COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

O R D E R

On December 22, 2005, in Case No. 2005-00042,[1] the Commission approved rates for Duke Energy Kentucky ("Duke") and provided for their further adjustment in accordance with Duke's Gas Cost Adjustment ("GCA") clause. On August 9, 2007, Duke filed its GCA to be effective August 29, 2007. Duke previously obtained Commission approval to file its GCA within 20 days of the proposed effective date.[2]

While GCAs have been a staple of Kentucky utility legal jurisprudence for many decades, their continuing availability as a lawful means to reflect changes in a utility's natural gas costs has recently been called into question.[3] Although the Opinion and Order relates only to a single tariff involving a single surcharge assessed by a single utility, the language of the Opinion and Order articulates a broader principle. The Court

[1] Case No. 2005-00042, Adjustment of the Gas Rates of The Union Light, Heat and Power Company.

[2] Case No. 2003-00386, The Application of The Union Light, Heat and Power Company for Authority to Make Monthly Adjustments of the Expected Gas Cost Components of Its Gas Cost Adjustment rate, Order dated November 6, 2003.

[3] Commonwealth of Kentucky, ex rel., Gregory D. Stumbo, Attorney General v. Public Service Commission, et al., Franklin Circuit Court, Civil Action 06-CI-269, Opinion and Order (Aug. 1, 2007) (hereinafter, the "Opinion and Order").

finds, "there is no inherent authority to perform interim single-issue rate adjustments because such a mechanism would undermine the statutory scheme"[4] and that "the PSC may not allow a surcharge without specific statutory authorization."[5] Reconciling this language with the many existing surcharges, surcredits, and rate adjustments outside a general rate proceeding that the Commission has authorized since the 1930s is not without difficulty.

In a meeting with stakeholders (regulated utilities and ratepayer groups, including the Attorney General), differing perspectives were offered as to the significance of the Opinion and Order in contexts outside the lone tariff at issue in that proceeding. On the one hand, jurisdictional utilities and consumer groups asserted that the Circuit Court's language is obiter dicta, is unnecessary to reach the ultimate holding of the Opinion and Order and should be completely disregarded.[6] See Brown v. Diversified Plastics, 103 S.W.3d 108 (Ky. App. 2003) ("A statement in an opinion not necessary to the decision

[4] Opinion and Order at 6.

[5] Opinion and Order at 7.

[6] See August 22, 2007 joint comments of Louisville Gas and Electric Company and Kentucky Utilities Company; August 22, 2007 comments of Atmos Energy Company; August 22, 2007 joint comments of BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky, AT&T of the South Central States, LLC, TCG Ohio, SBC Long Distance, LLC, d/b/a SBC L.D., d/b/a AT&T L.D., Cincinnati Bell Telephone Company LLC, Windstream Kentucky East, Inc., Windstream Kentucky West, Inc., and Windstream Communications, Inc.; August 21, 2007 joint comments of Big Rivers Electric Corporation, Kenergy Corp., Jackson Purchase Energy Corporation and Meade County Rural Electric Cooperative Corporation; August 22, 2007 comments of Columbia Gas of Kentucky, Inc.; August 22, 2007 comments of Delta Natural Gas Company; August 22, 2007 comments of Duke Energy Kentucky, Inc.; August 22, 2007 comments of East Kentucky Power Cooperative, Inc.; August 22, 2007 comments of North Shelby Water Company; August 22, 2007 comments of Northern Kentucky Water District; and August 22, 2007 comments of US 60 Water District of Shelby and Franklin Counties,

of the case is obiter dictum. It is not authoritative but may be persuasive or entitled to respect according to the reasoning in the opinion."); 2 Am. Jur. 2d ADMINISTRATIVE LAW § 73 ("Despite the rule regarding the obligation of agencies to follow court precedent, an agency does not have to incorporate dicta as policy; nor does it have to apply a holding beyond the scope of the decision itself. . . ."). On the other hand, the Attorney General argues for a much broader construction of the Opinion and Order:

> It is the position of the Office of the Attorney General that the Commission should follow the second course of action or option, that of adhering to the strict language of the Opinion and Order and thus suspend consideration of any other non-statutory surcharges. . .The Attorney General believes Judge Shepherd's ruling is quite clear, and wholly lawful. As such, his ruling has full force and effect unless or until the Commonwealth's appellate courts reverse, remand or modify the ruling. . .the Attorney General agrees with the position Judge Shepherd set forth in his ruling, that the Commission lacks inherent authority to review a utility's costs outside of a base rate case, and thus the Commission cannot allow surcharges absent express statutory authority.[7]

It goes without saying that the positions advocated by the Attorney General and the other stakeholders are incompatible. Given the enormous consequences to Kentucky utilities and ratepayers that would result from giving the Opinion and Order the improper weight, the Commission has sought clarification from the Court of Appeals on an emergency basis. That motion is now pending.

