

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AEP KENTUCKY)	
TRANSMISSION COMPANY, INC. FOR A)	
CERTIFICATE OF PUBLIC CONVENIENCE)	CASE NO.
AND NECESSITY PURSUANT TO KRS)	2011-00042
278.020 TO PROVIDE WHOLESALE)	
TRANSMISSION SERVICE IN THE)	
COMMONWEALTH)	

ORDER

This matter comes before the Commission through the application of AEP Kentucky Transmission Company, Inc. ("KY Transco") for a Certificate of Public Convenience and Necessity ("CPCN"), pursuant to KRS 278.020(1), to authorize it to begin providing utility service that consists of wholesale electric transmission service in Kentucky. KY Transco is a third-tier subsidiary of American Electric Power Company, Inc. ("AEP"), is an affiliate of Kentucky Power Company ("Kentucky Power"), and is a member of PJM Interconnection, LLC ("PJM"). KY Transco states that its transmission service will be subject to the jurisdiction of both this Commission and the Federal Energy Regulatory Commission ("FERC"). Its application states that its operations will be subject to this Commission's jurisdiction "as a utility within the meaning of KRS 278.010(3) because it will own, control, operate, and manage facilities to be used for the transmission of electricity to the public for compensation."¹ KY Transco is one of seven wholesale transmission subsidiary companies established by AEP since 2009.

¹ Ky Transco Application at 2.

BACKGROUND

Parties intervening in this matter are the Attorney General of the Commonwealth of Kentucky and Kentucky Industrial Utility Customers, Inc. Neither party filed testimony or a post-hearing brief. The hearing in this matter was initially scheduled for June 21, 2011, but was cancelled and KY Transco was required to file supplemental testimony after it had filed press releases regarding AEP's plans for adding new transmission facilities in Kentucky and after the Commission became aware of the publication of statements by AEP officials concerning AEP's possible divestiture of Kentucky Power. KY Transco and Kentucky Power addressed these issues in supplemental testimony and the case was heard on October 19, 2011.

KY Transco filed its post-hearing brief on November 18, 2011. By Order dated March 22, 2012, the Commission directed KY Transco to provide additional information and file testimony by a consultant whose report on investor perceptions of transmission-only companies ("transcos") was presented in support of its request for a CPCN.² KY Transco submitted the additional information and testimony of its consultant on May 16, 2012. The record is complete and this matter now stands submitted for a decision.

KY TRANSCO'S PROPOSAL

KY Transco asserts that various construction projects that Kentucky Power will be required to undertake in the next five to ten years will put a significant strain on Kentucky Power's financial condition due to its size, credit standing, and the expected

² Ms. Julie Cannell, a financial advisor, authored a report on investors' views of AEP's formation of transcos. She had not been presented as a witness, but her report had been filed as an exhibit to the testimony of one of the witnesses who appeared for KY Transco at the October 19, 2011 hearing.

magnitude of those projects.³ Creating a transco, which would be responsible for a large part of the future transmission facilities to be built in Kentucky, would lessen this strain and result in a financially healthier Kentucky Power, according to KY Transco. It states that, with its stronger balance sheet, KY Transco would be able to attract capital at lower costs, which, in the long run, would produce lower costs for Kentucky Power's ratepayers.

KY Transco states that when financing is constrained, transmission projects that are not immediately needed may be deferred. Due to its expected ability to obtain financing more easily than Kentucky Power, KY Transco contends that it will be able to undertake projects that might otherwise be deferred, thereby increasing transmission reliability. KY Transco claims that it will free-up capital capacity for Kentucky Power, which will result in "[a]n indirect benefit on the reliability of Kentucky Power's generation and distribution systems."⁴

KY Transco also states that its operation is not expected to adversely affect the credit quality or risk levels of Kentucky Power or other AEP operating companies. In summary, KY Transco claims that it will:

1. Stand in the shoes of Kentucky Power by constructing only transmission projects that Kentucky Power would have constructed and not operate as a merchant transmission provider.
2. Finance future transmission projects only, and not acquire any existing Kentucky Power transmission assets absent specific Commission approval.

³ According to the application, AEP is facing this issue in other states in which it operates. AEP transcos have been approved, or are operating, in Indiana, Michigan, Ohio, and Oklahoma and requests to form transcos are pending in other states.

⁴ Direct testimony of Lisa M. Barton at 5.

