COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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COMMISSION

In the Matter of:

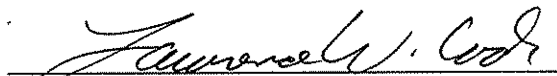
THE APPLICATIONS OF BIG RIVERS ELECTRIC CORPORATION FOR: (I) APPROVAL OF WHOLESALE TARIFF ADDITIONS FOR BIG RIVERS ELECTRIC CORPORATIONS, (II) APPROVAL OF TRANSACTIONS. (III) APPROVAL TO ISSUE EVIDENCES OF INDEBTEDNESS, AND (IV) APPROVAL OF AMENDMENTS TO CONTRACTS; AND OF E.ON U.S., LLC, WESTERN KENTUCKY ENERGY CORP. AND LG&E ENERGY MARKETING, INC. FOR APPROVAL OF TRANSACTIONS	) CASE NO. 2007-00455

ATTORNEY GENERAL'S RESPONSES TO THE REQUESTS FOR INFORMATION OF THE COMMISSION STAFF

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and submits his Responses to the Requests for Information of the Commission Staff.

Respectfully submitted,

JACK CONWAY
ATTORNEY GENERAL OF KENTUCKY



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CERTIFICATION, CERTIFICATE OF SERVICE AND NOTICE OF FILING

Counsel certifies that the responses attached hereto are true and accurate to the best of his knowledge, information, and belief formed after a reasonable inquiry. Counsel further certifies that on this the 17th day of April, 2008, he has filed the original and ten copies of the foregoing Attorney General's Responses to the Requests for Information of the Commission Staff with the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601, and certifies that this same day he has served the parties by mailing a true copy of same, via U.S. First Class Mail, postage prepaid, to:

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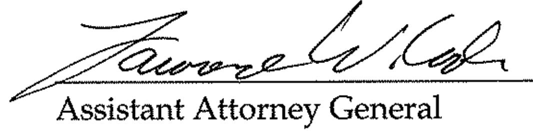

Assistant Attorney General

RESPONSES OF THE ATTORNEY GENERAL TO THE REQUESTS FOR INFORMATION OF THE COMMISSION STAFF

General Objection

As a preliminary matter, the Attorney General objects to those data requests which require the Attorney General to divulge his work product during the discovery phase. Therefore, he objects to providing his mental impressions, conclusions, opinions, or legal theories concerning the litigation; to wit, the legality of the various ratemaking mechanisms filed in this case. See CR 26.03. These data requests require the Attorney General to address the legality of a myriad of terms, clauses, or conditions contained within contracts and rate making mechanisms which have been involved in the case since its inception. The Attorney General believes that equity dictates that all parties be required to address such requests. Further, it is premature to ask these data requests as new discovery unfolds and will likely continue to do so at the hearing.

The Attorney General puts the Commission and other parties on notice that for those data requests which counsel has provided a response, the Attorney General will not offer testimony and will not be available for cross examination during the hearing.

QUESTION 1: For each of the mechanisms or rate-making treatments listed below, state "yes" if the AG is of the opinion that the Commission has the statutory authority to approve and allow its implementation or state "no" if the AG's opinion is that the Commission lacks such authority. For each "yes" response, identify the specific statue(s) under which the Commission's approval authority is based.

a. Smelter Times Interest Earned Ratio ("TIER") Adjustment.

b. Smelter Non-Fuel Adjustment Clause Purchased Power. Adjustment ("Non-FAC PPA").

c. Smelter Surcharge 1.

d. Smelter Surcharge 2.

e. Smelter Equity Development Credit.

f. Non-Smelter Member Discount Adjustment.

g. Non-Smelter "GRA."

h. Non-Smelter Unwind Credit.

i. Non-Smelter Member Rate Stability Mechanism, related to the Economic Reserve.

j. Non-Smelter TIER-Related Rebate.

k. Non-Smelter Non-FAC Purchased Power Regulatory Assets and Regulatory Liabilities.

l. Non-Smelter Non-FAC PPA.

m. Fuel Adjustment Clause.

RESPONSE: 1.(a) – (f); (h)-(m) . Objection. The Commission Staff's discovery request seeks to force the disclosure of the mental impressions, conclusions, opinions, or legal theories of the Office of the Attorney General concerning this litigation and which are the OAG's trial preparation materials which are not the proper subject-matter for discovery. Further, the request seeks information that is or may be subject to and protected by the Attorney-Client and/or Work Product privileges. Without waving these objections, the Attorney General states the following.

The Attorney General notes the Commission Staff's inference in the data request that the Commission is an entity with limited jurisdiction, and the PSC, as a creature of statute, must have a statutory basis of authority in order to approve each specific rate-making treatments listed. The Attorney General agrees with the inference. That stated: there is no express statutory authority for any of the items in the list. Nonetheless, the legislature's grant of express authority carries with it a judicially recognized power of authority by implication through which the Commission may take actions that are strictly necessary in order to prevent a discontinuance of service or to address a utility facing

bankruptcy.[1] The judiciary's recognition of Commission power by implication for such a purpose is quite narrow, and it does not reflect an expansion of Commission power. Indeed, the judiciary does not recognize any theory of Commission authority by implication through which the Commission may expand its jurisdiction/authority.

In this proceeding, the record is replete with evidence that the relationship between BREC and E.ON is strained; that there are grave concerns about the condition of the BREC's generation and transmission facilities under the operation of E.ON; that there are grave concerns about BREC's ongoing financial viability in the event one or both smelters leave the Commonwealth; that there is significant uncertainty regarding future commodity costs related to fuel and environmental / emissions treatment; that there is significant uncertainty whether current and future credit market conditions will permit BREC to consummate its planned financing under the proposed transaction and within the interest rate constraints assumed in its financial model; and, most importantly,

[1] The Attorney General recently argued the concept of necessarily implied authority in *Public Service Commission, et al. v. Commonwealth of Kentucky ex rel. Stumbo*, 2007-CA-001635. For purposes of convenience, the Attorney General attaches hereto as "Attachment A" a copy of his previously-filed brief in that matter. The brief speaks for itself.

that without the unwind transaction "the worst that can happen is BREC is **obliterated through bankruptcy** due to its inability to respond to some unanticipated financial and/or legal event."[2] Thus, there is evidence of a clear threat to the continuation of utility service at reasonable rates, and, as importantly, the express statutory provisions do not provide a specific remedy for preventing or otherwise addressing this threat to continuation of service. In tandem with the above evidence, many of the "rate making mechanisms and/or treatments" referenced herein are more aptly described as terms, clauses or conditions contained within contracts negotiated almost exclusively at the wholesale level by, between and among sophisticated energy producers / users, represented by highly capable counsel, thus minimizing the impact on the public at large. Without these contracts (or mechanisms / treatments, as variously referred to), it is highly doubtful that BREC could once again become a viable utility. Hence, the crafting of these mechanisms are for the narrow purpose of utility viability (rather than regulatory convenience, easing an administrative burden, or regulatory expediency).

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[2] *See* "Attachment B," "The Pros, Cons and Recommendation Concerning the Unwind, Presented to the Big Rivers' Board" September 20, 2007, page 27, found in the Joint Response to Attorney General's Supplemental Request by Member Cooperatives.

Accordingly, approving the proposed rate contracts/mechanisms is within the Commission's authority by implication given the very real threat to the viability of this utility and its ability to continue service in the absence of the action (which is strictly necessary). In passing, the Joint Applicants state that the myriad of mechanisms must stand in their totality and that each one is dependent on the other, but for the fuel adjustment clause. Determining the legality of an administrative agency's exercise of power in reliance upon a claim of authority by implication is done on a case-by-case basis. A mechanism that is strictly necessary under one set of facts (therefore valid) may be an invalid exercise of authority under a different set of facts. With regard to this Application and the evidence, to date, in this proceeding, the Attorney General believes that Commission approval of this package of mechanisms falls within the narrow judicially-recognized limit of Commission authority by implication. *See*, for guidance and comparison, *National Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503, 515 (Ky. App. 1990)(Commission has authority by implication to approve variable rate mechanism to prevent **bankruptcy** of Big Rivers).

Finally, the Commission has yet to conduct a hearing in this matter; therefore, the record in this case is not yet complete. Accordingly, the Attorney General reserves the right to alter or amend his opinion until the close of the evidentiary record.

1.(g). Not applicable. As the Attorney General understands it, the "GRA" reference in the model is not a mechanism or rate-making treatment per se, but is instead an assumed level of rate increase pursuant to yet-to-be filed rate applications before the Commission. The "GRA" input data would be subject to Commission approval at the time BREC actually filed a rate request before the Commission; therefore, the Commission would need to consider any future application for a rate increase separately, just as it currently does with every other jurisdictional utility. It appears that BREC intends to use the GRA as an internal tool to assist with computation of the amount of potential future rate increases. If that is the GRA's sole purpose, then the Attorney General does not object to its use by the Company. However, if there is some other purpose, the Attorney General cannot condone the concept of acquiescing to the timing and/or amount of a future rate increase percentage in the context of financial modeling. Further, if there is

some other purpose for the use of the GRA, then the Attorney General reserves the right to fully challenge any future rate increases filed on behalf of BREC.

QUESTION 2. If the AG is unable to respond to each sub-part of Item 1 above, by definitively stating either "yes" or "no," explain in detail when the AG will be able to provide a definitive "yes" or "no" answer.

RESPONSE: Not applicable.

RESPONSE PROVIDED BY:
COUNSEL
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QUESTION 3. Is it the AG's recommendation that the Commission grant final approval of the proposed Unwind Transaction, including approval of each rate mechanism and rate treatment enumerated in Item 1 above, before the AG expresses an opinion in this case on the Commission's statutory authority to approve and implement each rate mechanism and rate treatment? If no, explain in detail when and how the AG intends to express such an opinion in this case.

RESPONSE: The Attorney General renews and reiterates his objections set forth in his response to Question No. 1. Further, since the hearing in this matter has not yet been conducted, the Attorney General reserves the right as a party to this proceeding to alter or amend his opinion until such time as all evidence has been presented. Without waiving those objections, the Attorney General states as follows: No. The Attorney General has expressed his opinion as noted in response to PSC 1-1.

QUESTION 4: Does the AG believe that it would be prudent and reasonable for Big Rivers Electric Corporation ("Big Rivers") to consummate the proposed Unwind Transaction prior to a final, non-appealable decision on the Commission's statutory authority to approve rate surcharges in the case of *Public Service Commission, et al. v. Commonwealth of Kentucky ex rel. Stumbo*, 2007-CA-001635 (Ky. App.)? If yes, explain in detail why an affirmation of the underlying Franklin Circuit Court decision would not negate the Commission's authority to approve and implement the proposed rate mechanisms and rate-making treatments in Item 1 above.

RESPONSE: The Attorney General renews and reiterates his objections set forth in his response to Question No. 1. Further, since the hearing in this matter has not yet been conducted, the Attorney General reserves the right as a party to this proceeding to alter or amend his opinion until such time as all evidence has been presented. Without waiving those objections, he states as follows: As a preliminary statement, it is within the Commission's jurisdiction and authority to choose not to rule on this matter until such time as there is a final, non-appealable decision in the case of *Public Service*

Commission, et al. v. Commonwealth of Kentucky ex rel. Stumbo, 2007-CA-001635. However, notwithstanding its authority to do so, this case has progressed even though the Commission in other previous matters has denied various and sundry applications for deficiency requirements.[3]

Regardless of whether the Commission chooses to allow this case to proceed on the current docket, the Attorney General notes that the Joint Applicants have stated that the Commission's approval is required in an expedited fashion in order for the financing to take place. In light of the Attorney General's previously filed testimony, his response to PSC 1-1 and his overall concerns about BREC's future, a recommendation for a provisional approval is warranted. Otherwise, the unwind may not occur and BREC may experience a potential bankruptcy as identified by the cooperatives as a distinct, if not probable, possibility. In other words, unless there is an approval, services could be discontinued.

[3] *See, e.g.*, In the Matter of: Application Of Mallard Point Disposal Systems, Inc. To Revise Non-Recurring Charges, Case No. 2006-00331 (Order dated Sept. 13, 2006); In the Matter of: Application Of Northern Kentucky Water District For Approval Of Improvements To The Memorial Parkway Treatment Plant, Issuance Of A Certificate Of Convenience And Necessity And Approval Of Financing, Case No. 2006-00400 (Order dated Oct. 10, 2006); In Re The Union Light, Heat and Power Company dba Duke Energy Kentucky, Inc., Case No. 2006-00172 (Order dated June 27, 2006).

Since the Attorney General has no idea as to how the court of last resort will rule in the case of *Public Service Commission, et al. v. Commonwealth of Kentucky ex rel. Stumbo,* 2007-CA-001635, any discussion regarding possible affects on the instant matter would be mere conjecture.

QUESTION 5: Is the full position of the AG on the Unwind Transaction reflected in the direct testimony of his witness, David Brevitz? If no,

a. Explain why the AG has not revealed his full position on the proposed unwind transaction to the Commission and the parties.

b. Explain in detail when and how the AG will reveal his full position on the Unwind Transaction to the Commission and the parties.

RESPONSE: The Attorney General renews and reiterates his objections set forth in his response to Question No. 1. Further, since the hearing in this matter has not yet been conducted, the Attorney General reserves the right as a party to this proceeding to alter or amend his opinion until such time as all evidence has been presented. Without waiving those objections, he states as follows: Until the conclusion of the hearing in the instant matter and the conclusion of fact finding (which is obviously ongoing as evidenced by the Commission's own data requests), the Attorney General can not tender his final opinion on the transaction. Moreover, on April 11, 2008, the Attorney General received the Joint Applicants' Motion to Amend and Supplement Application, which is the

second amendment to the application. Hence, the Attorney General and other parties continue to receive new information. Accordingly, the Attorney General will not waive his right to tender his final position in this matter until the appropriate time for the filing of briefs, as set forth in the procedural schedule.

QUESTION 6. Refer to the Direct Testimony of David Brevitz ("Brevitz Testimony"), pages 47 through 50. Mr. Brevitz states eight conclusions based on his review of the case record. In conclusion No. 1 on pages 47-48, Mr. Brevitz notes the absence of several significant items from the record. He also states "The Commission could reasonably hold this proceeding in abeyance until these matters have been accomplished and addressed through additional discovery and analysis presented before the Commission." However, at page 50, Mr. Brevitz makes a "provisional recommendation" that the Commission approve the Unwind Transaction, subject to 17 specific conditions.

a. Explain what Mr. Brevitz means when he says that his recommendation is "provisional."

b. Given the outstanding issues noted in Mr. Brevitz's conclusion No. 1 on page 47, lines 21-28, explain in detail why he is making a provisional recommendation to approve the Unwind Transaction rather than making a recommendation to hold the proceeding in abeyance until there is a final resolution of the outstanding issues.

c. In making his "provisional recommendation" and proposed condition No. 1 on page 50, is Mr. Brevitz assuming that additional procedural steps will be established to afford discovery, supplemental testimony, and a hearing on the resolution of the outstanding issues or is the AG waiving any right to such additional procedural steps?

RESPONSE: 6.a. In general, the Attorney General refers the Commission Staff to the following dictionary definition of "provisional": "under terms not final or fully worked out or agreed upon; "probationary employees"; "a provisional government"; "just a tentative schedule." [4] More specifically, "provisional" should be construed in the context of Mr. Brevitz' testimony to mean that approval is recommended "provisionally" assuming the several significant items missing from the record subsequently are provided in satisfactory form and substance by BREC. Finally, unless the listed conditions are met, the approval should be denied.

6.b. The Attorney General does not object to any decision to hold the proceeding in abeyance; however, the viability of BREC as an

[4] http://www.wordreference.com/definition/provisional

ongoing operation appears to be in question. See Response to PSC 1-1 above. Assuming the Joint Applicants' claims that time is of the essence are in fact true, a provisional approval with the conditions would allow the Joints Applicants to proceed as expeditiously as possible with the transaction. If the Joint Applicants fail to comply with the order, the order granting the transaction would fail.

6c. Mr. Brevitz makes no such assumption. The Attorney General does not waive any rights to "such procedural steps." Depending on the nature of the information later provided, additional discovery, testimony and hearing may be required in order for the Commission and the Attorney General to discharge their respective duties in this matter.

QUESTION 7. Refer to the Brevitz Testimony, pages 50 through 52. Mr. Brevitz has recommended that 17 conditions be included as part of the Commission's approval of the proposed Unwind Transaction.

a. In condition Nos. 3, 11, 14, and 16, Mr. Brevitz requires that Big Rivers advise the AG of the occurrence of certain material changes or events. None of the remaining 13 conditions include this requirement. Explain in detail why Mr. Brevitz believes the AG needs to be advised of these particular changes or events.

b. Explain why Mr. Brevitz does not believe that the AG needs to be advised on other changes included in the recommendation, such as changes in environmental regulations that would have a material effect on Big Rivers, changes in the Smelter contracts, or changes in the labor union agreements.

c. In condition No. 1, on page 50, Mr. Brevitz states that if the resolution of a pending matter would unfavorably impact the Unwind Financial Model base case rates and results, "E.ON and/or the smelters must step forward to fund and eliminate those unfavorable impacts in order to restore the 'base case' projections." Explain in detail how the Commission can make and enforce such a requirement on "E.ON and/or the smelters."

d. Condition No. 6 on page 51 appears to be some text. Provide the complete text of the condition.

e. Condition No. 9 on page 52 states in part that Big Rivers will continue to employ at least the same level of workforce as it currently employs. Does Mr. Brevitz mean the workforce level discussed in the application or the workforce level actually in place after the consummation of the Unwind Transaction? Explain the response.

RESPONSE 7.a. Regarding condition no. 3, the Attorney General would like to be kept aware of when BREC completes its due diligence, and the measures BREC took to complete this imperative task. Regarding condition no. 11, financing and credit market conditions are presently very uncertain. Financing is one of, if not the most crucial components underlying the instant action; as such, the Attorney General believes it is important that he be kept apprised of any such material changes. Regarding condition no. 14, the Attorney General believes it is imperative that HMPL's consent be obtained; thus, any material changes to agreements involving HMPL constitute a matter of which the Attorney General wishes to kept apprised. Regarding condition no. 16, BREC's ability to wheel excess power would have crucial financial implications in the event that one (or perhaps even both) of the smelters eventually leaves the Commonwealth; thus the Attorney General wishes to be kept advised in this regard.

7.b. The Attorney General believes BREC will either advise the Commission or will initiate the proceedings necessary to adequately address such matters.

7.c. It would not be necessary for the Commission to "enforce" this requirement. The consequence of not accepting the requirement is that the transaction fails to obtain Commission approval.

7.d. The second sentence of this condition should begin: "Upon request of the Commission, BREC's required provision of minutes and documents shall be extended."

7.e. The intent of this condition is to refer to the work force level as reflected in the Financial Model which BREC provides in this case. Total staffing appears to be held constant over the period 2008 – 2011, per the spreadsheet "Unwind staffing_Rev0707_Reflects 2008 Dollars_Rev 1.xls".

ATTACHMENT A

Commonwealth of Kentucky
Court of Appeals

No. 2007-CA-001635

KENTUCKY PUBLIC SERVICE COMMISSION
and DUKE ENERGY KENTUCKY, INC.,
(f/k/a Union Light, Heat & Power) **APPELLANT**

v.

Appeal from Franklin Circuit Court
Consolidated/Lead Case No. 06-CI-0269
Hon. Phillip J. Shepherd, Judge

COMMONWEALTH OF KENTUCKY, ex rel
GREGORY D. STUMBO, ATTORNEY GENERAL **APPELLEE**

BRIEF FOR THE COMMONWEALTH

Submitted by,

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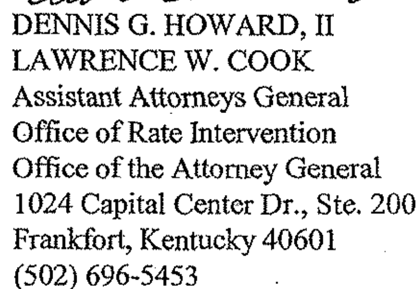
Attorney General of Kentucky



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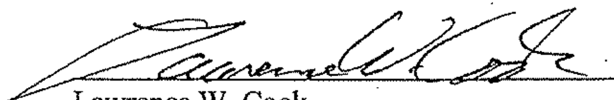
Certificate of Service on Back of Cover

CERTIFICATE OF SERVICE

Pursuant to CR 76.12 (6), I hereby certify that the record on appeal was not withdrawn from the Franklin Circuit Court Clerk. I further certify that on this 22nd day of February, 2008, the original and copies of this Brief were filed with the Clerk of the Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601, and that copies were mailed via U.S. First Class Mail, postage pre-paid, to the following: Hon. Phillip J. Shepherd, Franklin Circuit Court Judge, Division One, 214 St. Clair Street, Frankfort, KY40601; David S. Samford, Gerald E. Wuetcher, Anita L. Mitchell, Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, KY 40602, *Counsel for Appellant Kentucky Public Service Commission;* Sheryl G. Snyder, M. Holliday Hopkins, Jason P. Renzelmann, Frost Brown Todd LLC, 400 W. Market St. 32nd Floor, Louisville, KY 40202-3363 and John J. Finnigan, Jr., Duke Energy Services, Inc., 2500 Atrium II, P.O. Box 960, Cincinnati, OH 54201, *Counsel for Appellant Duke Energy Kentucky, Inc.*; John N. Hughes, Attorney at Law, 124 W. Todd St. Frankfort, KY 40601; Mark R. Hutchinson, Wilson, Hutchinson & Poteat, 611 Frederica Street, Owensboro, KY 42301, *Counsel for Amicus Curiae, Atmos Energy Corporation;* James M. Miller, Sullivan, Mountjoy, Stainback & Miller PSC, 100 St. Ann Building, P.O. Box 727, Owensboro, KY 42302-0727, *Counsel for Amicus Curiae, Big Rivers Electric Corporation;* Richard S. Taylor, 225 Capital Ave., Frankfort, KY 40601; Stephen B. Seiple, Lead Counsel, Columbia Gas of Kentucky, Inc., 200 Civic Center Dr., P.O. Box 117, Columbus, OH 43216-0117, *Counsel for Amicus Curiae, Columbia Gas of Kentucky, Inc.;* Robert M.. Watt III, Stoll Keenon Ogden PLLC, 300 W. Vine St., Ste. 2100, Lexington, KY 40507-1801, *Counsel for Amicus Curiae, Delta Natural Gas Company, Inc.;* David Smart, General Counsel, Charles A. Lile, Sr. Corp. Counsel, 47785 Lexington Rd., P.O. Box 707, Winchester, KY 40392-0707, *Counsel for Amicus Curiae, East Kentucky Power Cooperative;* Mark R. Overstreet, Stites and Harbison PLLC, 421 W. Main St. P.O. Box 634, Frankfort, KY 40602-0634, *Counsel for Amicus Curiae, Kentucky Power Company;* and Kendrick R. Riggs, Deborah T. Eversole, W. Duncan Crosby III, Stoll Keenon Ogdon PLLC, 2000 PNC Plaza, 500 W. Jefferson St. Louisville, KY 40202, *Counsel for Amicus Curiae, Kentucky Utilities Company and Louisville Gas and Electric Company.*



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COUNSEL FOR APPELLEE

STATEMENT CONCERNING ORAL ARGUMENT

The Attorney General believes that oral argument would be helpful to the Court.

Counterstatement Of Points And Authorities

Statement Concerning Oral Argument....................................i

Counterstatement Of Points And Authorities........................ii-ix

Counterstatement Of The Case..1-4

Argument

I. The Commission Was Given No Authority To Conduct Between-General Rate Case-Hearings Or To Impose Annual Single-Issue Surcharge Rate Increases For Mains Replacement Program Costs Under KRS 278.509, And No such Authority Pre- Existed The Statute's Enactment.

1. **KRS Ch. 278 Provides Comprehensive Scheme for Utility Regulation**

KRS 278.030, 278.040, 278.180, 278.190, 278.192, 278.260, 278.270, 278.390.. 4-5

In Re Louisville Gas & Elec. Co., Ky. PSC Case No. 2004-00459, and *In Re Kentucky Utilities*, Case No. 2004-00460 (2005 WL 1163147) Joint Order of April 15, 2005...5

2. **KRS 278.509 Created New Right for Mains Replacement Cost Recovery, but Did Not Authorize Cost Recovery Via Surcharge 5**

3. **PSC Lacked Any Express or Implied Authority to Approve Rider AMRP, its Surcharge, and to Conduct Annual Post-General Rate Case Hearings to Adjust Rider AMRP Surcharge 6**

a. PSC Must Strictly Construe Legislature's Grant of Power to Regulate Utility Rates; Said Grant Cannot Be Interpreted by Implication or Inference; PSC is Proscribed From Acting on a Matter Which the Legislature Has Not Established. *South Cent. Bell Tel. Co. v. Util. Regulatory Comm'n*, 637 S.W.2d 649, 653 (Ky. 1982)...................................6

b. PSC Exceeded Scope of its Authority by Allowing DEK to Surcharge its AMRP Expenses. *Public Service Comm'n of Kentucky v. Attorney General of the Com.*, 860 S.W.2d 296, 298 (Ky. App. 1993)....................6

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d. When Legislature Intends to Allow Cost Recovery and the Means of Collecting Cost Outside of General Rate Cases, it Expressly Provides for Such....................7

i. Right to Single-Issue Cost Recovery is Controlled Solely by Terms of Applicable Statute. *Kentucky Indus. Util. Customers, Inc. v. Kentucky Utilities Co.*, 983 S.W.2d 493, 500 (Ky. 1998)....................7

ii. Statutes Authorizing Single-Issue Cost Recovery Outside of General Rate Case: KRS 278.012, 278.015, 278.023, 278.130, 278.183, 278.285, 278.455, 278.516....................7

iii. The enumeration of particular things excludes ideas of something else not mentioned. *Lewis v. Jackson Energy Coop. Corp.*, 189 S.W.3d 87, 91 (Ky. 2005). 8

e. There Being No Express Authorization for: (a) Single-Issue AMRP Surcharge Rate Increases; or (b) Between General Rate Case Hearings, DEK's Sole Remedy is to Seek Cost Recovery Via General Rate Case....................8

f. Post-Rate Case AMRP Hearings Violate Both Long-Standing PSC Policy Against Single-Issue Ratemaking, and Statute Limiting Costs to be Recovered to Those Incurred During the Mandated Test Year. *In Re Louisville Gas & Elec. Co.*, and *In Re Kentucky Utilities, supra.* 8-9

KRS 278.192. 9

g. Since Rider AMRP was Designed to Recover Long-Term Costs of Predictable Nature, it is Not a Formulaic Rate Like Those Designed to Recover Volatile Costs such as Fuel...9-10

h. PSC Cannot Authorize Single-Issue Cost Recovery

For Future Costs That It Cannot Directly Consider For Recovery In A General Rate Case; Thus PSC is Precluded From Doing Indirectly What it Cannot Do Directly. *Southeastern Land Co. v. Louisville Gas & Elec. Co.*, 262 Ky. 215, 90 S.W.2d 1, 3 (1936)........................9

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IV. CONCLUSION 25

COUNTERSTATEMENT OF THE CASE

Appellee Attorney General of the Commonwealth of Kentucky [hereinafter "Appellee" or "Attorney General"] does not accept the Statement of the Case set forth in Appellants' brief; therefore, he tenders the following Counterstatement of the Case.

On May 4, 2001, Appellant Duke Energy Kentucky, Inc. ["DEK"],[1] an investor-owned utility, filed an application with Co-Appellant Kentucky Public Service Commission ["PSC" or "Commission"] pursuant to KRS 278.180 for an adjustment of its general rates pertaining to its gas service.[2] In that filing, DEK sought approval for general rate increases, as well as the right to employ a unique cost tracking rider ["Rider AMRP"] designed to capture (between general rate cases) its costs associated with its Accelerated Mains Replacement Program ["AMRP Program"]. DEK sought implementation of the AMRP Program only after years of failing to keep pace of adequate maintenance on its system of aging cast iron and bare steel mains.[3] Rider AMRP thus allowed DEK to automatically recover such costs on an interim, between-general-rate-case basis.[4]

In its Order of January 31, 2002, the PSC authorized DEK to implement Rider AMRP for an initial three-year period, and to tender annual filing reviews of new AMRP costs during that period.[5] Significantly, the surcharge formula that Rider AMRP established also allowed DEK to *automatically* recover both a return on investment, and a return of each preceding year's net increase in plant investment incurred under the mains replacement program for the three years following the completion of the 2001 general

[1] *F/k/a* "Union Light, Heat & Power," or "ULH&P."
[2] Commission Case No. 2001-00092, the final Order of which was dated on Jan. 31, 2002 [hereinafter "Jan. 31, 2002 Order"], R.A. 1-165 (excerpts attached hereto as "APX B").
[3] *Id.* at 71.
[4] DEK originally proposed that the PSC be given only 30 days to complete its review of each annual AMRP filing. *Id.* at 78.
[5] *Id.* at 79-80.

rate case.[6] This return on investment was in addition to the general *opportunity* to earn a return on equity that DEK is allowed to earn under its general rates.[7] Rider AMRP thus allowed for the automatic, guaranteed reimbursement of these items, on an annual between-general-rate-case-basis, outside of the context of a general rate case.[8] Rider AMRP therefore shifted all risk for return on investment from DEK's shareholders to its ratepayers.

The Commission approved each of DEK's annual applications for adjustments to Rider AMRP. The Attorney General appealed each such ruling to the Franklin Circuit Court. [9] On February 25, 2005, DEK filed its next general rate case, this time seeking approval of the Rider AMRP program for its remaining duration.[10]

While DEK's 2005 rate case was pending, the Kentucky Legislature passed HB 440,[11] which would later be codified at KRS 278.509.[12] As originally drafted, that bill

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[6] *Id.* at 79, and at Appendix G, p. 2; *see also* PSC Case No. 2005-00042, the final Order of which was dated Dec. 22, 2005, p. 70 [hereinafter "Dec. 22, 2005 Order"], R.A. 1-107 (excerpts attached hereto as "APX C").