Until the question is resolved, however, the Commission must continue to receive, consider, and adjudicate cases involving rate adjustments outside of a general rate proceeding. After considering the Opinion and Order, other legal authorities, the

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Kentucky, Inc. The Commission hereby takes notice of all comments provided by stakeholders in the days following entry of the Opinion and Order.

[7] See August 22, 2007 comments of the Attorney General.

comments of all stakeholders, and the unique facts of this situation affecting all stakeholders, we are convinced that the Commission has authority to approve the relief sought herein under the plenary grant of authority set forth by the General Assembly in Chapter 278 of the Kentucky Revised Statutes. In accordance with its tariff and prior Commission Orders, Duke seeks to adjust its natural gas cost to reflect its expected change in wholesale gas costs. This will result in a decrease of 15.1 cents per Mcf in the wholesale rate and a decrease of 45.6 cents per Mcf in the retail rate. Duke's prior Gas Cost Recovery Rate was $8.872 and will now be $8.416.

The Attorney General, ironically, opposes allowing the Gas Cost Recovery Rate to adjust downward in accordance with Duke's tariff, stating:

> The Commission is prohibited from providing the relief [Duke] seeks because the General Assembly has not conferred that power and authority by way of a statute to the Commission.[8]

To the extent that this relief is not authorized by a specific statute, we are not convinced that the Opinion and Order or the case of Boone County Water and Sewer District v. Public Service Commission, 949 S.W.2d 588 (Ky. 1997) prohibit the granting of this rate adjustment. As has been pointed out, "a court has authority to decide only the issues squarely before it and even then only as to the parties to that action."[9] We are mindful of the general rule that an administrative agency has no obligation to apply the decision of a circuit court beyond the confines of the specific case in which that

[8] Brief of the Attorney General, August 27, 2007, p. 3. The Attorney General also objects to the Commission having made him a party to this proceeding.

[9] August 22, 2007 comments of Kentucky Power Company *citing* Matthews v. Ward, 350 S.W.2d 500, 501-502 (Ky. 1961); Funk v. Milliken, 317 S.W.2d 499, 513 (Ky. 1958).

decision was announced even if it were final, much less while that decision is being appealed. See, e.g., National Organization of Veterans Advocates v. Sec'y. of Veterans Affairs, 260 F.3d 1365, 1373-74) (Fed. Cir. 2001) (agency not foreclosed from re-litigating lower court's interpretation of regulation); Restatement (Second) of Judgments § 28 (even final judgments of courts other than highest court of record do not necessarily preclude agency from re-litigating a legal interpretation in future proceedings). Moreover, the Rules of the Kentucky Supreme Court expressly provide that binding precedent is established only by the Supreme Court and the Court of Appeals, SCR 1.040(5); and the Kentucky Rules of Civil Procedure preclude a party from even citing the opinion of the Franklin Circuit Court "as binding precedent. . . ." CR 76.28(4)(c). We agree that under existing Kentucky precedent, the Opinion and Order is not binding in any context outside the single tariff at issue therein.[10]

Apart from the questionable value of the Opinion and Order as binding precedent during the pendency of that appeal, we are further guided by several Kentucky authorities affirming the Commission's right to authorize rate adjustments outside of a general rate proceeding and the principle of stare decisis. Such rate adjustment methodologies have been implicitly approved by the General Assembly and explicitly approved by the Kentucky Supreme Court. See 807 KAR 5:056; Union Light, Heat & Power Co. v. Public Service Commission, 271 S.W.2d 361, 364 (Ky. 1954) (regulations

[10] See Louisville Water Company v. Weis, 25 Ky. L. Rptr. 808, 76 S.W. 356 (1903) citing Cohens v. Virginia, 6 Wheat 264, 5 L.Ed. 257 (1821) ("It is a maxim not to be disregarded, that general expressions in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in the subsequent suit when the very point is presented for decision.").

