



139 East Fourth Street, R 25 At II  
P O. Box 960  
Cincinnati, Ohio 45201-0960  
Tel: 513-287-3601  
Fax: 513-287-3810  
[John.Finnigan@duke-energy.com](mailto:John.Finnigan@duke-energy.com)

John J. Finnigan, Jr.  
Associate General Counsel

**VIA FACSIMILE AND OVERNIGHT MAIL**

August 27, 2007

Ms. Elizabeth O'Donnell  
Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, KY 40602

RECEIVED

AUG 28 2007

PUBLIC SERVICE  
COMMISSION

RE: The Purchased Gas Cost Adjustment Filing of Duke Energy Kentucky  
Case No. 2007-00362

Dear Ms. O'Donnell:

I am enclosing an original and twelve copies of the Memorandum of Duke Energy Kentucky, Inc. regarding Lawfulness of Purchased Gas Cost Adjustment in response to the Commission's August 23, 2007 Order. Please date-stamp and return the two extra copies of the filing in the enclosed envelope.

If you have any questions, please do not hesitate to call me.

Sincerely,

John J. Finnigan, Jr.  
Associate General Counsel

JJF/bjl

Enclosure

cc: Dennis Howard II (w/encl.)  
Larry Cook, Assistant Attorney General (w/encl.)

COMMONWEALTH OF KENTUCKY

RECEIVED

BEFORE THE PUBLIC SERVICE COMMISSION

AUG 28 2007

PUBLIC SERVICE  
COMMISSION

In the Matter of:

THE PURCHASED GAS COST	)	
ADJUSTMENT FILING OF	)	CASE NO. 2007-00362
DUKE ENERGY KENTUCKY	)	

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MEMORANDUM OF DUKE ENERGY KENTUCKY, INC.  
REGARDING LAWFULNESS OF PURCHASED GAS COST ADJUSTMENT

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Duke Energy Kentucky, Inc. (“DE-Kentucky,” f/k/a “The Union Light, Heat and Power Company”) submits this memorandum of law in response to the Commission’s August 23, 2007 Order requiring the parties to address the Commission’s legal authority to approve the purchased gas cost adjustment requested by DE-Kentucky.

The Attorney General has questioned the Commission’s legal authority in light of the Franklin Circuit Court’s August 1, 2007 Opinion and Order in *Commonwealth of Kentucky, ex rel. Gregory D. Stumbo, Attorney General, v. Public Service Comm’n and Union Light, Heat and Power Co.*, Civil Action No. 06-CI-269. The Franklin Circuit Court ruled, in an unpublished opinion, that KRS 278.509 is unconstitutional, and that the Commission lacks legal authority to approve rate adjustments for DE-Kentucky’s Rider AMRP, a surcharge mechanism that allows DE-Kentucky to recover gas main replacement costs. The Franklin Circuit Court also stated that the Commission has “no inherent authority to perform interim single-issue rate adjustments because such a mechanism would undermine the statutory scheme [of Kentucky Revised Statutes

Chapter 278].”<sup>1</sup> On August 13, 2007, DE-Kentucky and the Commission jointly appealed the Franklin Circuit Court’s Opinion and Order to the Kentucky Court of Appeals.<sup>2</sup> On August 22, 2007, the Attorney General advised the Commission that, in light of the Franklin Circuit Court’s Opinion and Order, the Commission lacks legal authority to approve any surcharge adjustments outside of a general rate case, unless a specific statute authorizes the Commission to approve such adjustments.<sup>3</sup>

Although the Franklin Circuit Court’s unpublished Opinion and Order states that the Commission lacks authority to approve other types of surcharges, the Opinion and Order has no force and effect apart from its narrow holding that KRS 278.509 is unconstitutional, and that the Commission lacked legal authority to approve rate adjustments for DE-Kentucky’s Rider AMRP.

Additionally, Kentucky procedural rules and decisional law make clear that unpublished opinions cannot be relied on as authority in other proceedings. Civil Rule 76.28(4)(c) provides: "Opinions that are not to be published shall not be cited or used as authority in any other case in any court of the state." The precursor to this rule, prior to the reorganization of the Kentucky judicial system in 1976, was Ky. R. App. P. 1.310(b), which also barred reliance on unpublished opinions. In a case involving Ky. R. App. P. 1.310(b), the Kentucky Court of Appeals ruled that court filings relying on unpublished

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<sup>1</sup> *Commonwealth of Kentucky, ex rel. Gregory D. Stumbo, Attorney General, v. Public Service Comm’n and Union Light, Heat and Power Co.*, Civil Action No. 06-CI-269 at 6 (Opinion and Order)(August 1, 2007).

<sup>2</sup> *Kentucky Public Service Comm’n and Duke Energy Kentucky, Inc. f/k/a “The Union Light, Heat and Power Co.” v. Commonwealth of Kentucky, ex rel. Gregory D. Stumbo, Attorney General*, Case No. 2007-CA-001635.

<sup>3</sup> Letter from Dennis G. Howard, II, Acting Director, Office of Rate Intervention, Kentucky Attorney General, to Beth O’Donnell, Executive Director, Kentucky Public Service Commission, dated August 22, 2007 (posted on Kentucky Public Service Commission website at [www.psc.state.ky.us](http://www.psc.state.ky.us)).

opinions should be stricken, and the attorneys instructed to re-file their pleadings without the offending opinion.<sup>4</sup>

As an administrative agency, the Commission is not required to apply a circuit court's ruling beyond the confines of the specific case in which that decision was announced. See, e.g., *National Organization of Veterans Advocates v. Sec'y. of Veterans Affairs*<sup>5</sup> (agency not foreclosed from re-litigating lower court's interpretation of regulation); Restatement (Second) of Judgments § 28 (even final judgments of courts other than highest court of record 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). This is especially true when the circuit court's order has been appealed.