[7] *See generally* Dec. 22, 2005 Order, pp. 64-73. The Rider AMRP approved by the Commission mimicked the between general rate case capital cost recovery specifically authorized by the General Assembly for electric utilities in KRS 278.183 ("Environmental Surcharge").

[8] In general rate cases, the Commission gives regulated utilities an opportunity to earn an allowed rate of return. Actual rates of return may vary depending on various circumstances.

[9] The first Rider AMRP was approved in Kentucky PSC Case No. 2001-00092, January 31, 2002 Order and in a subsequent Order dated March, 13, 2002, R.A.1-165. These Orders were appealed to the Franklin Circuit Court in Civil Action No. 02-CI-499 (R.A. 1-165). The first set of PSC Orders approving costs to be collected under the Rider AMRP was issued in Kentucky PSC Case No. 2002-00107 on August 30 and November 21, 2002. These Orders were appealed to the Franklin Circuit Court in Civil Action No. 02-CI-1628 (R.A. 2-59). The second set of Orders increasing the costs to be collected under the Rider AMRP was issued in Kentucky PSC Case No. 2003-00103 on August 25 and August 29, 2003. Those Orders were appealed to the Franklin Circuit Court in Civil Action No. 03-CI-1189 (R.A. 1-24). The third Order increasing costs to be to be collected under the Rider AMRP was issued in Kentucky PSC Case No. 2004-00098 on August 24, 2004. This Order was appealed to the Franklin Circuit Court in Civil Action No. 04-CI-1308 (R.A. 1-10). The last PSC Order was in Case No. 2005-00042, Dec. 22, 2005 Order (Franklin Circuit Court 2006-CI-269; R.A. 1-107).

[10] Case No. 2005-00042; *see* Dec. 22, 2005 Order, pp. 64-73, in which the PSC re-approved Rider AMRP.

[11] 2005 Ky. Acts Ch. 148, a copy of which is attached hereto as "APX F."

[12] That statute provided:

> Notwithstanding any other provisions of law to the contrary, upon application by a regulated utility, the commission may allow recovery of costs for investment in natural gas pipeline replacement programs which are not recovered in the existing rates of a regulated utility. No

had only one section which amended an existing statute found in a different chapter of the Kentucky Revised Statutes (Ch. 234), which deals with "Liquefied Petroleum Gas and Other Flammable Liquids." While pending in the Senate, HB 440 was amended to include the section which became KRS 278.509.

The PSC then concluded DEK's 2005 rate case, and re-approved its Rider AMRP. In doing so, the PSC concluded that it had authority for the re-approval under both its general ratemaking powers and under the newly-enacted KRS 278.509. Appellee appealed the PSC's re-approval of Rider AMRP to the Franklin Circuit Court.[13] During oral arguments on the parties' cross-motions for summary judgment, the trial court *sua sponte* ordered supplemental briefing to address the issue of whether the enactment of KRS 278.509 was in compliance with Ky. Const. § 51.

On August 1, 2007, the Franklin Circuit Court entered its Opinion and Order ["Opinion and Order"][14] invalidating Rider AMRP. The Court reversed the Commission order that approved Rider AMRP.[15] The Court also ruled that the Commission lacked the *inherent or implied authority to engage in interim single-issue rate adjustments* except when done with specific statutory authorization.[16] The Court further specifically found that: (a) the Commission may not allow a surcharge without specific statutory authorization; [17] (b) the recovery of expenses in the interim between rate cases is a right not encompassed in the PSC's general power; [18] (c) the Commission has no inherent authority to perform interim single-issue rate adjustments because such a mechanism

recovery shall be allowed unless the costs shall have been deemed by the commission to be fair, just and reasonable.

[13] Action No. 06-CI-269, appealing Dec. 22, 2005 Order in PSC Case 2005-00042 (R.A. 1-107).
[14] R.A. 240-48, Aug. 1, 2007 Opinion and Order (attached hereto as "APX.A").
[15] Opinion and Order at 8.
[16] *Id.* at 5 - 7.
[17] *Id.* at 7.
[18] *Id.* at 6.

would undermine the statutory scheme;[19] (d) outside a general rate case there is no context in which to consider any expense;[20] and (e) that KRS 278.509 violated § 51 of the Kentucky Constitution, and thus provided no basis for the Commission's authorization of Rider AMRP.[21]

On August 13, 2007, Appellants herein filed their Notice of Appeal in the instant matter. In a joint motion filed with this Court, Appellee agreed to a stay of the Opinion and Order,[22] which the Court entered on September 14, 2007.

ARGUMENT

I.

THE COMMISSION WAS GIVEN NO AUTHORITY TO CONDUCT BETWEEN-GENERAL RATE CASE-HEARINGS OR TO IMPOSE ANNUAL SINGLE-ISSUE SURCHARGE RATE INCREASES FOR MAINS REPLACEMENT PROGRAM COSTS UNDER KRS 278.509, AND NO SUCH AUTHORITY PRE- EXISTED THE STATUTE'S ENACTMENT.

KRS Ch. 278 establishes a comprehensive scheme governing utility rates and services. KRS 278.030 establishes the right of every utility to receive fair, just and reasonable rates for the services it renders. The PSC's authority over rates is established in KRS 278.040. The procedure to be followed when a change in rates is sought is set out in KRS 278.180 and 278.190. KRS 278.192 establishes the test year to be utilized in support of requests for general rate increases under KRS 278.190. KRS 278.270 authorizes the PSC to adopt and order the implementation of new rates at the conclusion of its investigation if warranted. These provisions are all designed to establish fair, just

[19] *Id.*
[20] *Id.* at 7.
[21] *Id.* at 2-5.
[22] The Attorney General's acquiescence to the stay, however, was given solely with regard to issues not before this Court and which thus are irrelevant to the instant appeal. His acquiescence, therefore, should not be interpreted as any type of concession.

and reasonable base rates as a function of the utility's overall financial picture in the general rate case.[23]

Absent a court ruling suspending or vacating a PSC order establishing rates, KRS Ch. 278 provides that once base rates are established, they continue in effect even in the face of changes in the utility's actual costs and revenues, until: (1) the utility decides circumstances have so changed that it no longer has an opportunity to earn a fair return on its investment and applies for an increase in base rates; or (2) the PSC or another party seeks to reduce the utility's rates because they are unreasonable.[24]

In addition to the general rate case, KRS Ch. 278 contains many specific statutes authorizing specialized cost recovery for water, sewer, electric, gas and telephone utilities for certain expenses, services, and programs. At issue here is KRS 278.509, which created a new permissive right for gas utilities to recover costs for mains replacement programs, but does not expressly authorize the utility to recoup those costs via a surcharge. The PSC found the statute's failure to expressly provide for cost recovery outside the general rate case to be irrelevant in light of the Commission's alleged *implied* authority to conduct between-general rate case single-issue hearings and to authorize the surcharge.[25]

In an analysis covering several pages, the PSC in its Order[26] reiterated that it had ruled prior to the enactment of KRS 278.509 that it possessed authority to establish a surcharge for these single-issue costs and to create procedures outside of a general rate

[23] *See, e.g., In Re Louisville Gas & Elec. Co.*, Ky. PSC Case No. 2004-00459, and *In Re Kentucky Utilities*, Case No. 2004-00460 (2005 WL 1163147) Joint Order of April 15, 2005 at p. 3 (copy attached hereto as "APX E").
[24] *See* KRS 278.390; 278.270; 278.180; and 278.260.
[25] Dec. 22, 2005 Order, pp. 64-69.
[26] *Id.*

case for periodically reviewing and amending the surcharge. The PSC thus held that the failure of KRS 278.509 to set forth a specific mechanism for surcharge cost recovery did not limit its alleged pre-existing implied authority.[27]

Both prior to the enactment of KRS 287.509 and after, the PSC's actions regarding Rider AMRP exceeded its scope of authority. The PSC lacked, and continues to lack the implied (or any other) authority necessary to establish the Rider AMRP surcharge and to conduct annual hearings to adjust that surcharge to recover post-general rate case costs. The statute made no provision for such.

> The legislative grant of power to regulate rates will be strictly construed and will neither be interpreted by implication nor inference. . . . In fixing rates, the Commission *must* give effect to all factors which are prescribed by the legislative body, but may not act on a matter which the Legislature has not established. *South Cent. Bell Tel. Co. v. Util. Regulatory Comm'n*, 637 S.W.2d 649, 653 (Ky. 1982)[emphasis in original; citations omitted].

When a statute prescribes the procedures that an administrative agency must follow, the agency may not add to or subtract from those requirements. *Public Service Comm'n of Kentucky v. Attorney General of the Com.*, 860 S.W.2d 296, 298 (Ky. App. 1993)(citations omitted). By allowing DEK to surcharge for its AMRP expenses, the PSC has exceeded its scope of authority.

KRS 278.509, as enacted, does not establish an alternative single-issue ratemaking procedure or surcharge recovery for mains replacement cost recovery. Silence in the enabling statute does not create authorization. This silence stands in stark contrast to many other sections of KRS Ch. 278 that do ***affirmatively and expressly*** establish both cost recovery and alternative ratemaking mechanisms and procedures. Indeed, KRS Ch. 278 is replete with statutes [hereinafter "Ch. 278 special statutes"] that not only grant

[27] *Id.*

entitlement to recover certain costs, but also precisely specify the availability of single-issue rate treatment for those costs outside of a general rate case. These Ch. 278 special statutes thus establish both cost recovery rights and a non-general rate case means by which the cost recovery is to occur. However, the scope of application of each right embodied in the Ch. 278 special statutes is controlled solely by the terms of the statute establishing each right. *Kentucky Indus. Util. Customers, Inc. v. Kentucky Utilities Co.*, 983 S.W.2d 493, 500 (Ky. 1998).[28]

The Ch. 278 special statutes include the following: KRS 278.183 (which, *inter alia*: (1) authorizes recovery of environmental compliance costs via surcharge; and (2) requires the PSC to conduct a hearing within six months of the application, and specifies the matters to be considered therein); KRS 278.012, 278.015 and 278.023 (authorizing rate increases for water and sewer districts and associations without prior Commission action in the event of water wholesaler rate increases, and special rate recovery procedures for certain projects); KRS 278.130 (requiring the PSC to approve requests for rate increases to recover the annual PSC assessment and limiting the hearing thereon to solely that issue);; KRS 278.285 (authorizing the development and implementation of demand side management ("DSM") and home energy heating assistance programs and specifying that DSM cost recovery mechanisms may be considered in either a general rate case or separate proceeding); KRS 278.455 (authorizing a reduction in a generation and transmission cooperative's rates, based on certain conditions); and KRS 278.516 (alternative rate recovery for telecommunications providers).

[28] The Kentucky Supreme Court held in part that the right to recover environmental compliance costs through a surcharge without filing a general rate case is a new right established by the enabling statute at issue in that case, KRS 278.183. Only those costs allowed by the statute may be recovered by that surcharge. *Id.* at 500.

The Ch. 278 special statutes demonstrate unequivocally that the Legislature knows how to allow for alternative rate procedures for cost recovery, and includes those procedures in the enabling legislation when it so desires. But in KRS 278.509 ***there is no like provision.*** "It is a primary rule of statutory construction that the enumeration of particular things excludes ideas of something else not mentioned." *Lewis v. Jackson Energy Coop. Corp.*, 189 S.W.3d 87, 91 (Ky. 2005). Absent specific enabling legislation otherwise, the matter can only be resolved via a general rate case, per KRS 278.180 and 278.190.[29] Neither KRS 278.509, nor any other provision of Ch. 278 grants the Commission the express authority to conduct between-general rate case-hearings or to impose single-issue surcharge rate increases for mains replacement costs.

Moreover, the post-rate case AMRP cases constitute single-issue ratemaking. Yet the PSC has a well-established policy against single-issue ratemaking, having previously ruled:

> Simply stated, the pending applications appear to be requests for the Commission to engage in single-issue rate-making by focusing exclusively on one or more closely related items of revenue and expense, to the exclusion of all other items of revenue and expense. **Although the Commission has, in limited instances, previously engaged in single-issue rate-making, those instances were either specifically authorized by statute or the result of a unanimous agreement by all parties with approval by the Commission.** While the General Assembly has authorized single-issue rate-making for recovery of the Commission's annual assessment and the costs of its consultants (KRS 278.130), environmental costs (KRS 278.183), and demand side management costs (KRS 278.285), there is no provision of law authorizing a rate case focused exclusively on MISO-related revenues and expenses. . . . [30] (emphasis added).

Thus, the PSC itself has ruled that there can be no single-issue ratemaking absent express statutory authority. However, Rider AMRP was designed specifically to recover

[29] *See, Kentucky Indus. Util. Customers, Inc., supra.*
[30] *In Re Louisville Gas & Elec. Co.*, and *In Re Kentucky Utilities*, *supra* at n. 23.

future costs that lie *outside* of the statutorily-mandated test year costs that were utilized to develop DEK's rates. KRS 278.192 precludes consideration of such a rate in a general rate case. Rider AMRP thus constitutes single issue ratemaking for which the Commission had no statutory authority in which to engage. Additionally, the mere fact that Rider AMRP was filed for PSC consideration in the course of a general rate case does not somehow confer the authority to implement it.[31]

Appellants' contention that Rider AMRP is merely a formulaic rate (involving factors subject to change, such as fuel costs) is misplaced. Rider AMRP does not recover recurring, volatile current costs like those for fuel or gas supply. The costs it considers are not volatile, but readily ascertainable. Unlike the Fuel Adjustment Clause regulation[32] (in which the utility passes-through costs but makes no profit), Rider AMRP constitutes a long-term investment on which a return is sought. The PSC cannot authorize single-issue cost recovery for future costs that it cannot directly consider for recovery in a general rate case. Such a rate would circumvent and render meaningless the limits placed on the costs to be considered in support of the general rate increase imposed by KRS 278.192. The rule of *Southeastern Land Co. v. Louisville Gas & Elec. Co.*, 262 Ky. 215, 90 S.W.2d 1, 3 (1936) -- what a utility is forbidden to do directly, it may not accomplish by indirection by way of resort to any device or subterfuge leading to the same result -- applies with equal force and effect to the PSC. Thus, a state agency that is expressly precluded from a course of action cannot attempt to initiate that action via a claim of implied authority. The limits of the PSC's power are and always have been set by the Legislature.[33] Although

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[31] KRS Ch. 278 does not confer any such authority.

[32] 807 KAR 5:056, which is an example of a formulaic rate mechanism.

[33] *See, e.g., Boone County Water v. Public Service Commission,* 949 S.W.2d 588, 591 (Ky. 1997)(*citing South Central Bell Tel. Co. v. Utility Reg. Comm'n, supra*); *Public Service Comm'n. v. Jackson Co. Rural*

the PSC clearly has many ratemaking methodologies available to it, they are limited to those expressed in KRS Ch. 278.[34]

Appellants further assert that the PSC's interpretation of its statutes is entitled to deference. However, the interpretation of a statute is a legal question. *Revenue Cab. v. Hubbard*, 37 S.W.3d 717, 719 (Ky. 2000). The Judiciary has the exclusive right to interpret the laws of the Commonwealth. *Lafferty v. Huffman*, 99 Ky. 80, 35 S.W. 123, 124 (1896).[35] Courts are not bound to accept the legal conclusions of an administrative body. *Epsilon Trading Co., Inc. v. Revenue Cabinet*, 775 S.W.2d 937, 940 (Ky. App. 1989). Whether the PSC exceeded the scope of its authority is a question of law that the Court of Appeals scrutinizes closely and reviews *de novo*.[36] Furthermore, an administrative agency's action in excess of its statutory power is arbitrary and clearly erroneous.[37] Since the PSC's actions in establishing Rider AMRP were in excess of its authority, they are also clearly unlawful pursuant to KRS 278.410(1).

A. The Commission Had No Implied Authority to Order Creation of Rider AMRP, to Order Surcharge Authority to Recover AMRP Costs, and to Order Between Rate Case Hearings to Determine Surcharge Amount

The PSC's powers are purely statutory.[38] When a statute prescribes the procedures

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Elec. Co-op., Inc., 50 S.W.3d 764, 767 (Ky. App. 2001); *Public Service Comm'n v. Attorney General of the Comm., supra* at 298; *Commonwealth v. Phon,* 17 S.W.3d 106,108 (Ky. 2000)(statutes should be construed in such a way that they do not become meaningless or ineffectual); *Hardin Co. Fiscal Court v. Hardin Co. Bd. of Health*, 899 S.W.2d 859, 861-62 (Ky. App. 1995).

[34] *See, National Southwire Aluminum Co., infra.*

[35] *See also, Traynor v. Beckham*, 116 Ky. 13, 74 S.W. 1105, 1106 (1903), and *LRC v. Brown*, 664 S.W.2d 907, 912 (Ky. 1984)(Interpretation of the law lies within the peculiar province of the Judiciary).

[36] *Cincinnati Bell, infra* n. 38 (*citing Com., Transportation Cabinet v. Weinberg,* 150 S.W.3d 75 (Ky.App.2004)).

[37] *Com., Transp. Cab. v. Cornell,* 796 S.W.2d 591, 594 (Ky. App. 1990); *Public Util. Com'n v. City Pub. Serv. Bd. of San Antonio,* 53 S.W.3d 310, 316 (Tex.2001)(Texas Supreme Court gives weight to how the Public Utilities Com'n. interprets its statutes, but only if the interpretation is reasonable and not inconsistent with statute); *Massachusetts Hosp. Ass'n., Inc. v. Dept. of Medical Sec.*, 588 N.E.2d 679, 683 (Mass. 1992).

[38] *Public Service Comm'n. v. Jackson Co. Rural Elec. Co-op., Inc., supra* at 797 (*citing Boone County Water, supra);Cincinnati Bell Tel. Co. v. Kentucky Public Service Com'n,* 223 S.W.3d 829, 836 (Ky. App.

that an administrative agency must follow, the agency may not add or subtract from those requirements.[39]

> "'Administrative agencies derive their power and authority from other sources. They are agents of those principals and cannot act beyond the intended grant of authority. Generally, the authority comes from a delegation by the legislative branch . . . to perform some duty assigned to it by the legislature, and hence agencies have only such authority as is delegated by the legislature. From this, we derive a basic concept that an agency cannot act outside its delegated authority.' . . . The Kentucky courts have not been as deferential toward administrative agency power as have the federal courts and have struck down legislative delegations as recently as 1996. *See Flying J Travel Plaza v. Com., Transp. Cabinet*, Ky., 928 S.W.2d 344 (1996)." OAG 99-2,[40] p. 6, (*quoting* Koch, *Administrative Law & Practice* § 12.13, p. 170 (2d ed. 1997)).

Nonetheless, it is equally well-settled law in Kentucky that administrative agencies possess not only their expressed enumerated powers, but also those that are necessarily implied to accomplish their expressly enumerated powers. The *amici* cite numerous Kentucky decisions which upheld agency actions based on necessarily implied authority. Yet in each such case, a common thread emerges which is woefully lacking in the PSC's action in the instant appeal: in each case, it was found the agency simply could not carry out its mandated mission without the exercise of implied authority.

Thus, a health board was found to have the implied authority to purchase a building from which it conducted its operations (even though no express authority existed);[41] a jailer's responsibilities included the duty to cooperate with other agencies to provide humane medical treatment, even though he was not expressly required to do

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2007); *accord*, 73B *C.J.S. Public Utilities* § 159 (2007)(A public utilities commission possesses only that authority conferred expressly by statutes, or by necessary or fair implication, but has no inherent powers (citations omitted)).

[39] *Union Light, Heat & Power Co. v. Public Service Comm'n*, 271 S.W.2d 361 (Ky. 1954).

[40] 1999 Ky. Op. Atty. Gen. 2-46.

[41] *Ashland-Boyd County City-County Health Dept. v. Riggs*, 252 S.W.2d 922 (Ky. 1952).

so;[42]when a county fiscal court attempted to execute its statutory duty to revise precinct boundaries, the court found the agency had the implied authority to spend money to pay its commissioners to gather the necessary data and produce a report, and to pay for newspaper publication of the changes based on the report;[43] and a school board can set aside funds for students' recreation, although that power was not expressly authorized.[44]

In *Public Service Comm'n v. Cities of Southgate and Highland Heights*, 268 S.W.2d 19, 21 (Ky. 1954),[45] the PSC was found to have implied authority to approve the sale of a utility in order to fulfill its statutory obligation of insuring adequate utility service.[46] The Court found that if the purchaser was unable to provide adequate utility service:

> , ". . . the sale would be the practical equivalent of a **discontinuance of service.** The [PSC] . . . in order to carry out its responsibility, must have the opportunity to determine whether the purchaser is ready, willing and able to continue providing adequate service."[47] [emphasis added]

Appellants and the *amici* also make abundant reference to the *National*

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[42] *County of Harlan v. Appalachian Reg. Healthcare, Inc.*, 85 S.W. 3d 607, 611 (Ky. 2002)("Not to require the jailer to cooperate with other officials in providing the necessary services **would produce an absurd result** and frustrate the system envisioned by the legislature.")[emphasis added].

[43] *Jefferson County ex rel Grauman v. Jefferson County Fiscal Court*, 301 Ky. 405, 192 S.W.2d 185 (1946)("The power to appoint necessary attendants upon the court is inherent in the court in order to enable it to perform properly the duties delegated to it by the Constitution." *Id.* at 186).

[44] *Dodge v. Jefferson County Bd. of Educ.*, 298 Ky. 1, 181 S.W.2d 406-07 (1944).

[45] Copy attached hereto as "APX D."

[46] *But cf. Public Service Com'n of Kentucky v. Attorney General of Com.*. 860 S.W.2d 296, 298 (Ky. App. 1993), which **refused to find authority which the PSC deemed was necessarily implied** (". . . the PSC's attempt to use the provisions of KRS 278.255 as a basis for allocating the cost of the merger study to the respondent Water Districts exceeds the statutory authority granted to the PSC . . . If the General Assembly had intended the cost of the merger study under KRS Chapter 74 to be funded like a management audit under KRS 278.255, such provision could easily have been specifically included in the language of Chapter 74. It was not." *Id.* at 298.)

[47] *Id.* at 21. Significantly, however, the court limited the PSC's necessarily implied powers, refusing to find that the agency had authority to determine whether public ownership was more beneficial than private, and which type of ownership would result in the lowest rates. *Id.*

Southwire[48] ruling, in which the PSC approved a variable wholesale electric rate to a very large commercial client (an aluminum smelter) not regulated by the PSC.[49] In that case, the PSC found that, "Big Rivers' **future solvency** was inextricably linked to the health of the smelters," and that the variable smelter rate provided a fair resolution to Big Rivers' financial problems.[50] The Court agreed with the PSC, going so far as to add, "[t]he potential consequences of this situation for all parties and for Western Kentucky were **monstrous**."[51] Thus, the PSC in *National Southwire* could not have met its statutory obligation of preventing discontinuance of utility service (in this case to tens of thousands of customers spread across an entire region of the Commonwealth) had it not produced an adequate resolution based on authority that was necessarily implied.

However, the PSC in the instant appeal has no authority -- express or implied -- to establish surcharge recovery for mains replacement programs. In 2001, the PSC ruled [52] that it has broad implied authority under KRS Ch. 278 to approve Rider AMRP, which was designed to grant cost recovery for capital additions made *after* rates found to be fair, just and reasonable had gone into effect. However, the Ch. 278 special statutes set forth above, which establish specific authority for ratemaking procedures other than general rate cases, belie Appellants' and the *amici's* claim that the PSC has always had authority to engage in such ratemaking -- for if true, all the Ch. 278 special statutes are meaningless surplus. Furthermore, by the time the Commission made its 2001 ruling, the Kentucky Supreme Court had already found in *Kentucky Indus. Util. Customers, supra*

[48] *National Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503 (Ky. App. 1990)(copy attached hereto as "APX D").
[49] *Id.* at 505.
[50] *Id.* at 507-08 [emphasis added].
[51] *Id.* at 515 [emphasis added].
[52] *See,* PSC Case No. 2001-00092, Jan. 31, 2002 Order, pp. 75-76; this finding was reiterated in the 2005 rate case, PSC Case No. 2005-00042, Dec. 22, 2005 Order, p. 64.

that the right to surcharge recovery for electric utilities' capital costs related to environmental compliance is a substantive right that did not pre-exist the enactment of KRS 278.183. The Court found:

> "The legislation involved is substantive and not remedial. The surcharge creates a **<u>new right</u>** for all electric utilities, that is, the right to recover expenses as well as a return on and a return of capital costs associated with environmental projects without filing a general rate case." *Id.* at 500 [emphasis added].

Quite simply, this right did not exist under the authority granted to the Commission to establish fair, just and reasonable rates pursuant to KRS 278.030. It took the enactment of KRS 278.183 to create that new right. In the same fashion, the right to cost recovery for mains replacement programs did not exist for gas utilities prior to the enactment of KRS 278.509. That statute established only the right to *cost recovery*, <u>not</u> a right to *surcharge recovery* of those costs. The Kentucky Legislature has repeatedly demonstrated through legislation that specifically authorizes surcharge recovery outside of a general rate case that when it *intends* such recovery, it *directs* such recovery. It did not do so in KRS 278.509, and that authority may not be implied. The PSC did not have the implied power prior to the enactment of KRS 278.509, nor does it now possess the implied power under KRS 278.030 and 278.040 to: (a) establish Rider AMRP; (b) authorize surcharge recovery of costs; or (c) conduct between rate case hearings to determine the amount of that surcharge.

Based on the foregoing authorities (and numerous other decisions), it is well-established law in Kentucky that administrative agencies possess those powers set forth by statute, as well as those powers **necessarily** implied to execute their **expressly enumerated** powers. In both *Cities of Southgate and Highland Heights, supra,* and

National Southwire, supra, the PSC was facing issues crucial to its central mission: continuation of utility service under unique circumstances. In both cases, courts upheld the exercise of implied authority because the PSC could not fulfill its statutorily-charged mission but for the exercise of authority unique to each case.

The PSC therefore should have implied authority to address issues not expressly addressed in its statutes, when the risks a utility faces are: (a) volatile; (b) substantial (i.e., the ramifications extend to a company's solvency); and (c) are outside the utility's control. However, such was never the case with Rider AMRP. DEK was never facing bankruptcy, despite the fact that it unilaterally decided to increase the pace of its replacement program; indeed, mains replacement is anything but a unique issue for a gas utility. Furthermore, DEK was always free to obtain cost reimbursement via a standard rate case. Thus, there was never any need for a unique remedy to prevent insolvency or any other "monstrous" result, as was the situation in *National Southwire.*

In the instant appeal, the Attorney General is not second-guessing DEK as to the need for an accelerated replacement program (even though that need was created largely as a result of the company's failure to adequately maintain its mains).[53] Rather, the sole issue is that Appellants always had a means of seeking recovery for those costs: the traditional rate case, per KRS 278.030, 278.180 and 278.190. While that statutory remedy may pose some procedural inconveniences, such has never been a justification for unilateral expansion of administrative power.[54]

When considering rate issues in the context of a rate case, the PSC fulfills its statutory mission. The Franklin Circuit Court was thus correct in finding that the PSC

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[53] *See* n. 3, *supra.*
[54] 73B C.J.S. *Public Utilities* § 159 (2007), n. 12 (*citing, Cities of Austin, Dallas, Ft. Worth and Hereford v. Southwestern Bell Tel. Co.,* 92 S.W.3d 434 (Tex. 2002)).

lacks authority to order recovery of expenses in the interim between rate cases,[55] and that it has no inherent authority to perform interim single-issue rate adjustments because such mechanisms undermine the statutory scheme.[56] As such, the PSC's orders establishing and reaffirming Rider AMRP were both unreasonable and unlawful under KRS 278.410 (1).

II.
KRS 278.509 DOES NOT AUTHORIZE RECOVERY OF THE UTILITY'S RETURN ON INVESTMENT AS A COST.

The Franklin Circuit Court found, *inter alia*, that the PSC has no inherent authority to perform interim single-issue rate adjustments because such a mechanism would undermine the statutory scheme,[57] and that the Commission may not allow a surcharge without specific statutory authorization.[58] Both in the initial creation of Rider AMRP [59] and in its renewal,[60] the PSC granted DEK the right to recover **as a cost** an automatic return on investment of its AMRP expenses. In so doing, the PSC cited to its alleged inherent authority. Although the trial court found this issue was rendered moot by its ruling,[61] Appellee believes, however, that this issue provides even further evidence of the PSC's overreaching, and therefore warrants consideration from this Court as potential additional or alternative grounds for affirming the Opinion and Order. *See, Jarvis v. Com.*, 960 S.W.2d 466, 469 (Ky. 1998).[62]

KRS 278.509 did not define the return on investment as a cost subject to cost recovery. Nevertheless, the PSC ruled that the return on DEK's investment is an

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[55] Opinion and Order at 6.
[56] *Id.*
[57] *Id.*.
[58] *Id.* at 7.
[59] PSC Case No. 2001-00092, Jan. 31, 2002 Order, p. 79.
[60] PSC Case No. 2005-00042, Dec. 22, 2005 Order, pp. 71-72.
[61] Opinion and Order at 8.
[62] *See also, Newman v. Newman*, 451 S.W.2d 417, 420 (Ky. 1970); *Union Light, Heat & Power Co. v. Public Service Com'n.*, 271 S.W.2d 361, 365 (Ky. 1954).

ordinarily recognized element of the utility's cost of capital and is, therefore, subject to cost recovery under KRS 278.509.[63]

The PSC's finding in this regard is wholly without merit. It is true only when speaking of the establishment of base rates pursuant to a general rate case, where the costs of equity and capital are constitutionally required considerations. It is not true for the purpose of a cost recovery statute where the return on investment is not defined as a cost subject to recovery. Base rates differ significantly from a cost recovery mechanism. The base rate case considers all costs and all financial considerations the utility faces at the time the case is brought. Moreover, constitutional law requires that base rates be established at levels sufficient to allow the utility recovery of: (a) ordinary expenses and the return **of** investment; and (b) an *opportunity* to earn a return **on** investment – a profit.[64] On the other hand, a cost recovery statute addresses the different and more limited issue of authorizing certain defined costs for guaranteed cost recovery. Only those costs defined *by the statute* may be recovered on a cost recovery basis rather than under the base rate on an opportunity to earn basis.