promulgated by the PSC "have the force and effect of law."); see also Commonwealth ex rel. Beshear v. Kentucky Utilities Co., 648 S.W.2d 535, 537 (Ky. App. 1982); Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Co., 983 S.W.2d 493, 498 (Ky. 1998) (acknowledging the validity of fuel adjustment clauses). In direct opposition to the Opinion and Order, Kentucky's highest court has held, the Commission's jurisdiction "is implied necessarily from the statutory powers of the commission to regulate the service of utilities." Public Service Commission v. Cities of Southgate, 268 S.W.2d 19, 21 (Ky. 1954); see also Humana of Kentucky, Inc. v. NKC Hospitals, Inc., 751 S.W.2d 369, 372-373 (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); Ashland-Boyd County City-County Health Department 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."). Moreover, the Kentucky Court of Appeals has observed that the Commission is not confined to any single rate methodology. In National Southwire Aluminum Co. v. Big Rivers Electric Corp., 785 S.W.2d 503 (Ky. App. 1990), the Court squarely held:

> Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. . . [T]he real goal for the PSC is to establish fair, just and reasonable rates. There is no litmus test for this and there is no single prescribed method to accomplish the goal.

Id. at 512, 513, quoting Federal Power Comm. v. Hope Natural Gas Co., 320 U.S. 591, 64 S. Ct. 281, 287 (1944). In other words, "neither the Kentucky statutes nor Kentucky case law place such restrictions on the PSC when fulfilling its duty to establish fair, just

and reasonable rates." Id. at 510. None of these authorities were discussed in the Opinion and Order.

Even apart from the question as to whether the Opinion and Order has value as precedent and the significant number of authorities supporting the Commission's practice of allowing fair, just, and reasonable rate adjustments outside of a general rate proceeding, we also find the specific and unique circumstances of jurisdictional utilities offer a compelling factual basis for continuing to authorize such rate relief. The fuel adjustment clause ("FAC"), for instance, has been a cornerstone of the electric industry in Kentucky since at least the mid-1930s.[11] Since 1978, the uniform fuel adjustment clause regulation has been a fixture of the Kentucky Administrative Regulations. There has been no significant challenge to the FAC for at least 25 years, a significant fact in its own right. See Homestead Nursing Home v. Parker, 86 S.W.3d 424, 426 (Ky. App. 1999) ("an administrative agency's construction of its statutory mandate, particularly its construction of its own regulations, is entitled to respect and is not to be overturned on appeal unless clearly erroneous."); Hagan v. Farris, 807 S.W.2d 488, 490 (1991) ("A construction of a law or regulation by officers of an agency without interruption for a long period of time is entitled to controlling weight."). Without continued FAC relief, vulnerable utilities such as East Kentucky Power Cooperative, Inc. ("EKPC") would be facing financial ruin:

> At EKPC's current FAC basing point, one month of FAC revenue recovery amounts to approximately $27 million, which exceeds EKPC's total margins in most years. Even a one month suspension of the current recovery of that level of

[11] See August 22, 2007 joint comments of Louisville Gas and Electric Company and Kentucky Utilities Company.

> costs would threaten EKPC's financial survival. EKPC estimates that it would need immediate, emergency rate relief from the Commission for a minimum annual increase of $320 million, if the FAC recovery were suspended.[12]

This case obviously concerns a gas GCA, not a fuel adjustment clause, but we find the purpose, effect, logic, and legal analysis to be identical. While the consequences of any general suspension of these rate adjustments may not be as grave for other jurisdictional utilities, virtually all commenting utilities identified significant long-term financial, operational, and credit risks associated with any significant delay.[13]

Jurisdictional utilities would not be alone in shouldering needless risk and administrative burden if the Commission were to generally suspend these rate adjustment proceedings as the Attorney General urges. Consumer groups also oppose the Attorney General's construction, as it would inevitably limit utility participation in energy assistance programs and inject uncertainty into the commodity cost portion of customers' bills. Without the energy assistance programs funded by surcharges, "some customers could be left in extreme cold in winter or extreme heat in summer, creating life-threatening conditions."[14] Likewise, "elimination of the fuel adjustment clause or the

[12] August 22, 2007 comments of East Kentucky Power Cooperative, Inc.

[13] See August 22, 2007 comments of Atmos Energy Company; August 22, 2007 comments of Columbia Gas of Kentucky, Inc.; August 22, 2007 comments of Delta Natural Gas Company; August 22, 2007 comments of Duke Energy Kentucky, Inc.; August 22, 2007 comments of East Kentucky Power Cooperative, Inc.; August 22, 2007 comments of Kentucky Power Company; August 22, 2007 joint comments of Louisville Gas and Electric Company and Kentucky Utilities Company; August 22, 2007 comments of North Shelby Water Company; and August 22, 2007 comments of U.S. 60 Water District of Shelby and Franklin Counties, Kentucky, Inc.

