COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE MEMBERSHIP OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY IN THE MIDWEST INDEPENDENT TRANSMISSION SYSTEM OPERATOR, INC.	)))))	CASE NO. 2003-00266

O R D E R

On July 17, 2003, the Commission, on its own motion, opened this investigation of the membership of Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") in the Midwest Independent Transmission System Operator, Inc. ("MISO"). MISO is a non-profit corporation formed by LG&E and KU and numerous other transmission-owning utilities in the Midwest for the purpose of independently controlling and operating its members' transmission facilities. MISO has been approved by the Federal Energy Regulatory Commission ("FERC") to operate as a Regional Transmission Organization ("RTO").

The Order initiating this investigation established the following four issues to be reviewed:

1. The applicability of the transfer of control statute, KRS 278.020(5), to the transfers by LG&E and KU of control of their respective transmission facilities to MISO.[1]

[1] This transfer of control statute was previously codified as KRS 278.020(4) at the time the July 17, 2003 Order was issued.

2. The extent to which LG&E and KU, as providers of bundled retail electric service, utilize and receive benefits from the services provided by MISO.[2]

3. MISO's anticipated expansion of services into areas, such as resource adequacy and demand response, that were not within MISO's original scope and that have traditionally been provided under the supervision and control of state regulation, rather than by a multi-state, regional organization.

4. The feasibility of LG&E and KU joining an RTO in the South since most utilities in the South are similar to LG&E and KU to the extent they are vertically integrated and provide bundled retail services.

Intervention was requested by and granted to the Attorney General's Office ("AG"), MISO, and Kentucky Industrial Utility Customers, Inc. ("KIUC"). LG&E, KU, and MISO filed extensive testimony, hearings were held on February 25-27, 2004 and April 8, 2004, and the parties filed briefs.

By Order dated June 22, 2004, the Commission reopened the record to receive additional evidence on what was then MISO's recently filed Transmission and Energy Markets Tariff ("TEMT"). MISO's TEMT is frequently referred to as its "Day 2" operations, which include the running of a day-ahead and real-time energy market, region-wide security constrained economic dispatch, and transmission congestion pricing through the allocation of financial transmission rights ("FTRs") and locational marginal pricing. The Commission also directed LG&E and KU to address the feasibility

[2] The July 17, 2003 Order noted that a similar analysis had been conducted in conjunction with Case No. 2002-00475, Application of Kentucky Power Company d/b/a American Electric Power For Approval, To The Extent Necessary, to Transfer Functional Control of Transmission Facilities Located in Kentucky to PJM Interconnection, L.L.C. Pursuant to KRS 278.218.

and costs of joining any other RTO, not just an RTO in the South, in recognition of our approval of Kentucky Power Company's membership in PJM Interconnection, LLC ("PJM"), an RTO in the Mid-Atlantic region.

LG&E, KU, and MISO then filed supplemental testimony and new cost-benefit analyses that reflected the anticipated impacts of MISO's Day 2 energy markets. Another hearing was held on July 20, 2005, supplemental briefs were filed, and the case now stands submitted for a decision.

THE NEED FOR PRIOR APPROVAL TO TRANSFER CONTROL OF TRANSMISSION FACILITIES

Kentucky law prohibits the change in control of any utility without prior approval of the Commission. Specifically, the statute cited in the Commission Order initiating this investigation, KRS 278.020(5), provides as follows:

> No person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission 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.

Under KRS Chapter 278, the term "utility" is defined, in pertinent part, as:

> Any person … who owns, controls, operates, or manages any facility used or to be used for or in connection with:
> (a) The generation, production, transmission, or distribution of electricity to or for the public, for compensation, for lights, heat, power or other uses.

KRS 278.010(3)(a). LG&E is a combination electric and gas utility, while KU is an electric-only utility. With respect to their electric operations, they both own, control, operate, and manage facilities that are used to generate, transmit, and distribute electricity.[3] By performing all three of these electric functions, LG&E and KU are commonly referred to as being vertically integrated utilities. In contrast, there are other electric utilities within the Commonwealth that perform only the distribution function, i.e., the electric distribution cooperatives, while there are others that perform only the generation and transmission function, i.e., the generating and transmission cooperatives, commonly known as "G&Ts."

It is clear under the statutory definition set forth in KRS 278.010(3)(a) that the term "utility" encompasses any person who owns, controls, operates, or manages any facility that is used to perform any <u>one</u>, or any combination, of the enumerated functions of generation, transmission, or distribution. Consequently, both LG&E and KU satisfy the statutory definition of "utility" with respect to <u>each</u> of the electric functions they perform: generation, transmission, and distribution. LG&E and KU are thus generating utilities, transmission utilities, and distribution utilities.

The transfer of control statute, KRS 278.020(5), prohibits any transfer of control, or the right to control any utility by the "sale of assets, transfer of stock, <u>or</u> <u>otherwise</u>." (emphasis added). Under the facts presented here, LG&E and KU entered into a contractual agreement to transfer, and on February 1, 2002 they did transfer, control of their respective transmission facilities to MISO.

LG&E and KU argue that KRS 278.020(5) is inapplicable to their respective transfers of operational control of transmission facilities to MISO because that statute does not apply to mere transfers of assets, as occurred here, as opposed to the transfer

[3] Unless otherwise noted, all subsequent references to LG&E in this memo are limited to its electric operations.

of control of a utility. Further, LG&E and KU argue that the General Assembly did not intend KRS 278.020(5) to apply to LG&E's and KU's transfers of transmission assets because another statute, KRS 278.218, which was enacted after the transfers to MISO occurred, specifically requires prior Commission approval of asset transfers.

The asset transfer statute referenced by LG&E and KU, KRS 278.218, became effective on April 24, 2002. That statute provides as follows:

> (1) No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars ($1,000,000) or more and:
>
> > (a) The assets are to be transferred by the utility for reasons other than obsolescence; or
> >
> > (b) The assets will continue to be used to provide the same or similar service to the utility or its customers.
>
> (2) The commission shall grant its approval if the transaction is for a proper purpose and is consistent with the public interest.

KRS 278.218. LG&E and KU assert that this more recently enacted statute was intended to expand the Commission's jurisdiction to encompass asset transfers, a subject which was not previously within the scope of the Commission's jurisdiction. Citing rules of statutory construction, LG&E and KU claim that a finding by the Commission that the transfers of transmission facilities to MISO needed prior approval under KRS 278.020(5) would render the newly enacted KRS 278.218 to have been a meaningless and unnecessary legislative act and that statutes should be construed, if possible, to avoid such results.