Base rates, however, do not insure that the utility will produce net returns. *Hope*, *supra* at 603. Base rates are set at a level sufficient to allow the utility the opportunity to earn that amount.[65] There is no guarantee under the base rates that the utility will earn enough to meet its cost obligations, much less enough to also provide a return on investment to its investors.[66]

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[63] Dec. 22, 2005 Order, p. 70.
[64] *Fed. Power Comm'n. v. Hope Nat. Gas Co.*, 320 U.S. 591 at 603; 64 S.Ct. 281; 288; 88 L.Ed. 333 (1944); *Bluefield Water Works & Imp. Co. v. P.S.C. of W. Va.*, 262 U.S. 679, 690; 43 S.Ct. 675; 67 L.Ed. 1176 (1923).
[65] *Bluefield*, supra.
[66] *Id.* at 692-93.

Cost recovery statutes are altogether different. Unlike statutes establishing the right to a fair, just and reasonable rate, a cost recovery statute that fails to authorize recovery of a profit or return on investment does not run afoul of constitutional law because the utility retains the right to bring a general rate case to recover costs not addressed in a cost recovery statute. *Kentucky Indus. Util. Customers*, *supra*, at 500. Unlike base rates, cost recovery statutes entitle the utility to recoup that which the Legislature decrees may be recouped, regardless of the company's earnings status. Consequently, the concept of revenues sufficient to allow an opportunity to earn a potential return on investment is irrelevant to cost recovery legislation.

Had the Legislature intended to transform the mere *opportunity* to earn a return on investment into a cost to be recovered under a cost recovery statute (and thereby to become a *guaranteed* profit), it would have explicitly and directly so stated. Although the Legislature did not do so in KRS 278.509, it did indeed precisely, explicitly and directly express its intent in this regard in the other statute establishing cost recovery entitlements for capital intensive utility programs: KRS 278.183. That statute demonstrates the fallacy of the PSC's assumption that inclusion of the return on investment for ratemaking purposes in base rate considerations also constitutes inclusion of the return as a cost for the purposes of a cost recovery statute. KRS 278.183 specifically identifies and defines the return,[67] and provides that it is to be established and recovered as a cost of compliance (even though the potential cost of equity component of capital costs is an ordinary consideration for the purpose of establishing base rates).[68]

[67] *See* KRS 278.183 (1) ". . . These costs shall include a reasonable return on construction and other capital expenditures and reasonable operating expenses . . .".
[68] This is true even though that cost recovery statute begins by establishing the right of the utility to recover all of "its costs."

Thus, under KRS 278.183 the potential return on investment[69] has become a cost for which cost recovery via the mechanism is authorized not because it is a "cost" normally considered in a base rate case, but rather only because in the context of the statute, it is designated as recoverable by the cost recovery statute itself.

The terminology granting the utility the right to cost recovery for "its costs" as used in KRS 278.183 is unquestionably as broad as or broader than the terminology granting the utility the right to recover its "costs for investment" as used in KRS 278.509. Even so, KRS 278.183 goes on to spell out the return on investment as a cost subject to recovery while KRS 278.509 does not. The failure of KRS 278.509 to specify the return on investment as a cost subject to recovery is not a silence without meaning. The Commission is not free to expand the reach of a cost recovery statute beyond those costs it designates for recovery. *Public Service Comm'n of Kentucky, supra.*[70]

Therefore, return on investment must also be deemed a cost before it can be recovered under a cost recovery statute. *South Cent. Bell Tel. Co. v. Util. Regulatory Comm'n,* 637 S.W.2d 649 (Ky. 1982).[71] Though the return on investment is something the PSC both should and must consider in a base rate case under KRS 278.030, it is not a cost subject to cost recovery under KRS 278.509 because it is not expressly defined as a cost. For KRS 278.183 the return on investment has been defined as a cost for cost recovery, for KRS 278.509 it has not.

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[69] For purposes of the statute, the return is calculated through financial analysis to establish the return necessary to induce investment, rather than looking at actual returns paid.

[70] The Court held that the PSC's attempt to assign costs under a statute where the authority relied on is not in the statute was an act in excess of its statutory authority. 860 S.W.2d 296, at 298. (*See also, Kentucky Indus. Util. Customers, Inc., supra*).

[71] In that case, it was held that although the Commission has statutory authority to regulate rates and to regulate services, it may not act in areas the Legislature has not authorized to reduce rates to penalize for poor service. *Id.* at 653-54.

III. TRIAL COURT CORRECTLY FOUND KRS 278.509 UNCONSTITUTIONAL

The Franklin Circuit Court was correct in holding [72] that what is now codified as KRS 278.509 [73] does not comport with Ky. Const. § 51.[74]

While § 51 of Kentucky's Constitution has been construed to resolve all doubts in favor of the validity of legislation,[75] nonetheless Kentucky's highest court has held that the title of the act must be read as a whole to determine the subject embraced because, **"there are wholesome limits to what can be loaded into one bill."** *McGuffey v. Hall*, 557 S.W.2d 401, 407 (Ky. 1977)(emphasis added). In *McGuffey, supra*, the Court construed a bill entitled, "AN ACT relating to health care malpractice insurance and claims." One section of the bill amended an existing statute (KRS 311.377) conferring indemnity to various health care providers who performed their duties as members of certain peer review boards, while other sections pertained to health care malpractice claims.[76] The court noted that although conduct that results in a malpractice claim could also lead to a peer review proceeding, there was an insufficient relationship between the bill's title and its content to pass the dictates of § 51.[77] Significantly, the *McGuffey* court cautioned that the subject of the challenged sections must bear more than a coincidental relationship to the title and remainder of the act as being sufficiently related to the title.[78]

[72] Opinion and Order, pp. 2-5.
[73] HB 440 of the 2005 Regular Legislative Session; 2005 Ky. Acts Ch. 148 (see APX F).
[74] That section commands in pertinent part: "No law enacted by the General Assembly shall relate to more than one subject and that shall be expressed in the title,…."
[75] See, e.g., *Bowman v. Hamlett*, 159 Ky. 184, 166 S.W. 1008, 1009 (1914).
[76] *Id.* at 405-06.
[77] *Id.* at 407.
[78] *Id.* A subsequent attempt to amend the same statute (KRS 311.377) by means of a bill entitled "AN ACT relating to the establishment of certificate of need, licensing and regulation of health facilities and health services," likewise failed to pass § 51 scrutiny. *Sweasy v. King's Daughters Mem. Hosp.*, 771 S.W.2d 812 (Ky. 1989)(*citing McGuffy, supra*).

The *McGuffey* and *Sweasy*[79] holdings both state that a relationship between a bill's content and its title that is merely coincidental does not pass § 51 scrutiny. The mere fact that the bills referenced in each case related to *medical* malpractice and *medical* peer review did not provide sufficient nexus. In the instant appeal, there is likewise a similar coincidental relationship between the language set forth in § 2 of HB 440 and the bill's title.[80]

For several reasons, the phrase "gas delivery systems" as set forth in HB § 1 fails to provide sufficient nexus between the Bill's subject matter and its title. First, the "gas delivery systems" contemplated in HB 440 § 1 are clearly not a "gas delivery system" subject to PSC regulation. Second, there are many types of gas, each bearing their own unique properties and characteristics, many being subject to very different forms of delivery and regulatory schemes.[81] Consequently, unlike the situation in which the title employs language synonymous with and uniformly applied to a given subject-matter, the title here does nothing to alert the reader to the subject of utility cost recovery for natural gas pipelines. Third, the act's title does not limit itself solely to the subject of gas delivery systems. Instead it employs the conjunctive "gas delivery systems *and* appliances." It is necessary to look at the bill's entire title, not just a portion thereof, to determine what subject it covers. *McGuffey, supra*, at 406. Fourth, while a natural gas utility's pipelines are used to deliver gas to its customers, such delivery does not transform those pipelines

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[79] *See* n. 80, *supra*.

[80] Appellants' brief (at pp. 4-5) indicates the Kentucky Senate found the amendment of § 2 to be germane to HB 440's title; yet such an argument is irrelevant in light of well-established Kentucky law that the Judiciary has the ultimate and sole power and duty to determine a statute's constitutionality. *Rose v. Council for Better Educ., Inc.*, 790 S.W.2d 186, 209 (Ky. 1989).

[81] *See, e.g.*, KRS 74.405 ("Gas Delivery Systems Administered by Water Commissioners"). Appellants state that all pipelines and appliances ". . . are all part of a single interconnected system . . .," all of which run solely on natural gas (Appellants' brief, p. 25). However, such is patently not the case (*see, e.g.*, KRS 234.272, definitions regarding propane gas industry).

into a gas delivery system of the type that is paired with appliances for legislative consideration.[82]

As originally tendered for consideration by the House, House Bill 440 comprised only one section (§ 1). That section amended KRS 234.175 with reference to "gas-consuming appliances, equipment, or other component of a gas delivery system" -- a single subject, all parts of which are expressed in the title of the act.[83] However, Bill § 2, creating the new provision of KRS Chapter 278 that would become KRS 278.509, was subsequently added as a Senate Floor Amendment.[84] The subject of § 2 addresses an entirely different subject matter, as evidenced by the fact that it also references an entirely different chapter of the KRS. Thus § 2's subject is neither described by, nor is it germane to the title of the act. When it is clear that a bill's original sections relate to the title, but subsequently added sections do not, those sections that do not so relate violate Ky. Const. § 51 and are therefore void. *Thompson, supra* at 624.

Though no magic language is required to make a title relevant to the subject of the act, it is worth noting that acts affecting the regulation of public utilities normally bear titles announcing that the act relates to public utilities or to specific types of utilities.[85] By

[82] *Cf., Thompson v. Commonwealth*, 159 Ky. 8, 166 S.W. 623 (1914) (Though an act contains in its title reference to House of Reform, sections of the legislation that address the punishment of those under the age of 21 by confinement in a House of Reform are constitutionally defective under § 51 of the Kentucky Constitution where the full title of the act is "An act to appropriate money for the benefit of the Houses of Reform, to provide funds to pay the existing deficit and to make improvements at the Houses of Reform.").

[83] See § 1 which provides in pertinent part: "KRS 234.175 is amended to read as follows:...
(3) A person shall not install gas-consuming appliances, equipment, or other components of a gas delivery system.... (4) A person shall not alter, modify, maintain or repair gas-consuming appliances, equipment, or other components of a gas delivery system..."

[84] In addition to the new Section, an amendment to the title to make it "AN ACT relating to natural gas" was proposed. § 2 was passed but the amendment to the title of the Act was withdrawn.

[85] Appellee attaches hereto in "APX. G" copies of the following legislation: (a) SB 335 (Enact. Acts 1992, ch. 308, § 1) establishing KRS 278.192 the title of which reads: "AN ACT relating to utilities"; (b) SB 341 (Enact. Acts 1992, ch. 102, § 1) establishing KRS 278.183, the environmental surcharge, the title of which also reads "AN ACT relating to utilities"; and (c) SB 323 (Enact. Acts 1992, ch. 306, § 1) establishing KRS

examining the direct relationship between an act titled "AN ACT relating to utilities" and the subject it covers, it becomes readily apparent that HB 440's title, "AN ACT relating to gas delivery systems and appliances" provides no clue to the subject-matter of § 2 of the act. The Franklin Circuit Court was thus correct in finding that the Act violates Ky. Const. § 51.

It is beyond dispute that HB 440 relates to two subjects. The bill's title reads: "AN ACT relating to gas delivery systems and appliances." Clearly, the bill has *two* primary purposes: (1) amend KRS 234.175 to enhance safety requirements for in-building installations of gas-consuming appliances, equipment or other components of a gas delivery system with associated, consequent, protection from liability for such installations; and (2) to provide utilities falling under the PSC's regulation with the right to cost recovery for investment in natural gas pipeline replacement programs.

Regulated utilities are subject to an entirely different regulatory scheme than that created for regulating gas-consuming in-building appliances and gas delivery systems.[86] Natural gas may be used as fuel for in-building gas-consuming appliances and gas delivery systems, but so may other types of gas. Consequently, any reference to gas delivery systems in conjunction with appliances does not serve to give a clue that cost recovery for natural gas pipelines is a subject-matter of the act. The distinction is further made clear by the fact that a second Senate Floor Amendment to change the title of the Act to "AN ACT relating to natural gas" was made. That amendment was withdrawn.

278.512, the title of which reads "AN ACT relating to telecommunications." In all of these, the attention of the reader is clearly drawn to the subject of the act.

[86] *See generally* KRS Chs. 278 and 234. 807 KAR 5:022 § 1 (6) states that only a propane company which transports propane to more than 10 customers is subject to PSC jurisdiction. To the best of counsel's knowledge, only one propane company (Bright's Propane Service, Inc.) satisfies this jurisdictional requisite.

The fact that §§ 1 and 2 address distinct and separate subject matters is further demonstrated by the use of modifiers in each provision of the act. § 2 modifies the pipelines for which the utility cost recovery is allowed, limiting that recovery to natural gas pipelines. Were natural gas pipelines sufficiently similar to or germane to gas delivery systems and appliances to be described by the general title of the act, it would not be necessary for § 2 to define itself as relating cost recovery for natural gas pipelines (as opposed to all gas pipelines or gas delivery systems). Conversely, § 1 of the act, which clearly relates to the act's title, limits its application to gas-consuming appliances, equipment and systems. Clearly, the natural gas pipelines of regulated utilities do not consume gas; rather, they merely transport it.[87]

Finally, Appellants may yet attempt to argue that, as a matter of safety, it was in the public interest to incent gas utilities to replace aging dangerous pipelines by allowing cost recovery for those programs and, consequently, that the public safety interest for both §§ 1 and 2 of HB 440 is the same. However, safety is not mentioned in the title of the act and cannot be used as a subject-matter tie for two otherwise unrelated sets of legislation. Public interest is not grounds to uphold a constitutionally defective statute. *Fannin v. Williams*, 655 S.W.2d 480, 484 (Ky. 1983). Moreover, the mere fact that safety is one issue does not elevate the relationship between the two sections beyond one of mere coincidence. *McGuffey, supra*. Any such argument thus fails to pass Ky. Const § 51 scrutiny.

[87] "Problems relating to design, installation and maintenance of gas-consuming appliances have nothing to do with ratemaking procedures of the PSC." Opinion and Order at 5.

IV. CONCLUSION

The Franklin Circuit Court was correct in finding that: (1) the PSC lacks any express or implied authority to: (a) authorize implementation of Rider AMRP; (b) authorize surcharge authority for DEK to recover its AMRP-related costs; and (c) hold between-rate-case hearings to determine the amount of the AMRP surcharge; and (2) KRS 278.509 violates Ky. Const. § 51, thus depriving the PSC of any express authority to authorize DEK to implement Rider AMRP.

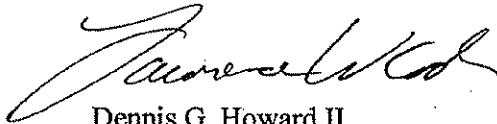
Furthermore, additional / alternative grounds exist for affirming the Franklin Circuit Court's Opinion and Order, in that KRS 278.509 did not authorize return of the utility's return on investment as a cost.

Therefore, the PSC's Orders were clearly unlawful and unreasonable pursuant to KRS 278.410(1).

WHEREFORE, Appellee respectfully requests that this honorable Court AFFIRM the judgment of the Franklin Circuit Court.

Respectfully submitted,

JACK CONWAY
ATTORNEY GENERAL



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COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION I
No. 06-CI-269

COMMONWEALTH OF KENTUCKY, ex rel.
GREGORY D. STUMBO, ATTORNEY GENERAL — PLAINTIFF

v. — OPINION & ORDER

KENTUCKY PUBLIC SERVICE COMMISSION
and
UNION LIGHT, HEAT AND POWER COMPANY — DEFENDANTS

* * * * *

This action is before the Court for final resolution of the Attorney General's appeal of the final administrative order of the Public Service Commission (PSC), allowing Union Light, Heat and Power (Union) to adjust its rates to reflect pipeline replacement expenditures through an interim rate review, passing those costs on to its customers through a surcharge on its base rate.

FACTUAL BACKGROUND

Union undertook its Accelerated Mains Replacement Program (AMRP) to replace 150 miles of cast iron and bare steel mains over a ten year period. Based on the cost of this program, in its 2001 rate case, Union obtained approval for a tariff for the subsequent three years, the Rider AMRP. This tariff allowed Union to exact a surcharge on its base rate to offset the cost of investment in the mains replacement program. The surcharge encompassed the preceding year's net investment in the AMRP. This AMRP tariff was re-approved in Union's 2005 rate case, this time under the statutory authority of the newly-enacted KRS 278.509. This statutory AMRP has not yet been used to collect any surcharge.

KRS 278.509

KRS 278.509, enacted by the 2005 General Assembly, provides:

> Notwithstanding any other provision of law to the contrary, upon application by a regulated utility, the commission may allow recovery of costs for investment in natural gas pipeline replacement programs which are not recovered in the existing rates of a regulated utility. No recovery shall be allowed unless the costs shall have been deemed by the commission to be fair, just, and reasonable.

The PSC has claimed it possessed inherent authority to allow interim review prior to enactment of this statute. The newly enacted statutory grant of authority, KRS 278.509, supersedes any implied authority the PSC may have possessed under its existing statutory scheme. *See* South Cent. Bell Tel. Co. v. Util. Regulatory Comm., 637 S.W.2d 649 (Ky. 1982). Thus, this matter cannot be resolved without full analysis of KRS 278.509.

CONSTITUTIONALITY

Because the statute controls, its constitutionality must be addressed. The Kentucky Constitution Section 51 provides:

> No law enacted by the General Assembly shall relate to more than one subject, and that shall be expressed in the title, and no law shall be revised, amended, or the provisions thereof extended or conferred by reference to its title only, but so much thereof as is revised, amended, extended or conferred, shall be reenacted and published at length.

The Kentucky Supreme Court has said this provision is to be liberally construed, resolving doubt in favor of validity. Yeoman v. Commonwealth, 983 S.W.2d 459, 476 (Ky. 1998). This construction requires that a statute be upheld if it provides a "clue" about the contents. Id. However, the Court has also stated the title must be read as a whole to provide limits on what can be included in a single bill. McGuffey v. Hall, 557 S.W.2d 401 (Ky. 1977).

The Kentucky Supreme Court addressed this issue in Grayson County Bd. of Educ. v. Casey, 157 S.W.3d 201 (Ky. 2005), regarding a portion of the budget bill that authorized each board of education to allocate funds for indemnity insurance covering the negligence of school bus drivers. The Court found this provision was not sufficiently related to the budget bill's title: "AN ACT relating to appropriations providing financing for the operations, maintenance, support, and functioning of the government of the Commonwealth of Kentucky and its various officers, cabinets, departments, boards, commissions, institutions, subdivisions, agencies, and other state supported activities." The Court found the provision

did not appropriate any state funds or require the state to pay any judgment; thus, the provision was in violation of Section 51 of the Kentucky Constitution.

While the standard for compliance with Section 51 is minimal, it is not met in the present case. When read as a whole, the title "AN ACT relating to gas delivery systems and appliances" suggests the relevant gas delivery systems are those connecting to appliances within a structure. While Union's 150 miles of natural gas pipeline may fairly be said to deliver gas, the entirety of the title suggests a relationship between the items. Read in context, a reasonable person would expect the gas delivery system to be that which services the appliances. Further, Senate Floor Amendment (SFA) 1 to the legislation actually relates *only* to procedural requirements at the Public Service Commission for the recovery of investment in the main utility pipeline. *See* 2005 Ky. Acts, c. 148, sec. 2. While the pipeline might conceivably be considered a gas delivery system, the title of this bill gives no clue that the content is an amendment of PSC procedure for setting utility rates for "recovery of costs for investment in natural gas pipeline replacement programs."

Defendants argue that the General Assembly resolved the question of whether the subject amendment was germane to the bill, and they have provided the Court with the videotape of the proceedings on the Senate floor concerning this legislation. *See Exhibit A,* Brief of the Public Service Commission, 2/08/07 (Tape of Senate Floor Debate on House Bill 440, March 3, 2005). Indeed, the provision of the bill dealing with PSC ratemaking[1] was challenged in a point of order during the Senate debate. However, the ruling of the President of the Senate that SFA No. 1 was germane to the bill for purposes of the Senate Rules is not dispositive of the constitutional issue under Section 51.[2]

Determining constitutionality is the province of the judiciary. As our Supreme Court has ruled in addressing a similar question regarding a legislative determination of the validity of administrative

1 2005 Ky. General Assembly, House Bill 440, Senate Floor Amendment (SFA) No. 1.
2 The Court also notes that Legislative Record indicates that the sponsor of Senate Floor Amendment No. 1 also filed a title amendment to House Bill 440 (Senate Floor Amendment No.2). However, the title amendment was never called for a vote or adopted. It is not clear that this title defect could have been cured with a title amendment, but clearly the title to the bill as passed is defective under Section 51 of the Constitution.

regulations, "[i]t requires no citation of authority to state unequivocally that such a determination is a judicial matter and is within the purview of the judiciary." Legislative Research Comm'n v. Brown, 664 S.W.2d 907, 919 (Ky. 1984).

The legislature cannot be the final judge of the questions concerning the constitutionality of its own acts. *See, e.g.,* Rose v. Council for Better Educ., Inc., 790 S.W.2d 186 (Ky. 1989). Just as it would infringe upon the separation of powers enjoyed by the legislature under Sections 27 and 28 of the Constitution for the Court to interfere with the legislature's exercise of discretion, it would violate the separation of powers for the Court to abdicate its duty to pass on the question of constitutionality. Id. While the ruling of the President of Senate on the legislative point of order is entitled to respect and due consideration, it is not dispositive of the constitutional issue presented here. The ruling of the President of the Senate may have conclusively decided the issue of whether the amendment to the Bill was germane under the Rules of the Senate (thus, making a vote on the SFA No. 1 in order under the Senate Rules), but it is not conclusive on the issue of whether the SFA No. 1 complied with Section 51 of the Constitution.

Similarly, legislative discussion regarding the content of the act does not cure the constitutional defect where the title of the act is not sufficient to inform a reasonable person of the general content and subject matter of the legislation. Just as legislators are entitled to know what they are voting for, the public is entitled to notice that its rights may be affected by a proposed amendment.

The Constitution provides that an act cannot relate to more than one subject. As enacted, the provisions of this act include amendments to two vastly different subjects that are codified in statutes that have no common thread or relationship. *See* KRS 278.509 and KRS 234.175. Those statutes are not interconnected or related in any way. The latter chapter is entitled "Liquefied Petroleum Gas and Other Flammable Liquids," while the subject provision is contained in the chapter entitled "Public Service Commission." This utter lack of commonality or reasonable relationship further demonstrates that the two sections of the bill are unrelated.

The rule in Hayden's case is further supports the finding that the two subjects of House Bill 440 are unrelated. Courts are required to construe statutes by examining the plain language of the statute and by consideration of the problem the statute was intended to remedy. City of Bowling Green v. Board of Ed. of Bowling Green Indep. Sch. Dist., 443 S.W.2d 243 (Ky. 1969); Kentucky Indus. Util. Customers, Inc. v. Kentucky Utilities Co., 983 S.W.2d 493, 500 (Ky. 1998). When looking at the act in relationship to the problem it was intended to address, it is apparent that these provisions are not related. Problems relating to design, installation, and maintenance of gas-consuming appliances have nothing to do with ratemaking procedures of the PSC. Solving the problem of how Union is to recover its pipeline investment has no effect on the problem of unlicensed persons maintaining or installing gas-consuming appliances and other components of a gas delivery system.

INHERENT AUTHORITY

The Court has observed "a claim that an agency has 'inherent authority' may be problematic in light of the general principle of agency law that 'administrative agencies are creatures of statutes and must find within the statute warrant for the exercise of any authority which they claim.'" Fankhauser v. Cobb, 163 S.W.3d 389 (Ky. 2005), citing Dept. for Natural Res. v. Stearns Coal and Lumber Co., 563 S.W.2d 471, 473 (Ky. 1978). The PSC claims authority implied under KRS 278.030 and KRS 278.040, regarding the setting of reasonable rates, to perform an interim review on a single cost. These statutes give the PSC authority to regulate utilities and set rates that are "fair, just, and reasonable."

The fact KRS 278.509 was enacted suggests that the existing authority of the PSC did not allow interim hearings on single issues. Similarly, in KRS 278.183, the legislature created an interim review mechanism for the environmental surcharge. It is a well known rule of construction that legislation should not be construed to lack meaning, but rather that the legislature intends to do something by its action. White v. Commonwealth, 178 S.W.3d 470 (Ky. 2006); Aubrey v. Office of Attorney Gen., 994 S.W.2d 416 (Ky.App. 1998). While the legislature may speak to clarify existing authority, enactment of prior interim review statutes supports the construction that the legislature is creating new authority.

Statutory creation of a mechanism for interim review of a cost would be unnecessary if the PSC possessed such implied authority inherently.

Upon review of KRS 278.183, the environmental surcharge, the Court noted the statute "creates a new right" and characterized that right as the ability to recover expenses "without filing a general rate case." Kentucky Indus. Util. Customers, Inc., 983 S.W.2d at 500. The PSC argued that KRS 278.509 would be a nullity if it did not provide for interim rate increases because KRS 278.030 already allows rate increases through a general rate case. That is exactly so. KRS 278.509 would likewise have been a nullity if the PSC possessed inherent authority for interim review. Rather, the recovery of expenses in the interim between rate cases is a right not encompassed the PSC's general power.

PSC argued that this case was distinguishable from the environmental surcharge statute because the Rider AMRP was approved during a rate case. However, that position would allow the PSC, through a rate case, to grant itself new authority to hear an issue as an interim review. Ratemaking is a legislative function and the PSC may only act to the extent authority has been delegated to it. See Id. at 497.

Finally, there is no inherent authority to perform interim single-issue rate adjustments because such a mechanism would undermine the statutory scheme. Certainly the PSC can perform single issue interim review when given statutory authorization, including a standard by which to exercise their discretion. However, finding the PSC to have authority to review any single expenditure outside the context of a rate case would create a means to circumvent the general rate case mechanism created by KRS 278.190.

Utilities regulated by the PSC are now confronting the problem of the aging infrastructure required to deliver services to the public. Water and sewer lines, telephone lines, and the electric grid are all part of the aging infrastructure of regulated utilities throughout Kentucky. If this Court acquiesces in the exercise of power by the PSC to review such large and capital intensive infrastructure replacement projects outside the context of a general rate case under some vague theory of "inherent

power," it could create an exception to the requirement for utilities to have their rates approved in a general rate case that would swallow the rule.

Outside a general rate case there is no context in which to consider any expense. Without context, almost any expenditure can be justified and made to appear reasonable. A utility could bring all of its expenditures as interim expenses, evade rate case review, and deprive the public of the overall picture of its financial condition. The end result would be that consumers could unfairly bear the entire burden of infrastructure replacement, even when there are offsetting savings from new technologies, increased efficiencies, market conditions, or other developments that increase the return of investment of the utility. Those offsetting considerations can only be fully developed and considered in the context of a general rate case in which the utility company is required to justify its rates, taking into consideration all income and all expenses.

The PSC contends that the Rider AMRP is a mechanism for changing rates and that the fact the mechanism was approved during a general rate case renders it valid. The PSC created a formula for reasonableness of the tariff Union would seek on a yearly basis. PSC asserts the formula itself is a rate set during the rate case and that the determination that the formula is reasonable necessarily includes the determination that the amount recovered yearly pursuant to the formula is reasonable.

The Kentucky Supreme Court indicated that failure to consider an expense in context does not render it inherently unreasonable. Kentucky Indus. Util. Customers, Inc., 983 S.W.2d at 498. Certainly it is established that the surcharge mechanism itself is not impermissible. However, the environmental surcharge statute was held to be constitutional. This is a critical distinction from the current case. It is not questioned that the legislature, pursuant to its authority to regulate the utility rates, may allow a surcharge. Rather, this Court finds the PSC may not allow a surcharge without specific statutory authorization.

Requiring that any charge, absent statutory authorization, be considered within a rate case does not deprive the utility of anything. Union may still recover this cost by bringing a rate case and

justifying the rate increase as part of its overall financial picture. Union is not deprived of a profit. The opportunity to have a return on investment is rolled into the base rate and Union is entitled to ask for an increase in the rate if additional costs deprive them of this profit opportunity.

CONCLUSION

Absent statutory authority for an interim review and surcharge, the cost of the AMRP must be considered in the context of a rate case. The additional issue the Plaintiff raised regarding whether return on investment is properly included as a cost in a surcharge for the AMRP is mooted by this determination. Within a rate case, the PSC will consider this program in the full context of the operations of Union, including all expenses and Union's opportunity to earn a return on investment, in setting a fair, just and reasonable base rate.

Accordingly, the final administrative order of the Public Service Commission in this action is REVERSED and this action is REMANDED to the Public Service Commission for further proceedings not inconsistent with this judgment. This is a final and appealable order and there is no just cause for delay.

So ORDERED this 31st day of July 2007.

PHILLIP J. SHEPHERD, JUDGE
Franklin Circuit Court, Division I

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	))	CASE NO. 2001-00092

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COMMONWEALTH OF KENTUCKY

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ADJUSTMENT OF GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	))	CASE NO. 2001-00092

O R D E R

The Union Light, Heat and Power Company ("ULH&P"), a wholly owned subsidiary of The Cincinnati Gas and Electric Company ("CG&E"),[1] is an electric and gas utility that purchases, sells, stores, and transports natural gas in Boone, Campbell, Gallatin, Grant, Kenton, and Pendleton counties in Kentucky.[2] As of September 30, 2000, ULH&P had 83,363 natural gas customers.[3]

BACKGROUND

On March 29, 2001, ULH&P filed a letter giving notice of its intent to file an application for approval of an increase in its gas rates to produce additional annual revenues of $7,252,472, an increase of 8.4 percent. On May 4, 2001, ULH&P filed its application. The application contained deficiencies, which ULH&P subsequently cured,

[1] ULH&P is a Kentucky corporation and one of three wholly-owned utility subsidiaries of CG&E. CG&E is an Ohio corporation and a public utility subsidiary of Cinergy Corp. ("Cinergy"), a registered public utility holding company that was created in October 1994.

