v. S. Bell Tel. & Tel. Co.*, 436 S.W.2d 794, 796-7 (Ky. 1969), overruled on other grounds, *Com. Dept. of Transp., Bureau of Highways v. Louisville Gas & Elec. Co.*, 526 S.W.2d 820 (Ky. 1975) (*Ward* court noting that "the prior decision . . . was by a circuit court and not by this court." *Id.* at 796.).

[84] 464 U.S. 154 (1984).

[85] *Id.* at 160.

[86] *See, e.g., National Organization of Veterans Advocates v. Sec'y. of Veterans Affairs*, 260 F.3d 1365, 1373-74 (Fed. Cir. 2001) (agency not foreclosed from relitigating lower court's interpretation of regulation); Restatement (Second) of Judgments § 28 (even final judgments of courts other than highest court of record on issues essential to the judgment do not necessarily preclude agency from re-litigating a legal interpretation in future proceedings); Pierce, Administrative Law Treatise, § 2.9 (federal agency is not required to acquiesce in a decision of one circuit in proceedings in another circuit).

[87] *See, e.g., Union Light, Heat & Power Co. v. Public Service Commission*, 271 S.W.2d 361, 366 (Ky. 1954).

Kentucky's utility markets. The Commission should decline to follow such an unprecedented and disruptive course of action.

In sum, the Circuit Court's Opinion and Order has no precedential effect in this proceeding. The Commission should – indeed must – continue to apply the controlling precedents which uphold the Commission's power to authorize fuel adjustment clauses.

V. AN ORDER REQUIRING THE COMPANIES TO REFUND FAC REVENUES OR SUSPEND THEIR FAC TARIFFS WOULD BE CONFISCATORY, IN VIOLATION OF THE FIFTH AND FOURTEENTH AMENDMENTS TO THE U.S. CONSTITUTION.

Because of the sheer volume of costs the Companies recover under their FAC tariffs, any order directing the Companies to refund such revenues already collected or suspending the operation of the Companies' FACs would be confiscatory and would therefore violate the Companies' constitutional protection against takings afforded by Just Compensation Clauses of the Fifth and Fourteenth Amendments.[88] In its seminal opinion in *Duquesne Light Co. et al. v. Barasch et al.*, the U.S. Supreme Court wrote, "The guiding principle [of Takings Clause jurisprudence as applied to public utilities] has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory."[89] The Court clarified that "[a] rate is too low if it is 'so unjust as to destroy the value of [the] property for all the purposes for which it was acquired,' and in so doing 'practically deprive[s] the owner of property without due process of law'."[90]

There can be no plausible debate about whether suspending the Companies' FACs or ordering massive refunds of past FAC cost recovery would be confiscatory. FAC cost recovery

[88] Of course, an order directing refunds or disallowances after a Commission finding certain costs improper under 807 KAR 5:056 Section 1(12) is entirely permissible, though the Companies do not believe that they have collected any improper costs

[89] 488 U.S. 299, 307 (1989).

[90] *Id.* at 307-08 (quoting *Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578, 597 (1896)).

constitutes nearly 10% of the Companies' total regulated revenues on an annual basis: the Companies' FAC recovery from November 1, 2004 through the present day totals over $300 million. The order of such a refund would immediately place the Companies in financial peril, and the effects upon the Companies' bond and credit ratings would be grave; an order suspending the Companies' future FAC cost recovery would also have significant and negative financial impacts. There can be no serious question that an order requiring a significant refund or suspension of future collection of FAC revenues would indeed be confiscatory, making any such order a violation of the Companies' Fifth and Fourteenth Amendment rights.

VI. GRANTING THE AG'S REQUEST IN THESE CASES WILL HARM CUSTOMERS AND CAUSE THE COMPANIES TO TAKE WHATEVER LEGAL STEPS ARE REQUIRED TO ENSURE THEIR CONTINUED ECONOMIC HEALTH AND ABILITY TO CONTINUE TO PROVIDE RELIABLE AND LOW-COST SERVICE TO THEIR CUSTOMERS.

Granting the AG's request in these proceedings is not only illegal for the reasons previously discussed, but will have significantly harmful effects on the Companies' customers and the Companies' ability to continue to provide low cost service.

A. Ending the FAC Would Result in Loss of Benefits to Utilities and Customers Alike.

If the Commission determines that the Companies may no longer recover through their properly tariffed fuel adjustment clauses, customers and the Companies will lose significant benefits because approximately 30% of the fuel costs they incur are not embedded in base rates. First and foremost, the FACs benefit the Companies and their customers by avoiding numerous base rate cases the Companies would have to file if they had to recover all of their fuel costs through base rates. Such proceedings are expensive and time consuming, and are a considerable strain on the Commission's resources as well. Also, use of FACs allows customers to enjoy in nearly real-time the benefits of lower-cost fuel, whereas if the Companies' fuel costs exceed

those in base rates, the Companies are permitted to recover those additional and prudent costs without unwieldy administrative proceedings. Equally as important are the Commission's regular six-month and two-year FAC review proceedings which allow for vigilant and frequent oversight of the Companies' fuel acquisition and generation dispatch procedures to ensure that customers pay only prudent fuel costs. Suspension of these procedures would destroy these well-established and long-standing benefits to customers and the Companies.

