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November 13, 2009

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PUBLIC SERVICE COMMISSION

VIA HAND DELIVERY

Jeff DeRouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RE: ***Louisville Gas and Electric Company and Kentucky Utilities Company 2009 Application for Approval of Purchased Power Agreements and Recovery of Associated Costs***
Case No. 2009-00353

Dear Mr. DeRouen:

Enclosed please find and accept for filing the original and ten copies of Louisville Gas and Electric Company's and Kentucky Utilities Company's Response to Joint Motion to Reconsider in the above-referenced matter. Please confirm your receipt of this filing by placing the stamp of your Office with the date received on the enclosed additional copies and return them to me in the enclosed self-addressed stamped envelope.

Should you have any questions, please do not hesitate to contact me.

Yours very truly,

Kendrick R. Riggs

KRR:ec
Enclosures
cc: Parties of Record

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In re the Matter of:

LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY 2009 APPLICATION FOR APPROVAL OF PURCHASED POWER AGREEMENTS AND RECOVERY OF ASSOCIATED COSTS	))))))	**CASE NO. 2009-00353**

RESPONSE OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY TO JOINT MOTION TO RECONSIDER

Louisville Gas and Electric Company and Kentucky Utilities Company (collectively, the "Companies"), for their Response to the Joint Motion of the Attorney General of Kentucky ("AG") and Kentucky Industrial Utility Customers, Inc. ("KIUC") (collectively, the "Movants"), state as follows:

Introduction

On November 10, 2009, the Movants requested reconsideration of those portions of the Commission's October 21, 2009 Order in this case (the "October 21 Order") indicating that the Public Service Commission ("Commission") has authority to authorize a surcharge in a general rate case on two grounds: (1) that the Court of Appeals in *Kentucky Public Service Commission and Duke Energy Kentucky Inc., f/k/a The Union Light, Heat and Power Company, v. Commonwealth of Kentucky, ex rel. Greg Stumbo*, Case No. 2007-CA-001635-MR (Ky. App., November 7, 2008)[1] made no distinction between surcharges authorized in a general rate case and those authorized outside a general rate case [Attorney General of Commonwealth of

[1] Discretionary Review by the Kentucky Supreme Court has been granted. *See* 2009-SC-000134; 2009-SC-000150. The Commission and Duke Energy of Kentucky filed their briefs with the Kentucky Supreme Court. The Attorney General's brief has not yet been filed.

Kentucky and KIUC's Joint Motion to Reconsider ("Joint Motion"), at 2]; and (2) that the court in *Stumbo* held that, without exception, "as a matter of law, ... the PSC cannot authorize surcharges without specific statutory authorization" [Joint Motion at 2].

Movants assert that because the Court of Appeals has drawn no legal distinction between surcharges set within full KRS 278.190 rate cases and surcharges set independently of such cases, the Commission lacks the authority to set any surcharge. The Companies absolutely disagree with that conclusion. Instead, because the Court of Appeals has drawn no legal distinction between surcharges set within full KRS 278.190 rate cases and those set independently of such cases, the Companies assert that, as a matter of law, the procedural vehicle chosen by the Commission to set a surcharge is not limited by the *Stumbo* analysis. The actual holding of *Stumbo,* Slip Op. at 12, is that "[w]e conclude that the PSC cannot authorize the imposition of a surcharge ***for the main replacement program proposed by Duke*** without specific statutory authorization." (Emphasis added.) To be sure, there is sufficient uncertainty as to the ultimate parameters of the court's holding to justify the Commission in filing a petition for discretionary review and to justify the Kentucky's Supreme Court in granting that petition; but there is no uncertainty here. The Court of Appeals in *Stumbo* drew a very specific exception to general statutory rule it declared, declaring that when the "subject of the rate increase [is] not amenable to review via a general rate increase ... to set a 'fair, just, and reasonable' rate required by statute, the "courts have held the authority to approve such rates ***outside the general rate procedure*** to be within the regulatory commission's implied authority." *Stumbo,* Slip Op. at 11 (emphasis added). The exception thus drawn, and as further described in *Stumbo,* fits the surcharge proposed in this case, both procedurally and substantively, like a glove.

Argument

I. THE *STUMBO* DECISION DID NOT PROHIBIT ALL SURCHARGES FOR WHICH THERE IS NO EXPLICIT STATUTORY AUTHORITY.

The Court of Appeals in *Stumbo* did not prohibit all surcharges for which there is no explicit statutory authorization, as Movants inexplicably assert. Instead, the Court of Appeals ruled that "specific statutory authorization" is required for a surcharge that includes a rate of return for a "pending long-term capital improvement" such as Duke Energy of Kentucky's gas main replacement program. *Stumbo,* Slip Op. at 12. The court's discussion pertaining to long-term capital improvements does not apply to the Companies' proposed surcharge to recover the costs of their agreements to purchase energy from wind farms located in LaSalle County, Illinois (the "Wind Power Contracts"). The rationale that *does* apply to the Wind Power Contracts appears elsewhere on page 12 of *Stumbo,* where the Court of Appeals accepted the legality of the fuel adjustment clause and contrasted it to the gas main replacement program at issue, which involves a capital expenditure that is "amenable to the test-year review concept to be followed in a general rate case" and a "replacement cost to be considered in a general rate increase case." *Id.* The long-term capital improvement program for which explicit statutory authorization was required was explicitly found by the court to be "*unlike* a fuel adjustment clause that permits the utility to pass the fluctuating fuel prices to its customers but from which it makes no additional profit." *Id.* (Emphasis added.)