[2] ULH&P distributes and sells electricity in Boone, Campbell, Grant, Kenton, and Pendleton counties in Kentucky.

[3] For the same period, ULH&P had 123,884 electric customers. See ULH&P's Response to the Commission Staff's Third Data Request dated September 4, 2001, Item 3.

and the application was considered filed as of June 6, 2001.[4] ULH&P's application includes a proposal to establish an Accelerated Main Replacement Program ("AMRP") Rider, a tracking mechanism that will permit ULH&P to recover the costs of its accelerated cast iron and bare steel main replacement program. To determine the reasonableness of the request, the Commission suspended the proposed rates for 5 months from their effective date pursuant to KRS 278.190(2) up to and including December 5, 2001. ULH&P voluntarily extended this suspension until January 15, 2002.[5]

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), requested and was granted full intervention.[6]

On June 21, 2001, the Commission issued a procedural schedule to investigate ULH&P's rate application.[7] The schedule provided for discovery, intervenor testimony, rebuttal testimony by ULH&P, a hearing, and an opportunity for the parties to file post-

[4] The Commission rejected ULH&P's May 4, 2001 filing due to deficiencies noted by letter dated May 22, 2001. On June 6, 2001, ULH&P filed information in response to the deficiency letter, which the Commission determined cured the noted deficiencies.

[5] On July 27, 2001, ULH&P filed a motion requesting an extension of 3 weeks to respond to various data requests. In its motion, ULH&P acknowledged that the extension would require the modification of the procedural schedule established by the Commission's June 21, 2001 and July 13, 2001 Orders. ULH&P stated that if the requested extension of time were granted, it would not implement its proposed rates prior to January 15, 2002. The Commission granted the requested extension by Order dated August 6, 2001.

[6] Stand Energy Company filed a motion to intervene on August 6, 2001. However, the Commission denied this motion by Order dated August 10, 2001 and denied reconsideration by Order dated September 13, 2001.

[7] The procedural schedule was subsequently amended by Commission Orders dated July 13, 2001, August 6, 2001, and August 30, 2001.

hearing briefs. ULH&P filed its rebuttal testimony on November 13, 2001. ULH&P's rebuttal testimony contained revisions to several exhibits and proposed to update its capitalization to reflect balances as of September 30, 2001. These revisions indicated that ULH&P's requested increase in annual revenues should be $7,006,120 rather than the $7,252,472 originally proposed.[8] ULH&P's rebuttal testimony also included a proposal to establish an earnings sharing mechanism in conjunction with its proposed AMRP Rider. On November 21, 2001, the AG filed a motion to strike the earnings sharing mechanism testimony. The Commission granted the AG's motion to strike the earnings sharing mechanism rebuttal testimony at the hearing held at the Commission's offices in Frankfort, Kentucky on November 28 and 29, 2001.[9]

The procedural schedule provided for post-hearing briefs to be submitted by December 18, 2001. Both parties timely filed briefs and the case now stands submitted for a decision.

TEST PERIOD

ULH&P proposes the 12-month period ending September 30, 2000 as the test period for determining the reasonableness of the proposed rates. The AG also utilized this 12-month period. The Commission finds it is reasonable to utilize the 12-month period ending September 30, 2000 as the test period in this proceeding. In utilizing a

[8] Smith Rebuttal Testimony, Rebuttal PGS-1, page 1 of 8. Further, in ULH&P's responses to hearing data requests, ULH&P recognized the impact the use of a lower effective Kentucky income tax rate would have on its proposed revenue increase. Based on this information, ULH&P determined the increase would be $6,690,249. See ULH&P's Response to the Commission Staff's Hearing Requests, Item 13.

[9] Transcript of Evidence ("T.E."), Volume I, November 28, 2001, at 13-14.

historic test period, the Commission has given full consideration to appropriate known and measurable changes.

However, the Commission is concerned that approximately 7 months had passed between the end of the proposed test period and the filing of ULH&P's application. ULH&P testified that its rate application had been ready for filing in January 2001, but decided to delay filing at that time because "there were many, many newspaper articles and a lot of bad publicity about the rising cost of gas and, quite bluntly, in deference to that, we chose to hold up the filing for a couple of months to see where that was going and to get that behind us."[10] ULH&P agreed that the data should be as good as possible, but it believes the delay was a good decision given the circumstances. ULH&P noted that the Commission has accepted applications with test periods older than the 7 months existing in this case.

While the Commission may have in the past accepted rate case applications with older test periods, ULH&P should not have relied on that fact to justify the time lapse in this case. When ULH&P decided to delay the filing of its application, it should have considered using a more current test period, such as the 12-months ending December 31, 2000. However, as stated above, the Commission in this case will accept the use of the 12-month period ending September 30, 2000 as the test period in this case. In future rate case applications where a historical test period is utilized, the Commission will expect a more current test period to be used.

[10] Id. at 203-204.

- Rate GCAT - Gas Cost Adjustment Transition Rider applicable to customers who switch from firm service under Rate GS to transportation service under Rate FT-L
- Rate GTS - Gas Trading Service applicable to FRAS and AS pool customers to trade daily gas supplies
- Rate IMBS - Interruptible Monthly Balancing Service applicable to FRAS and AS customers
- Rate SSIT - Spark Spread Interruptible Transportation applicable to commercial gas fired electric generators where gas is the primary fuel source

The Commission addresses the AMRP Rider below. The Commission will accept and approve the other revisions, cancellations, and new tariffs as proposed by ULH&P.

AMRP Rider

ULH&P's distribution system contains approximately 1,000 miles of distribution mains, 150 miles of which are cast iron and bare steel that date back to 1887 and 1906 respectively.[177] ULH&P asserts that cast iron and bare steel mains are more prone to leaks than coated steel or polyethylene, which may lead to higher operating and maintenance expenses, greater line losses and greater safety and reliability risks.[178] ULH&P states that it has not kept pace with the national average on its replacement of its cast iron and bare steel mains. Therefore, it has begun an AMRP pursuant to which

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[177] Torpis Direct Testimony at 8.

[178] Id. at 6.

it plans to replace all its cast iron and bare steel mains within 10 years.[179] ULH&P cites safety and reliability as the major reasons for its decision to accelerate its mains replacement. ULH&P projects that the capital expenditures required for this program will double its current investment in plant and that such an investment will have a substantial impact on its earnings.[180]

In order to alleviate this impact, ULH&P proposes a tracking mechanism, the AMRP Rider, that would permit it to recover its investment costs on a more current basis than that which traditional rate-making permits. ULH&P contends that if the rider is not approved, it will be forced to file several rate cases over the next 10 years in order to recover the costs of this program.[181] ULH&P's proposed methodology computes the revenue requirement effect of both the return on and recovery of the net change in its plant investment attributable to the AMRP. This calculation is done on an annual basis and uses traditional rate-making theory and financial data to be approved in this proceeding. The revenue requirement calculation will also recognize the net reduction in maintenance costs due to the AMRP. ULH&P proposes to file the AMRP Rider annually, on or about the last day of February, to be effective April 1. To address regulatory lag inherent in its proposed AMRP Rider, ULH&P proposes that it be permitted to defer depreciation and continue accruing AFUDC on replacements from the time those replacements are placed into service until such time as recovery begins

[179] ULH&P engaged Stone & Webster in late 2000 to perform an independent review of its distribution system and its cast iron and bare steel replacement program. Torpis Direct Testimony at 7.

[180] ULH&P Brief at 5.

[181] Randolph Direct Testimony at 15.

through the AMRP Rider. ULH&P proposes that the AMRP Rider remain in effect for 10 years. ULH&P also proposes to include the AMRP Rider as part of the customer charge levied on residential and commercial customers' bills, while transportation and industrial customers would pay the AMRP Rider as part of a volumetric charge.

The AG objects to the proposed rider on several grounds and contends that the Commission should deny it. The AG argues that ULH&P is seeking approval of a mere concept and therefore has failed to present the Commission with adequate evidence upon which it may render findings of fact and conclusions of law.[182] He asserts that if the Commission does in fact approve ULH&P's proposal, its decision will constitute a major policy change that must be accomplished through the promulgation of a regulation pursuant to KRS Chapter 13A and not through an Order.[183] The Commission does not find the AG's arguments persuasive. KRS Chapter 13A.100 provides:

> [a]ny administrative body which is empowered to promulgate administrative regulations shall, by administrative regulation prescribe . . . (1) Each statement of general applicability, policy, procedure, memorandum, or other form of action that implements; interprets; prescribes law or policy; describes the organization, procedure, or practice requirements of any administrative body; or affects private rights or procedures available to the public; . . . .

The Commission finds that no "general" policy is implicated here, and that there has been sufficient information provided to enable it to render a decision on the AMRP Rider in this case. The decision reached by the Commission in this case is, and in all future cases will be, based on the specifics of the case before it. This decision is not, and shall not be construed as, a Commission policy nor a statement of general

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[182] AG Brief at 3.

[183] Id. at 16-18.

applicability. Therefore, the Commission finds that no administrative regulation is necessary.

Other objections of the AG are based upon his having mistaken directive statutes for enabling statutes. For example, the AG asserts that the future test-year filing investigated by the Commission in Administrative Case No. 331,[184] a method later approved by the General Assembly, directly addresses the type of regulatory lag ULH&P claims makes the tracker necessary. He contends that before ULH&P may seek the relief proposed, it must avail itself of all regulatory opportunities available to it, including that of a future test-year filing pursuant to KRS 278.192. He asserts that the Commission has refused in the past to allow the type of relief ULH&P proposes, that it has in the past clearly demonstrated its unwillingness to engage in "single issue" rate-making and that it should abide by its own precedent and deny ULH&P's request. The Commission agrees that in an application for a general increase in rates the use of a future test year may help alleviate regulatory lag, but disagrees that the use of a future test year is the only method that may be used to address the problem. The Commission also disagrees that a utility must first use a future test year or demonstrate its ineffectiveness before it may seek approval of any other method. KRS 278.192 states in part::

> For the purpose of justifying the reasonableness of a proposed general increase in rate, the commission shall **allow** a utility to utilize either an historical test period. . .or a forward-looking test period . . . . (Emphasis added)

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[184] Administrative Case No. 331, An Investigation of Appropriate Guidelines for Filing Forecasted Test Period.

KRS 278.192(1). The statute permits the utility to file a future test period case. It does not prohibit other alternatives. It does not state that the Commission shall require a utility to utilize either one method or the other; nor does it state that a utility shall prove that both of these opportunities are ineffective before it may seek other relief. Had the General Assembly intended such a result, it could have expressly stated that intent.

The AG also contends that, prior to 1992, KRS Chapter 278 required only that the Commission set fair, just and reasonable rates. He contends that the enactment in 1992 of the future test-year statute and the environmental surcharge statute clearly indicate that, absent specific legislative authority, the Commission does not have the authority to approve ULH&P's proposal. He states that had the Commission, under its broad authority to set fair, just and reasonable rates, had the authority to participate in "single issue" rate-making or consider capital additions outside a general rate case, it would not have been necessary for the General Assembly to enact the statutes permitting a future test-year filing (KRS 278.192) or the environmental surcharge (KRS 278.183). The Commission disagrees. It believes the General Assembly intended prior to 1992 and after 1992 for the Commission to have broad implied and discretionary authority to establish fair, just and reasonable rates. The Commission agrees with the AG that the enactment of KRS 278.183 has changed its authority, but disagrees with the AG on what that change represents. KRS 278.183 states in part:

> Notwithstanding any other provision of this chapter, effective January 1, 1993, a utility **shall be entitled** to the current recovery of its cost of complying with the Federal Clean Air Act. . .These costs **shall include** a reasonable return on construction and other capital expenditures and reasonable operating expenses. . . . (Emphasis added)

Contrary to what the AG suggests, this statute was not enacted to grant the Commission authority it did not already have. Instead, this statute was enacted by the legislature to limit the Commission's otherwise broad, discretionary authority. The legislature intended for environmental compliance costs to be recovered on a current basis and intended to, and did, by the enactment of KRS 278.183, remove the Commission's authority to deny such recovery. In addition, the legislature mandated the specific costs that are to be included. In other words, rather than authorizing the Commission to establish a surcharge, the General Assembly mandated that it establish a surcharge under certain conditions.

The AG has made a similar argument with regard to the General Assembly's enactment of the KRS 278.285, the demand-side management statute.[185] The Commission, again, finds this statute to be directive rather than authorizing. The General Assembly specifically set forth factors that the Commission is to consider when determining the reasonableness of demand-side management plans that are proposed. In addition, the mandatory language used by the General Assembly in KRS 278.285(3) once again removes Commission discretion. It specifically directs the Commission on how to assign the costs of the programs.

In addition to finding that it has the authority under its general powers to establish fair, just and reasonable rates, the Commission finds that it has the authority to review and approve the AMRP Rider pursuant to KRS 278.290. KRS 278.290 authorizes the Commission, on its on motion, upon complaint or upon application, after hearing, to ascertain the value or make reevaluations from time to time of all new construction,

[185] AG's Brief at 23.

extensions and additions to the property of a utility if the valuation or revaluation is necessary or advisable in order to determine the reasonableness of any rate. That is precisely what the tracker is to do. This is precisely what the Commission will be asked to do when ULH&P files its annual AMRP Rider application.

However, the Commission has reviewed the specific AMRP Rider mechanism as proposed by ULH&P and finds that components of it are neither reasonable nor acceptable. The continued accrual of AFUDC and the deferral of depreciation on utility plant already in service is inappropriate and unduly compensates ULH&P. By making such a proposal, ULH&P goes beyond attempting simply to eliminate regulatory lag. While the Commission is willing to consider alternative cost recovery approaches to address unique situations like the one presented by the AMRP, it will not consider a methodology that allows a utility to earn a return on or recovery of amounts greater than the true investment in plant in service. The Commission notes that in ULH&P's rebuttal testimony it introduces for the first time the inclusion of property taxes as a cost to be recovered.[186] The Commission believes that the net changes in this expense, especially in the early years of the AMRP, will be immaterial and difficult to identify.

ULH&P has proposed that the rate of return applied to its net investment in replacement lines be grossed up for uncollectible accounts, the PSC Assessment, state income taxes, and federal income taxes. The Commission does not believe it is appropriate to include a gross up for uncollectible accounts and the PSC Assessment in the AMRP Rider. The Commission notes that in the environmental surcharge mechanisms its has approved, the gross up factor has only included state and federal

[186] Smith Rebuttal Testimony, Rebuttal PGS-6, page 1 of 3.

income taxes. There is no requirement that the gross up factor used for the AMRP Rider must match exactly the gross up factor used to determine ULH&P's revenue increase in this base rate proceeding.

The Commission finds it unworkable to review the AMRP Rider within a 30-day processing time as originally proposed by ULH&P. ULH&P has indicated that a 60-day period might be acceptable. The Commission believes it will need at a minimum a 60-day review period, and will need to hold a hearing for each annual revision of the AMRP Rider.

The Commission does not find it appropriate to include the AMRP Rider within existing customer charges or volumetric charges on the applicable customers' bills. ULH&P's customers are entitled to know how much this significant line replacement program is impacting their natural gas bills. Separate disclosure is a necessity.

The Commission finds the replacement of ULH&P's cast iron and bare steel mains within 10 years to be necessary and in the public interest. We also recognize the significant impact the accelerated main replacement program will have on ULH&P over the next 10 years. The Commission believes we have the statutory authority to establish, and that we should establish, a method of recovery that will help to eliminate any impediment to the success of the program. However, because the AMRP Rider proposal is a case of first impression for the Commission, we believe that it should be established for an initial 3-year period. Having found that the replacement program is in the public interest and having recognized the impact on ULH&P, the Commission finds at this time no reason to believe that the mechanism cannot be continued for 10 years. However, we believe that establishing the Rider for an initial 3-year period will allow

both ULH&P and the Commission an opportunity to review the operation of the mechanism and make a decision on its renewal.

We will therefore authorize a modified AMRP Rider, using the revenue requirements concept initially suggested by ULH&P. The actual steps in calculating the annual AMRP Rider, the rate base and costs components included in the AMRP Rider, and the formats to be provided with each annual filing are shown on Appendix G. However, ULH&P will not be permitted to accrue AFUDC beyond the replacement plant in service date; nor will it be permitted to defer depreciation on that plant once its goes into service. Similar to ULH&P's proposal, the rate of return on its AMRP rate base will be the overall cost of capital found reasonable in this proceeding, grossed up for the state and federal income taxes. The effective state income tax rate utilized in this case shall be used. The Commission will require ULH&P to thoroughly document all costs and expenses included in the annual AMRP Rider filings. In light of the situation involving the Lafarge project, discussed later in this Order, the Commission places ULH&P on notice that it will be expected to avoid a repeat of that situation.

The Commission will accept the concept of a per-customer charge for the residential and commercial customers and a volumetric charge for transportation and industrial customers; however, the AMRP Rider must be disclosed as a separate line item on all bills. The AMRP Rider filing will be submitted on March 31 of each year, and the Commission will attempt to process the filing within 60 days. However, because a hearing will be necessary, and because the time needed for review of the filing may be extensive, the Commission will reserve the option of extending the review period. When ULH&P makes its annual filing, it will serve the AG with a complete copy. In addition,

certain periodic information relating to the construction under the AMRP will be required. Those information needs and their corresponding filing deadlines are also included in Appendix G.

Therefore, for the reasons mentioned earlier, the Commission believes it is reasonable to authorize the AMRP Rider for an initial 3-year period. The 3-year period will be effective as of the date of this Order. If ULH&P wishes to continue the AMRP Rider, it will need to file a general rate application to "roll-in" the Rider and to justify its continuation. The Commission believes it will be necessary to examine ULH&P's total gas operations in conjunction with a review to continue the AMRP Rider. It will also allow the Commission the opportunity to "roll-in" the replacement lines into the base rates of ULH&P and, if the AMRP Rider is continued, prevent the AMRP Rider from becoming too large a portion of the customer bill.

OTHER ISSUES

Certificate of Public Convenience and Necessity

ULH&P argues that a Certificate of Public Convenience and Necessity ("CPCN") is not required for its AMRP. It asserts that the statutes and regulations require a CPCN for extensions, not for replacement.[187] The Commission disagrees with ULH&P's interpretation. KRS 278.020(1) provides that a CPCN is required for utility construction "except. . .ordinary extensions of existing systems in the usual course of business." Construct means "[t]o adjust and join materials, or parts of, so as to form a permanent whole. To put together constituent parts of something in their proper place and order." Black's Law Dictionary 283 (5th Ed. 1979). The definition of "construction" includes

[187] ULH&P Brief at 13.

"[t]he act of fitting an object for use or occupation in the usual way, and for some distinct purpose." Black's Law Dictionary 283 (5th Ed. 1979). Administrative Regulation 807 KAR 5:001, Section 9(3) defines "usual course of business" construction as [1] that which does not "create wasteful duplication of plant," does not conflict with "service of other utilities," and does not involve sufficient money to "materially affect" the utility's financial condition; or [2] that which does not result in "increased charges" to the utility's customers." The record indicates that the proposed program will involve sufficient capital outlay to materially affect the existing condition of the utility and will ultimately result in increased charges to its customers. Therefore, it is clear that ULH&P's accelerated replacement program is "construction," does not meet the "ordinary course of business exemption," and requires a CPCN.

As previously discussed, the Commission finds the replacement of ULH&P's old cast iron and bare steel mains an important endeavor and finds that general approval of this construction program should be granted. However, the Commission also finds that specific engineering and construction information is required, as well as more precise information concerning the exact locations at which the construction will occur. Therefore, ULH&P must file an application for a CPCN for its replacement program pursuant to Administrative Regulation 807 KAR 5:001, Sections 8 and 9, and we will expedite our review of the application.

In conjunction with its AMRP, and pursuant to the advice of Stone & Webster,[188] ULH&P stated in its original filing that it also planned to replace the customer-owned cast iron and bare steel service lines when it replaces the mains. ULH&P also indicated

[188] Torpis Direct Testimony at 13.

SUMMARY

The Commission, after consideration of all matters of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in Appendix A are the fair, just, and reasonable rates for ULH&P to charge for service render on and after January 31, 2002.

2. The rates proposed by ULH&P would produce revenue in excess of that found reasonable herein and should be denied.

3. The depreciation rates contained in the depreciation study filed in this case are reasonable and should be approved for use as of the date of this Order.

4. The deferred debits recorded by ULH&P for the Cinergy merger-related expenses should be removed from its books and the accounting entries reflecting this adjustment should be filed with the Commission within 30 days of the date of this Order.

5. The various tariff additions, cancellations, and modifications proposed by ULH&P, with the exception of the AMRP Rider, are reasonable and should be approved.

6. The AMRP Rider as proposed by ULH&P is not reasonable and should be denied.

7. The AMRP Rider, as modified and discussed herein, is reasonable and should be approved. The AMRP Rider should be authorized for an initial period of 3 years from the date of this Order.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A are approved for service rendered on and after January 31, 2002.

2. The rates proposed by ULH&P are denied.

3. ULH&P shall, within 20 days of the date of this Order, file its revised tariff sheets setting out the rates approved herein.

4. The proposed revisions to Rate IT, Rate FT, and Rider X and the proposed cancellation of Rate SS are approved.

5. The proposed Rate AS, Rate DGS, Rate FRAS, Rate GCAT, Rate GTS, Rate IMBS, and Rate SSIT are approved.

6. The AMRP Rider as proposed by ULH&P is denied. The AMRP Rider, as modified and discussed herein, is approved for an initial period of 3 years from the date of this Order.

7. The depreciation rates contained in the depreciation study submitted in this case are approved for use as of the date of this Order.

8. Within 30 days of the date of this Order, ULH&P shall file copies of its accounting entries removing deferred Cinergy merger-related expenses from its books.

9. Within 30 days of the date of this Order, ULH&P shall file copies of its accounting entries adjusting the investment in the Lafarge pipeline to $467,547.

10. Within 90 days of the date of this Order, ULH&P shall file a report detailing the modifications its has made to its work order system to improve the cost reporting and the assignment of costs between regulated and unregulated operations.

11. Beginning with the quarter ending June 30, 2002, ULH&P shall file supplemental financial statements, using the format shown on Appendix H. These supplemental financial statements shall be filed quarterly and shall be filed with the Commission no later than 45 days after the end of the reporting quarter.

Done at Frankfort, Kentucky, this 31st day of January, 2002.

By the Commission

ATTEST:

Executive Director

APPENDIX G

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED JANUARY 31, 2002

AMRP RIDER – PERIODIC REPORTING AND ANNUAL FILING FORMATS

This Appendix includes the filing formats ULH&P will prepare when submitting its application for the annual adjustment to the AMRP Rider. ULH&P will not modify any filing format without prior consent of the Commission Staff.

In order for the Commission to properly monitor the accelerated main replacements, ULH&P will need to provide the following information:

1) A list of the names and addresses of the contractors utilized for AMRP projects.

2) A copy of the bid document signed with each contractor showing a description and scope of the work, construction specifications, and construction management.

3) Construction schedule for each job.

4) Reasonable size maps for each location.

5) A 3-month progress report showing the manner of replacing the pipes, progress and percentage of job finished, pressure testing, pictures, etc.

6) Copies of updated welding certification for each welder kept on site for inspection by the Commission's investigator.

7) Annual progress report for work completed, the amount of a progress payment and the costs of removal of the old pipes.

Items 1 through 3 are to be filed as contracts are issued. Items 4 and 6 are to be filed at the beginning of each project. Item 5 will be dependent upon the starting date of each project. Item 7 will be filed along with ULH&P's application for the annual adjustment of the AMRP Rider. ULH&P may request a conference with the Commission's Engineering Staff if clarifications are needed concerning Items 1 through 7.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement – Page 1

	Investment Reflected In Base Rates	AMRP for 12-Months Ending (Date)	Cumulative AMRP To Date
Return on Investment:			
Original Cost of Plant in Service –			
Mains – Cast Iron			
Mains – Bare Steel			
Mains – Plastic			
Services – Cast Iron			
Services – Bare Steel			
Services – Plastic			
Meter Relocations			
Customer Service Lines			
A. Total Original Cost of Plant in Service			
Accumulated Depreciation –			
Mains – Cast Iron			
Mains – Bare Steel			
Mains – Plastic			
Services – Cast Iron			
Services – Bare Steel			
Services – Plastic			
Meter Relocations			
Customer Service Lines			
B. Total Accumulated Depreciation			
C. Deferred Income Taxes Associated with Referenced Plant in Service			
Net Rate Base for AMRP Purposes (A – B – C)			
Authorized Rate of Return, adjusted for Income Taxes	11.885%	11.885%	11.885%
D. Return on AMRP Related Investment			
Operating Expenses:			
Depreciation Expense –			
Mains – Cast Iron			
Mains – Bare Steel			
Mains – Plastic			
Services – Cast Iron			
Services – Bare Steel			
Services – Plastic			
Meter Relocations			
Customer Service Lines			
Maintenance Expense – Account 887			
E. Total Operating Expenses			
Total Annual Revenue Requirements (D + E)			
Increase (Decrease) in Annual Revenue Requirements			

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement – Page 2

Calculation of Authorized Rate of Return:

	% of Total Capital	Cost Rate Allowed	Weighted Aver. Cost of Capital	Gross-Up Factor	Authorized Rate of Return
Long-Term Debt	26.857%	7.296%	1.959%		1.959%
Short-Term Debt	20.415%	3.545%	0.724%		0.724%
Common Equity	52.728%	11.000%	5.800%	1.586546	9.202%
Totals	100.000%		8.483%		11.885%

Supporting Schedules:

Overall Project Recap & Summary –

	Miles Replaced under AMRP	Total Cost of Replacement under ARMP	Percentage of Total AMRP Completed to Date
Original from Information submitted in Case No. 2001-00092			NA
Status of Total AMRP as of this Filing			

With each annual filing, ULH&P will prepare an Overall Project Recap & Summary. This schedule will compare information originally submitted in Case No. 2001-00092 with the current status of the AMRP as of the date of the filing.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement – Page 3

Plant in Service Added Through AMRP –

Project Identifier (Work Order Ref. #or Contract Ref.)	Date Project Started	Percentage Completed	Costs for Current 12 Months	Cumulative Total Project Costs
Mains – Plastic				
(List Separately)				
Services – Plastic				
(List Separately)				
Meter Relocations				
(List Separately)				
Customer Service Lines				
(List Separately)				
Totals				

All projects and/or jobs performed in association with AMRP will be included in this schedule. Each project or job will be identified by its Work Order Reference Number or a Contract Reference. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement – Page 4

Plant in Service Retired/Removed Through AMRP -

Project Identifier (Retirement Work Order Ref. #)	Date Project Started	Percentage Completed	Total Investment Retired or Removed
Mains – Cast Iron			
(List Separately)			
Mains – Bare Steel			
(List Separately)			
Services – Cast Iron			
(List Separately)			
Services – Bare Steel			
(List Separately)			
Meter Relocations			
(List Separately)			
Totals			

All retirements or replacements performed in association with AMRP will be included in this schedule. Each retirement or replacement will be identified by its Retirement Work Order Reference Number. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

Maintenance Expense – Account 887 –

In support of the amounts reported for Account 887, ULH&P will submit a detailed schedule of the identified expenses. This schedule will include, at a minimum: a document or journal reference, the name of the vendor, the date of the transaction, the cost allocated to ULH&P's gas operations, and a description of the transaction. Any expenses included in this supporting schedule resulting from an allocation of costs from CG&E or Cinergy Services will also be detailed in the manner described. ULH&P will maintain any additional supporting documentation to support any expense shown on this schedule.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement – Page 5

Calculation of Depreciation Expense and Accumulated Depreciation -

Depreciable Plant in Service	Depreciation Rate	Beginning Accumulated Depreciation Balance	Depreciation Expense for Current 12 Months	Adjustments Due to Retirement or Replacement	Ending Accumulated Depreciation Balance
Mains – Cast Iron					
Mains – Bare Steel					
Mains – Plastic					
Services – Cast Iron					
Services – Bare Steel					
Services – Plastic					
Meter Relocations					
Customer Service Lines					
Totals					

The balances shown for accumulated depreciation and the calculation of depreciation expense will be shown on this schedule. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

Customer Service Lines –

Project Identifier (Work Order Ref. # or Contract Ref.)	Date Project Started	Cost of Lines Added Due to AMRP	Cost of Lines Added Due to Normal Operations
(List Each Project Separately)			
Totals			

This schedule will reflect those customer service lines ULH&P assumes ownership for in conjunction with AMRP and those assumed during the normal repairs, maintenance, or replacement. Only those customer service lines ULH&P assumes ownership over in conjunction with AMRP can be included for recovery through the AMRP Rider mechanism. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

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C

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	))	CASE NO. 2005-00042

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	))	CASE NO. 2005-00042

O R D E R

The Union Light, Heat and Power Company ("ULH&P") a wholly owned subsidiary of The Cincinnati Gas and Electric Company ("CG&E"),[1] is an electric and gas utility that purchases, sells, stores, and transports natural gas to 92,414 customers[2] in six counties in Kentucky.[3]

BACKGROUND

On January 24, 2005, ULH&P filed notice of its intent to apply for an increase in its gas rates utilizing a forward-looking test period and to request approval to continue

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[1] ULH&P is a Kentucky corporation and the primary utility subsidiary of CG&E. CG&E is an Ohio corporation and a public utility subsidiary of Cinergy Corp. ("Cinergy"), a registered public utility holding company that was created in October 1994.