3. Have a minimal effect on Kentucky Power, other than to improve its ability to maintain its current credit rating and to increase its opportunity for investment in facilities used to serve the public.
4. Be subject to substantial regulation by the Commission, if its request for a CPCN is granted.
5. Have the support of Kentucky Power's management.
6. Function as a "[f]inancing vehicle for transmission projects Kentucky Power otherwise would construct, assuming it had the financial ability to do so"⁵

ANALYSIS

KY Transco's application for a CPCN to provide utility service presents two major issues for adjudication by the Commission. The first is a legal issue of whether KY Transco will be providing utility service that is subject to the Commission's jurisdiction under KRS Chapter 278. The second is a factual issue of whether the public convenience and necessity require a new service provider in the form of a transco in response to the financial condition and capital needs of Kentucky Power. The Commission need only address the second issue, which relates to public convenience and necessity, if it finds that KY Transco will be providing utility service subject to our jurisdiction.

With regard to the first issue of whether KY Transco will be providing utility service that is subject to the Commission's jurisdiction, KY Transco states that it "will provide utility service in the form of the transmission of electricity to its wholesale customers."⁶ KY Transco asserts that if its application is approved, KY Transco would

⁵ KY Transco's post-hearing brief at 7.

⁶ KY Transco's post-hearing brief at 13.

be subject to substantial regulation by the Commission.⁷ That regulation would include jurisdiction over numerous aspects of its operations, such as the construction and siting of facilities, financing, and certain aspects of its service, but would not include jurisdiction over its rates or tariffs.⁸ Further, KY Transco states that it “will provide the same wholesale transmission service currently being provided by Kentucky Power.”⁹

The record clearly shows that KY Transco will be engaged exclusively in the transmission of electricity in interstate commerce and will provide wholesale only transmission service.¹⁰ No retail transmission service will be provided directly to end-use customers in Kentucky.¹¹ Its transmission assets will be regulated exclusively by the Federal Energy Regulatory Commission (“FERC”). KY Transco’s rates for transmission service will be set forth in a tariff to be on file with FERC, and no rates or tariffs will be on file with the Commission.

The Commission’s jurisdiction is purely statutory. Kentucky courts have long recognized that “[t]he PSC is a creature of statute and has only such powers as have been granted to it by the General Assembly.” *Boone County Water and Sewer v. Public Service Comm’n*, 949 S.W.2d 588, 591 (Ky. 1997). The Kentucky General Assembly has provided that, “The commission shall have exclusive jurisdiction over the regulation of rates and service of utilities” KRS 278.040(2). This statutory grant of jurisdiction

⁷ KY Transco’s post-hearing brief at 10-11.

⁸ KY Transco’s post-hearing brief at 9-10.

⁹ KY Transco’s Response to Staff’s Fourth Data Request, Item No. 16.

¹⁰ KY Transco’s Response to Staff’s Fourth Data Request, Item No. 15, and KY Transco’s Response to Staff’s First Data Request, Item No. 2a.

¹¹ KY Transco’s Response to September 13, 2011 Conference Request, Item No. 1.

to the Commission has also been held to be a limitation on the Commission's jurisdiction.

More than 70 years ago, in addressing the Commission's authority over the terms and conditions in a municipal franchise for utility service, Kentucky's then-highest Court declared that the Commission's "jurisdiction is exclusively confined 'to the regulation of rates and service.'"¹² The following year, the Court again addressed the Commission's jurisdiction under what is now KRS 278.040(2), holding that it "was expressly stated that the intention was to confer jurisdiction only over the matter of rates and service."¹³

In establishing a statutory scheme for the regulation of utilities, as now codified in KRS Chapter 278, the General Assembly directed that "[u]nder rules prescribed by the commission, each utility shall file with the commission, within such time and in such form as the commission designates, schedules showing all rates and conditions for service established by it and collected and enforced." KRS 278.160(1). Pursuant to this directive, the Commission promulgated 807 KAR 5:011, Section 1(9), which defines a "tariff" as "a utility's schedule of each of its rates, charges, tolls, maps, terms, and conditions of service over which the commission has jurisdiction," and Section 2(2), which requires that "[e]ach utility shall maintain a complete tariff with the commission." Thus, under Kentucky statutes and regulations, a utility must file with the Commission a

¹² *People's Gas Co. of Kentucky v. City of Barbourville*, 291 Ky. 805, 165 S.W. 2d 567, 572 (Ky. 1942).

¹³ *Benzinger v. Union Light, Heat & Power Co.*, 293 Ky. 747, 170 S.W. 2d 38, 41 (Ky. 1943). See also, *Simpson County Water District v. City of Franklin*, 872 S.W. 2d 460, 463 (Ky. 1994). ("*Benzinger* ... acknowledged the legislative intent of the act as to place the regulation of rates and service under the exclusive jurisdiction of the PSC.")

tariff setting forth all the rates and conditions of service that are subject to the Commission's jurisdiction.