LG&E and KU also state that they have transferred only limited control to MISO, authorizing it only to coordinate and evaluate transmission capacity and reliability functions, while LG&E and KU continue to own, staff, maintain, and operate their transmission assets. Finally, LG&E and KU argue that they had a good faith belief that no Commission approval was needed here based on an earlier transfer of control to the North American Electric Reliability Council ("NERC"), and the fact that the Commission was aware of the transfer of control to MISO, but the Commission did not indicate the need for the transaction to be approved. MISO also asserts that the LG&E and KU transfer of transmission facilities did not require prior Commission approval under KRS 278.020(5).

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that, pursuant to the terms of a contractual agreement, LG&E and KU transferred operational control of their transmission facilities to MISO on February 1, 2002. Thus, under the definition of "utility" set forth in KRS 278.010(3)(a), LG&E and KU are no longer utilities with respect to the operations function of their respective transmission facilities. The function of operating LG&E's and KU's transmission facilities was transferred to MISO, which now controls those facilities and uses them to transmit electric energy in interstate commerce. By providing this interstate transmission operations function, MISO's rates and terms of service are regulated by the FERC. Since MISO does not offer its transmission service directly to retail customers in Kentucky, MISO is not a utility as defined under KRS 278.010(3)(a) and is not subject to our regulatory jurisdiction.

The recently enacted transfer of assets statute, KRS 278.218, extended the Commission's jurisdiction to review the transfers of utility assets when such transfers do not constitute a change in control of a utility and, thus, would not fall within the purview of KRS 278.020(5). Here, LG&E and KU have acknowledged that they transferred operational control of their transmission assets to MISO.[4] Upon the transfer, LG&E and KU ceased operating their transmission assets for the principal benefit of their native load customers, and MISO commenced operating those assets for the benefit of its Midwest transmission operations.

Even though MISO did not become a Kentucky jurisdictional utility by acquiring operational control of LG&E's and KU's transmission facilities, and even though LG&E and KU continue to be jurisdictional utilities with respect to other utility functions they perform, LG&E and KU did transfer to MISO the utility function of operational control of their transmission facilities. Under these circumstances, LG&E's and KU's transfer of transmission facilities is a transfer of control of a utility function as defined under KRS 278.010(3)(a), and that transfer falls within the ambit of KRS 278.020(5).

The Commission further finds unpersuasive the claims by LG&E and KU that they have transferred only limited control to MISO, since they continue to perform significant functions with respect to their transmission assets. The degree of control which has been transferred to MISO is very significant, as noted by LG&E and KU in their explanation of how the transfer of transmission assets transforms aspects of what

[4] February 26, 2004 Transcript of Evidence at 167.

is presently retail service into wholesale transactions.[5] LG&E and KU acknowledge that one major effect of the transfer to MISO is to sever the historic connection between their respective generation and the electric service provided to retail customers.[6] The LG&E and KU generation used to serve native load customers must now be scheduled or bid through the MISO energy market at wholesale rates that are not subject to the Commission's jurisdiction. The energy thus scheduled or bid is then resold by LG&E and KU to their native load customers. Consequently, as a result of the transfer of control to MISO, what had historically been a purely retail sale of power subject to our jurisdiction has been transformed into a wholesale sale of power that is beyond the scope of our jurisdiction.

With respect to LG&E's and KU's argument that operational control of their transmission assets was previously transferred to NERC without prior Commission approval, there is nothing in the record to show either that the Commission was aware of the transfer to NERC or the date that the transfer occurred. Since NERC was created shortly after the 1965 Northeast blackout, the date of LG&E's and KU's alleged transfer to NERC is significant since KRS 278.020(5) was not enacted until 1986.[7] Consequently, we are unable to determine from the record whether the transfer to NERC required prior Commission approval under KRS 278.020(5) and, thus, that transfer creates no precedent for the transfer to MISO.

[5] Supplemental Rebuttal Testimony of Michael S. Beer, filed January 10, 2005, at 2-3 and 9-10.

[6] Id.

[7] 1986 Regular Session, Chapter 368, Section 1, Effective July 15, 1986.

Finally, there is no legal basis to support LG&E's and KU's argument that the change in control statute is inapplicable to their transfer to MISO because the Commission was aware of the transfer and the Commission failed to take any affirmative action. The statute expressly prohibits the acquisition or transfer of control without prior approval by the Commission. Thus, there is an affirmative duty on the utility and the acquirer to obtain Commission approval; there is no affirmative duty placed on the Commission to investigate whether a transfer of control has occurred. In any event, the Commission did initiate this present investigation in July 2003, approximately 18 months after the transfer occurred, to determine whether prior approval was needed.

ECONOMIC ISSUES

LG&E and KU were charter members of MISO, filing at FERC, with other Midwest transmission owners in 1998 to have MISO recognized as an RTO. LG&E and KU state that they had two goals when joining MISO: to comply with FERC Order 888, and later Order 2000, regarding the need to provide open access transmission service on a non-discriminatory basis, and to achieve greater transmission reliability. Under the MISO Transmission Owner's Agreement, MISO has functional responsibilities necessary to comply with Order 888 and to ensure transmission system reliability across its footprint. MISO received FERC's approval as an RTO in 2001.

LG&E and KU claim they did not foresee MISO operating energy markets when they joined. However, on March 31, 2004, MISO filed with FERC to establish its Day 2 real-time and day-ahead energy markets. Prior to the filing, LG&E and KU had expressed concerns about the Day 2 Markets' scope and cost. Despite the concerns of

LG&E and KU, and others, FERC approved the Day 2 Markets which became operational on April 1, 2005.

The record in this case includes multiple economic analyses filed by LG&E, KU and MISO, all purporting to demonstrate the projected costs and benefits to LG&E and KU of either remaining as members of MISO or exiting MISO. In summary, the LG&E and KU analyses support exiting MISO while the MISO analyses support remaining as members. The economic analyses, although performed in different ways using different models, all attempted to estimate the financial impact to LG&E and KU through 2010 from remaining in MISO or exiting MISO. The AG supports LG&E and KU exiting MISO while KIUC has taken no position on the issue.

<u>LG&E and KU Position</u>

LG&E and KU assert that MISO is now a substantially different organization than the one they joined in 1998. For example, LG&E and KU point out that MISO's operating budget and capital budget have increased by 1,100 percent and 311 percent, respectively, since 2000. Due to MISO's structural changes, in particular the implementation of its Day 2 energy market, the LG&E and KU analyses show that the benefits of remaining in MISO are not adequate to offset the increased costs of membership. LG&E and KU argue that they are not only facing increased costs, particularly for an energy market, that were not anticipated when they joined MISO, but are also exposed to increased financial risks they would not otherwise face, but for MISO's energy market. For these reasons, they have requested the Commission to authorize their withdrawal from MISO.