[2] ULH&P had 92,414 retail gas customers and 130,909 retail electric customers as of May 31, 2005; See ULH&P's Updated Filing pursuant to KRS 278.192(2)(b) and 807 KAR 5:001, Section 10(8)(d), filed July 15, 2005, WPB-5.1f.

[3] The six counties are Boone, Campbell, Gallatin, Grant, Kenton, and Pendleton. ULH&P distributes and sells electricity in Boone, Campbell, Grant, Kenton, and Pendleton counties in Kentucky.

its Accelerated Main Replacement Program ("AMRP") Rider.[4] On February 25, 2005, ULH&P filed its application in which it sought an increase in gas revenues of $14,048,768, an increase of 10.79 percent. ULH&P also sought approval to continue the AMRP Rider through 2011, approval to increase its bad check and reconnection charges, and approval to assume ownership of customer service lines at the time of installation. ULH&P proposed that its new rates become effective on April 1, 2005. Finding that additional proceedings were necessary to determine the reasonableness of the request, the Commission, pursuant to KRS 278.190(2), suspended the proposed rates for 6 months up to and including September 30, 2005.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), requested and was granted full intervention.

On March 21, 2005 and April 28, 2005, the Commission issued procedural schedules that provided for discovery, intervenor testimony, rebuttal testimony by ULH&P, and a public hearing. A public hearing was held on August 15 and 16, 2005. ULH&P and the AG filed written briefs on September 21, 2005.

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[4] In its January 31, 2002 Order in Case No. 2001-00092 the Commission authorized the AMRP Rider for an initial 3-year period. The Commission told ULH&P if it wished to continue the AMRP Rider beyond the initial 3-year period, it would need to file a general rate application to "roll-in" the AMRP Rider into base rates and to justify the continuation of the AMRP Rider. ULH&P's notice filing on January 24, 2005 was in compliance with this directive. See Case No. 2001-00092, Adjustment of Gas Rates of The Union Light, Heat and Power Company, final Order dated January 31, 2002 at 80.

On September 14, 2005, ULH&P moved for interim approval of a new AMRP Rider to take effect with the first billing cycle in October 2005.[5] ULH&P contended that the Commission had the jurisdiction to approve the new AMRP Rider rates because those rates were lower than the full increase it had the legal right to place into effect, the Commission had already held a hearing on the pending rate increase, and the implementation of the new AMRP Rider rates would avoid customer confusion. The AG opposed the request, citing his continuing challenge to the lawfulness of the AMRP Rider and noting that the Commission had previously refused to grant the requested relief in Case No. 2004-00403.[6] In its September 29, 2005 Order the Commission denied ULH&P's motion, finding that the AG's action for review of the Orders in Case No. 2001-00092 deprived the Commission of jurisdiction to consider ULH&P's motion.[7]

On September 30, 2005, pursuant to KRS 278.190(2), ULH&P gave notice of its intention to place its proposed rates into effect for services rendered on and after October 1, 2005. In its October 3, 2005 Order, the Commission found that it was unable

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[5] ULH&P proposed that the new AMRP Rider would take effect subject to refund and would remain in effect until it implemented the new general gas rates to be established in this case. The new AMRP Rider rates would remain at the same level as the AMRP Rider rates that were scheduled to expire at the end of the September 2005 billing cycle. ULH&P stated that if the Commission granted its request, it would refrain from placing its proposed general gas rates into effect subject to refund for October 2005; however, ULH&P reserved the right to place its proposed general gas rates into effect subject to refund beginning in November 2005.

[6] Case No. 2004-00403, The Union Light, Heat and Power Company's Motion for Extension of Filing Date and Continuation of Its Current Rider AMRP Rates, final Order dated January 27, 2005.

[7] The Commission also found that ULH&P had offered no authority to support any of its positions in the motion. See September 29, 2005 Order at 3-4.

to complete its investigation within the suspension period and that ULH&P had complied with the statutory provisions to place the proposed rates into effect, subject to refund.

All information requested at the public hearing has been filed and the case now stands submitted for a decision.

TEST PERIOD

Pursuant to KRS 278.192, any application utilizing a forward-looking test period shall include a base period and the forward-looking test period. The base period cannot begin more than 9 months prior to the date of filing. It cannot have less than 6 months of actual historical data and no more than 6 months of estimated data at the time of filing. The forward-looking test period corresponds to the first 12 consecutive calendar months the proposed increase would be in effect after the maximum suspension provided in KRS 278.190(2).

ULH&P proposed that its base period in this case would be June 1, 2004 through May 31, 2005. It also proposed that its forward-looking test period would be October 1, 2005 through September 30, 2006. In his evaluation of ULH&P's proposed revenue increase, the AG used the same forward-looking test period. The AG stated his belief that the proposed forward-looking test period represented a reasonable starting point to determine ULH&P's revenue needs.[8]

When a forward-looking test period approach is used, the Commission's focus is on determining the reasonableness of the utility's budgeting and other processes used to arrive at the forward-looking test period balances. One of the methods used to determine the reasonableness of the budgeting process is a review of the utility's

[8] Transcript of Evidence ("T.E."), Volume I, August 15, 2005, at 175.

approved herein moves in the direction proposed by ULH&P. However, it is tempered somewhat by gradualism and, to a greater extent, by the difference between ULH&P's requested revenue increase and the revenue increase being awarded. The resulting RS customer charge is $12.00 while the GS customer charge will increase to $30.00. The other classes' customer charges will be increased as proposed by ULH&P with the remainder of the increases assigned the different classes being recovered through increases in their respective volumetric charges.

Continuation of the AMRP Rider

In Case No. 2001-00092, we stated,

> The Commission finds the replacement of ULH&P's cast iron and bare steel mains within 10 years to be necessary and in the public interest. We also recognize the significant impact the accelerated main replacement program will have on ULH&P over the next 10 years. The Commission believes we have the statutory authority to establish, and that we should establish, a method of recovery that will help to eliminate any impediment to the success of the program. However, because the AMRP Rider proposal is a case of first impression for the Commission, we believe that it should be established for an initial 3-year period. Having found that the replacement program is in the public interest and having recognized the impact on ULH&P, the Commission finds at this time no reason to believe that the mechanism cannot be continued for 10 years. However, we believe that establishing the Rider for an initial 3-year period will allow both ULH&P and the Commission an opportunity to review the operation of the mechanism and make a decision on its renewal
>
> * * * * *
>
> Therefore, for the reasons mentioned earlier, the Commission believes it is reasonable to authorize the AMRP Rider for an initial 3-year period. The 3-year period will be effective as of the date of this Order. If ULH&P wishes to continue the AMRP Rider, it will need to file a general rate application to "roll-in" the Rider and to justify its continuation. The Commission believes it will be necessary to examine ULH&P's total gas operations in conjunction with a review to continue the AMRP Rider. It will also allow the Commission the opportunity to "roll-in" the replacement lines into the base rates of ULH&P and, if the AMRP Rider is continued,

prevent the AMRP Rider from becoming too large a portion of the customer bill.[157]

In its application ULH&P proposed to continue the AMRP Rider. In support of its request, ULH&P stated that through December 2004, it has replaced approximately 90 miles of cast iron and bare steel mains and plans to replace another 111 miles of such mains by 2010.[158] ULH&P further argued that, based upon a 45 percent decline in discovered leaks between 1999 and 2004, AMRP improved the safety and reliability of its gas distribution system.[159] It also pointed to the reduction in its Account No. 887 – Maintenance of Main expense of approximately 44 percent[160] as evidence of the AMRP's benefits. ULH&P stated that the replacement of gas mains under the AMRP is on schedule and within budget and that it has maintained a replacement rate to permit completion of all designated mains by 2010 as originally anticipated.[161] ULH&P argued that the AMRP Rider had allowed it to obtain current recovery of the costs associated with the AMRP in more economical and efficient manner than a typical general rate case. ULH&P also argued that the AMRP Rider has allowed the replacement of a significant portion of ULH&P's cast iron and bare steel mains without a significant impairment of ULH&P's financial condition.[162]

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[157] Case No. 2001-00092, January 31, 2002 Order at 78-80.

[158] Hebbeler Direct Testimony at 5.

[159] Id. The incidence of leaks repaired dropped from 983 in 1999 to 537 in 2004.

[160] Id. The expense recorded in Account No. 887 decreased from $1,500,000 in 1999 to $846,000 in 2004.

[161] Id. at 7.

[162] Steffen Direct Testimony at 8.

Since ULH&P filed this case utilizing a forward-looking test period, all AMRP related construction through September 30, 2006 has been incorporated into base rates. ULH&P proposed to make the next filing under its AMRP Rider in March 2008, and then annually through 2011.[163] The March 2008 filing would cover AMRP-related construction for the period from October 1, 2006 through December 31, 2007. The remaining AMRP Rider filings would cover a calendar year period. ULH&P's AMRP Rider filing in March 2011, if approved, would continue in effect until ULH&P's next general gas rate case.

The AG opposed the establishment of the AMRP Rider in Case No. 2001-00092, contending that it constituted singe-issue rate-making and that the Commission lacked the statutory authority to authorize the AMRP Rider. He has brought in Franklin Circuit Court actions to review the Commission's decision to authorize the AMRP Rider in Case No. 2001-00092 as well as our decisions in three subsequent cases that established the annual AMRP Rider surcharge.[164]

In this case, the AG opposed the continuation of the AMRP Rider and renewed his argument that the Commission lacks the statutory authority to establish the Rider.

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[163] As ULH&P has to incur the construction costs before requesting recovery through the AMRP Rider, the March 2011 filing would cover the AMRP-related construction for calendar year 2010, the last year of the program.

[164] The three cases that established annual AMRP Rider surcharge were Case No. 2002-00107, An Adjustment of Rider AMRP of The Union Light, Heat and Power Company, final Order dated August 30, 2002 and rehearing Order dated November 21, 2002; Case No. 2003-00103, An Adjustment of Rider AMRP of The Union Light, Heat and Power Company, final Order dated August 25, 2003 and rehearing Order dated August 29, 2003; and Case No. 2004-00098, An Adjustment of Rider AMRP of The Union Light, Heat and Power Company, final Order dated August 24, 2004.

He refers to two recent cases[165] in which the Commission refused to establish cost trackers in non-general rate cases and acknowledged that certain findings in our Order in Case No. 2001-00092 regarding our rate-making authority "may be overly broad when viewed in light of the Supreme Court's decision in the above-cited *KIUC v. KU* case."[166] The AG also argued that the recently enacted KRS 278.509 does not authorize the Commission to impose single-issue rate increases or approve a new AMRP Rider outside of a general rate proceeding.[167]

The AG also took exception to certain aspects of the proposed AMRP Rider. First, he contended that ULH&P's proposed AMRP Rider tariff fails to comply with KRS 278.509. The AG argued that KRS 278.509 permits the recovery of the costs of investment only, and not any return on AMRP-related investment. He asserted that if the Kentucky General Assembly had intended for a utility to receive a return on investment as well as the cost of the investment it would have specifically stated a

[165] Case No. 2004-00459, The Application of Louisville Gas and Electric Company for Approval of New Rate Tariffs Containing a Mechanism for the Pass-Through of MISO-Related Revenues and Costs Not Already Included in Existing Base Rates and Case No. 2004-00460, The Application of Kentucky Utilities Company for Approval of New Rate Tariffs Containing a Mechanism for the Pass-Through of MISO-Related Revenues and Costs Not Already Included in Existing Base Rates, final Orders dated April 15, 2005.

[166] AG's Post-Hearing Brief at 31-32. The AG did, however, acknowledge that the Commission in those two recent cases specifically distinguished ULH&P's AMRP Rider because it was considered within the context of a general rate case, which is the same distinction that the AG made in a reply memorandum in those cases. See Case Nos. 2004-00459 and 2004-00460, Reply of the Attorney General to the Response of Louisville Gas and Electric Company and Kentucky Utilities Company to the Attorney General's Motion to Dismiss the Companies' request for MISO expense trackers at 7. The AG has now argued that the distinction is without meaning.

[167] Id. at 33.

return on investment was permitted. The AG also argued that KRS 278.509 makes no provision for the offset of costs for investment with decreases in O&M expense as the proposed AMRP Rider does.[168]

The AG stated that any new AMRP Rider should permit collection of the charges from Residential and General Service classes by a mix of demand and customer charges or a volumetric charge instead of the customer charge approach. He contended this approach is consistent with ULH&P's COSS.

The AG also stated that the AMRP Rider should be clearly designated as a line item on customers' bills.[169] He suggested that the Commission should either approve the AMRP Rider for a 3-year period only or attach a sunset clause that would match with the end of the AMRP. Lastly, the AG advocated that ULH&P be required to file a general rate case to "roll-in" to base rates the AMRP Rider.[170]

ULH&P opposed these arguments. In its rebuttal testimony, ULH&P noted that the AG's objections were addressed and rejected in Case No. 2001-00092. It contended that the AMRP Rider is good public policy as it allowed ULH&P to recover the costs associated with the AMRP in a timely manner and avoid possible financial impairment. ULH&P emphasized the AMRP's safety and reliability benefits, its reduction of regulatory lag, and its maintenance of the sound financial condition of ULH&P. It described the Rider as a fair and balanced rate mechanism.[171] ULH&P

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[168] Id. at 33-34.

[169] Id. at 35.

[170] Id. at 35-36.

[171] Steffen Rebuttal Testimony at 1-3.

argued that recovering the AMRP Rider from Residential and General Service customers through a customer charge was reasonable, as the AMRP-related costs were fixed costs for capital expenditures that benefit all customers on its distribution system.[172] In its brief, ULH&P argued that the AG's contention that KRS 278.509 did not provide the Commission with authority to approve the AMRP Rider was without merit and should be rejected. ULH&P contended that the Commission already has the authority to establish the AMRP Rider and that KRS 278.509 simply strengthens the argument in support of that authority. ULH&P noted that the AG offered no evidence regarding the benefits of the AMRP or the financial impacts to the program if the AMRP Rider were discontinued.[173]

The AG's arguments have not convinced us that our earlier decision was erroneous. We previously held our authority to establish fair, just, and reasonable rates includes the authority to review and approve the AMRP Rider.[174] Contrary to the AG's belief, whether a surcharge was authorized as part of a general rate case or outside of a general rate case is a significant distinction. As we noted in our decisions in Case Nos. 2004-000459 and 2004-00460,

> The Commission does acknowledge that certain findings in Case Nos. 1999-00046 and 2001-00092 regarding our rate-making authority <u>may be</u> overly broad when viewed in light of the Supreme Court's decision in the above-cited *KIUC v. KU* case. To the extent that our prior findings are inconsistent with those of the Court, our findings must yield. However, the Commission also recognizes that Case No. 1999-00046 was ultimately consolidated into a general rate application, and that Case No. 2001-

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[172] Id. at 4-5.

[173] ULH&P Brief at 35-36.

[174] Case No. 2001-00092, January 31, 2002 Order, at 76.

> 00092 was a general rate case application that complied with 807 KAR 5:001, Section 10. Thus, regardless of the findings therein on our statutory authority, the proposed rates were reviewed in conjunction with general rate cases.[175]

We further do not accept the AG's position that KRS 278.509 precludes or prohibits the inclusion of a component for return on investment in the AMRP. KRS 278.509 states:

> Notwithstanding any other provision of law to the contrary, upon application by a regulated utility, the commission may allow recovery of costs for investment in natural gas pipeline replacement programs which are not recovered in the existing rates of a regulated utility. No recovery shall be allowed unless the costs shall have been deemed by the commission to be fair, just, and reasonable.

It is generally accepted in rate-making that the return on an investment is properly considered part of the cost of that investment. The AG has failed to provide any legal authority or precedent for the exclusion of a return on utility plant investment that the Commission has determined to be reasonable.

The AMRP Rider language on O&M expense reductions as offsets is not specific as to how those reductions were actually recognized in the determination of the annual AMRP Rider. The revenue requirement of the net plant additions, which is in effect the cost of the investment, is the sum of the return on net AMRP-related utility plant and operating expenses. The only operating expenses included in the AMRP calculations are depreciation expense and Account No. 887 – Maintenance of Mains. The O&M

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[175] Case Nos. 2004-00459 and 2004-00460, April 15, 2005 Order at 7-8 (emphasis added)(footnotes omitted).

expense reductions have been in Account No. 887, and have been used as an offset to the AMRP-related depreciation expense.[176]

The Commission is not persuaded by the AG's arguments concerning the recovery of the AMRP Rider from the Residential and General Service customers and finds that ULH&P's proposal on this point should be approved. When this AMRP Rider is rolled into base rates, however, the Commission will consider arguments for the use of a COSS to allocate those costs.

In our January 31, 2002 Order in Case No. 2001-00092, we found that the AMRP was in the public interest, recognized the impact the AMRP would have on ULH&P, and found at that time no reason to believe that the AMRP Rider could not be continued for 10 years. Based on the evidence in this case, the Commission finds the AMRP is still in the public interest, will still have a financial impact on ULH&P, and an AMRP Rider should be authorized for the remaining years of the AMRP. The Commission further finds that the AMRP Rider should be determined using the same approach approved in Case No. 2001-00092 and modified in Case No. 2002-00107.

In addition, the Commission makes the following findings concerning the AMRP and AMRP Rider:

1. ULH&P should make the first filing under the renewed AMRP Rider by March 31, 2008. This filing should cover AMRP-related construction for the period October 1, 2006 through December 31, 2007;

2. ULH&P should make filings under the renewed AMRP Rider for 2009 and 2010 by March 31 of those years. These filings should cover AMRP-related construction for the previous calendar year period;

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[176] See Case No. 2002-00107, August 30, 2002 Order, Appendix B for a calculation of the AMRP revenue requirement.

3. The AMRP Rider contained in the annual filings should be effective for service rendered on and after a specific date;

4. The AMRP Rider should be collected from the customer classes as proposed by ULH&P;

5. The AMRP Rider should be disclosed as a separate line item on customers' bills;

6. The reasonable rate of return on the AMRP rate base should be the overall cost of capital found reasonable in this proceeding, grossed up for federal and state income taxes only;

7. The Commission will endeavor to complete its review of the annual AMRP Rider filings within 60 days. Because a hearing will be necessary and the review may be extensive, however, the Commission may extend the length of the review period;

8. ULH&P should serve complete copies of the annual AMRP Rider filing on the AG when it submits such filings with the Commission; and

9. ULH&P should continue to annually seek Certificates of Public Convenience and Necessity for its AMRP-related construction.

As to the annual AMRP Rider filing that is due on March 31, 2011, the Commission agrees with the AG's suggestion to "roll-in" the AMRP Rider into ULH&P's base rates at the AMRP's end. We find that based upon the assumption that the AMRP is completed by 2010, ULH&P should synchronize the filing of a general gas rate case to coincide with the termination of the AMRP Rider authorized from the March 31, 2010 filing. ULH&P should verify in writing in its March 31, 2010 AMRP Rider filing whether the AMRP will be completed in 2010.

The Commission further finds that the AMRP Rider tariff should contain a more precise description of how the AMRP Rider is calculated. At a minimum, this description should state that the AMRP Rider revenue requirement includes:

a. The AMRP net rate base is AMRP-related plant in service minus AMRP-related accumulated depreciation minus ADIT associated with AMRP-related plant in service;

b. All components of the AMRP net rate base reflect adjustments to exclude retirements or removals of plant related to the AMRP construction;

c. The rate of return on the AMRP net rate base is the overall rate of return on capital authorized in this case, grossed up for federal and state income taxes;

d. Operating expenses included in the revenue requirement are depreciation expense and Account No. 887 – Maintenance of Mains; and

e. Reductions in Account No. 887 expenses will be reflected in the determination of the revenue requirement.

Ownership of Service Lines

ULH&P requested approval to be responsible for making all new installations of customer service lines and for thereafter maintain the lines in accordance with Commission regulations. Under 807 KAR 5:022, Section 9(17)(a)(2), "The customer, or the company at its option and with commission approval, shall furnish and lay necessary pipe to make the connection from curb stop to place of consumption and shall keep the service line in good repair and in accordance with reasonable requirements of the utility's rules and the commission's administrative regulations."

In Case No. 2001-00042, ULH&P was granted approval to assume ownership of service lines it replaced in conjunction with the AMRP. In its January 31, 2002 Order, the Commission stated that before ULH&P could assume responsibility for the customer service lines, it would need to seek a deviation from 807 KAR 5:022, Section 9(17), and include in its application for a Certificate of Public Convenience and Necessity for the

The Commission notes that ULH&P has had three different gas cost adjustments ("GCA") in effect during the time since it put its proposed base rates into effect on October 1, 2005. These GCAs were approved in Case No. 2005-00363[179] to be effective September 29, 2005, Case No. 2005-00420[180] to be effective October 30, 2005, and Case No. 2005-00457 to be effective November 30, 2005. With the approval herein of base rates that differ from the proposed rates it placed in effect, ULH&P will be required to file revised tariffs that supersede the tariffs filed in compliance with the October 3, 2005 Order issued in this proceeding as well as the Orders referenced herein issued in Case Nos. 2005-00420 and 2005-000457.[181]

SUMMARY

The Commission, after consideration of all matters of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in Appendix A are the fair, just, and reasonable base rates for ULH&P to charge for service rendered on and after October 1, 2005.

2. The rates proposed by ULH&P would produce revenue in excess of that found reasonable herein and should be denied.

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[179] Case No. 2005-00363, Notice of Purchased Gas Adjustment Filing of The Union Light, Heat and Power Company, final Order dated September 22, 2005.

[180] Case No. 2005-00420, Notice of Purchased Gas Adjustment Filing of The Union Light, Heat and Power Company, final Order dated October 24, 2005.

[181] The effective date of the GCA approved in Case No. 2005-00363 precedes the date ULH&P placed its proposed base rates in effect; therefore, there is no need to revise the tariffs filed pursuant to the September 22, 2005 Order issued in that case.

3. The depreciation rates contained in ULH&P's depreciation study filed in this case, as modified herein, are reasonable and should be approved for use as of the date of this Order.

4. ULH&P should be granted permission to deviate from 807 KAR 5:022, Section 9(17), and permitted to assume the ownership of service lines at the point of installation.

5. The proposed tariff language changes for service lines and Rate ASFRAS should be approved.

6. The AMRP Rider, as modified and discussed herein, is reasonable and should be approved.

IT IS THEREFORE ORDERED that:

1. The base rates in Appendix A are approved for service rendered on and after October 1, 2005.

2. The rates proposed by ULH&P are denied.

3. ULH&P shall, within 20 days of the date of this Order, file its revised tariff sheets setting out the base rates approved herein together with the two GCAs approved by the Commission that went into effect after October 1, 2005, and have been in effect since that date, up to and including the date of this Order.

4. The depreciation rates contained in ULH&P's depreciation study filed in this case, as modified herein, are approved for use as of the date of this Order.

5. The request for permission to deviate from 807 KAR 5:022, Section 9(17), is approved. ULH&P is granted approval to install, own, and maintain all new service lines.

6. The proposed tariff language changes for service lines and Rate ASFRAS are approved.

7. The AMRP Rider, as modified and discussed herein, is approved.

8. The proposed increase in the reconnection charges is approved.

9. The proposed increase in the bad check charge is denied.

10. Within 30 days of the date of this Order, ULH&P shall file with the Commission a report on the amount of excess revenues collected from October 1, 2005 through the date of this Order and a plan for refunding these revenues. This plan shall included interest for the period the excess revenues were collected at the average of the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release. The refunds will be based on each customer's usage while the proposed rates were in effect and shall be made at a one-time credit to the bills of current customers and by check to customers that have discontinued service since October 1, 2005.

11. ULH&P shall file a general base rate case in 2011 to roll-in the AMRP Rider into base rates, as discussed herein.

Done at Frankfort, Kentucky, this 22nd day of December, 2005.

By the Commission

ATTEST:

Executive Director

Index Tab

D

PUBLIC SERVICE COM'N v. CITIES OF SOUTHGATE, ETC.
Ky.,1954
PUBLIC SERVICE COMMISSION et al.
v.
CITIES OF SOUTHGATE, HIGHLAND HEIGHTS et al.
April 30, 1954.
Rehearing Denied June 11, 1954.

Action by several cities seeking to set aside an order of Public Service Commission approving sale of a utility system. The Franklin Circuit Court, W. B. Ardery, J., entered judgment setting aside Commission's order and the Commission and others appealed. The Court of Appeals, Cullen, C., held that determination of Commission that sale price was within general range of a fair price was sufficient, and Commission was not required to fix a specific valuation on the property.

Judgment reversed with directions.

West Headnotes

[1] Public Utilities 317A 118

317A Public Utilities
317AII Regulation
317Ak118 k. Transfer of Property or Franchises; Consolidation. Most Cited Cases
(Formerly 317Ak6.11)
Jurisdiction of Public Service Commission to pass upon sales of utility systems is necessarily implied from the statutory powers of commission to regulate the service of utilities. KRS 278.010 et seq., 278.040.

[2] Public Utilities 317A 114

317A Public Utilities
317AII Regulation
317Ak114 k. Service and Facilities. Most Cited Cases
(Formerly 317Ak6.7)

Public Utilities 317A 118

317A Public Utilities
317AII Regulation
317Ak118 k. Transfer of Property or Franchises; Consolidation. Most Cited Cases
(Formerly 317Ak6.11)
Public Service Commission is charged with responsibility, and vested with power, to see that the service of public utilities is adequate, and where an existing utility proposes to sell its system the commission must have the opportunity to determine whether the purchaser is ready, willing and able to continue providing adequate service. KRS 278.010 et seq., 278.040.

[3] Public Utilities 317A 118

317A Public Utilities
317AII Regulation
317Ak118 k. Transfer of Property or Franchises; Consolidation. Most Cited Cases
(Formerly 317Ak6.11)
The power of Public Service Commission to determine whether a proposed purchaser of a utility system is ready, willing and able to provide adequate service is necessarily implied from the statutes. KRS 278.010 et seq., 278.040.

[4] Public Utilities 317A 120

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak120 k. Nature and Extent in General. Most Cited Cases
(Formerly 317Ak7.1)
From a mere grant of power to Public Service Commission to regulate rates and service, court would not imply a declaration of policy that not only must rates be reasonable but that the type of ownership that would provide the lowest rate is the only type of ownership that would be permitted to operate a utility service. KRS 278.010 et seq., 278.040.

[5] Public Utilities 317A 169.1

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317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(B) Proceedings Before Commissions
317Ak169 Orders
317Ak169.1 k. In General. Most Cited Cases
(Formerly 317Ak169, 317Ak19(1))

Final statement, in order of Public Service Commission approving sale of a utility system, to the effect that nothing in order should be considered as a finding with respect to value of property, was construed as a statement intended merely as a warning to parties that sale price would not be conclusive for rate base purposes. KRS 278.010 et seq., 278.040.

[6] Public Utilities 317A ⚷169.1

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(B) Proceedings Before Commissions
317Ak169 Orders
317Ak169.1 k. In General. Most Cited Cases
(Formerly 317Ak169, 317Ak19(1))

In proceeding before Public Service Commission for approval of a sale of a utility system, broad determination by commission that the price was within the general range of a fair price was sufficient, and commission was not required to fix a specific valuation on the property. KRS 278.010 et seq., 278.040.

*19 J. D. Buckman, Jr., Atty. Gen., J. Gardner Ashcraft, Asst. Atty. Gen., Stephens L. Blakely, Blakely, Moore & Blakely, Covington, Floyd C. Williams, Cincinnati, Ohio, Cornelius W. Grafton, Wyatt, Grafton & Grafton, Louisville, for appellants.
James M. Honaker, Frankfort, for appellees.
CULLEN, Commissioner.

In an action in the Franklin Circuit Court, the cities of Southgate, Highland Heights, Cold Springs, Crestview, Bellevue, Dayton and Fort Thomas sought to set aside an order of the Public Service Commission which approved a sale of water utility properties by Union Light, Heat and *20 Power Company to Commonwealth Water Company. The court entered judgment setting aside the order and remanding the case to the commission for further proceedings. From that judgment the commission, Union and Commonwealth have appealed.

Prior to April 3, 1953, Union had been operating electric, gas and water systems in a substantial area in northern Kentucky, principally in Campbell County. The water system served the cities of Fort Thomas, Bellevue, Dayton and Silver Grove, and a number of unincorporated areas. The water business represented only about five percent of Union's total business, its main operations being in the fields of gas and electricity.

On April 3, 1953, Union entered into a contract to sell its water system to Commonwealth, which was a company newly organized by a group of persons who were experienced in the water business and who owned and were operating another water company in a different part of the state. The price was approximately $600,000. The contract was conditioned upon approval by the Public Service Commission, and on April 17, 1953, Union and Commonwealth filed a joint application with the commission for approval of the sale. The cities named in the first paragraph of this opinion thereupon intervened, asking that the proposed sale be disapproved and that the matter be continued for the purpose of enabling the cities to make arrangements to purchase the water system from Union.

During the course of the hearings before the commission, the cites submitted an offer in general terms, that they would buy the water system at the price agreed to be paid by Commonwealth. The proposal was that the purchase would be made either by the cities acting jointly and sharing the cost on a proportionate basis, or by a water district which the cities would cause to be organized under KRS Chapter 74. However, the offer was not complete, in that the cities had not agreed on a specific proration of the cost and other details, nor was a water district organized before the case was decided by the Public Service Commission.

Evidence was brought out on the hearings that, because Union could use joint meter reading and joint billing for its three kinds of utility services, Union's operating costs for the water system would be some $10,000 per year less than those of Commonwealth.

The Public Service Commission found: (1) It had

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jurisdiction to pass on the proposed sale; (2) the desire of the cities to purchase the property was not sufficient grounds for disapproving the sale; (3) the cities, because of tax considerations, could operate the system more economically than either Union or Commonwealth, but this fact did not constitute grounds for disapproving the sale; (4) it was not necessary to determine 'with detailed finality' whether Union or Commonwealth could provide the most economical service; (5) Commonwealth was 'ready, willing and able' to provide water service in the area; and (6) the proposed sale was in the public interest. The commission thereupon ordered that the sale be approved, but closed its order with the following statement:

'Nothing contained herein shall be considered as a finding of the Commission with respect to the value of the properties transferred.'