KY Transco, however, has definitively stated that all of its transmission assets are regulated exclusively by FERC¹⁴ and has specifically stated that "KY Transco would not be subject to any requirements of 807 KAR 5:011 that relate to KY Transco's rates or tariffs, including any requirement that such rates or tariffs be filed with the Public Service Commission of Kentucky, as KY Transco's rates and tariffs are within the exclusive jurisdiction of the Federal Energy Regulatory Commission."¹⁵ While KY Transco asserts that aspects of its service will be subject to Commission jurisdiction,¹⁶ in the absence of a tariff on file with the Commission, KY Transco will not be in compliance with Kentucky law.

The Commission further finds that the definitions set forth in KRS Chapter 278 include the term "regulated activity," which "means a service provided by a utility or other person, the rates and charges of which are regulated by the commission." KRS 278.010(23). Under this definition, the wholesale transmission service that KY Transco proposes to offer would not be a regulated activity, since the rates and charges for KY Transco's transmission service would not be regulated by the Commission. And since the only service that KY Transco is requesting authority to offer is wholesale transmission service, by law, KY Transco would not be providing a regulated service within the parameters of the Commission's jurisdiction under KRS Chapter 278.

¹⁴ KY Transco's post-hearing brief at 9.

¹⁵ KY Transco's Response to Staff's Fourth Data Request, Item No. 19, at 4.

¹⁶ *Id.*

Therefore, the Commission finds that the service that KY Transco proposes to provide in Kentucky cannot be classified as "utility service," as that term is used in the CPCN statute, KRS 278.020(1), since KY Transco's service would not be a Commission regulated activity. Consequently, KY Transco does not legally qualify for the issuance of a CPCN to provide only wholesale transmission service which would not be a Commission regulated activity and which would be provided under rates and tariffs that are not filed here as required by KRS 278.160(1) for regulated activities.

The fact that KY Transco intends to provide the same wholesale transmission service that Kentucky Power now provides does not convert that FERC regulated activity into one that is a Commission regulated activity under KRS Chapter 278. Kentucky Power provides its retail customers with a bundled service consisting of electric generation, transmission, and distribution. Kentucky Power has on file with the Commission tariffs setting forth its rates and terms and conditions for service, all of which are regulated by the Commission. If the only service provided by Kentucky Power were wholesale transmission, and if it had no tariffs on file with the Commission, that wholesale transmission service would similarly not be a regulated activity as defined in KRS 278.010(23). As noted in the Dissenting Opinion, should KY Transco propose to construct transmission facilities capable of operating at 69 kV or above, those facilities will be subject to siting review by the Kentucky State Board on Electric Generation and Transmission Siting, pursuant to KRS 278.700(5) and 278.714.¹⁷ To the extent that the review of an unregulated transmission line may seem to be less

¹⁷ See e.g., Case No. 2010-00223, *Application of Southern Indiana Gas & Electric Co. D/B/A Vectrin Energy Delivery of Indiana, Inc. for a Certificate to Construct an Electric Transmission Line from Its A.B. Brown Plant to the Big Rivers Reid EHV Station* (Ky. PSC Sep. 26, 2012).

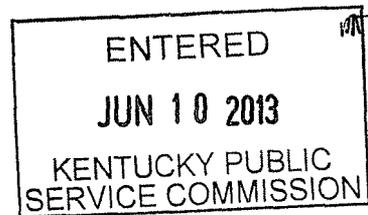
stringent than the review of a regulated transmission line under KRS 278.020(2), that reflects a policy decision by the General Assembly. It is the General Assembly that establishes the legal bounds of our jurisdiction and we simply cannot expand our jurisdiction to include unregulated wholesale transmission service based on policy reasons.

Having concluded in the negative on the first issue, i.e., that KY Transco will not be providing utility service subject to our jurisdiction, we need not address whether the public convenience and necessity require a new service provider.

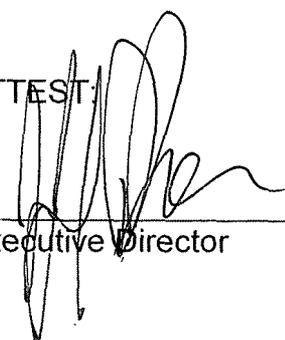
IT IS THEREFORE ORDERED that KY Transco's application for a CPCN to provide wholesale electric transmission service in Kentucky is denied.

By the Commission

Vice Chairman Gardner is dissenting.