B. Ending the FAC Would Result in Disruption.

Suspension of the Companies' FACs would also result in significant disruption for the Companies and their customers. Certainly, any order in this proceeding requiring the Companies to disgorge their FAC revenues for the two years under review – approximately $300 million – would be catastrophic to the Companies, because there exists no standard rate mechanism to recover those costs; moreover, as previously discussed, to do so would be retroactive ratemaking. Even if the Commission were to suspend the Companies' FACs only on a purely prospective basis, significant disruption would still likely result. In the very short term, customers' bills would decrease due to the lack of fuel cost recovery. But those bills would rise again once the Companies were able to adjust their rates for the fuel costs previously recovered through the FAC tariffs. A series of price shocks would result as the Companies returned to the Commission to adjust their fuel costs as necessary. All of this is a stark contrast to the much smoother cost curve associated with FAC recovery of fuel costs, which tend to move up and down in a far less precipitous manner than would be the customers' experience through a series of base rate cases.[91]

[91] As noted in Argument VI.A. above, FACs allow for rapid benefits to customers when the Companies are able to procure lower-cost fuel. For example, as the Companies install flue gas desulfurization units, they are able to burn high-sulfur coal, which is a lower-cost fuel.

C. Ending the FAC Would Set Unnecessary Precedent in Derogation of Commission's Authority to Exercise Discretion in the Public Interest.

Suspending the Companies' FACs will also serve to diminish the Commission's lawful authority to regulate public utilities in the public interest, which regulation is the Commission's *raison d'être*. Proceeding in any manner other than processing these kinds of cases as usual would be an implicit admission by the Commission that: (1) the Franklin Circuit Court is correct; (2) the Kentucky Civil Rules of Civil Procedure and the published opinions of the Court of Appeals and Kentucky Supreme Court no longer apply to judgments entered by the Franklin Circuit Court; and (3) decades upon decades of higher court authority acknowledgement and legislative acquiescence notwithstanding, the Commission in fact lacks express authority and does not possess the corresponding authority to create beneficial rate mechanisms like FACs. As shown at length above, it clearly is the case that the Commission currently possesses and has always had the authority to promulgate FAC-type regulations. It could serve only to detract from the Commission's long-held and legislatively imparted authority to protect the public interest to disallow the Companies the relief they seek in this proceeding or to proceed in any other like proceeding in any way other than "business as usual."

CONCLUSION

This Joint Responsive Memorandum of Law has clearly demonstrated the rule of law requires rejection of the AG's position. The Commission should not hesitate to do so. This is not only the correct answer to the AG's challenge, but also places the AG in correct legal position of having the burden of proof under KRS 278.430 to show by clear and satisfactory evidence that the order is unlawful to the higher courts. The AG should be given that burden.

For these reasons, the Companies respectfully request that the Commission conclude these proceedings by issuing orders determining that:

1. the Companies' request for relief pursuant to Administrative Regulation 807 KAR 5:056 is lawful;

2. the Companies have complied with the provisions of Administrative Regulation 807 KAR 5:056 during the two-year periods under review;

3. the charges and credits applied by the Companies through their FAC tariffs for period November 1, 2004 through October 31, 2006 are approved;

4. the proposed amounts of fuel are incorporated into the Companies' electric base rates as filed; and

5. the base period component of the Companies' FAC rate formulas are reset to be 17.03 mills per kWh for LG&E and 25.91 mills per kWh for KU going forward.

In the alternative, if the Commission is considering granting the AG's request to deny the Companies' requests for relief in these proceedings, the Commission must open a separate proceeding to afford the Companies full due process on their FAC tariffs and to adhere to the requirements of KRS Chapter 278.

In no event should the Commission proceed with an abrupt termination of the Companies' FAC tariffs. Such an order will be appealed straightaway to the Franklin Circuit Court; and the Companies will immediately seek a temporary restraining order, followed by a temporary injunction and then a permanent injunction. Such an order will also likely cause the Companies to petition the Commission for authority to establish regulatory assets on their books for the amount of fuel expense not recovered through their FAC tariffs for recovery through base rates in future base rate cases.

An order conditioning the operation of the fuel adjustment clause as being subject to refund is also an illegal exercise of authority. Such an order also will be immediately appealed

to the Franklin Circuit Court, along with a concurrent request for a temporary restraining order, followed by a temporary injunction and then a permanent injunction. Such an order also will likely cause the Companies to request the Commission to incorporate the current level of fuel expense collected through each Company's FAC tariff into its base rates.

Neither order is consistent with the rule of law discussed in this responsive memorandum. The Commission should follow the law by granting the Companies their requested relief.

Dated: August 29, 2007

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing was served on the following persons on the 29th day of August 2007, United States mail, postage prepaid:

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