Upon their appeal to the circuit court, the cities contended that the public interest would best be served through municipal ownership of the water system, and that in any event the sale to Commonwealth should not have been approved because of the evidence that Commonwealth could not operate the system as cheaply as Union.

The circuit judge, in a written opinion, expressed his views that in the public interest the cities should be given an 'equal and adequate opportunity to acquire the water property, on equal terms * * * with Commonwealth,' and that it was necessary, in the public interest, that the commission find which of the companies could provide the most economical service. However, the basis assigned by the judge for setting aside the commission's order was that, because of the statement in the order that the commission was not finding the value of the property, the order was unreasonable,*21 arbitrary and invalid. The case was remanded to the commission with directions to find the value of the property, the amount of any offers to buy other than Commonwealth's, and whether Union or Commonwealth could furnish the lower water rate. The commission also was directed to reexamine the evidence 'in the light of public interest, and measured in part by the economy of the service considered.'

On the appeal to this Court, the first contention of Union and Commonwealth is that the Public Service Commission has no jurisdiction over sales of utility systems. The contention is that this is a question of jurisdiction of subject matter, and therefore, under the general rule that jurisdiction of subject matter cannot be conferred by appearance, waiver or agreement, the fact that the two companies applied to the commission for approval of the sale is of no significance. The Public Service Commission, although joining with the other two appellants in their other contentions, does not join in this one, but maintains it does have jurisdiction.

[1] It is true that the governing statute, KRS Chapter 278, does not in express terms confer jurisdiction upon the Public Service Commission to pass upon sales of utility systems. However, we are of the opinion that the jurisdiction is implied necessarily from the statutory powers of the commission to regulate the service of utilities.KRS 278.040.

[2] Counsel concede that a public utility subject to the jurisdiction of the Public Service Commission cannot discontinue operation without approval of the commission. See 43 Am.Jur., Public Utilities and Services, § 78, p. 621. Obviously, if a sale were made to a purchaser incapable of carrying on the service, the sale would be the practical equivalent of a discontinuance of service. The Public Service Commission is charged with responsibility, and vested with power, to see that the service of public utilities is adequate, and where an existing utility proposes to sell its system the commission, in order to carry out its responsibility, must have the opportunity to determine whether the purchaser is ready, willing and able to continue providing adequate service.

[3][4] It is our opinion that the power of the Public Service Commission to determine whether a proposed purchaser of a utility system is ready, willing and able to provide adequate service is necessarily implied from the statutes. However, the appellee cities would have us extend the implication so as include the power in the commission to determine whether public ownership is more beneficial than private ownership, and to determine under whose ownership the lowest rates may be achieved. The latter two questions address themselves to basic public policy, upon which we feel an express legislative declaration is required. From a mere grant of power to regulate rates and

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service, we are unwilling to imply a declaration of policy that not only must rates be reasonable, but the type of ownership that will provide the lowest rates is the only type of ownership that will be permitted to operate a utility service.

[5] We do not ascribe the same meaning as did the circuit judge to the final statement in the order of the Public Service Commission, that nothing in the order should be considered as a finding with respect to the value of the property. Apparently, he construed this statement as meaning that the commission had given no consideration to the value of the property in relation to the purchase price. We think the statement was intended merely as a warning to the parties that the sale price would not be taken as conclusive for rate base purposes.

From the commission's order as a whole, it is apparent that the commission did give general consideration to the value of the property in relation to the price offered, at least to the extent of determining that the transaction was not unreasonable or impracticable. In passing upon the ability of Commonwealth to provide adequate service, the commission necessarily considered the *22 financial structure of Commonwealth, and the probabilities of Commonwealth being able to operate successfully from a financial standpoint.

As a matter of fact, no one contended before he commission that the price was excessive. The cities were willing to pay the same price.

[6] We think it was sufficient for the commission to make a broad determination that the price was within the general range of a fair price. To require the commission to fix a specific valuation on the property, in a proceeding for sale, would unduly hamper and restrict the commission in later regulation of rates.

The judgment is reversed, with directions to set it aside and to enter a judgment sustaining the order of the Public Service Commission.

Ky.,1954
Public Service Com'n v. Cities of Southgate, Highland Heights
5 P.U.R.3d 519, 268 S.W.2d 19

END OF DOCUMENT

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National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.
Ky.App.,1990.

Court of Appeals of Kentucky.
NATIONAL-SOUTHWIRE ALUMINUM COMPANY, Appellant,
v.
BIG RIVERS ELECTRIC CORPORATION; Public Service Commission of Kentucky; Alcan Aluminum Corporation; Green River Electric Corporation; Meade County Rural Electric Cooperative Corporation; Henderson-Union Rural Electric Cooperative Corporation; Jackson Purchase Electric Cooperative Corporation; Commonwealth Aluminum Corporation; Willamette Industries, Inc.; Utility Ratecutters of Kentucky, Inc.; Alumax Aluminum Corporation; Firestone Steel Products Company, a division of the Firestone Tire and Rubber Company; Attorney General of the Commonwealth of Kentucky, By and Through his Utility and Rate Intervention Division; City of Hawesville, Kentucky; Hancock County, Kentucky; and Southwire Company, Appellees.
ALCAN ALUMINUM CORPORATION, Appellant,
v.
BIG RIVERS ELECTRIC CORPORATION; National-Southwire Aluminum Company; Public Service Commission of Kentucky; Green River Electric Corporation; Meade County Rural Electric Cooperative Corporation; Henderson-Union Rural Electric Cooperative Corporation; Jackson Purchase Electric Cooperative Corporation; Commonwealth Aluminum Corporation; Willamette Industries, Inc.; Utility Ratecutters of Kentucky Incorporated; Alumax Aluminum Corporation; Firestone Steel Products Company, a division of The Firestone Tire and Rubber Company; Attorney General of the Commonwealth of Kentucky, By and Through his Utility and Rate Intervention Division; City of Hawesville, Kentucky; Hancock County, Kentucky; and Southwire Company, Appellees.
Nos. 88-CA-1999-MR, 88-CA-2001-MR.

Jan. 26, 1990.
Rehearing Dismissed April 18, 1990.

Aluminum smelters appealed from judgment of the Franklin Circuit Court, William L. Graham, J., which affirmed order of Public Service Commission establishing fixed rates for all electric power sold by electric utility except for electricity sold to smelters, for which Commission established variable electric rate, based on fluctuating world price of aluminum. Consolidating appeals, the Court of Appeals, Howerton, C.J., held that: (1) Commission was not required to base rates only on property value of utility's assets which were used and useful but, rather, it was sufficient that rates were fair, just and reasonable; (2) variable rate did not violate state statutes and any discrimination was either too uncertain or was within acceptable limits; (3) no due process violation resulted from fact that Commission established new rates under external pressure from electric utility's creditor; and (4) Commission was not required to make specific findings to support its abrogation of smelter's contract for electrical service through cooperative.

Affirmed.

Wilhoit, J., concurred in part, dissented in part and filed opinion.

West Headnotes

[1] Electricity 145 ⚷11.3(2)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(2) k. Determination of Rate Base.
Most Cited Cases
Public Service Commission, in setting rates electric utility could charge, was not required to base rates only on property value of utility's assets which were used and useful but, rather, it was sufficient that rates were fair, just and reasonable; it was acceptable that rates required rate payors to pay for excess capacity of generator. KRS 278.030(1), 278.270, 278.290, 279.010(8).

[2] Electricity 145 ⚷11.3(5)

145 Electricity
145k11.3 Regulation of Charges

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145k11.3(5) k. Reasonableness of Charges. Most Cited Cases
Variable electric rate charged to aluminum smelters based on fluctuating world price of aluminum did not violate state statutes and any resulting discrimination was either too uncertain or within acceptable limits; variable rate and special classification for smelters was fairly debatable as being sound and reasonable for all concerned and chosen "pivot point" was not unreasonable. KRS 278.030(3), 278.170(1).

[3] Constitutional Law 92 ⚷4371

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)17 Carriers and Public Utilities
92k4371 k. Gas and Electricity. Most Cited Cases
(Formerly 92k298(7))

Electricity 145 ⚷11.3(1)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(1) k. In General. Most Cited Cases
No due process violation resulted when Public Service Commission established new electric rates under external pressure from creditor of electric utility which had filed foreclosure action and placed embargo on loans to state cooperatives.

[4] Electricity 145 ⚷11.3(6)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(6) k. Proceedings Before Commissions. Most Cited Cases

Electricity 145 ⚷11.3(7)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(7) k. Judicial Review and Enforcement. Most Cited Cases
Public Service Commission's engaging in ex parte efforts to resolve problems arising in electric rate setting proceeding did not constitute reversible error; it appeared that Commission's ex parte efforts were done with each of parties, and that such efforts were basically for purpose of mediation and fact-finding.

[5] Constitutional Law 92 ⚷4371

92 Constitutional Law
92XXVII Due Process
92XXVII(G) Particular Issues and Applications
92XXVII(G)17 Carriers and Public Utilities
92k4371 k. Gas and Electricity. Most Cited Cases
(Formerly 92k298(7))

Electricity 145 ⚷11.3(2)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(2) k. Determination of Rate Base. Most Cited Cases
Public Service Commission's setting electric rates which required rate payors to pay for excess capacity of electric utility's generator did not involve change in standard for fixing rates as set out in prior case so as to constitute denial of due process. U.S.C.A. Const.Amend. 14.

[6] Electricity 145 ⚷11.3(1)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(1) k. In General. Most Cited Cases
Determination of what facilities are "used and useful" is only one of many factors which may be considered in establishing electric rates.

[7] Public Utilities 317A ⚷122

317A Public Utilities
317AII Regulation
317Ak119 Regulation of Charges
317Ak122 k. Mode of Regulation. Most Cited Cases
Public Service Commission has many appropriate rate-making methodologies available to it and must have some discretion in choosing best one for each situation.

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[8] Electricity 145 ⚷11.3(6)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(6) k. Proceedings Before Commissions. Most Cited Cases
Public Service Commission, in setting variable electric rate chargeable to aluminum smelters, was not required to make specific findings to explain why average cost provisions were against public interest so as to support its abrogation of smelter's contract for electrical services through cooperative; contract was for 20 years and contemplated rate changes by Commission.

[9] Public Utilities 317A ⚷169.1

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(B) Proceedings Before Commissions
317Ak169 Orders
317Ak169.1 k. In General. Most Cited Cases
(Formerly 317Ak169)
Generally, utility contracts are subject to rate changes ordered by Public Service Commission, no matter what contracts provide.

[10] Public Utilities 317A ⚷169.1

317A Public Utilities
317AIII Public Service Commissions or Boards
317AIII(B) Proceedings Before Commissions
317Ak169 Orders
317Ak169.1 k. In General. Most Cited Cases
(Formerly 317Ak169)
Prior approval of contract and utility rate does not estop Public Service Commission from subsequently changing rate.

[11] Electricity 145 ⚷11.3(6)

145 Electricity
145k11.3 Regulation of Charges
145k11.3(6) k. Proceedings Before Commissions. Most Cited Cases
Public Service Commission's order setting variable electric rate chargeable to aluminum smelters was sufficiently saturated with details and findings to explain why average cost provisions were against public interest to support its abrogation of smelter's contract for electrical services through cooperative; order was unequivocal about magnitude of problems confronting electric utility, aluminum smelters, and other customers and potential impact on public and entire region of western portion of state was identified.

*505James Park, Jr., Katherine Randall, Brown, Todd & Heyburn, Lexington, Allison Wade, Booth, Wade & Campbell, and Caroline W. Spangenberg, Kilpatrick & Cody, Atlanta, Ga., for Nat.-Southwire Aluminum Co.
Lawrence E. Forgy, Jr., Stoll, Keenon & Park, Lexington and Richard G. Raff, Public Service Com'n of Kentucky, Frankfort, for Public Service Com'n of Kentucky.
Morton Holbrook, Ridley M. Sandidge, Jr., Lizbeth Ann Tully, Allen Holbrook, Holbrook, Wible, Sullivan & Helmers, P.S.C., Owensboro and Paul H. Keck, Michael F. Healy, and Douglas L. Beresford, Newman & Holtzinger, P.C., Washington, D.C., for Big Rivers Elec. Corp.
David C. Brown, Stites & Harbison, Louisville, and Mark R. Overstreet, Stites & Harbison, Frankfort, for Alcan Aluminum Corp.
James M. Miller, Holbrook, Wible, Sullivan & Helmers, P.S.C., Owensboro, for Green River Elec. Corp.
Frank N. King, Jr., Dorsey, Sullivan, King, Gray & Norment, Henderson, for Henderson-Union Rural Elec. Co-Op. Corp.
Paulette J. Taylor, San Mateo, Cal., William Vetter, Bethesda, Md., and Lindsey Ingram, Stoll, Keenon & Park, Lexington, for Alumax Aluminum Corp. and Commonwealth Aluminum Corp.
John S. Hoffman, Sheffer, Hoffman, Neel, Wilson & Thomason and A.M. Harvey, *506 Henderson, for Firestone Steel Products Co.
John McCarty, Hawesville, for City of Hawesville, Ky.
Harold W. Newton, Hawesville, for Hancock County.
James R. Watts, Brandenburg, for Meade County Rural Elec. Co-Op. Corp.
W. David Denton, Denton & Keuler, Paducah, for Jackson Purchase Elec. Co-Op. Corp.
Wells T. Lovett, Lovett & Lamar, Owensboro, for Willamette Industries, Inc.
Don Meade, Miller and Meade, Louisville, for Utility Ratecutters of Ky., Inc.
Frederic J. Cowan, Atty. Gen., Pamela Johnson and

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Paul E. Reilender, Jr., Asst. Attys. Gen., Utility & Rate Intervention Div., Frankfort, for Com. of Ky. thru Utility and Rate Intervention Div.

Before HOWERTON, C.J., and WEST and WILHOIT, JJ.

HOWERTON, Chief Judge.

National-Southwire Aluminum Company (NSA) and Alcan Aluminum Corporation (Alcan) appeal from a judgment of the Franklin Circuit Court affirming an order of the Public Service Commission (PSC) in Case No. 9885. The order established fixed rates for all electric power sold by Big Rivers Electric Corporation (Big Rivers), except for the electricity sold to the two aluminum smelters. For them, the PSC established a variable electric rate, based on the fluctuating world price of aluminum. The two appeals have been consolidated for our review.

The two aluminum companies present nine allegations of error. While there are basic similarities in their arguments, each party has presented somewhat different claims of error, avoiding considerable duplication. NSA's lead argument is that the new electric rates were established to satisfy the debts of Big Rivers rather than to require its customers to pay for what was actually "used and useful" of Big Rivers' excessive generating capacity. NSA's remaining arguments are that the PSC's order is not supported by findings, that it resulted from external pressure from the Rural Electrification Administration (REA), that the order failed to follow or comply with an earlier order of the PSC, and that the variable rate is discriminatory.

Alcan's main arguments follow by attacking the use of a variable rate, which it claims (1) violates Kentucky statutes and (2) is discriminatory. Alcan also contends that the new order abandoned the standards established by the earlier PSC order without explanation or prior notice. The final argument is that the new rate abrogates Alcan's contract with the appellee, Henderson-Union Rural Electric Cooperative Corporation. When analyzing these issues, we will consolidate them as may be appropriate.

We have reviewed the essential portions of the enormous record in this case, and we have considered the excellent briefs and appendices furnished by all parties. We have also heard the oral arguments of counsel, of which we have the added benefit of a video tape recording for referral. After serious consideration of all of this data, a majority of this panel concludes that the judgment of the Franklin Circuit Court must be affirmed. The statutory duty of a reviewing court is to consider if an order of the PSC is unlawful or unreasonable. KRS 278.410. *Lexington Telephone Co. v. Public Service Commission*, 311 Ky. 584, 224 S.W.2d 423 (1949). Neither the Franklin Circuit Court nor this Court have found any clear and convincing proof that the PSC's order violated either standard.

FACTUAL BACKGROUND

Big Rivers is a non-profit, non-stock rural electric generation and transmission cooperative which serves approximately 75,000 customers in Western Kentucky. NSA ***507** and Alcan are Big Rivers' two largest customers. At the time the PSC issued its order, the two smelters regularly purchased approximately 70 percent of Big Rivers' total electrical output, making NSA and Alcan dependent upon Big Rivers, and Big Rivers dependent upon the aluminum companies.

In 1980, Big Rivers applied for a certificate of convenience and necessity to construct two new coal-fired generators to be known as Wilson 1 and 2. A certificate was issued authorizing construction of both plants, and construction began on D.B. Wilson 1 on June 20, 1980. REA funded the project. Anticipated growth in Western Kentucky did not rise as expected, and it was soon determined that the load requirements for Big Rivers' service area would not need the additional capacity of Wilson 2. That portion of the project was cancelled.

As Wilson 1 neared completion in April 1984, Big Rivers filed for a rate increase with the PSC in Case No. 9006. NSA and Alcan quickly claimed that any rate increase would jeopardize their continued ability to operate. Big Rivers withdrew that rate request; but, in November 1984, it again filed for a rate increase in Case No. 9163, offering to exclude the cost of Wilson 1 from the proposed increase. The two aluminum companies again opposed this proposal, and the PSC denied any increase.

Big Rivers was unable to pay its obligations to

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REA, and in January 1985, REA declared all outstanding debts to be due and demanded full payment. It also instituted foreclosure action in the U.S. District Court of the Western District of Kentucky. Big Rivers' debts were approximately 1.1 billion dollars.

In October 1985, NSA filed an action with the PSC requesting a decrease in electric rates. This case was assigned No. 9437. The electric rates in 1985 were approximately 26 mils per kilowatt hour. As Big Rivers had not been allowed any rate change for several years, and since its financial fortunes were sinking, it again filed for a rate increase on August 7, 1986. The two actions, one for an increase and one for a decrease, were consolidated and designated Case No. 9613.

Wilson 1 was now complete and in operation. The foreclosure action was also pending, and Big Rivers and its creditors were attempting to negotiate a debt restructuring plan which also became a focal point of the hearing before the PSC. The purpose of the workout plan was to reduce the amounts required for debt service, to provide rates that would preserve the economic viability for the smelters, and to lead to the settlement of the foreclosure action.

The PSC denied the rate relief requested in Case No. 9613 on March 17, 1987, but at the same time, it established a new case, No. 9885, to investigate Big Rivers' wholesale electric rates. Big Rivers began its efforts to prepare a revised workout plan with REA and to redetermine its needs for new rates.

On July 20, 1987, Big Rivers filed with the PSC its compliance report, a business plan, and a revised workout plan, together with suggested tariffs and supporting data, and it also suggested that a variable rate be determined for the two aluminum smelters. It is interesting to note that the original idea for the variable rate was suggested by experts on behalf of the aluminum companies. The new proposed workout plan between Big Rivers and its principal creditors (REA and two New York banks) was to expire on August 10, 1987. In this plan, the creditors agreed to a debt service shortfall of 350 million dollars. Interest rates were to be lowered and payments extended over a longer term.

When the PSC established Case No. 9885, it ordered the parties to negotiate and attempt to work out a settlement. This proved to be too difficult, however, and the PSC began taking a more active role in order to strike a balance between the conflicting interests. The PSC retained a special counsel and employed experts to audit Big Rivers, NSA, and Alcan. It also retained an expert to evaluate and design appropriate tariffs for the smelters. The ***508** hearings were held in Frankfort from August 4 through August 6, 1987.

The entire record, including the previous cases, was incorporated by reference for Case No. 9885. The PSC's order in Case No. 9613, establishing 9885, allowed four months for study and negotiation, and the order provided that fair, just, and reasonable rates would be expeditiously set at the end of that four-month period. The order in 9885 was entered on August 10, 1987, the date the proposed workout plan with the creditors was to expire.

A fact of uncertain significance, but about which NSA and Alcan complain heavily, is that on April 9, 1987, REA placed an embargo on all cooperative loans which might otherwise be available to various operations in Kentucky. This was done during the time for study and negotiation, and during the time of the pending foreclosure. The PSC acknowledged that the embargo was an external factor to be dealt with, but it also determined that the embargo was not a controlling issue. NSA sought to delay any hearing to finally resolve the question of rates until REA lifted its embargo, but the PSC denied that request.

PSC's Order in Case No. 9885

Since the order in 9885 is being challenged, it is essential for this Court to briefly summarize some of its major points. It acknowledged that the case was quite complex, that Big Rivers was in arrears on its debts by approximately 1 billion dollars, and that its assets were involved in a foreclosure action. The order expressed that the economic future of Western Kentucky was linked to Big Rivers, and the PSC indicated that the long-term existence of NSA and Alcan must be considered. The PSC then sought to weigh and balance the competing and conflicting interests.

In Case No. 9613, the PSC refused to apply the concept of "used and useful" exclusively, and it did

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not indicate it would apply any other single, rigid standard. The controlling standard for rate determination is found in KRS 278.030(1), and that standard is "fair, just and reasonable rates." The PSC claims that its order in Case No. 9885 attempted to balance the equities and to reach a fair, just and reasonable result. In balancing the interests, the PSC considered in No. 9613 and No. 9885 the proposed workout plan, the condition of Big Rivers, the condition of the aluminum smelters, the role of REA and the smelters in deciding to build Wilson 1, the interests of the residential and other rate payers, and the fact that Big Rivers is a cooperative owned by its members who are its customers.

The order in Case No. 9885 does not rely on cash flow targets, but on a minimum debt service schedule. The order acknowledged that REA agreed to a debt service shortfall of 350 million dollars and that the revised plan should not require additional rate increases for debt service during the term of the plan. The PSC also anticipated that off-system sales of electricity would grow and help in the payment for the system and its operation. The PSC acknowledged that the off-system projections appeared to be realistic in the new plan.

The PSC specifically "found" that the inclusion of variable aluminum smelter power rates are an important new feature which will make it more likely that the smelters will stay in business when aluminum prices are low. There was testimony in the record that a variable rate would greatly assist the smelters in weathering the down turns in the aluminum market which are an inevitable part of a highly-cyclical industry.

The PSC also found that Big Rivers' future solvency was inextricably linked to the health of the smelters. It concluded that the new rate structure provided a fair resolution of Big Rivers' financial problems and that it provided just and reasonable rates for its customers. The order clearly did not approve everything that Big Rivers requested, and we note that Big Rivers was a complainant with NSA and Alcan when the case was filed in the Franklin Circuit Court.

The PSC further found that the flexible rates were based on findings of what NSA should pay, and not on what it merely could *509 pay. The PSC determined that the existing rates established in 1981 were "unjust, unreasonable and insufficient."

As to the flexible rate, the PSC indicated "the rate is likely to produce, over time, the same amount of revenue that would be produced under a conventional, flat rate. NSA's witness, Dr. Howard V. Pifer III, testified that ...'as an alternative, the commission could set innovative rates for the aluminum smelters which link electricity prices to aluminum prices'." Other witnesses also recommended the variable rate, and the PSC found that if either smelter closed due to a burdensome flat rate during a recession, the consequences for Big Rivers and the other customers would be disastrous.

In establishing a variable rate to be paid by the aluminum companies, the pivot point for electric rates was to be 32 mils. The companies would pay 32 mils per kilowatt at such times as the average world price for aluminum was 62 cents per pound. For each one cent rise in the price of aluminum, the price for electricity would rise by 0.7 mils to a ceiling of 44 mils. For each one cent fall below 62 cents per pound, the price for electricity would drop by 0.8 mils per kilowatt to a floor of 18.1 mils. These rates were less than Big Rivers had requested, but they were also higher than NSA or Alcan wished to pay.

The order encouraged Big Rivers and the aluminum companies to continue negotiations, and the PSC agreed to willingly examine any proposed changes. The order also allowed for future hearings to consider such things as inflation or deflation, and especially changes in the cost of coal.

The PSC determined that the variable rate formula should produce an excess for the minimum debt service in the early years when aluminum prices were projected to be high. The PSC anticipated that the prices would become lower in the future. The order indicated that the earlier high prices would allow some early payment of additional principal and interest. Even if aluminum prices subsequently drop, and if the debt service lags, the PSC nevertheless determined that the maximum permissible arrearages of 350 million dollars would not be exceeded. The projections for early high aluminum prices have proven to be correct. Only time will tell if the prices will substantially decrease.

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The order required cooperation from all parties. The overall aim was to balance fairly the needs and interests of the generator, the customers, and the creditors. REA made significant concessions in helping to resolve the problems of Big Rivers.

The order in Case No. 9885 required that three conditions be met before it was placed into effect on September 1, 1987. First, the creditors had to accept the revised workout plan and the approved rates. Next, the foreclosure action had to be dismissed, and the creditors were required to acknowledge that Big Rivers was not presently in default. Finally, REA's embargo of financial assistance for all Kentucky cooperatives had to be lifted.

In addition to finding that the old rates were unjust and unreasonable, the PSC specifically found that the new rates are fair, just and reasonable. It also specifically found that the revised workout plan will provide a long-term resolution to Big Rivers' financial difficulties and that the economic stability of NSA and Alcan will be enhanced by the variable rates which are tied to the market price of aluminum.

Big Rivers and the aluminum companies filed a complaint in the Franklin Circuit Court challenging the order of the PSC. The Franklin Circuit Court affirmed the order, and the aluminum companies have appealed. Big Rivers is now in the posture of supporting the PSC's order.

Judge Graham of the Franklin Circuit Court is to be commended for his thorough and excellent opinion in deciding this case on August 19, 1988. We generally concur with his opinion but, as we have some differences and as the issues on this appeal have some variations, we will consider and present our reasoning for the resolution of each allegation of error.

STANDARD OF REVIEW

As was mentioned earlier, our standard for review is set forth in KRS 278.410(1). ***510** The statute provides that an order of the commission may be vacated or set aside only if the court finds it to be unlawful or unreasonable. The parties challenging the order have the burden of proving unlawfulness or unreasonableness by clear and satisfactory evidence. KRS 278.430. To be held unlawful, the order must violate a state or federal statute or constitutional provision, and an order is unreasonable if it is not supported by substantial evidence and the evidence leaves no room for a difference of opinion among reasonable minds. *Energy Regulatory Comm'n v. Ky. Power Co.*, Ky.App., 605 S.W.2d 46 (1980).

At the outset, we conclude that the order is fair, just and reasonable, that the findings are adequate, and that the order and new rates are supported by substantial evidence in this gigantic record. The order is not arbitrary or unreasonable. The big questions are whether the order is otherwise lawful and whether it was adopted in a lawful manner.

THE ISSUES

Among the issues presented and remaining to be resolved are allegations that the PSC failed to follow the statutory guidelines, that it denied the aluminum companies due process of law, and that the order is discriminatory. Alcan also argues that the order abrogates its contract with Henderson-Union. Any one of these allegations, if correct, would be a challenge to the lawfulness of the order. We will consider each of these issues.

I.

[1] NSA and Alcan first argue that the PSC erred by setting rates based on Big Rivers' debts without first considering whether Wilson 1 is an excess, unneeded facility that is neither used nor useful in servicing customers. In support of this proposition, they claim that Kentucky statutes require that rates be based on a utility's property value using only the assets which are used and useful. They further allege that Kentucky case law prohibits a utility from recovering through its rate structure the cost of property not used and useful. Another related allegation is that the PSC and the Franklin Circuit Court erred in applying a portion of the doctrine found in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944). That doctrine is that it is the result reached rather than the method employed which is controlling.

Although we believe the arguments have some basis in our public policy and precedents, we nevertheless must conclude that neither the Kentucky

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statutes nor Kentucky case law place such restrictions on the PSC when fulfilling its duty to establish fair, just and reasonable rates. We agree that the concept of "used and useful" has had an application in Kentucky rate making. To some extent, it appears to be part of our public policy to insure that utility consumers do not pay unreasonable rates and that utilities do not make unreasonable expansions. We do not agree with the smelters' argument, however, that somehow the historical concept of "used and useful" must be given an overriding, all-encompassing application. A determination of what is used and useful is one of many factors which should be considered when establishing rates. We also note that Kentucky has recognized and applied the Hope doctrine in some more recent cases. Although it may appear that the PSC put the cart before the horse when it fixed no specific value for the utility and primarily set a rate to satisfy the workout plan, we nevertheless conclude that the PSC gave adequate consideration to all applicable factors, including the used and useful facilities of Big Rivers. This very unique factual situation causes us to also conclude that the PSC must have some flexibility in its efforts to fix such rates which fairly balance the conflicting interests of the producer of electricity and the consumer.

Some states, such as Indiana and Pennsylvania, apparently continue to require establishment of rates which allow recovery only on the portion of a utility's property which is presently and almost completely used and useful. Federal cases allow individual states significant latitude in deciding *511 what method they choose to establish utility rates.

Our courts are not equipped to establish utility rates, and we only review the methods and results of PSC activity. Our role is to *ensure* that the rates are lawfully established and that they are fair, just and reasonable, based on the evidence. KRS 278.030(1). Our Court's role is also to insure that the conflicting interests of all parties concerned with utility rates are fairly balanced. If the PSC accomplishes this, we have no reason to substitute our judgment or reverse the PSC simply because it has failed to strictly adhere to the historical concept of "used and useful."

In Hoecher, *"Used and Useful": Autopsy of a Rate Making Policy,* 8 Energy Law Journal 303 (1987), the author of the article indicates that the concept of used and useful is still alive, but it may not be too well. Close examination of the concept and a reevaluation of its usefulness has been prompted by some failed or cancelled nuclear power plants which may or may not have been prudently constructed. In his conclusion, Hoecher wrote at 333, "... used and useful cease to deny utilities access to the ratepayer's purse simply because a utility asset was not actively employed and no immediate service or benefit was being supplied." He also concluded at 333:

[W]hen utilities commit capital in reasonably prudent pursuit of their obligations to invest in future service and to convey benefits to future as well as present ratepayers, agencies may decide to afford rate base treatment or cost of service recovery to investments not then providing service to consumers. Such so-called departures from traditional used and useful, whether called risk allocation or something else, do not often contravene the purpose and rationale of used and useful when the interests of the ratepaying public generally are taken into account.