ATTEST:



Executive Director

Dissenting Opinion of
Vice Chairman James W. Gardner

The case before us presents this Commission with two very important policy issues facing the regulatory community today: What is the best way to build transmission lines; and what is the relationship between federal and state authorities on this issue? Because the policy consequences of the majority decision on these issues are wrong for Kentucky, and because its legal reasoning is unconvincing, I respectfully dissent.

First, the legal reasoning of the majority opinion is novel and confusing. This opinion relies on FERC's having exclusive jurisdiction over rates and two 70-year old Kentucky cases. It is not disputed that FERC will have the exclusive jurisdiction over the transmission rates of the AEP Kentucky Transmission Company. Additionally, those cases merely hold that the PSC's jurisdiction is limited to rates and services.

The opinion, however, then jumps to the conclusion that if we can't regulate all rates and services, then we won't regulate any of the rates and services, because it is not a utility. This conclusion, however, is not expressed at all in those cases, nor in the statutes relied upon by the majority.

The majority also relies on our own regulation, 807 KAR 5:011, to buttress its conclusion. That regulation merely requires a tariff to be filed and maintained with the commission and defines tariffs as rates, tolls, charges, etc., over which we have jurisdiction. In fact, this regulation actually supports the opposite conclusion! The regulation doesn't say that if a utility's rate is not on file with the commission, it is not a jurisdictional utility. In a tautologous manner, it merely says that those rates which we regulate must be on file with us so we can regulate them. It says nothing else.

It is noteworthy to point out that Kentucky Power Company does not even currently file its transmission rates with the Commission, because FERC currently sets these rates. Thus, there would be no change at all. The transmission tariff would be set by FERC, as it is now, and not filed with us.

Second, with respect to the policy, as noted above, the majority decision seems to say, "Because we can't regulate all aspects of this proposed transmission company, we won't regulate any of it." The majority in my opinion is gambling that after we deny the applicant the ability to be a utility, AEP will build future transmission lines in Kentucky as it always has, i.e. by Kentucky Power Company itself. However, I believe that it is far more likely that the transmission will be built by the applicant, AEP Kentucky Transmission Company, Inc., as an unregulated merchant company. If that occurs we relinquish all regulation.¹

Prior to this decision the Commission has consistently refused or has been reluctant to relinquish authority to federal utility regulators (i.e. FERC or FCC), to the market itself, or to regional transmission organizations. But I believe this decision does just that. We have let the perfect be the enemy of the possible. I do not believe we should further limit our ability to have a seat at the transmission planning table, but this decision, in fact, does that. The applicant acknowledges that there are many areas where we would still be able to regulate if we were to allow AEP Kentucky Transmission

¹ As Commissioners, the three of us would, of course, sit on the seven-member siting board to review a transmission application; however, that review is similar to that of a local planning and zoning board, where we basically are limited to considering only aesthetics.

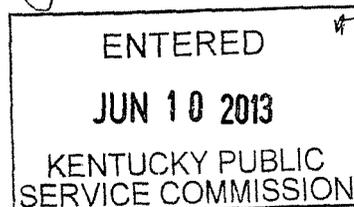
Company, Inc. to be a utility.² I would not risk losing the ability to regulate those important matters.

A lot has happened in utility regulation in the last 70 years. The federal government has assumed more and more authority from the states. The price of natural gas has been deregulated. The price of transporting gas on interstate pipelines is set by FERC, yet we still regulate the distribution of natural gas, even though the commodity cost of natural gas and interstate pipeline rates are not set by us. Likewise, we do not set the rates for telephone service. The FCC does, even though we still regulate some aspects, such as customer service. Likewise, just because we don't regulate all electric transmission functions, doesn't mean we shouldn't regulate any of them.

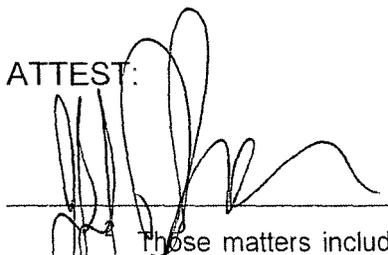
Finally, having concluded that the applicant is a utility, I also believe the evidence is sufficient that there is a public need and necessity for such service.

For these reasons, I respectfully dissent and would grant the applicant a certificate.


James W. Gardner, Vice Chairman



ATTEST:



Those matters include transfer of control, construction and siting of transmission lines under KRS 278.020, service, transfer of assets, all financings, transactions with affiliates, requirement to obtain a CPCN before bidding on a franchise, production and examination of books and records, and revenues would be subject to levy of assessment.

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