In response to the July 2003 Order initiating this case, LG&E and KU analyzed the benefits and costs of: (1) continuing MISO membership; (2) withdrawing from MISO and joining an RTO in the southern region of the country; and (3) withdrawing from MISO and contracting for reliability coordination services. In response to our June 2004 Order, they have also analyzed the benefits and costs of withdrawing from MISO and joining the Southwest Power Pool ("SPP") or PJM.

LG&E and KU assert that they have a contractual right to withdraw as members of MISO, although they would be responsible for a proportionate share of MISO's capital costs. With an estimate of the MISO exit fee included in their analysis, LG&E and KU showed that withdrawing and contracting for reliability coordination services would be preferable because it would produce the greatest net economic benefits. They refer to this alternative as the Transmission Owner Reliability Coordination ("TORC") option and it was initially estimated to produce savings in excess of $65 million for the period 2005-2010.[8]

The LG&E and KU analyses included a later estimate of $12.6 million in savings they would realize under their proposed TORC option solely for calendar year 2005.[9] LG&E's and KU's final estimate of savings and costs for the period 2005-2010,

[8] Prefiled Rebuttal Testimony of Matthew J. Morey, filed February 9, 2004, at 8. This reflected an estimated exit fee of $24 million.

[9] Additional Supplemental Rebuttal Testimony of Matthey J. Morey, filed April 1, 2005, Exhibits MJM-1, MJM-2, and MJM-3. This was filed in response to MISO's March 3, 2005 cost-benefit study, which modeled only calendar year 2005.

depending on various assumptions including the amount of the exit fee, produced estimates of net annual benefits ranging between $4 million and $13 million.[10]

The LG&E and KU analysis showed that withdrawing from MISO and becoming a member of SPP was more costly than the TORC option, while remaining in MISO was more costly than SPP membership. Membership in PJM was the least preferred option because its membership costs were the highest of the RTOs considered. SPP does not operate an energy market, which apparently results in its costs being the lowest relative to MISO and PJM.

In addition to increased costs, LG&E and KU claim they now face increased financial risks as a result of MISO's Day 2 Markets. An example of this increased risk involves LG&E and KU choosing to not "self-schedule" their generation and load into the Day Ahead Market, but attempting to reduce their costs by utilizing MISO's economic dispatch and purchasing power if it is bid into the market below their cost of production. If they are successful, they can reduce their energy costs; if they are unsuccessful, they must pay higher energy costs due to congestion. Another example cited is the potential that the LG&E and KU allocation of FTRs may not be adequate to hedge their native load against congestion costs, resulting in higher energy costs. An additional risk of the MISO energy market is the ability of MISO to direct curtailments of the LG&E and KU low cost generation due to regional reliability concerns, forcing them to run higher cost generating units to serve their load.

Citing these risks and the increased costs of MISO membership, LG&E and KU request that the Commission authorize their withdrawal from MISO. They also request

[10] LG&E's and KU's September 6, 2005 post-hearing brief at 18.

authorization to establish a regulatory asset, for accounting and rate-making purposes, for the MISO exit fee so the cost can be deferred until their next base rate cases.

If they withdraw from MISO, LG&E and KU believe they can comply with FERC Orders 888 and 2000 by entering into an agreement with an independent transmission coordinator, similar to arrangements entered into by other utilities. LG&E and KU believe they can comply with NERC reliability rules by contracting with a NERC-certified reliability coordinator, for reliability coordination.

<u>MISO Position</u>

MISO estimated annual net benefits of approximately $46.3 million for LG&E and KU if they remain in MISO. This estimate consists of the following benefits and costs for LG&E and KU:[11]

(1) $19.2 million increase in annual transmission revenues.

(2) $8.2 million increase in annual off-system sales margins.

(3) $11.3 million decrease in annual costs of serving native load.

(4) $22.5 million increase in annual FTR revenues.

(5) $14.9 million increase in annual administrative and other costs.

MISO attributed the LG&E and KU membership benefits largely to the results of MISO having implemented centralized security constrained economic dispatch across its footprint. MISO stated that this created a sizeable wholesale spot market for electricity, which established transparent spot prices and allowed vertically integrated utilities such as LG&E and KU to increase their volume of off-system sales and participate in a larger number of wholesale market transactions.

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[11] MISO's March 3, 2005 Cost-Benefit Study.

MISO also provided actual results of the operation of its Day 2 Market, which it claimed showed substantial benefits to LG&E and KU. According to MISO, operations over the 3 months prior to the last hearing, April through June 2005, show that LG&E and KU experienced a net benefit of $25 million. Based on these results, MISO claims that the actual experience of its Day 2 Market demonstrates that remaining members of MISO is in the best interest of LG&E and KU and their customers.

<u>LG&E and KU Rebuttal</u>

LG&E and KU focused significant attention on the history of MISO's cost-benefit analyses. MISO filed a total of five analyses, with each subsequent analysis correcting errors in the prior analysis. LG&E and KU cite these errors and claim these errors demonstrate that MISO has a limited understanding of the LG&E and KU transmission systems and operations.

LG&E and KU state that MISO has overestimated the benefits of continued MISO membership, in particular overestimating the levels of FTR revenues and transmission revenues. They also contend that MISO has both underestimated off-system sales margins and overestimated the cost to serve native load in the TORC option.

LG&E and KU showed that while MISO had estimated a $19.2 million increase in transmission revenues to LG&E and KU, MISO failed to recognize additional transmission payments by LG&E and KU. Correcting for this error reduces the additional net transmission revenues to $6.1 million on an annual basis.[12] They also pointed out that inconsistencies in the application of transmission payments accounted

[12] Additional Supplemental Rebuttal Testimony of Matthew J. Morey, filed April 4, 2005, at 18-20.

for most of the $8.2 million benefit in off-system sales that MISO attributed to continued membership. Adjusting to reflect a consistent application of transmission payments results in a restated annual benefit of $1.8 million for off-system sales.

LG&E and KU concluded that there would be no appreciable difference in the cost to serve native load under the TORC option compared to remaining in MISO. Since the native load to be served would be the same under either scenario, the same generation fleet would be economically dispatched to serve that load, in patterns that were almost identical and with nearly identical costs. Any differences that might occur would be due to the costs for generation to make off-system sales, and those costs should not vary significantly between MISO membership or the TORC option.