Substitute the words "wind energy" for "fuel" in that sentence, and it describes the tracking mechanism proposed here. Both the fuel adjustment surcharge and the proposed wind energy surcharge are unlike gas main replacement programs that are amenable to review in a general rate case. Both pass on "fluctuating" costs. Neither provides any "additional profit."

Furthermore, neither has explicit statutory authorization, and neither can reasonably be affected by other considerations at issue in setting base rates.

Movants' contention that the surcharge proposed in this case is subject to the reasoning applied to long-term capital improvement program at issue in *Stumbo,* rather than to the reasoning applied in that same opinion to fluctuating cost adjustments that include no return on equity, must be rejected.

II. A FULL-BLOWN RATE CASE PURSUANT TO KRS 278.190 IS NOT A PROCEDURAL, SUBSTANTIVE, LEGAL OR LOGICAL PREREQUISITE TO APPROVAL OF THE SURCHARGE SOUGHT HEREIN.

The Commission has discretion to use the procedures it believes are reasonable, based on the facts before it. The Commission's decision to limit its own statutory authority to the procedural means specified in KRS 278.190 is erroneous in at least four basic ways: [1] KRS 278.190 is a procedural statute rather than a substantive one; [2] KRS 278.190 is permissive rather than mandatory, providing only that, when a "schedule stating new rates" (in the *plural*) is filed, the Commission "*may*" suspend it and institute certain proceedings; [3] Declaring KRS 278.190 to be the sole procedural method available to change a rate fails to take KRS 278.180 into account at all;[2] and [4] In focusing restrictively on KRS 278.190 rather than on the substantive standard for ratemaking -- KRS 278.030's "fair, just and reasonable" standard -- the Commission unnecessarily deprives *itself* of discretion to employ a different procedure if the ultimate goal of KRS 278.030 reasonably requires it. Indeed, if the Commission refuses to reconsider its KRS 278.190 requirement in this case pursuant to the Companies' request, it will

[2] KRS 278.180, in contrast to KRS 278.190, which pertains to a "schedule" of 'rates," allows new "rates" (plural) or a new "rate" (singular) to go into effect upon thirty days' notice (or less) and the filing of a tariff. If the Commission does not suspend the rate pursuant to KRS 278.190, as it "may" do, then the new rate is effective without any required detailed review at all. There is no requirement that KRS 278.190 procedures be applied. Indeed, there is no reference to KRS 278.190 in KRS 278.180 *at all.* KRS 278.180 is made a nullity by a ruling indicating that a full-blown rate case pursuant to KRS 278.190 and its implementing regulations is the sole way to change or implement any single rate.

forego the sound opportunity to explore whether the surcharge was in fact "fair, just and reasonable."

Substance and not procedure ultimately governs rate making, as the court held in *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 511 (Ky. App. 1990)(the "ultimate resulting rate should be a more important consideration than some specific, mandated method for determining it"). The Commission must be able to determine the best method of reaching the statutory "fair, just and reasonable" goal in the reasonable exercise of its discretion and should not limit its options for doing so

As Kentucky's highest court explained in *Ashland-Boyd County City-County Health Dept. v. Riggs,* 252 S.W.2d 922, 923 (Ky. 1952), "Powers of administrative boards and agencies are those conferred expressly or by necessary or fair implication.... It is a general principle of law that where the end is required, the appropriate means are implied." Here, the required end is a "just and reasonable rate." Absent specific statutory limitation, the appropriate "means" to that end are left to the Commission.[3] But KRS 278.190, by its own terms, is discretionary. Thus,