The Commission has broad statutory authority over ratemaking. The Commission is empowered to set "fair, just and reasonable rates."<sup>6</sup> The General Assembly granted the Commission "exclusive jurisdiction over the regulation of rates and service of utilities," but did not prescribe that rates could be determined only in general rate cases or where authorized by specific statute.<sup>7</sup> The Commission's broad complaint authority over utilities allows the Commission to set just and reasonable rates.<sup>8</sup> Indeed, if a utility did not request a monthly purchased gas cost adjustment, the Commission could file a complaint against the utility each month and re-set the utility's rates to allow the utility to recover its incremental gas costs. The Attorney General argues that the Commission lacks legal authority to re-set the purchased gas cost adjustment rate upon request by the

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<sup>4</sup> *Yocum v. Justice*, 569 S.W.2d 678 (Ky. Ct. App. 1977).

<sup>5</sup> 260 F.3d 1365, 1373-74 (Fed. Cir. 2001)

<sup>6</sup> KRS 278.030(1).

<sup>7</sup> KRS 278.040(2).

<sup>8</sup> KRS 278.270.

utility. KRS 278.270 clearly empowers the Commission to re-set this rate at the Commission's own initiative. It makes no sense that the General Assembly, therefore, would have limited the Commission from approving such a change when the utility requests an adjustment.

The statutes authorizing the Commission to adjust rates distinguish a "general increase in rates"<sup>9</sup> case from a change to "any rate."<sup>10</sup> A general increase in rates must be supported by twelve months of financial data, while a change in any rate does not require such support. By creating this distinction between general rate cases and changes to specific charges, the General Assembly clearly intended to authorize the Commission to approve any type of surcharge that the Commission deems just and reasonable, without the need for a general rate case.

Kentucky courts have recognized that the Commission can approve interim rate adjustments not supported by a specific statute. For example, although no statute expressly authorizes the Commission to make interim adjustments to the fuel adjustment surcharge, the Kentucky Supreme Court acknowledged in *Kentucky Power v. Energy Regulatory Comm'n of Kentucky* that the Commission can properly do so.<sup>11</sup> In *Kentucky Power*, the Supreme Court ruled that in a general rate case, where the Commission modified the formula for the fuel adjustment clause subsequent to the test period, the Commission must adjust the utility's test period revenue requirement to reflect the additional fuel expense attributable to the new fuel adjustment clause formula.<sup>12</sup>

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<sup>9</sup> KRS 278.192.

<sup>10</sup> KRS 278.180.

<sup>11</sup> *Kentucky Power Co. v. Energy Regulatory Comm'n of Kentucky*, 623 S.W.2d 904 (Ky. 1981)

<sup>12</sup> *Id.* at 907.

Likewise, in *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*,<sup>13</sup> the Kentucky Court of Appeals ruled that the Commission could approve an electric rate for aluminum smelters that varied with the market price for aluminum, even though no specific statute authorized such variable rates.<sup>14</sup> The Court of Appeals followed the U.S. Supreme Court's reasoning in *Federal Power Comm'n v. Hope Natural Gas Co.*<sup>15</sup> that the test for whether a rate is reasonable is the end result, not the method used to set the rate.<sup>16</sup> The Court of Appeals approved the variable rates even though no specific statute authorizes variable rates.

### CONCLUSION

Based on Kentucky procedural rules and case law, the Franklin Circuit Court's Opinion and Order does not apply beyond its narrow holding. Such rules and case law also prohibit the Attorney General from citing the Circuit Court's ruling in other proceedings. Additionally, Kentucky statutes and case law clearly authorize the Commission to approve interim surcharge adjustments even where no statute specifically authorizes that type of surcharge adjustment. The Attorney General's position that the Commission lacks such authority is without merit. DE-Kentucky respectfully submits that the Commission has legal authority to approve interim adjustments to DE-Kentucky's purchased gas cost adjustment rate, as the Commission has done for the past several decades. DE-Kentucky request that the Commission approve DE-Kentucky's pending purchased gas cost adjustment, and that the Commission not order DE-Kentucky

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<sup>13</sup> 785 S.W.2d 503 (Ky. Ct. App. 1990).

<sup>14</sup> *Id.* at 510-514.

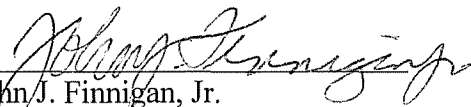
<sup>15</sup> 320 U.S. 591 (1944).

<sup>16</sup> *Id.* at 510-512.

to collect purchased gas cost revenues subject to refund, given that the Commission has clear legal authority to approve such adjustments.

Respectfully submitted,

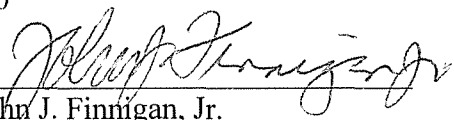
DUKE ENERGY KENTUCKY, INC.

By:   
John J. Finnigan, Jr.  
Assistant General Counsel  
(Attorney No. 86657)  
Duke Energy Shared Services, Inc.  
Room 2500 Atrium II  
P. O. Box 960  
Cincinnati, Ohio 45201-0960  
phone: (513) 287-3601  
fax: (513)287-3810  
e-mail: john.finnigan@duke-energy.com

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Memorandum of Duke Energy Kentucky, Inc. Regarding Lawfulness of Purchased Gas Cost Adjustment was served on the following via e-mail and ordinary United States mail, postage prepaid, this 27th day of August, 2007:

Dennis Howard II  
Larry Cook  
Assistant Attorney General  
The Kentucky Office of the Attorney General  
1024 Capital Center Drive  
Frankfort, Kentucky 40602-2000

  
John J. Finnigan, Jr.