At 334-335, Hoecher reasoned, "[t]he flexibility inherent in the *Hope* formula translates into a myriad of ratemaking practices that will seek not only to insure an equitable exchange of value but to affect consumption, production, and distribution behaviors, and even create markets." The article concludes, at 335 with this statement: "[t]he public should indeed pay for what it gets and get what it pays for. Unless this is more precisely explained and applied, however, agencies and courts will overlook used and useful for other means to accomplish the particular end results they desire."

Although Kentucky statutes contain the term "used and useful," and some Kentucky cases have limited rates based on what was "used and useful" and not allowed recovery for much excess capacity, we do not find that our statutes and cases mandate such limitations. Indeed, they should not be construed so restrictively. A strict adherence to "used and useful" is not necessary for the courts to determine if PSC rates are lawful and reasonable. The public will be protected by judicial review, and the ultimate resulting rate should be a more important consideration than some specific, mandated method for determining it.

The controlling statutes for utility rate-making are KRS 278.030(1) and KRS 278.270. KRS

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278.030(1) authorizes utilities to collect "fair, just and reasonable rates." KRS 278.270 authorizes the PSC to "prescribe a just and reasonable rate" when it finds existing rates to be "unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation...."

KRS 278.290 also pertains to the fixing of utility rates. The language is broad and generally permissive as to what factors to consider. The only reference to considering property which is "used and useful" is in (3). The section specifically applies to rate investigations for a utility servicing two or more municipalities, and it allows for reasonable differentials in rates between municipalities. While one might argue that the statute requires a limit on rate r covery for assets which are only used and useful, we find such an interpretation to be unnecessarily and unwisely restrictive.

***512** Alcan attempts to carry its proposed statutory scheme a step further by arguing that the definition of a "system" in Chapter 279 limits a utility's rates to a recovery of what is used and useful. KRS 279.010(8) provides that a system "means and includes any plant, works, facilities and properties, and all parts thereof and appurtenances thereto, used or useful in the generation, production, transmission or distribution of electric energy." We find no clear reason from this definition of a co-op "system" which requires an interpretation that the PSC must value only property used and useful in setting utility rates, especially with the concept that only that property which is fully utilized may be valued.

In KRS 278.290(1), the legislature gives this guidance to the PSC in establishing value of utility property in connection with rates. It reads, in part:

In fixing the value of any property under this subsection, the commission shall give due consideration to the history and development of the utility and its property, original cost, cost of reproduction as a going concern, capital structure, and other elements of value recognized by the law of the land for rate-making purposes.

This appears to afford the PSC broad discretion in factors to be considered in rate-making. It is certainly broad enough to consider such things as replacement cost, debt retirement, operating cost, and at least some excess capacity in order to insure continuation of adequate service during periods of high demand and some potential for growth and expansion. It also allows for consideration of whether expansion investments were prudently or imprudently made, and whether a particular utility is investor owned or a cooperative operation. Any of these factors might be extremely significant in varying situations when determining what ultimately would be a fair, just and reasonable rate and would allow for a balancing of interests.

The aluminum companies argue that Kentucky case law also prohibits a utility from recovering the cost of its property not used and useful. They cite as their leading case *Fern Lake Co. v. Public Service Comm'n*, Ky., 357 S.W.2d 701 (1962). *Fern Lake* involved an investor-owned water system. It had developed a system which far exceeded what was needed. The court did declare that the excess facilities were not used and useful and did not allow them as a factor in establishing a rate base. The appellants also cite *Blue Grass State Telephone Co. v. Public Service Comm'n*, Ky., 382 S.W.2d 81 (1964), which reaffirmed *Fern Lake*.

We believe that neither case is absolutely controlling for various reasons. For one thing, they use language such as "should not include," which is substantially less than "must not include." Each case is also distinguishable in that both utilities were investor-owned rather than cooperatives, neither utility was approaching bankruptcy, and an application of the "used and useful" standard was somewhat appropriate for those cases. Kentucky is simply not shackled to a mechanical application of the used and useful standard.

We find no error by the PSC or the Franklin Circuit Court in its application of the *Hope* doctrine. In *Hope, supra,* the opinion reads, at 64 S.Ct. at 287: "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. [Citations omitted.] It is not the theory but the impact of the rate order which counts." At least two more recent Kentucky cases have cited *Hope.*

In *Commonwealth ex rel. Hancock v. South Central Bell Tel. Co.*, Ky., 528 S.W.2d 659 (1975), the court cited *Hope* and ruled at 662,"one who seeks to set aside a rate order of a public regulatory body

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much excess exists, we are satisfied with the result.

Having reviewed this case thoroughly, we hold that the rates in Case No. 9885 are neither unlawful nor unreasonable. The interests of all parties are reasonably balanced. Big Rivers is alive and is providing a good, dependable electric system, which the smelters must have. There is excess capacity to provide dependable and adequate electricity at times of peak or extreme demand, and there is potential for some industrial and population growth. The consumers, who are in essence the owners in this case, are paying appropriate rates to keep the system going, and the creditors have contributed a fair share to help solve the financial crisis.

We affirm on this issue.

II.

[2] NSA and Alcan next attack the imposition of a variable rate. They argue that it violates Kentucky statutes and that it discriminates against them. We conclude that there is no statutory violation and that any discrimination is either too uncertain or that it is within acceptable limits.

The aluminum companies claim that the PSC erred not only in setting a variable rate for them, but also by establishing the rate at the wrong "pivot point." The PSC set the expected average pivot point at 32 mils per kilowatt when the average world price for aluminum is 62 cents per pound. NSA and Alcan claim that the pivot point corresponding to the price non-smelters will pay is 27.6 mils. They then argue that, over the 10-year life of the ordered rates, they will pay an extra 76 million dollars.

No one can accurately agree or disagree with these allegations, as only time will tell the accuracy of the PSC's estimates or the smelters' estimates. The variable rate depends on the current price of aluminum. If the average price over the 10-year period is under 62 cents per pound, the average rate based on the "pivot point" could be less than 27.6 mils. The variable rate drops faster than it rises. If the price is below 62 cents per pound, the price of electricity may drop to 18.1 mils per kilowatt. Furthermore, the non-smelter rate-payers have two rate increases scheduled during the 10-year life of the order. Their final rate will be closer to the 32 mils per kilowatt.

The expert witnesses attempted to provide an average payment over 10 years to balance what the smelters and non-smelter customers pay for electricity. The variable rate was designed to require the smelters to pay more for electricity when aluminum prices are high, when they likely can afford to pay more. The variable rate will protect the smelters from high production costs when aluminum prices are low. We also note that the PSC encouraged Big Rivers and the smelters to continue to negotiate a settlement of their differences. If that does not happen, and if the variable rates prove to be unrealistic and unreasonable, the PSC may reopen the case. We find nothing unlawful or unreasonable in the order.

By selling 70 percent of its output to NSA and Alcan, Big Rivers is definitely linked to the aluminum business. The fortunes of the producer and the consumer are dependent on each other. The variable rate is a reasonable effort to protect the interests of each. As counsel for the PSC argued, the smelters and Big Rivers have been living together from the beginning, and they have now been married. In Case No. 9163 in 1985, NSA's expert witness recommended that the PSC adopt a "rate which fluctuated with the spot market price of aluminum." In 9885, the PSC agreed to do that.

Even if some discrimination actually exists, Kentucky law does not prohibit it per se. According to KRS 278.170(1), we only prohibit "unreasonable prejudice or disadvantage" or an "unreasonable difference." KRS 278.030(3) allows reasonable classifications for service, patrons, and rates by considering the "nature of the use, the quality used, the quantity used, the time when used ... and any other reasonable consideration."

***515** Although the smelters buy electric power in large quantities, they place a big demand on Big Rivers to provide continuous uninterrupted service and to be ready to make available on demand enormous amounts of energy. Wilson 1 gives Big Rivers the ability to do this, and NSA and Alcan must help pay for it.

Perhaps the leading case on rate discrimination is *Louisville & Jefferson County Met. Swr. Dist. v.*

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Joseph E. Seagram & Sons, 307 Ky. 413, 211 S.W.2d 122 (1948). Several sewer customers challenged the new rates on the basis that they were discriminatory. At 211 S.W.2d 125, the opinion reads, "... if the validity of the Board's action be fairly debatable its judgment must be allowed to prevail against the objection that the classification is discriminatory." The opinion adds that the Metropolitan Sewer District was vested with legislative and administrative discretion. The PSC, likewise, has legislative and administrative discretion. Its variable rate and special classification for the smelters is fairly debatable as being sound and reasonable for all concerned. We will not disturb that decision.

III.

[3] NSA claims that its due process rights were violated because the PSC established the new rates under extreme external pressure from REA. NSA argues that its most essential right is to have an impartial tribunal in fact and appearance. We certainly cannot disagree, but when we consider the totality of the circumstances in this case, we need not reverse the PSC order or the Franklin Circuit Court's judgment on this ground. Likewise, we see no necessity of remanding the case for a new hearing which may or may not be capable of happening without pressure.

Certainly, there was pressure to settle this nightmare. Big Rivers was in default. REA had filed a foreclosure action, and it had placed an embargo on loans to Kentucky cooperatives. However, no one has accused the REA of any wrongdoing, as it was merely pursuing its rights as a creditor.

The potential consequences of this situation for all parties and for Western Kentucky were monstrous. We note, however, the pressure was not coming completely from REA and the circumstances created by its actions. NSA applied its own pressure with threats to close its smelter and with its letter writing and newspaper attacks.

[4] During oral argument, we also learned that the PSC had engaged in some *ex parte* efforts to resolve the problems in this case. In some situations, such action might be condemnable, but it appears that the PSC's *ex parte* efforts were done with each of the parties, and such efforts were basically for purposes of mediation and fact finding. We find no reversible error resulting from this activity.

Although open hearings and some adjudicating are involved, rate making is basically a legislative function. *Commonwealth ex rel. Stephens v. South Central Bell Tel. Co., supra,* held that courts need not inquire into the wisdom of legislative procedures, unless they are tainted by malice, fraud or corruption. We are primarily concerned with the product and not with the motive or method which produced it. *Louisville & Jefferson Co. Met. Swr. Dist., supra.* We find no taint of fraud, malice or corruption by the PSC, and none is alleged. Rather, we should commend the members of the PSC and their counsel for the product they finally hammered out.

NSA may reasonably argue its suspicion of an impartial tribunal, but the facts just do not support any actual wrongdoing by the PSC. REA agreed to lower its interest rate and to a longer payout. The PSC withheld the rate relief until REA lifted its embargo on Kentucky loans and dismissed its foreclosure action against Big Rivers. The new rates were less than requested by REA and Big Rivers to satisfy their workout plan. There is no evidence that the order in 9885 was tainted by any special dealing between the PSC and REA, or between the PSC and any party.

We will not dispute the fact that it would have been better if the rates could have ***516** been fixed without the atmosphere of the embargo or the foreclosure, but REA could not have been forced to drop either action. If the PSC and REA had merely remained at cross purposes, the foreclosure could have been finalized, and it is possible that the REA could have taken over the utility and fixed its own rates. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n,* 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983).

Even with pressure from all sides, the PSC wisely moved forward on schedule to obtain quick finality in establishing the rates, and it was able to balance the interests of all parties.

IV.

[5] Another *issue alleging* a denial of due process is raised by NSA and Alcan. Both argue that

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the PSC changed the standards for fixing rates as set out in the order for Case No. 9613 without any notice or explanation of how the rates would actually be fixed in Case No. 9885. NSA further alleges that the changes resulted from the extreme external pressure applied by REA. We disagree and find no reversible error.

This argument continues to complain about the fact that the new rates require the rate-payers to pay for the excess capacity of Wilson 1. The PSC did set the new rates high enough to give Big Rivers a reasonable chance to pay its debt to REA under the terms of the new workout plan; but, since we have already decided that neither our Kentucky statutes nor our Kentucky or federal decisions require the smelters' restricted application of "used and useful" in rate-making, we will not discuss that point again.

[6] While we agree that a party is entitled to know the issues on which the decision will turn, the PSC had so many options available for rate-making that it is difficult to appreciate the charge that it changed the rules. A determination of what facilities are "used and useful" is only one of the many factors which may be considered in establishing rates.

The order in 9613 rejected the argument that rate-making is simply an exercise in applying a "used and useful" standard. NSA and Alcan were put on notice of that fact when the PSC provided, "[w]e must carry out a complex balancing of equities in allocation of risk." This is what was finally accomplished in 9885.

We also fail to see how the authorization of rates sufficient to satisfy a debt service is a total departure from precedent. Cooperative utilities are similar to publicly-owned utilities as being treated differently from for-profit, invester-owned utilities. In City of Covington v. Public Service Comm'n, Ky., 313 S.W.2d 391 (1958), the court wrote, at 393-394:

In the case of *publicly-owned* utilities, it appears that the trend is to determine revenue requirements on the basis of actual *cash* needs. [Citation omitted.] Under this approach, a municipally-owned utility with a bonded indebtedness must be allowed to charge sufficient rates to meet the interest and amortization requirements of its debt. [Emphasis in original.]

[7] While we are aware of differences in the way this rate request has been approached in the four or five times it has been before the PSC, we find no unreasonable inconsistencies or unlawful arbitrariness. Although we expressed some criticism of the PSC's methods in this case and suggested some other methods for most utility rate-making, the PSC has many appropriate rate-making methodologies available to it, and it must have some discretion in choosing the best one for each situation. *Citizens Telephone Co. v. Public Service Comm'n*, Ky., 247 S.W.2d 510 (1952). 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.

V.

[8] The final ground for reversal is argued primarily by Alcan. It claims that the PSC made no specific findings to support its abrogation of Alcan's contract for electric service through Henderson-Union. ***517** The contract provision for rates specified that they would be based on "the average cost of capacity and energy." Alcan argues that the new variable rate abrogates the contract and that Kentucky law requires specific findings to explain why the average cost provisions are against the public interest, citing *Pearl v. Marshall*, Ky., 491 S.W.2d 837 (1973). We find no reversible error.

Although NSA and Alcan have direct transmission lines from Big Rivers, each has a contract with a cooperative for the purchase of power. NSA buys power through Green Rivers Electric Corporation and Alcan purchases its electricity through Henderson-Union Rural Electric Cooperative Corporation. Both contracts permit the PSC to establish rates. Each contract provides in part that rates for electric service are subject "to such changes as may be authorized into effect from time to time by the Kentucky Public Service Commission."

[9][10] The contracts were for 20 years and they contemplated rate changes by the PSC or changes due to a "force majeure." Furthermore, Kentucky law generally holds utility contracts are subject to rate changes ordered by the PSC, no matter what the contracts provide. *Board of Education of Jefferson County v. William Dohrman, Inc.*, Ky.App., 620 S.W.2d 328 (1981). Also, a prior approval of a

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contract and rate does not estop the PSC from subsequently changing the rate. *Fern Lake Co. v. Public Service Comm'n, supra.*

[11] Although we do not agree that a rate change in this case required a "public interest" test with supporting findings, we nevertheless conclude that the PSC order in 9885 is sufficiently saturated with details and "findings" that such a test would be satisfied. The order was unequivocal about the magnitude of the problems confronting Big Rivers, the aluminum companies, and the other customers. The potential impact on the public and the entire region of Western Kentucky was identified. The economic future of the area and the joint survival of Big Rivers and the smelters was at stake. The PSC stated that its fundamental responsibility was to seek "a solution that would fairly balance the interest of all parties." We believe that the PSC's actions certainly considered and satisfied the "public interest."

The Franklin Circuit Court correctly determined that the order of the PSC in Case No. 9885 was neither unlawful nor unreasonable, and we affirm that judgment.

WEST, J., concurs.
WILHOIT, J., concurs in part, dissents in part, and files a separate opinion.WILHOIT, Judge, concurring in part and dissenting in part.

With great reluctance I respectfully dissent in part from the majority opinion. This reluctance springs from an appreciation of the enormity and immediacy of the problem which this case presented to the Public Service Commission (PSC) and the impressive efforts of that body to reach an equitable solution, not to mention the thoughtful consideration given to those efforts by the Franklin Circuit Court and the majority here. I do so only because I believe the method by which the rates were reached appears to have failed to take into account important and well-established public policy and because of this failure, it is impossible for a reviewing court to ascertain whether the rates fixed are "unlawful or unreasonable." KRS 278.410(1).

I recognize that rate theory, in determining the value of a rate base, is not as important as the results actually achieved by the rate order. *See City of Lexington v. Public Service Commission*, Ky., 249 S.W.2d 760 (1952), *overruled on other grounds, Stephens v. Kentucky Utilities Co.*, Ky., 569 S.W.2d 155, 159 (1978). Still, the reasonableness of a rate of return to a utility cannot be decided in isolation from the rate base to which the return is applied, *see Citizens Telephone Co. v. Public Service Commission*, Ky., 247 S.W.2d 510 (1952); *Commonwealth ex rel. Hancock v. South Central Bell Telephone Co.*, Ky., 528 S.W.2d 659 (1975), so that what investment is included in the rate base, as opposed to the formula used to evaluate the ***518** investments, is of critical importance to a proper determination of the reasonableness of a rate. What the PSC appears to have done in setting the rate base here is to have included in the base investment in property which under established public policy should not be included; although it might be argued that the PSC never did establish a rate base, but merely decided on what it was convinced was the most equitable way to retire the debt incurred by Big Rivers. *Cf. City of Covington v. Public Service Commission*, Ky., 313 S.W.2d 391 (1958). In any event, in the March 17, 1987, order it concluded, correctly I believe, that "[r]ate base and debt service coverage for a cooperative utility must be determined by applying the same standards applicable to investor-owned utilities." In fact, it would be hard to quarrel with the PSC's recitation in that order of what its guideposts should be in setting a new rate for Big Rivers. Yet the results it reached in Case No. 9885 strongly indicates that it lost sight of at least one such guidepost of particular importance.

It is "whistling in the dark" to suggest that the concept of "used and useful" is no longer of much moment in our public policy when it comes to setting utility rates. Our statutes and case law, some of which are cited by the majority, as well as a history of rulings by the PSC itself, are indicative of an established public policy that only those investments by a utility, which were prudently made and which are used and useful in furnishing service to the rate-paying public, are to be included in the rate base for fixing the rates to be charged by the utility. Accepting that the PSC has found in a somewhat converse fashion that Big Rivers has met its burden of showing the investment in the Wilson Generator to have been prudent, the inquiry must then focus on the "used and useful" requirement for inclusion of assets in rate base. From the record before us, this step in the rate-setting process appears ultimately to have been discarded by the PSC.

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"[F]air, just, and reasonable rates for the services rendered," KRS 278.030(1), by a utility are not established simply by setting a rate which bankrupts neither the utility nor its customers, the ratepayers. Just as a utility should not be denied a fair return on its investment properly included in rate base, so a customer or consumer should not be required to pay for investments made by the utility which are of no benefit to the consumer. The "used and useful" concept protects against rates based upon such "useless" investments.

"Used and useful" as it now exists in our public policy, and as it has come to be applied by our PSC and in a number of other jurisdictions, is a more flexible concept than the appellants believe. In my opinion, it would not operate to necessarily exclude from rate base any and all of the investment made in the Wilson generator. *Blue Grass State Telephone Co. v. Public Service Commission*, Ky., 382 S.W.2d 81 (1964), recognized that rate base should be "adjusted accordingly" as "the facilities purchased are not entirely usable," *id* at 82. The clear implication from this case is that such assets are includible in rate base to the extent they are "usable" for the benefit of the ratepayers. There is no dispute that all of Big Rivers' investments in generators, including the Wilson Generator, is being "used." The as yet unresolved question is the extent to which those investments are "useful." The method by which the PSC makes that determination should be left to its expertise, provided the method is fair and reasonable. *See, e.g., Philadelphia Electric Co. v. Pennsylvania Public Utility Commission*, 61 Pa.Commw. 325, 433 A.2d 620 (Pa.Commw.Ct.1981). It cannot simply disregard the "used and useful" standard in arriving at an end result which it deems reasonable.

I must confess that I am puzzled by the PSC's and the majority's fascination with *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944), interpreting the "just and reasonable" standard of the federal Natural Gas Act. That case was decided almost 10 years after our statutory provision allowing "fair, just and reasonable rates" was enacted and almost 20 years before *Fern Lake Co. v. Public Service Commission*, Ky., 357 S.W.2d 701 (1962), citing ***519** with approval *Public Service Commission v. Montana-Dakota Utilities Co.*, 100 N.W.2d 140 (N.D.1959). Simply put, the *Hope* decision has no bearing whatsoever on the "used and useful" concept which is a part of our public policy. The majority decision in *Jersey Central Power & Light Co. v. Federal Energy Regulatory Commission*, 810 F.2d 1168 (D.C.Cir.1987), not only offers no binding precedent on this question, but fails to furnish persuasive precedent as to why our policy, which forces an equal balancing of the right of the public to be served at a reasonable charge against the right of the utility to a fair return on the value of its property used in that service, should be exchanged for a policy more heavily weighted toward ensuring investors a return on their investment.

I concur with the majority that a variable rate for the appellants upon the facts presented would not be unlawful or unreasonable.

I would remand this case for a setting of rates based upon a rate base determined in accordance with the public policy of Kentucky.

Ky.App.,1990.
National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.
113 P.U.R.4th 89, 785 S.W.2d 503

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Index Tab

E

Re Louisville Gas and Electric Company
Case No. 2004-00459
Case No. 2004-00460

Kentucky Public Service Commission
April 15, 2005

BY THE COMMISSION:

*1 ORDER

On December 1, 2004, Louisville Gas and Electric Company ('LG&E') and Kentucky Utilities Company ('KU') tendered for filing applications for approval of tariffs which are designed to pass through to their respective electric customers the net revenues and net expenses resulting from the wholesale energy market tariffs adopted by the Midwest Independent System Operator, Inc. ('MISO '). The proposed tariffs are to operate as monthly surcharges imposed upon all customers' bills and are to reflect only the MISO revenues and expenses that are not already included in existing base electric rates. The applications state that the actual charges or credits to customers' bills will vary monthly, but the expectation is that the combined LG&E and KU customer billings will increase by $7 million annually.

By Order dated December 22, 2004, the Commission noted that LG&E and KU have requested approval of the MISO cost surcharges as 'just and reasonable' and as 'complements' to their existing rates, although they do not claim that their existing rates are not fair, just, and reasonable. The Commission further noted that the applications contain absolutely no financial information or exhibits to demonstrate that LG&E's or KU's existing rates are insufficient to allow full recovery of all MISO costs not already included in existing rates.

The December 22, 2004 Order raised the issue of whether the pending applications are actually attempts to obtain general adjustments in the existing rates of LG&E and KU without complying with the minimum filing requirements set forth in Administrative Regulation 807 KAR 5:001, Section 10. That Order established a schedule for the parties to file briefs on the issues of whether the Commission has the authority to consider the pending applications absent compliance with 807 KAR 5:001, Section 10, and whether the pending applications should be consolidated with the rehearing issues pending in LG&E's and KU's respective rate cases. [FN1]

Intervention was requested by and granted to the Office of the Attorney General ('AG') and Kentucky Industrial Utility Customers ('KIUC'). Each of those parties filed an initial brief and a reply brief, while LG&E and KU filed a response brief.

The AG and KIUC argue that the pending applications are single-issue rate cases and that there is no statutory authority for the Commission to engage in singleissue rate-making. They both cite KRS 278.192, which requires a utility rate

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application to utilize either an historic test period or a forward-looking test period, and note that the pending applications do not utilize any test period. References are also made to Administrative Regulation 807 KAR 5:001, Section 10, which specifies the financial information that must be filed to support a rate application, and the absence of compliance by LG&E and KU with that regulation.

LG&E and KU argue that the Commission has broad implied authority to approve the proposed rate surcharges pursuant to KRS 278.030, which requires rates to be fair, just, and reasonable. They claim that the Commission has numerous times over the years exercised its authority to approve rate mechanisms to track costs such as fuel and purchased gas, which are similar to the request here to track MISO costs and revenues. LG&E and KU further claim that new rates can be filed and implemented pursuant to the Commission's regulation governing tariffs, 807 KAR 5:006, without the need to comply with the regulation applicable to rate adjustments, 807 KAR 5:001, Section 10. They also cite a number of prior Commission decisions which stated that applications for approval of new rate tariffs, as opposed to changes in existing rate tariffs, were not general adjustments in rates and need not comply with the filing requirements in 807 KAR 5:001, Section 10. Finally, LG&E and KU request alternative relief in the form of an accounting deferral to establish a regulatory asset/liability for the unrecovered MISO revenues and expenses in the event the Commission determines that the pending applications cannot be considered on their merits.

***2** In his reply brief, the AG argues that the Commission cases cited by LG&E and KU should not now be relied upon because the Commission acted in excess of its implied authority in those cases and no court has considered the extent of the Commission's authority under KRS 278.030(1) to accept single-issue rate applications. The AG argues that LG&E and KU have failed to demonstrate that their existing rates are no longer fair, just, and reasonable due to the material financial impact of the unrecovered MISO revenues and expenses.

KIUC's reply brief argues that the Commission cases cited by LG&E and KU are not controlling precedent because they involved gas supply clauses or a profit-sharing provision, rather than the simple pass through of high costs and low revenues that will always result in higher charges to ratepayers.

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that LG&E and KU have proposed to implement rate surcharges to recover certain MISO-related revenues and expenses. For calendar year 2005 (annualized), LG&E and KU project that $7 million of additional revenue will be collected from ratepayers under the MISO surcharges. [FN2] On a per customer basis, LG&E and KU estimate the monthly impact to be an additional $0.20 for 1,000 kW usage. [FN3]

The proposed MISO surcharge tariffs are appended to the applications as Exhibits RMC-1 for LG&E and RMC-2 for KU. The texts of both surcharge tariffs state that, 'The monthly amount computed under each of the rate schedules to which this mechanism is applicable shall be increased or decreased by the [MISO surcharge],' and that the MISO surcharge is applicable '[i]n all territory served,' and is available '[t]o all Standard Rate Schedules and Pilot Programs. ' Thus, the MISO surcharges are intended as mandatory, not optional, rates and they are to be

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charged to every customer under every rate schedule.

The issue now before the Commission is whether the applications can be accepted as tariff filings or whether they must be dismissed as general adjustments in the existing rates, which do not comply with the minimum filing requirements set forth in 807 KAR 5:001, Section 10. By proposing to implement MISO surcharges, LG&E and KU are seeking to increase their combined revenues by $7 million annually by charging this surcharge rate to all existing customers. The statutory definition of 'rate' is very broad and includes 'any individual or joint fare, toll, charge, rental, or other compensation for service rendered or to be rendered by any utility....' KRS 278.010(12). The MISO surcharge is clearly a 'rate,' since it will obligate each customer to pay additional compensation for the service rendered by LG&E and KU. And since this new rate is to be charged to each customer in each existing rate class, the result will be that LG&E's and KU's existing rates will be adjusted by the addition of the MISO surcharge. Thus, the pending applications are proposing general adjustments in the existing rates of LG&E and KU. For the Commission to process those applications, LG&E and KU must satisfy the minimum filing requirements set forth in 807 KAR 5:001, Section 10.

***3** By enacting KRS Chapter 278, the Kentucky General Assembly adopted a comprehensive scheme for regulating the rates and service of utilities. Every utility has the right, under KRS 278.030(1), to charge rates that are 'fair, just and reasonable.' If a utility believes its existing rates are not fair, just, and reasonable, it has the right to file with the Commission new rates pursuant to KRS 278.180 and 278.190. When a utility chooses to file new rates that are to be charged to all existing customers, those new rates constitute a general adjustment in existing rates and the filing must be supported by all information specified in 807 KAR 5:001, Section 10.

Except as specifically provided for in KRS Chapter 278, no utility has the right to file an application to increase its existing rates absent compliance with 807 KAR 5:001, Section 10. This principle was affirmed by the Kentucky Supreme Court when it upheld the constitutionality of the environmental surcharge statute in Kentucky Industrial Utility Customers v. Kentucky Utilities Co., Ky., 983 S.W.2d 493 (1998). That statute, enacted in 1992 as KRS 278.183, expressly authorized a utility to apply for a surcharge to recover qualifying environmental costs not already included in existing rates without having to either show that its existing rates are not fair, just, or reasonable or comply with the minimum filing requirements of 807 KAR 5:001, Section 10.

In discussing the rate-making procedure under KRS Chapter 278, the Supreme Court stated as follows:

Prior to 1992, a utility could increase its rates only pursuant to the Fuel Adjustment Clause or as a general rate case. A general rate case pursuant to KRS 278.190 is a lengthy procedure in which a new base rate is approved only after thorough examination of all operations and costs by the PSC. In 1992, the General Assembly enacted the statute involved in this case [KRS 278.183] which allows utilities to use Kentucky coal and collect the costs of cleaning high sulfur coal. The effect is that the statute provides an alternate procedure to increasing the base rate by allowing utilities to recover the costs of environmental compliance by

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means of a surcharge rather than by opening a general rate case.

Id. at 496-497. The General Assembly has similarly authorized limited alternative procedures to a general rate case for a utility to recover certain specified costs, such as: wholesale increases in water and sewage costs (KRS 278.012); the Commission's annual assessment and consultant costs (KRS 278.130); and demand-side management costs (KRS 278.285). However, no such statutory authorization exists for the recovery of MISO costs absent a general rate case.

The Commission agrees in principle with the argument of LG&E and KU that, under KRS 278.030(1), we possess broad implied authority to adopt rate surcharges if they are found to be 'fair, just and reasonable.' However, absent specific statutory authorization, the Commission can only exercise its authority to adopt rate surcharges in the context of a general rate case.