[3] Kentucky cases upholding the doctrine of necessarily implied authority are legion. Examples include the following: *County of Harlan v. Appalachian Regional Healthcare, Inc.*, 85 S.W.3d 607, 611 (Ky. 2002) (Requiring the Harlan County jailer to take necessary steps to seek indigency determinations for medical treatment of inmates, although the statute did not expressly state that he had this duty, because "[t]he power granted by a statute is not limited to that which is expressly conferred but also includes that which is necessary to accomplish the things which are expressly authorized." The jailer thus had "a duty to take the necessary steps to seek an indigency" because otherwise the intent of the legislature to provide for medical treatment for indigents would be frustrated); *Chandler v. Strong,* 70 S.W.3d 405, 410 (Ky. 2002) (Attorney General had necessarily implied authority to view otherwise confidential records as part of a statutory mandate to investigate, because "[i]t is well recognized that a statute naturally carries with it all the powers necessary to its exercise." *Id.* at 410.); *Bd. of Educ. of Boyd Co. v. Trustees of Buena Vista School,* 76 S.W.2d 267, 268 (1934) (the scope of a public officer's powers includes not only those expressly defined by statute, as "such statutes seldom, if ever, define with precise accuracy the full scope of such powers," but also those "supplemental and collateral" powers necessary to accomplish the statutory purpose of the office); *Humana of Kentucky, Inc. v. NKC Hospitals, Inc.*, 751 S.W.2d 369, 372-73 (Ky. 1988) ("...administrative agencies are held to possess the powers reasonably necessary and fairly appropriate to make effective the express powers granted to or duties imposed on them") (internal citations and quotations omitted); *Jefferson County v. Jefferson County Fiscal Court,* 192 S.W.2d 185 (Ky. 1946) (holding that the county court did, in fact, have authority to spend money to pay commissioners to assist, and pay for newspaper publication, when it carried out its statutory duty to change precinct boundaries, even though no permission to spend the money was specifically given, because these powers were "necessarily implied" as part of the county court's statutory duties); *Dodge v. Jefferson County Board of Educ.*, 181 S.W.2d 406, 407 (Ky. 1944) (Deciding that School Board could set aside money for recreation

the question before the Commission here is whether it is *reasonable* to consider the proposed surcharge outside the context of a general rate case, not whether the Commission is *permitted by law* to consider the proposed surcharge outside the context of a general rate case.

The Companies submit that consideration outside the context of a general rate case of the surcharge proposed here is not only reasonable but is necessary in the public interest. The Wind Energy Contracts will be, of necessity, withdrawn otherwise, and the opportunity for the Commonwealth, the Companies, and the ratepayers to begin adapting to the all-but-inevitable federal renewable portfolio standards will be lost. On a more practical note, the costs to be recovered are irrelevant to base rate case considerations. No return on equity is sought; and so volatile a cost has no place in base rates. Even if the surcharge were proposed as part of a KRS 278.190 base rate case, it would be as a wholly separate issue. The Companies have made these arguments in greater detail in their previous filings in this case, and will not repeat them here.

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for school age children, and explaining that "The power and authority granted by a statute is not always limited to that which is specifically conferred, but includes that which is necessarily implied as incident to the accomplishment of those things which are expressly authorized"); *Long v. Mayo,* 111 S.W.2d 633 (Ky. 1937) (Kentucky Highway department was authorized to issue bonds and purchase capital stock of bridge company to end public payment of tolls; the court found no express authority for such a procedure, *id.* at 638, but noted that "It is an accepted rule recognized often by this court that not only those powers expressly granted by the statute, but such powers as are necessarily or fairly implied in, or incident to, the accomplishment of the things which are expressly authorized to be done." *Id.* Accordingly, "the department of highways has the implied power to pay the railway company.... The only purpose of [the statute] was to abolish toll bridges.... The agreement attacked here by appellant is but a logical step for the accomplishment of that purpose." *Id.*); *Johnston v. Louisville,* 11 Bush 527, 74 Ky. 527 (Ky. 1875) (A municipal corporation possesses both express powers and those that are necessarily implied from, or incident to, those expressly granted).

Public Service Comm'n v. Cities of Southgate and Highland Heights, 268 S.W.2d 19 (Ky. 1954) illustrates the strength of the doctrine of necessarily implied power with relation to the important mission with which the General Assembly has entrusted the Commission. Although there was no statute at that time giving the Commission explicit authority to approve or to deny a transfer of ownership of a utility, the Court held that such jurisdiction was necessarily implied:

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

Id. at 21 (emphasis added).

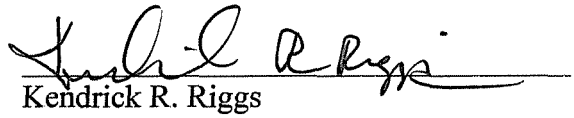
However, the Companies urge the Commission not to surrender its authority to determine fair, just and reasonable rates pursuant to the most reasonable procedural means available. The procedural limitations the Commission has imposed upon itself, in this instance, exceed those imposed by *Stumbo*. (Even the KIUC and the Attorney General, agree that the Court of Appeals did not distinguish between surcharges based on whether they were set in base rate cases.) The Companies submit that not only did the court draw no such distinction; more importantly, it positively declared that rates that are not amenable to general rate case review, such as the volatile and fluctuating cost recovery mechanism at issue here, may be approved "outside the general rate procedure." *Stumbo,* Slip Op. at 11.

Conclusion

For the foregoing reasons, although the Movants correctly state that the Court of Appeals in *Stumbo* drew no distinction between surcharges set in base rates and those set outside that context, Movants draw precisely the wrong conclusion. Accordingly, the Companies respectfully request that the Joint Motion filed by KIUC and the Attorney General be denied.

Dated: November 13, 2009

Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing was served on the following persons on the 13th of day of November 2009, United States mail, postage prepaid:

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