[14] August 20, 2007 comments of Community Action Council of Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc.

gas cost pass-through could have unintended consequences of raising rather than lowering consumers' bills."[15] In the context of water utilities, not being able to permit surcharge recovery will also delay or prevent the extension of water service to rural areas of the Commonwealth.[16] Moreover, the Commission simply lacks funding and personnel to process the glut of administrative proceedings and general rate proceedings required to transform Kentucky's regulated utility community from reliance upon existing rate methodologies to an anachronistic general rate methodology exclusively. We also take notice of the substantial costs associated with presenting a general rate case to the Commission and the fact that these costs are often passed on to customers.

In short, we conclude that Duke's proposed GCA adjustment is lawful under the general grant of authority to the Commission in Chapter 278 of the Kentucky Revised Statutes. To the extent that the Opinion and Order holds otherwise, we do not view it as controlling in this case, which does not relate to the single category of tariffs discussed at length therein. Boone County, likewise, does not prohibit the authorization of a gas cost adjustment Moreover, the substantial reliance upon rate adjustment mechanisms and the steady passage of time since their inception over 70 years ago leaves us loathe to unnecessarily disrupt their continued benefit for utilities and customers alike. The Commission recognizes that the Attorney General disagrees with this position, and we welcome any action for review that he might seek to bring as a means to further clarify

[15] August 21, 2007 comments of Community Action Council of Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc.

[16] See August 22, 2007 comments of Northern Kentucky Water District.

the scope and effect of the Opinion and Order and the lawfulness of these rate adjustment methodologies. The Commission further recognizes that the Court of Appeals could disagree with our interpretation of Kentucky law regarding the weight to be given the Opinion and Order while it is being appealed. In such case, the Commission would likely revisit this Order on its own motion.

After reviewing the record in this case and being otherwise sufficiently advised, the Commission finds that:

1. Duke's notice includes rates designed to pass on to its customers its expected change in wholesale gas costs.

2. Duke's Expected Gas Cost ("EGC") is $8.018 per Mcf, which is a decrease of 15.1 cents per Mcf from its previous EGC of $8.169.

3. Duke's notice sets out no current Refund Adjustment ("RA"). Duke's notice sets out a total RA of 0 cents per Mcf, which is an increase of .2 cents per Mcf from its previous total RA.

4. Duke's notice sets out a current quarter Actual Adjustment ("AA") of (65.5) cents per Mcf. Duke's notice sets out a total AA of 37.4 cents per Mcf, which is a decrease of 28.5 cents per Mcf from its previous total AA.

5. Duke's notice sets out a current quarter Balancing Adjustment ("BA") of (.3) cents per Mcf. Duke's notice sets out a total BA of 2.4 cents per Mcf, which is a decrease of 2.2 cents per Mcf from its previous total Ba.

6. Duke's Gas Cost Recovery Rate ("GCR") is $8.416 per Mcf, which is a decrease of 45.6 cents per Mcf from its previous GCR of $8.872.

7. The rates in the Appendix to this Order are fair, just, and reasonable, and should be approved for final meter readings by Duke on and after August 29, 2007.

IT IS THEREFORE ORDERED that:

1. The rates in the Appendix to this Order are approved for final meter readings on and after August 29, 2007.

2. Within 20 days from the date of this Order, Duke shall file with the Commission its revised tariffs setting out the rates authorized herein.

Done at Frankfort, Kentucky, this 28th day of August, 2007.

By the Commission

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2007-00362 DATED August 28, 2007

The following rates and charges are prescribed for the customers served by Duke Energy Kentucky. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

GAS SERVICE RATES

RATE RS
RESIDENTIAL SERVICE

	Base Rate		Gas Cost Adjustment	Total Rate
Commodity Charge for All Ccf Consumed	$.26687	plus	$.8416	$1.10847

RATE GS
GENERAL SERVICE

	Base Rate	Cost Adjustment	Total Rate
Commodity Charge for All Ccf Consumed	$.20949	$.8416	$1.05109

RIDER GCAT
GAS COST ADJUSTMENT TRANSITION RIDER

The amount of this charge or (credit) shall be $.03980 per 100 cubic feet. This rate shall be in effect during the months of September 2007 through November 2007 and shall be updated quarterly, concurrent with the Company's GCA filings.