LG&E and KU also demonstrated the speculative nature of assumptions employed by MISO in arriving at its $22.5 million estimate of annual FTR revenues.[13] These assumptions included the expectations that: (1) MISO's initial allocation of FTRs to LG&E and KU would continue unchanged throughout the study period; (2) the transmission users who must make FTR payments (which constitute FTR revenues to LG&E and KU) would not mitigate their payments by constructing additional generation or transmission facilities to alleviate the congestion that was underlying the FTRs; and (3) MISO's FTR market would not experience a shortfall in FTR payouts as other RTO-administered FTR markets have experienced historically.[14]

LG&E and KU also disagreed with MISO's assertion that increased off-system sales revenues are a result of MISO membership. LG&E and KU contend that factors

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[13] Id. at 15-18.

[14] Id. at 9-10.

unrelated to MISO, such as the level of their native load, weather, and wholesale market conditions, are the drivers of wholesale electric prices and volumes, and hence, the margins on off-system sales,

While the LG&E and KU actual experience in the energy market for April through June 2005 differs from their analysis as well as MISO's analysis, LG&E and KU assert that the actual experience is closer to their estimates. In response to MISO's claim that LG&E and KU realized a $25 million net benefit from off-system sales during April through June 2005, LG&E and KU claim that MISO did not reflect $24 million in costs associated with those off-system sales during that 3-month period.

Commission Findings

In reviewing the multiple cost-benefit analyses in this case, the Commission well recognizes that those analyses are merely reasoned estimates by experienced professionals who are attempting to predict future events. The analyses are based on various assumptions which are highly subjective and judgmental. In addition, our efforts to verify the results of the analyses in this case are made more difficult by the lack of long-term historic data regarding the operational impacts of the MISO Day 2 Market. Thus, we consider the cost-benefit analyses to be more indicative of future trends than absolute predictors of definitive results.

Based on a review of cost-benefit analyses and their underlying assumptions, the Commission finds the LG&E and KU analysis to be based on assumptions and inputs that are more reasonable than those incorporated by MISO's analysis. It is not reasonable to believe, as MISO's analysis assumes, that LG&E and KU will continue to receive over $20 million annually in FTR revenues in excess of congestion costs. The transmission users paying those costs have every incentive to avoid paying those costs and can be expected to do so. With respect to transmission revenues, MISO's estimate of $25.7 million as the annual financial benefit to LG&E and KU has been substantially overstated due to MISO's omission of transmission payments. Once these payments are properly offset against revenues, the net benefit is only $6.1 million.

On the cost side, MISO's analysis significantly underestimates the membership fees payable to MISO. For example, while MISO estimated that LG&E and KU would pay only $2.1 million annually for MISO's Revenue Sufficiency Guarantee and revenue neutrality uplift payments, the actual payments were $11.9 million for a 3-month period. With respect to off-system sales, the Commission is not persuaded that recent increased margins achieved by LG&E and KU are attributable to the MISO Day 2 Market. Rather, the more logical explanation is a combination of higher energy prices, reflecting higher fuel costs, and a decline in native load, freeing-up additional generation to make off-system sales.

In conclusion on this issue, the Commission finds that the LG&E and KU analysis is more credible and it provides a more reasonable indication of the likely outcome of exiting MISO and pursuing the TORC option. Therefore, LG&E and KU, and their retail customers, should economically benefit by exiting MISO and pursuing the TORC option.

SERVICE RELIABILITY

Another major issue reviewed in this case was whether there would be any appreciable degradation in the reliability of service provided by LG&E and KU if they exit MISO and pursue their preferred TORC option.

LG&E and KU Position

LG&E and KU state that upon exiting MISO they will operate their transmission system in accordance with the requirements specified in applicable ECAR documents and the NERC Operating Manual. They assert that any NERC-certified reliability coordinator, not just MISO, is required to have a "wide area view" of its reliability coordination area and of those areas surrounding it. NERC standards also require reliability coordinators to have agreements in place to direct generation redispatch, transmission reconfiguration, or reduce load to return the transmission system to a reliable state. LG&E and KU also point out that MISO has called a significant number of Transmission Loading Relief ("TLR") incidents since acquiring control of the LG&E and KU transmission facilities and that MISO has implemented a "manual redispatch" program that has also resulted in transmission curtailments.

LG&E and KU assert that there will be no gap between their current MISO membership and the reliability services to be offered under the TORC option. At all times, according to LG&E and KU, they will have the services of a NERC-certified reliability coordinator and NERC's TLR procedures will be used to manage system overloads. In addition, LG&E and KU point to Title XII, Subtitle A, of the Energy Policy Act of 2005 that requires the establishment of an Electricity Reliability Organization under which electric reliability standards will be mandatory, rather than voluntary, as has been the case in the past. Under such mandatory standards, LG&E and KU contend that the Commission can have confidence that their reliability will not suffer if they exit MISO and choose to contract with another reliability coordinator.

MISO Position

MISO states that reliability on the Kentucky portion of the transmission grid will be enhanced by LG&E and KU continuing as members of MISO, to the benefit of their retail customers. MISO asserts that it has a larger picture of system conditions than a stand-alone utility and that this creates advantages of RTO membership including the ability to share information to coordinate outage schedules on a regional basis and to coordinate planning by integrating LG&E and KU planning needs into a regional plan. If LG&E and KU exit MISO and then contract for reliability coordination, they will lose these advantages and their transmission system would not be as reliable and would not have an equal or lesser outage probability. By exiting MISO, LG&E and KU will have to enter into coordination agreements with other entities to obtain needed data and develop additional capabilities to estimate transmission flows occurring outside its system.[15]

MISO also cites the increase in TLR incidents called in the LG&E and KU service territories when functional control over their transmission systems was transferred to MISO, claiming that this increase was because LG&E and KU, or their previous security coordinator, had not adequately monitored potential contingencies. Absent regional real-time security-constrained economic dispatch performed by MISO, the primary tools available to a reliability coordinator to control power flows are TLRs, which interdict transactions that have an impact of 5 percent or greater on a congested interface.

[15] After this case's record was closed, LG&E and KU entered into agreements with SPP and TVA to serve as their independent transmission organization and reliability coordinator, respectively. We note that FERC, by Order dated March 17, 2006, In Docket Nos. EC06-4-000 and EC06-4-001, conditionally approved LG&E's and KU's agreements with SPP and TVA.

MISO states that TLRs are inefficient because they can lead to under-utilization of the transmission system and because they curtail transmission schedules without regard to the economic value of the transactions being curtailed.

Commission Findings

The Commission finds that the LG&E and KU transmission system will at all times be operated in accordance with NERC's operating standards. The LG&E and KU system historically operated with a high degree of reliability prior to MISO's acquisition of control, and there is no credible basis to believe that reliability will suffer under the TORC option. Even assuming that MISO is able to provide some degree of incremental reliability to LG&E and KU, the Commission is not persuaded that this benefit justifies the costs of continued MISO membership.