***4** The Commission further finds that neither the arguments raised nor the Commission cases cited by LG&E and KU are controlling or persuasive. A utility's compliance with the Commission's tariff regulation, 807 KAR 5:006, does not obviate the need to comply with all other applicable regulations. Absent compliance by LG&E and KU with 807 KAR 5:001, the Commission has no evidence to determine whether the existing rates are fair, just, and reasonable, or whether the proposed rates are fair, just, and reasonable. Such a determination by the Commission of 'fair, just and reasonable' rates is mandated by KRS 278.030(1). The expedited recovery of fuel costs under a fuel adjustment clause is specifically authorized by Administrative Regulation 807 KAR 5:056. An administrative regulation, once properly enacted, has the force of law. See Union Light, Heat & Power Co. v. Public Service Comm'n., Ky., 271 S.W.2d 361, 366 (1954)('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.') While most gas utilities have adopted gas cost adjustment clauses, LG&E and KU have cited no instance where such an ongoing clause was initiated outside of a general rate case where all the utility's revenues and expenses were subject to investigation and review.

Reliance by LG&E and KU on prior Commission cases involving incentive rates or performance-based tariffs is similarly misplaced. Those innovative rate proposals were adopted to provide the utility with an incentive to reduce its costs and pass some of the savings to ratepayers. Here, the LG&E and KU proposals are intended to substantially increase rates, not reduce them. The Commission does acknowledge that certain findings in Case Nos. 1999-00046 [FN4] and 2001-00092 [FN5] regarding our rate-making authority may be overly broad when viewed in light of the Supreme Court's decision in the above-cited KIUC v. KU case. To the extent that our prior findings are inconsistent with those of the Court, our findings must yield. However, the Commission also recognizes that Case No. 1999-00046 was ultimately consolidated into a general rate application, and that Case No. 2001-00092 was a general rate case application that complied with 807 KAR 5:001, Section 10. Thus, regardless of the findings therein on our statutory authority, the proposed rates were reviewed in conjunction with general rate cases.

In conclusion, the Commission finds that there is no statutory authority for LG&E and KU to apply for a rate surcharge which is limited to a single issue, i.e., MISO revenues and expenses, without demonstrating that their existing rates are

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insufficient.

By Orders dated June 30, 2004 in Case Nos. 2003-00433 [FN6] and 2003- 00434, [FN7] new electric rates were approved for LG&E and KU as being 'fair, just and reasonable,' which is the statutory standard for rates under KRS 278.030(1). Absent compliance by LG&E and KU with the filing requirements set forth in 807 KAR 5:001, Section 10, the record is devoid of the evidence necessary for the Commission to determine whether their existing rates are no longer 'fair, just and reasonable,' and, if they are not, the amount of rate relief needed. Consequently, the pending rate applications must be dismissed for failure to comply with the filing requirements set forth in 807 KAR 5:001, Section 10.

***5** All parties have objected to the Commission's suggestion to incorporate these rate applications into the rehearing phase of last year's LG&E and KU rate cases, Case Nos. 2003-00433 and 2003-00434. The parties maintain that it would be improper and inappropriate to expand the scope of the existing issues in those cases to include the MISO rate surcharges. The Commission agrees and will not further pursue that suggestion.

Finally, as to the request by LG&E and KU for alternative relief in the form of accounting deferrals, the record is also devoid of any evidence to support those deferrals. In 2001, LG&E and KU filed a joint application for approval of accounting deferrals (i.e., cost capitalization and subsequent amortization) for over $200 million in expenses for a Workforce Transition Separation Program. [FN8] That application was supported by a showing that the estimated savings from the program would exceed the costs, and that the costs were more properly collected over an extended period of time to match the receipt of benefits by the ratepayers. In 1991, the Commission authorized LG&E to amortize, over a future period of time, some of its 1989 costs for an earlier workforce reduction. In authorizing that amortization, the Commission was persuaded by LG&E's showing of 'the material nature of the costs, the future benefits of downsizing which should be available to the ratepayers and shareholders of LG&E, and the matching of those benefits with the costs.' [FN9] Here, however, LG&E and KU have made no showing of net benefits, no showing that the costs are more properly recovered over some future period of time, no showing that the costs are of a material nature, and no showing that it has fully reflected the impact of the MISO energy market tariffs on off-system sales revenue. Consequently, their request for an accounting deferral should be denied. In the event that LG&E and KU chose to file a new application for an accounting deferral of MISO costs, the Commission will fully investigate and review that application on its merits.

IT IS THEREFORE ORDERED that:

1. The applications by LG&E and KU to establish rate surcharges for the recovery of MISO revenues and expenses are dismissed.

2. The requests by LG&E and KU to establish accounting deferrals for certain MISO revenues and expenses are denied.

Done at Frankfort, Kentucky, this 15th day of April, 2005.

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FOOTNOTES

FN1 Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company, and Case No. 2003- 00434, An Adjustment of the Electric rates, Terms and Conditions of Kentucky Utilities Company.

FN2 Direct Testimony of Kent W. Blake at 7.

FN3 Id.

FN4 Case No. 1999-00046, Delta Natural Gas Company, Inc. For an Experimental Alternative Regulation Plan.

FN5 Case No. 2001-00092, Adjustment of Gas Rates of The Union Light, Heat and Power Company.

FN6 Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company.

FN7 Case No. 2003-00434, An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company.

FN8 Case No. 2001-00169, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company For an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be Included in Earnings Sharing Mechanism Calculations.

FN9 Case No. 1990-00158, Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company (Order dated September 30, 1991 at 14).

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AN ACT relating to gas delivery systems and appliances.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

Section 1. KRS 234.175 is amended to read as follows:

(1) Domestic and commercial gas-consuming equipment and appliances shall not be installed unless their correctness as to design, construction, and performance is certified by:

(a) A nationally recognized testing agency adequately equipped and competent to perform such services evidenced by the attachment of its seal or label to such gas appliances. This agency shall be one which maintains a program of national inspection of production models of gas appliances, at least once each year on the manufacturer's premises;

(b) By the American Gas Association Laboratories, as evidenced by the attachment of its listing symbol or approval seal to gas appliances and a certificate or letter certifying approval under the above-mentioned requirements, or listing by Underwriters' Laboratories, Inc., shall be considered as constituting compliance with the provisions of this section, providing, that the manufacturer has approval and certification of same from the Department of Housing, Buildings and Construction.

(2) Equipment not subject to A.G.A. or laboratory inspection must have approval of the department of housing, buildings and construction.

(3) A person shall not install gas-consuming appliances, equipment, or other components of a gas delivery system unless the installation is made in accordance with the instructions of the manufacturer of the appliance, equipment, or component and in compliance with the applicable administrative regulations promulgated by the Department of Housing, Buildings and Construction.

(4) A person shall not alter, modify, maintain, or repair gas-consuming appliances, equipment, or other components of a gas delivery system unless the alteration,

modification, maintenance, or repair is made in accordance with the instructions of the manufacturer of the appliance, equipment, or component and in compliance with the applicable administrative regulations promulgated by the Department of Housing, Buildings and Construction.

(5) A person licensed under this chapter or an agent or employee of the person shall not be liable for civil damages for injury to persons or property that result from the installation, alteration, modification, maintenance, or repair of a gas-consuming appliance, equipment, or component by a person other than the licensee or the licensee's agent or employee.

(6) (a) Except as provided in paragraph (b) of this subsection, a person licensed under this chapter or the licensee's agent or employee who provides gas to an end user shall not be liable for civil damages for injury to persons or property that result from the installation, alteration, modification, maintenance, or repair of the gas-consuming appliance, equipment, or component if the installation, alteration, modification, maintenance, or repair is done without the actual knowledge and consent of the licensee or the licensee's agent or employee.

(b) A person licensed under this chapter or his or her agent or employee shall not be exempt from liability for civil damages under paragraph (a) of this subsection if the person or his or her agent or employee is negligent or acts intentionally, and the negligence or intentional act causes or partially causes injury or damage.

SECTION 2. A NEW SECTION OF KRS CHAPTER 278 IS CREATED TO READ AS FOLLOWS:

Notwithstanding any other provision of law to the contrary, upon application by a regulated utility, the commission may allow recovery of costs for investment in natural gas pipeline replacement programs which are not recovered in the existing rates of a

regulated utility. No recovery shall be allowed unless the costs shall have been deemed by the commission to be fair, just, and reasonable.

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Every person, including a minor, whether lawfully or unlawfully employed, in the service of an employer any contract of hire or apprenticeship, express or implied, and all helpers and assistants of employees, her paid by the employer or employee, if employed with the knowledge, actual or constructive, of the ployer;

(2) Every executive officer of a corporation;

(3) Every person in the service of the state or [~~of~~] any ***of its*** political ***subdivisions*** [~~subdivision~~] or ***agencies*** [~~agency thereof~~], or of any county, city of any class, school district, drainage district, tax district, public or quasi-public corporation or other political entity, under any contract of hire, express or implied, and every official or officer ***of those entities*** [~~thereof~~], whether elected or appointed, while performing his official duties ***shall be considered an employee of the state.*** Every person who is a member of a volunteer ambulance service, fire or police department shall be deemed for the purposes of this chapter, to be in the employment of the political subdivision of the state where the department is organized. Every person who is a regularly enrolled volunteer member or trainee of the civil defense corps of this state, as established under KRS Chapter 39, shall be deemed for the purposes of this chapter, to be in the employment of this state. Every person who is a member of the Kentucky National Guard, while ***the*** [~~said~~] person is on [~~active~~] state ***active duty*** [~~service~~] as defined in KRS 38.010(4), shall be deemed for the purposes of this chapter to be in the employment of this state;

(4) Every person performing service in the course of the trade, business, profession, or occupation of an employer at the time of the injury; and

(5) Subject to the provisions in subsection (4) of this section, every person regularly selling or distributing newspapers on the street or to customers at their homes or places of business. For the purposes of this chapter, ***the*** [~~such a~~] person shall be deemed an employee of an independent news agency for whom he is selling or distributing newspapers, or, in the absence of ***an*** [~~such~~] independent agency, of each publisher whose newspapers he sells or distributes.

Section 12. Whereas personnel and units of the Kentucky National Guard are frequently ordered to plan and perform state active duty missions, such as flood relief, tornado assistance, or Kentucky Derby crowd control; and, whereas the need for personnel and units of the National Guard to perform state active duty missions has traditionally been greatest during the months April through June; and, whereas this Act provides vital clarification of the authorization of state active duty as well as other benefits, and emergency is declared to exist, and this Act shall become effective upon its passage and approval by the Governor.

Approved April 9, 1992

CHAPTER 308

(SB 335)

AN ACT relating to utilities.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 278 IS CREATED TO READ AS FOLLOWS:

(1) For the purpose of justifying the reasonableness of a proposed general increase in rates, the ommission shall allow a utility to utilize either an historical test period of twelve (12) consecutive calendar nonths, or a forward-looking test period corresponding to the first twelve (12) consecutive calendar months he proposed increase would be in effect after the maximum suspension provided in KRS 278.190(2).

(2) (a) Any application utilizing a forward-looking test period shall include a base period to be filed ith the application, which begins not more than nine (9) months prior to the date of filing, consisting not less than six (6) months of actual historical data and not more than six (6) months of estimated ta at the time of filing.

(b) Actual results for the estimated months of the base period shall be filed no later than forty-five 5) days after the last day of the base period.

(c) Upon the filing of an application for a proposed increase in rates based on either a historical or ward-looking test period, any intervening party in opposition to such application shall have the right mine all data, including individual invoices, which comprise the actual expenditures of the utility incurred ratemaking purposes for the preceding twelve (12) month period immediately prior to the filing date.

Section 2. KRS 278.190 is amended to read as follows:

(1) Every person, including a minor, whether lawfully or unlawfully employed, in the service of an employer under any contract of hire or apprenticeship, express or implied, and all helpers and assistants of employees, whether paid by the employer or employee, if employed with the knowledge, actual or constructive, of the employer;

(2) Every executive officer of a corporation;

(3) Every person in the service of the state or [of] any *of its* political *subdivisions* [subdivision] or *agencies* [agency thereof], or of any county, city of any class, school district, drainage district, tax district, public or quasi-public corporation or other political entity, under any contract of hire, express or implied, and every official or officer *of those entities* [thereof], whether elected or appointed, while performing his official duties ***shall be considered an employee of the state.*** Every person who is a member of a volunteer ambulance service, fire or police department shall be deemed for the purposes of this chapter, to be in the employment of the political subdivision of the state where the department is organized. Every person who is a regularly enrolled volunteer member or trainee of the civil defense corps of this state, as established under KRS Chapter 39, shall be deemed for the purposes of this chapter, to be in the employment of this state. Every person who is a member of the Kentucky National Guard, while *the* [said] person is on [active] state *active duty* [service] as defined in KRS 38.010(4), shall be deemed for the purposes of this chapter to be in the employment of this state;

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CHAPTER 308

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(2) (a) Any application utilizing a forward-looking test period shall include a base period to be filed with the application, which begins not more than nine (9) months prior to the date of filing, consisting of not less than six (6) months of actual historical data and not more than six (6) months of estimated data at the time of filing.

(b) Actual results for the estimated months of the base period shall be filed no later than forty-five (45) days after the last day of the base period.

(c) Upon the filing of an application for a proposed increase in rates based on either a historical or a forward-looking test period, any intervening party in opposition to such application shall have the right to examine all data, including individual invoices, which comprise the actual expenditures of the utility incurred for ratemaking purposes for the preceding twelve (12) month period immediately prior to the filing date.

Section 2. KRS 278.190 is amended to read as follows:

(1) Whenever any utility files with the commission any schedule stating new rates, the commission may upon its own motion, or upon complaint as provided in KRS 278.260, and upon reasonable notice, hold a hearing concerning the reasonableness of the new rates.

(2) Pending *the* [~~such~~] hearing and the decision thereon, and after notice to the utility, the commission may, at any time before *the* [~~said~~] schedule becomes effective, suspend the operation of *the* [~~said~~] schedule and defer the use of *the* [~~such~~] rate, charge, classification or service, but not for a longer period than five (5) months beyond the time when it would otherwise go into effect *if an historical test period is used, or longer than six (6) months if a forward-looking test period is used, pursuant to Section 1 of this Act*; and after such hearing, either completed before or after the rate, charge, classification or service goes into effect, the commission may make *those* [~~such~~] orders with reference thereto as it deems proper in the matter. If the proceeding has not been concluded and an order made at the expiration of [~~such~~] five (5) months, *or six (6) months, as appropriate,* the utility may place the proposed change of rate, charge, classification or service in effect at the end of *that* [~~such~~] period after notifying the commission, in writing, of its intention so to do. Where increased rates or charges are thus made effective, the commission may, by order, require the interested utility or utilities to maintain their records in *a* [~~such~~] manner as will enable them, or the commission, or any of its customers, to determine the amounts to be refunded and to whom due in the event a refund is ordered, and upon completion of the hearing and decision may, by further order, require such utility or utilities to refund to the persons in whose behalf *the* [~~such~~] amounts were paid *that* [~~such~~] portion of *the* [~~such~~] increased rates or charges as by its decision shall be found unreasonable. Provided, however, if the commission, at any time, during *the* [~~said five (5) months'~~] suspension period, finds that the company's credit or operations will be materially impaired or damaged by the failure to permit *the* [~~said~~] rates to become effective during *the* [~~said five (5) months'~~] period, *the* [~~said~~] commission may, after any hearing or hearings, permit all or a portion of *the* [~~said~~] rates to become effective under [~~such~~] terms and conditions as the commission may, by order, prescribe.

(3) At any hearing involving the rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility and the commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible, and in any event not later than ten (10) months after the filing of such schedules.

(4) *If* [~~In the event~~] the commission, by order, directs any utility to make a refund, as hereinabove provided, of all or any portion of *the* [~~such~~] increased rates or charges, the utility shall make the *refund* [~~same~~] within sixty (60) days after a final determination of the proceeding by an order of the court or commission with or without interest in the discretion of the commission. If the utility fails to make *the* [~~such~~] refund within sixty (60) days after *the* [~~such~~] final determination, any party entitled to *a* [~~such~~] refund may, after ten (10) days' written demand, bring an action [~~therefor~~] in any court of competent jurisdiction of this state, and may recover, in addition to the amount of the refund due, legal interest, court costs and reasonable attorney's fees. No such action may be maintained unless instituted within one (1) year after *the* [~~such~~] final determination. Any number of persons entitled to [~~such~~] refunds may join in as plaintiffs in a single action and the court shall render a judgment severally for each plaintiff as his interest may appear.

Approved April 9, 1992

CHAPTER 309

(SB 337)

AN ACT relating to public health.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 223 IS CREATED TO READ AS FOLLOWS:

(1) The General Assembly finds and declares that because of continuous introduction of new technology and changing concepts in environmental health, it is essential that an environmental health specialist undertake a program of continuing education to maintain professional competency.

(2) Effective July 1, 1993, no environmental health specialist's registration will be renewed until the registrant has submitted proof that shows satisfactory completion, in the previous year, of a continuing education program acceptable to the cabinet. These continuing education requirements shall be determined by administrative regulation of the cabinet.

(3) The cabinet shall promulgate administrative regulations pursuant to KRS Chapter 13A to carry out the provisions of this section, including guidelines and methods for reviewing and approving continuing education.

CHAPTER 102

(SB 341)

AN ACT relating to utilities.

WHEREAS, it is hereby declared the policy of the General Assembly to foster and encourage the continued use of Kentucky coal by electric utilities serving the Commonwealth; and

WHEREAS, electric utilities should have incentive to use Kentucky coal in deciding how to best achieve and maintain compliance with the federal Clean Air Act as amended and those environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal;

NOW, THEREFORE,

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 278 IS CREATED TO READ AS FOLLOWS:

(1) Notwithstanding any other provision of this chapter, effective January 1, 1993, a utility shall be entitled to the current recovery of its costs of complying with the federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal in accordance with the utility's compliance plan as designated in subsection (2) of this section. These costs shall include a reasonable return on construction and other capital expenditures and reasonable operating expenses for any plant, equipment, property, facility, or other action to be used to comply with applicable environmental requirements set forth in this section. Operating expenses include all costs of operating and maintaining environmental facilities, income taxes, property taxes, other applicable taxes, and depreciation expenses as these expenses relate to compliance with the environmental requirements set forth in this section.

(2) Recovery of costs pursuant to subsection (1) of this section that are not already included in existing rates shall be by environmental surcharge to existing rates imposed as a positive or negative adjustment [illegible]stomer bills in the second month following the month in which costs are incurred. Each utility, before initially imposing an environmental surcharge pursuant to this subsection, shall thirty (30) days in advance file a notice of intent to file said plan and subsequently submit to the commission a plan, including any application required by KRS 278.020(1), for complying with the applicable environmental requirements set forth in subsection (1) of this section. The plan shall include the utility's testimony concerning a reasonable return on compliance-related capital expenditures and a tariff addition containing the terms and conditions of a proposed surcharge as applied to individual rate classes. Within six (6) months of submittal, the commission shall conduct a hearing to:

(a) Consider and approve the plan and rate surcharge if the commission finds the plan and rate surcharge reasonable and cost-effective for compliance with the applicable environmental requirements set forth in subsection (1) of this section;

(b) Establish a reasonable return on compliance-related capital expenditures; and

(c) Approve the application of the surcharge.

(3) The amount of the monthly environmental surcharge shall be filed with the commission ten (10) days before it is scheduled to go into effect, along with supporting data to justify the amount of the surcharge which shall include data and information as may be required by the commission. At six (6) month intervals, the commission shall review past operations of the environmental surcharge of each utility, and after hearing, as ordered, shall, by temporary adjustment in the surcharge, disallow any surcharge amounts found not just and reasonable and reconcile past surcharges with actual costs recoverable pursuant to subsection (1) of this section. Every two (2) years the commission shall review and evaluate past operation of the surcharge, and after hearing, as ordered, shall disallow improper expenses, and to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of each utility.

(4) The commission may employ competent, qualified independent consultants to assist the commission in its review of the utility's plan of compliance as specified in subsection (2) of this section. The cost of any consultant shall be included in the surcharge approved by the commission.

(5) The commission shall retain all jurisdiction granted by Sections 1 and 2 of this Act to review the environmental surcharge authorized by this section and any complaints as to the amount of any environmental surcharge or the incorporation of any environmental surcharge into the existing base rate of any utility.

Section 2. KRS 278.020 is amended to read as follows:

(1) No person, partnership, public or private corporation or combination thereof shall begin the construction of any plant, equipment, property or facility for furnishing to the public any of the services enumerated in KRS 278.010, except retail electric suppliers for service connections to electric-consuming facilities located within its certified territory and ordinary extensions of existing systems in the usual course of business, until such person has obtained from the Public Service Commission a certificate that public convenience and necessity require such construction. Upon the filing of an application for such a certificate, and after any public hearing which the commission may in its discretion conduct for all interested parties, the commission may issue or refuse to issue the certificate, or issue it in part and refuse it in part, except that the commission shall not refuse or modify an application submitted under KRS 278.023 without consent by the parties to the agreement. ***The commission, when considering an application for a certificate to construct a base load electric generating facility, may consider the policy of the General Assembly to foster and encourage use of Kentucky coal by electric utilities serving the Commonwealth.*** Unless exercised within one (1) year from the grant thereof, exclusive of any delay due to the order of any court or failure to obtain any necessary grant or consent, the authority conferred by the issuance of the certificate of convenience and necessity shall be void, but the beginning of any new construction or facility in good faith within the time prescribed by the commission and the prosecution thereof with reasonable diligence shall constitute an exercise of authority under the certificate.

(2) No utility shall exercise any right or privilege under any franchise or permit, after the exercise of that right or privilege has been voluntarily suspended or discontinued for more than one (1) year, without first obtaining from the commission, in the manner provided in subsection (1) of this section, a certificate of convenience and necessity authorizing the exercise of that right or privilege.

(3) No utility shall apply for or obtain any franchise, license or permit from any city or other governmental agency until it has obtained from the commission, in the manner provided in subsection (1) of this section, a certificate of convenience and necessity showing that there is a demand and need for the service sought to be rendered.

(4) No person under the jurisdiction of the commission shall acquire or transfer ownership of or control, or the right to control, any utility, by sale of assets, transfer of stock or otherwise, or abandon the same, without prior approval by the commission. The commission shall grant its approval if the person acquiring the utility has the financial, technical, and managerial abilities to provide reasonable service.

(5) No individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust or other entity (an "acquirer"), whether or not organized under the laws of this state, shall acquire control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission. Any such acquisition of control without such prior authorization shall be void and of no effect. As used in this subsection, the term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a utility, whether through the ownership of voting securities, by effecting a change in the composition of the board of directors, by contract or otherwise. Control shall be presumed to exist if any such individual or entity, directly or indirectly, owns ten percent (10%) or more of the voting securities of the utility. This presumption may be rebutted by a showing that such ownership does not in fact confer control. Application for any such approval or authorization shall be made to the commission in writing, verified by oath or affirmation, and be in such form and contain such information as the commission requires. The commission shall approve any such proposed acquisition when it finds that the same is to be made in accordance with law, for a proper purpose and is consistent with the public interest. The commission may make such investigation and hold such hearings in the matter as it deems necessary, and thereafter may grant any application under this subsection in whole or in part and with such modification and upon such terms and conditions as it deems necessary or appropriate. The commission shall grant, modify, refuse or prescribe appropriate terms and conditions with respect to every such application within sixty (60) days after the filing of the application therefor or on a later date mutually acceptable to the commission and the acquirer. In the absence of any such action within such period of time, any such proposed acquisition shall be deemed to be approved.

(6) Subsection (5) of this section shall not apply to any acquisition of control of any:

(a) Utility which derives a greater percentage of its gross revenue from business in another jurisdiction than from business in this state if the commission determines that the other jurisdiction has statutes or rules which are applicable and are being applied and which afford protection to ratepayers in this state substantially equal to that afforded such ratepayers by subsection (5) of this section;

(b) Utility by an acquirer who directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such utility, including any entity created at the direction of such utility for purposes of corporate reorganization; or

(c) Utility pursuant to the terms of any indebtedness of the utility, provided the issuance of such indebtedness was approved by the commission.

(7) If any provision of this section or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of this section which can be given effect without the invalid provision or application, and to that end the provisions are declared to be severable.

Approved March 27, 1992

CHAPTER 103

(SB 35)

AN ACT relating to creation of the Kentucky Long-Term Policy Research Center, and making an appropriation therefor.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. KRS CHAPTER 7B IS ESTABLISHED AND A NEW SECTION THEREOF IS CREATED TO READ AS FOLLOWS:

The General Assembly finds and declares that:

(1) The growing complexity and interdependence of the modern world, demonstrated by such issues as global environmental change, changing workforce development needs, the aging population, international trade, the number of working poor, the need for improved access to health care, and the emergence of fundamental changes in the role of government, require that government decision-makers consider the long-term changes affecting the welfare of the Commonwealth of Kentucky and bring these factors to bear upon public policy;

(2) There is a need to coordinate state government's information resources to provide a systematic and comprehensive use of that information to guide policymakers concerning critical trends and alternative futures;

(3) To effect a prosperous future for the Commonwealth and its citizens, it is necessary for changes to occur in the way decisions are made in government so policymakers can consider the long-term implications of decisions and address emerging issues so the Commonwealth can take advantage of opportunities, avoid problems, and provide for continuity in policy; and

(4) It is necessary to establish mechanisms to bring all perspectives into the decision-making process to evaluate information, focus attention on areas in which information is inadequate, and identify critical trends and alternative futures based upon the best available information.

SECTION 2. A NEW SECTION OF KRS CHAPTER 7B IS CREATED TO READ AS FOLLOWS:

(1) The Kentucky Long-Term Policy Research Center is hereby established. The center shall be governed by a board with representation from the executive and legislative branches of state government and the private and civic sectors, universities, and local governments.

(2) The center shall be an agency and instrumentality of the Kentucky General Assembly.

(3) The board shall employ and fix the compensation of an executive director who shall be its secretary and principal executive officer.

SECTION 3. A NEW SECTION OF KRS CHAPTER 7B IS CREATED TO READ AS FOLLOWS:

(1) The board of the Kentucky Long-Term Policy Research Center shall consist of twenty-one (21) members, including ten (10) members selected from state government and eleven (11) at-large members selected from the private and civic sectors, universities, and local governments.

(a) State government members shall be appointed as follows:

1. Three (3) members of the House of Representatives and three (3) members of the Senate shall be appointed by the Legislative Research Commission; and

2. Four (4) members from the executive branch shall be appointed by the Governor.

(b) At-large members shall be appointed as follows:

all formal hearings shall be given at least twenty (20) days prior to the hearing date. All other pleadings, including discovery, filed by the Attorney General or the defendant licensee shall show that a copy has been furnished to the opposing party or parties. Witnesses may be subpoenaed and, with the exception of the Attorney General, the party requesting a subpoena shall pay the cost thereof. A court stenographer may be present at a formal hearing and the costs, including costs for a transcript, shall be paid by the requesting party.

(3) The licensee shall have the opportunity to be heard in person and by counsel in reference to the complaint filed. The hearing on the complaint shall be at a time and place prescribed by the Attorney General.

(4) All hearings shall be conducted by a hearing officer appointed by the Attorney General who shall preside at the hearing and cause a record of the hearing to be prepared. The hearing officer shall prepare a report with recommended findings of fact and conclusions of law for submission to the Attorney General. The report shall be subject to revision by the Attorney General.

(5) If the Attorney General determines that any licensee is guilty of a violation of any of the provisions of KRS 367.932 to 367.974, the license shall be denied, suspended, or revoked or fines imposed. The Attorney General shall furnish the licensee with a definite statement of his findings of facts and his reason or reasons for denial, suspension, or revocation of the rights of the licensee or imposition of fines as the case may be. The findings of fact shall, if supported by substantial evidence, be conclusive, but any person aggrieved shall have the right of an appeal within thirty (30) days after the entry of the order of suspension or revocation and shall do so by filing with the Franklin Circuit Court within the thirty (30) day period.

(6) Any party aggrieved by the action of the Attorney General in denying, suspending, or revoking a license or imposing fines may file in the office of the clerk of the Franklin Circuit Court an attested copy of the proceedings before the Attorney General, provided the aggrieved party shall first post a bond to secure the costs of the action in a sum approved by the clerk of the Circuit Court, with good and solvent surety. The Attorney General shall be a necessary party to all appeals. The Circuit Court clerk shall then docket the case and shall immediately issue a summons for the Attorney General.

Section 6. KRS 367.972 is amended to read as follows:

(1) All of the remedies, powers, and the duties provided for the Attorney General by KRS 367.190 to 367.300 and 367.990 pertaining to acts declared unlawful by KRS 367.170 shall apply with equal force and effect to acts declared unlawful by KRS 367.932 to 367.974 and 367.991 and the pre-need funeral laws existing prior to KRS 367.932 to 367.974 and 367.991.

(2) Nothing in KRS 367.932 to 367.974 and 367.991 shall be construed to limit or restrict the exercise of powers or the performance of the duties of the Attorney General which he is authorized to exercise or perform under any other provision of law *including direct court action to obtain injunctive relief and revocation of license*. The Attorney General has the power to establish such rules and regulations as are necessary to carry out these provisions.

Approved April 9, 1992

CHAPTER 306

(SB 323)

AN ACT relating to telecommunications.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 278 IS CREATED TO READ AS FOLLOWS:

(1) The legislature finds and determines that:

(a) Competition and innovation have become commonplace in the provision of certain telecommunications services in Kentucky and the United States;

(b) Flexibility in the regulation of the rates of providers of telecommunications service is essential to the well-being of this state, its economy, and its citizens; and

(c) The public interest requires that the Public Service Commission be authorized and encouraged to formulate and adopt rules and policies that will permit the commission, in the exercise of its expertise, to regulate and control the provision of telecommunications services to the public in a changing environment, giving due regard to the interests of consumers, the public, the providers of the telecommunications services, and the continued availability of good telecommunications service.

ATTACHMENT B

Recommendation - BR should Unwind for the following reasons: (continued)

- **While there are risks, BREC has negotiated compensation with those in mind.**
  - **BREC is developing an ERM program to prudently manage the organization & minimize risk.**
- **The worst that is likely to happen in the Unwind is that rates will go up.**
  - **In the existing transaction, the worst that can happen is BREC is obliterated through bankruptcy due to its inability to respond to some unanticipated financial and/or legal event.**