While we agree with MISO's position that TLRs are not the most efficient method for controlling congestion, we note that such procedures, when implemented according to NERC standards, are still recognized as an acceptable method for maintaining reliability. We note that FERC, in its conditional approval of LG&E's and KU's exit from MISO, also recognized TLRs as acceptable for maintaining grid reliability. Thus, the Commission finds that the reliability of the LG&E and KU transmission system will not be diminished if LG&E and KU exit MISO and pursue their preferred TORC option.

REGULATORY ISSUES

LG&E and KU claim that MISO membership infringes on the Commission's jurisdiction since MISO's energy market will undermine Kentucky's control of its low-cost generation resources. While they acknowledge that MISO's Day 2 Market does not alter this Commission's jurisdiction over retail rates, LG&E and KU contend that the

Day 2 Market severs the long-standing link between their generation and their native load. Now, LG&E and KU must schedule or bid all their generation into the MISO market and then purchase all needed energy from MISO at FERC-approved wholesale rates. As it is well settled that a state commission cannot disallow rate recovery of federally approved rates or charges, except in limited circumstances not applicable here, LG&E and KU claim that the Day 2 Market will erode this Commission's oversight over the costs upon which their retail rates are based.

The Commission finds that while we continue to have jurisdiction over the retail rates of LG&E and KU, the generating costs that we have historically reviewed as retail transactions are now wholesale transactions under the MISO Day 2 Market. Therefore, the rates at which LG&E and KU sell their generation to MISO, and the rates at which they buy energy to serve native load, are wholesale rates established under FERC tariffs, not Kentucky retail tariffs. In addition, since the inception of the Day 2 Markets, MISO has required a number of manual redispatches of the LG&E and KU generating facilities. These redispatches require LG&E and KU to substitute higher cost generation for available lower cost generation.[16] Even though this redispatch is financially detrimental to retail customers, the Commission has no authority to disallow the additional costs because they are wholesale costs that are passed through a FERC tariff to retail customers. Consequently, the MISO Day 2 Markets have impacted our regulatory authority since, under the doctrine of federal preemption, we cannot review the reasonableness of a rate that has been approved or is accepted for filing by FERC.

[16] July 21, 2005 Transcript of Evidence at 81.

The creation of the MISO Day 2 Markets is not the only activity that was not contemplated in 1998 when LG&E and KU joined with other transmission owners to create MISO. MISO has also expanded its activities into two areas that have historically been within the exclusive jurisdiction of state regulatory commissions: resource adequacy; and demand-side management ("DSM") programs. Currently, LG&E and KU are required by Commission regulation 807 KAR 5:058 to periodically file integrated resource plans which set forth the least cost mix of generation, transmission, and DSM programs to meet their Kentucky customers' future demands. These resource plans are reviewed on a stand-alone basis, as well as in conjunction for the requisite approvals to construct generation or transmission facilities under KRS 278.020(1), or to implement DSM programs under KRS 278.285.

MISO's expansion into areas of resource adequacy and DSM programs will be on a region-wide basis. Since the MISO region includes states that have deregulated generation, LG&E and KU could be required to pay higher costs to subsidize generation supplies that are needed in other states, but not needed to serve Kentucky ratepayers. Similarly, MISO's adoption of region-wide DSM programs would result in increased costs to LG&E and KU ratepayers, irrespective of whether those programs are appropriate or cost-effective in Kentucky as required by KRS 278.285(1).

MISO has also established a region-wide transmission expansion plan that could obligate LG&E and KU to construct transmission facilities at sites chosen by MISO. Although the Commission participates as a stakeholder with other state commissions in reviewing the MISO transmission expansion plan, we have but one vote and no veto in a group whose sole authority is advisory in nature. Thus, MISO's region-wide transmission expansion plan could create a potential conflict with the Commission's transmission siting jurisdiction under KRS 278.020(1), (2), and (8).

Finally, we note that the Dissenting Opinion suggests that LG&E and KU should be obligated to hold their retail customers harmless indefinitely if the costs of exiting MISO actually exceed the benefits. The Dissenting Opinion includes a statement that the Commission can shift to a utility the inherent risks that arise whenever there is a major change in utility operations. The Kentucky authority cited for this proposition consists of two cases where the utilities agreed to limited hold harmless provisions as part of settlement agreements. Here, there is no such agreement by LG&E and KU. The Dissenting Opinion also cites to the recent FERC decision imposing hold harmless conditions in conjunction with the LG&E and KU withdrawal from MISO. However, it is clear from that FERC opinion that the hold harmless conditions were imposed only in those circumstances where they had been expressly agreed to by LG&E and KU as part of their contractual agreement to join MISO. FERC actually rejected proposals that LG&E and KU should hold harmless future customers who are not currently served under an existing contract with a fixed rate, stating that, "The TO [Transmission Owners] Agreement plainly states that the hold harmless provision applies only to *existing* service, not *future* service, and only for the remaining term of the contract for existing service." *Louisville Gas and Electric Company*, 114 FERC ¶ 61, 282, para. 49 (emphasis in original). In Kentucky, LG&E and KU have no contractual agreements to hold any retail customers harmless, and none of their customers are served under contracts with rates that are not subject to change by the Commission. In previously approving the request by Kentucky Power Company to join PJM, the Commission did not impose a hold harmless requirement in the event that the costs of membership in that RTO exceed the value of the benefits received.[17]

LG&E's and KU's Exit Fee Proposal

If they are allowed to withdraw from MISO, LG&E and KU would pay the agreed-upon exit fee, and propose to establish a regulatory asset of the same amount. In their 2003 rate cases,[18] LG&E and KU and the AG suggested different variations on the details of the future rate-making treatment of the exit fee. Ultimately, consensus was reached on the details which can be summarized as follows:

1. Rate-making treatment of the regulatory asset will be addressed in LG&E's and KU's next rate cases;

2. LG&E and KU will continue to collect amounts for MISO Schedule 10 costs that they no longer incur through base rates and record such amounts in a regulatory liability account;[19] and

3. The regulatory liability balance will be used to offset the regulatory asset balance in their next rate cases.

LG&E and KU state that this approach is acceptable if, in addition to authorizing their exit from MISO, FERC lawfully establishes the amount of the exit fee. LG&E and KU state that MISO Schedule 10 charges must cease concurrent with their exit from MISO

[17] Case No. 2002-00475, Order dated May 19, 2004.

[18] 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.

[19] The MISO Schedule 10 costs included in base rate are $2,632,369 for LG&E and $3,587,785 for KU. See Case No. 2003-00433, LG&E Response to PSC-2, Item 16(j)(1) and Case No. 2003-00434, KU Response to PSC-2, Item 16(j)(1).

and their incurrence of the exit fee. They also state that this Commission, in addition to authorizing the creation of the regulatory asset for the exit fee, must also authorize the creation of the regulatory liability in which the revenues associated with the Schedule 10 charges will be recorded.

The AG has expressed support for this treatment of both the exit fee and the continued revenues to be collected for the Schedule 10 charges.[20] The AG also pointed out, as agreed to by LG&E and KU, that if there is a period of time before the next rate cases such that the regulatory liability exceeded the amount of the regulatory asset, the excess would be used to offset the requested increases in base rates. Having considered the positions of the parties, the Commission concludes that it is reasonable to establish a regulatory asset for the actual amount of the exit fee, subject to adjustment for future MISO credits, if any, and a regulatory liability for the MISO Schedule 10 charges, which are the only MISO costs now included in existing rates. This accounting treatment will have no immediate impact on LG&E's and KU's rates as it defers the rate-making disposition of these amounts until subsequent base rate cases. In addition, by deferring the rate-making treatment, we obviate the need to address potential claims regarding the legality of single-issue rate-making.

FERC Approval to Exit MISO

LG&E and KU filed with FERC on October 7, 2005 a petition for authority to withdraw from MISO. Therein they outlined this Kentucky proceeding and cited much of the evidence gathered herein. LG&E and KU also announced that in order to meet FERC and NERC requirements, they had negotiated an agreement for TVA to provide

[20] AG's April 26, 2004 post-hearing brief at 4-5.

reliability coordination services and an agreement for SPP to serve as their independent transmission operator for compliance with market power concerns and with FERC Order 888.

On March 17, 2006, FERC granted conditional approval for LG&E and KU to withdraw from MISO. Due to the nature of the conditions imposed by FERC, we expect LG&E and KU to review in detail the cost of compliance to ensure that the economics of a MISO exit are still favorable. In the event LG&E and KU do not exit MISO by July 1, 2006, they should file a status report by July 15, 2006 discussing in detail each condition precedent to their MISO exit, the current status of the condition, and the anticipated date that the condition will be satisfied.

SUMMARY

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that LG&E and KU should incur lower overall costs in the future by exiting MISO and pursuing the TORC option. These lower costs will eventually benefit ratepayers through lower rates or, alternatively, an offset to future rate increases. Withdrawing as members of MISO and pursuing the TORC option should have no adverse impact on the reliability of the LG&E and KU transmission systems. Thus, the request by LG&E and KU to withdraw as members of MISO is for a proper purpose and is consistent with the public interest.

IT IS THEREFORE ORDERED that:

1. LG&E and KU are authorized to withdraw from MISO and reacquire functional control of their transmission facilities.

2. LG&E and KU are authorized to establish for accounting purposes both a regulatory asset for the MISO exit fee, subject to adjustment for future MISO credits, if any, and a regulatory liability upon exiting MISO for the revenues collected which are associated with the MISO Schedule 10 charges included in existing rates.

3. Within 10 days of withdrawing from MISO, LG&E and KU shall file a written notice which sets forth the date of withdrawal, the amount of the withdrawal fee, and whether such fee was paid in one lump sum or over 5 years.

4. In the event that the MISO withdrawal is not accomplished by July 1, 2006, LG&E and KU shall file by July 15, 2006 a status report describing in detail the conditions that still need to be satisfied and the anticipated date that each condition will be satisfied.

Done at Frankfort, Kentucky, this 31st day of May, 2006.

By the Commission

DISSENTING OPINION OF
CHAIRMAN MARK DAVID GOSS

In my judgment this decision will have an enormous and far reaching impact on both the industry we regulate and the consumers whose interests we are required to protect. Today's ruling affects not only Kentucky's two largest electric utilities and their ratepayers with regard to rates and reliability; it could significantly diminish Kentucky's ability to have meaningful input into regional electricity planning. Because I believe the majority's decision, insofar as it relies upon the results contained in LG&E's and KU's ("Companies") cost-benefit analyses, is contrary to the law in this case and that it promotes an unwise policy concerning our regulation of electric utilities in the Commonwealth, I dissent.

Burden of Proof Assignment

Initially, it is important to determine who has the burden of proof in this case; unfortunately, no statute addresses this question. While the Commission itself initiated this investigation, the burden should be on one of the parties promoting a position in the case. The Commission's July 17, 2003 Order joined LG&E and KU as original parties; MISO subsequently intervened.

As the case has developed, LG&E and KU are the parties that have requested a change in the status quo; thus they have become *de facto* applicants. Case law is clear that "[a]pplicants before an administrative agency have the burden of proof." *Energy Regulatory Commission v. Kentucky Power Company*, 605 S.W.2d 46, 50 (Ky. App. 1980). Therefore, I believe the burden of proof here is appropriately assigned to LG&E and KU.

Policy Concerns

The majority's decision in this case sidesteps what I believe is inevitable electricity policy. Like it or not, electricity regulation in this region of the United States is developing around MISO and PJM. Active discussions both regionally and at FERC anticipate a joint and common market, bringing the two even closer together. Both

RTOs have been expanding, including the addition of Kentucky Power and other AEP affiliates to PJM. In the final Order in the Kentucky Power case, (Application of Kentucky Power Company d/b/a American Electric Power for Approval, to the Extent Necessary, to Transfer Functional Control of Transmission Facilities to PJM Interconnection, LLC, Case No. 2002-00475), this Commission found the benefits to Kentucky Power outweighed the costs and explicitly found that joining PJM "is consistent with the public interest." May 19, 2004, Order in Case No. 2002-00475, at 10. In keeping with these developments, the Commission has been an active member of both the Organization of MISO States and the newly formed Organization of PJM States, Inc. In my opinion, allowing LG&E and KU to withdraw from MISO would greatly diminish Kentucky's voice in how the Midwest electricity market is to operate. Kentucky has been a longtime participant in the stakeholder process at MISO because of the membership of three of our utilities; and, while we have not always been able to prevail on our positions, we have had the opportunity to help shape policy from the beginning. To the extent that many of FERC's policies are vetted through and implemented by the RTOs, I think a diminished voice at MISO is detrimental to Kentucky.

It is also important that Kentucky and the Companies play a role in MISO's regional transmission planning initiatives. Under MISO's planning procedures, Kentucky would be able to maintain some voice in the process of siting transmission, including sharing the cost of lines that have regional benefits, as lines through Kentucky would likely have. The Companies have been quick to point out that they do not want to pay for any portion of lines in other states that have regional benefits, and the

Commission has largely agreed in the past. In the coming years, however, there will likely be transmission lines proposed in Kentucky, having regional benefits that would be paid for in part by other states' ratepayers. These lines will benefit Kentucky by increasing the ability of Kentucky's utilities and merchant plants to export power to higher cost states. The Companies' ratepayers will see benefits from this process because congestion would be reduced, thereby further ensuring that Kentucky's native load will receive the lowest cost power available while maximizing the Companies' ability to sell surplus or higher cost power, the benefits of which should flow back to the ratepayers. I believe that this decision undermines our participation in and impact on this planning.

Cost/Benefit Analyses

The Commission has already articulated the standards to be applied in reviewing cost-benefit analyses. The most pertinent to the instant case is the Commission's consideration of Kentucky Power's application to join PJM Interconnection, LLC, Case No. 2002-00475. In a series of Orders[21] this Commission emphasized that a "public interest" standard applied and that the quantified results of a cost-benefit analysis must show no adverse impact on service or rates. For example, in the August 25, 2003, Order granting rehearing, the Commission detailed the analysis as follows:

> This standard establishes a two-step process: first, there must be a showing of no adverse effect on service or rates; and, second, there must be a demonstration that there will be some benefits. In this case, Kentucky Power failed the first step due to its inability to show that the transfer would not adversely affect its rates. In fact, membership in PJM

[21] Case No. 2002, 00475, Orders dated July 17, 2003; August 25, 2003; and May 19, 2004.

> was acknowledged to cost an additional $3 million per year, thus resulting in an adverse impact on rates. Had Kentucky Power been able to quantify benefits of at least $3 million annually, it would then have been able to satisfy the first step of the "public interest" standard, and then proceed to the second step.
>
> The second step of the "public interest" standard is that there "should also [be a] demonstrat[ion] that the proposed transfer is likely to benefit the public…. Such benefits, however, need not be immediate or readily quantifiable." Thus, while the standard does not require benefits to be immediate or readily quantifiable, the benefits referred to therein are what must be demonstrated <u>after</u> satisfying the first step by a showing of no adverse effect on service or rates. Here, Kentucky Power showed the transfer to have an adverse rate impact of $3 million annually, thus necessitating a quantification of benefits sufficient to offset those costs to eliminate the adverse effect on the utility's rates. While step two of the standard allows benefits to be other than immediate or readily quantifiable, step two applies only after satisfaction of step one.

August 25, 2003, Order in Case No. 2002-00475, at 4-5.

The primary reason the majority allows LG&E and KU to withdraw from MISO is the "benefit" they believe will flow to Kentucky ratepayers. The evidence relied on, however, falls short of the quantification we have required in prior cases, such as the Kentucky Power/PJM case referenced above. The inquiry should be focused on how the withdrawal will purportedly help the Commonwealth. The Companies estimate these benefits to be in a range of $4 million and $13 million annually. While this is a good deal of money, even at the high end of the estimate, the number reflects only about 1 percent of the Companies' annual gross revenues from electricity sales in 2005; not a large net benefit to customers, given the nature of the modeling. Significantly, these supposed benefits are based solely on forecasts, with little actual data included.

I certainly agree with the majority when they say that the competing analyses are based upon assumptions which are "highly subjective and judgmental." Majority Order at 16. The slightest overestimation of benefits would likely result in negative net benefits from the withdrawal.

Another factor in evaluating these estimated net benefits is the forecasted impact of membership in MISO on reliability. The Companies take the position that reliability is not enhanced by the membership in MISO, and they therefore quantify that component as zero. A zero valuation is intuitively wrong. Furthermore, given the relatively small net benefit the Companies estimate for withdrawal, their failure to consider any value whatsoever for reliability calls into serious question the overall credibility of their model.

Given the way the case has unfolded procedurally, I cannot help but think that we have missed an opportunity to reach a more informed decision. At this point in the process, the market has been in operation for 1 year. Much of what the Commission was forced to rely upon in this case were forecasts using only the first 2 or 3 months of market experience.[22] If a full year's worth of market data were analyzed using both LG&E's, KU's, and MISO's models, it would be possible to test their validity more accurately. While the first year of the market would not produce enough information to estimate the long-run benefits of membership to the Companies, it would have shown which model had higher predictability and therefore greater certainty. With both the relatively small net benefits predicted by the Companies and the incredibly large

[22] The majority appears to have similar concerns: "[O]ur efforts to verify the results of the analyses in this case are made more difficult by the lack of long-term historic data regarding the operational impacts of the MISO Day 2 Market." Majority Order at 16.

estimated net costs predicted by the MISO models, this rough analysis could have made our decision much more informed. Moreover, it would have been easy to reopen the record for the limited purpose of receiving a full year's worth of market data.

Clearly, the companies feel that the market has some potential benefit, evident in their choice not to self-schedule their own generation to meet their native load; instead, they choose to bid into and buy from the market, ensuring that they are able to take advantage of lower cost power at least to some extent. We cannot know what precise impact withdrawal from MISO might have, but any limitation to the Companies' access to that market would surely be detrimental to ratepayers.

Market-Based Rate Authority

One potentially significant impact of withdrawal could be the Companies' loss of their market-based rate authority. FERC has used RTO membership in the past as an assurance that utilities do not have market power. If there is perceived market power, they are not allowed to sell their power at market prices, but at prices determined by cost. Given the low cost generation of the Companies, this loss of market-based rate authority would have a dramatic impact on off-system sales revenues.

FERC relied heavily on the Companies' continued participation in MISO to find that the LG&E/KU merger would have no material impact on competition in the wholesale power market. The FERC stated:

> In this case, LG&E and KU have joined the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) and filed for approval to transfer operational control over their transmission facilities to the Midwest ISO. We find that the proposed mitigation measures and ratepayer protection mechanisms, in conjunction with LG&E's and KU's participation in the Midwest ISO, will ensure that the

> merger will not adversely affect competition, rates or regulation. On that basis, we will approve the merger without further investigation.

82 FERC ¶ 61,308 (1998), Docket No. EC98-2-000, Order issued March 27, 1998, slip op. at 1-2.

That same order left open FERC's ability to reconsider the issue of market power and hence, market-based rates, in the event the Companies ever chose to withdraw from MISO:

> We regard LG&E and KU's participation as parties in the Midwest ISO filings as evidence of their commitment to membership in the Midwest ISO. Our approval of the merger is based on LG&E and KU's continued participation in the Midwest ISO. If LG&E and KU seek permission to withdraw from the Midwest ISO proceeding or the ISO once it is operating, we will evaluate that request in light of its impact on competition in the KU destination markets, use our authority under section 203(b) of the FPA to address any concerns, and order further procedures as appropriate.

Id., slip op. at 37.

In his testimony in this proceeding, Mike Beer, Vice President of Rates and Regulatory for LG&E and KU, stated unequivocally that revocation of the Companies' market-based rate authority could impair off-system sales from which their ratepayers realize a benefit through base rate credits. Mr. Beer stated that the annual credit associated with off-system sales currently embedded in the Companies' base rates totals approximately $43 million. Mike Beer testimony at 7.

The revocation of LG&E's and KU's market-based rate authority by FERC is more than a mere possibility; and, if it occurs, could prove to be a substantial detriment to the Companies and their retail customers.

Hold Harmless Provision

When a utility proposes a major change in operations entailing significant risk to its customers, the regulatory body can impose a condition requiring the utility to hold those customers harmless against adverse consequences of the change.[23] The rationale for such a requirement is that, because the customers have no voice in the decision to change operations, they should not be saddled with the risk of a bad outcome. Paragraphs 33-51 of the FERC Order in this matter discuss such a requirement as it relates to other transmission owners. *Louisville Gas and Electric Company,* 114 FERC 61,282 (March 17, 2006). Article V, Section 2(A) of the Transmission Owners Agreement requires a transmission owner who asks to withdraw from MISO to hold other existing [wholesale] customers harmless. While the parties to the FERC case disagreed about the breadth of the requirement, all, including LG&E and KU, agreed that they were bound to some degree to hold wholesale customers harmless from the impact of the withdrawal. FERC detailed several rulings defining the scope of the requirement, such as Paragraph 44, holding "that this hold harmless commitment means that these existing [wholesale] customers will enjoy the same service and pricing that they would have been entitled to receive, absent Applicants' withdrawal." This reference to the FERC decision is admittedly not direct authority

[23] See, e.g., Orders from this Commission in Case No. 1994-00104, Application of the Cincinnati Gas & Electric Company and Cinergy Corp. For Approval of the Acquisition of Control of The Union Light, Heat and Power Company by Cinergy Corp., final Order dated May 13, 1994, at 5; and Case No. 1999-00149, Joint Application of Kentucky Power Company, American Electric Power Company, Inc. and Central and South West Corporation Regarding a Proposed Merger, final Order dated June 14, 1999, at 6.

under the facts of the instant case because FERC's jurisdiction extends only to the regulation of wholesale rates. However, it is demonstrative of the point that hold harmless requirements are reasonable, are used, and are sometimes necessary to protect the interests of affected third parties who have no voice in the process but could suffer substantial economic harm from others' actions.

Yet in this case, the Commission imposes no similar requirement to protect the Commonwealth's retail customers. These native load, captive customers likewise had no voice in the decision to withdraw, so they should not be forced to bear the consequences if LG&E's and KU's projections are wrong. By not requiring LG&E and KU to hold their retail customers harmless, the Commission is shifting the risk to those customers. If the cost of withdrawal proves to outweigh the benefit, captive load customers should not bear the consequences. The majority correctly states that this Commission did not impose a hold harmless requirement on Kentucky Power when we approved its integration into PJM. However, that is a much different situation than presented here.

First, that case involved Kentucky Power's request to <u>join</u> PJM; this case involves LG&E's and KU's desire to <u>withdraw</u> from MISO. At the time it joined PJM the "slate was clean" in terms of any effect on Kentucky Power's ratepayers because none of the costs/revenues associated with PJM membership had been built into rates. It was only as a result of Kentucky Power's recent rate case that this occurred.[24] This case, involving LG&E's and KU's request to withdraw from MISO, must be decided in the

[24] Case No. 2005-00341, General Adjustments of Electric Rates of Kentucky Power Company, final Order dated March 14, 2006.

context that the costs/revenues associated with MISO membership have already been built into retail rates. Therefore, there is a fundamental difference in the effect on ratepayers as between two utilities, one of which is joining an RTO and the other which is withdrawing from an RTO.

Second, Kentucky Power's integration into PJM was accomplished only after substantial concessions were made by the utility and PJM regarding the protection of Kentucky native load customers. After the concessions were agreed to, there were effectively no parties adverse to Kentucky Power's request, and certainly no competing cost-benefit analyses as in the instant case. Ultimately, the decision to allow Kentucky Power to join PJM was made by a unanimous Commission who believed that Kentucky Power had met its burden of proving that joining PJM was in the "public interest" and that there would be no adverse impact on service or rates. However, as discussed earlier in this dissent, I believe the evidence the Commission relied upon here falls short of what we required in the Kentucky Power/PJM case.

In this case, where the analyses are based on projections and incomplete actual results, we should be careful to make certain that customers are not harmed if the analyses are flawed. FERC has ensured that existing [wholesale] customers under its jurisdiction are protected; and I believe that we should offer similar protections to the retail customers under our jurisdiction by conditioning LG&E's and KU's withdrawal from MISO on their acceptance of a hold harmless provision.

Conclusion

This case has lasted for more than 2-1/2 years, producing thousands of pages of testimony and data and several Commission hearings. It has not been an easy case to process for Commission Staff and certainly not easy for the Commission to decide. The majority's Order is well-written and comprehensive. However, I simply cannot agree, without the benefit of more convincing evidence, that LG&E's and KU's withdrawal from MISO is in the "public interest" of Kentucky ratepayers.

The stated reason for permitting withdrawal in this case is the high cost associated with MISO membership. I share those concerns now and have ever since coming to this Commission.[25] There are substantial benefits to MISO membership, however, that offset those increased costs: market access, enhanced reliability, and a voice in regional planning and cost-allocation matters. As a "low-cost" state, the argument against continued MISO membership has always been that Kentucky's rates have no place to go but "up" as a result of regional planning and participation in regional markets. While this may be true to some extent, the "regionalization" train has already left the station, and it is unlikely to ever return. I believe it is more prudent for our utilities to be in a position to influence regional electricity policy rather than allowing others to shape it to suit their purposes.

Because we were not able to avail ourselves of at least a year's worth of MISO market data as a backdrop to consider the competing cost-benefit analyses; because allowing LG&E's and KU's withdrawal disregards a clear movement toward a more regional electricity policy necessitating continued input from Kentucky's utilities; because we do not adequately protect Kentucky's captive retail customers from harm

[25] Indeed, on several occasions FERC Chairman, Joseph Kelliher, has also expressed concern over high RTO costs, and has pledged that FERC will more closely monitor those costs in the future. I accept that this will occur.

should withdrawal prove unwise; and because the companies risk losing market-based rate authority due to their withdrawal, I respectfully DISSENT from the majority's Order.

Mark David Goss, Chairman
Kentucky Public Service Commission

ATTEST:

Executive Director