

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY UTILITIES)
COMPANY FOR AN ADJUSTMENT OF) Case No. 2009-00548
BASE RATES)

And

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND)
ELECTRIC COMPANY FOR AN) Case No. 2009-00549
ADJUSTMENT OF ELECTRIC AND GAS)
BASE RATES)

ATTORNEY GENERAL'S REPLY TO THE
JOINT RESPONSE OF KENTUCKY UTILITIES COMPANY
AND LOUISVILLE GAS AND ELECTRIC COMPANY
TO HIS MOTION TO DISMISS

The Attorney General, under the authority of the 3 June 2010 Orders of procedure issued for these proceedings, files his Reply to the Joint Response of Kentucky Utilities Company and Louisville Gas and Electric Company to his Motion to Dismiss. In view of the announced-intent of E.ON AG to sell E.ON U.S. LLC and the pending application for a transfer to the PPL Corporation, the test periods utilized by each applicant are no longer sufficient, reasonable for use in setting rates.

1. The Ultimate Ownership of LG&E and KU is Relevant to the Determination of Fair, Just and Reasonable Rates Under KRS Chapter 278.

The Joint Response opens with the claim, “the ultimate ownership of LG&E and KU is irrelevant to the determination of fair, just and reasonable rates under KRS Chapter 278.”¹ Compare this position with the Direct Testimonies of William E. Avera on behalf of LG&E and KU. Mr. Avera’s *first* statement in describing LG&E: “Along with Kentucky Utilities Company (“KU”), LGE is a wholly owned subsidiary of E.ON U.S. LLC (“E.ON U.S.”), which in turn is an indirect subsidiary of E.ON AG (“E.ON”).”² He opens his description of KU in the same manner.³

The fact of ownership is not simply a stale, historical note. Per Avera: “As a wholly-owned subsidiary of E.ON U.S., LGE *ultimately* obtains equity capital and most of its debt capital solely from the parent corporation, E.ON, whose common stock is included as one of the 30 members of the DAX stock index of major German companies. [emphasis added]”⁴ He observes the same for KU.⁵

¹ Joint Response, page 1.

² Direct Testimony of William E. Avera on behalf of Louisville Gas and Electric, Case No. 2009-00549, page 7, line 1.

³ Direct Testimony of William E. Avera on behalf of Kentucky Utilities Company, Case No. 2009-00548, page 7, line 1; see also, for example, Item 50 (a) of the Commission Staff’s 2nd Request for Information dated 1 March 2010

⁴ Direct Testimony of Avera, Case No. 2009-00549, page 9.

⁵ Direct Testimony of Avera, Case No. 2009-00548, page 8.

Contrary to the position of the Joint Response, the ultimate ownership is certainly relevant to ability of LG&E and KU to attract capital. This is why there has been inquiry by the Commission on this point.⁶

Ultimate ownership bears upon the business risk, financial risk, credit profile, and growth opportunities of each utility. It is difficult to overstate the relevance of the ultimate ownership on the financial, technical, and managerial aspects of both utilities. Yet, bearing in mind procedural orders through which the Companies are to make timely amendments to any response “though correct when made is now incorrect in any material respect,”⁷ the Companies insist that the stated intent of E.ON AG to sell-off E.ON U.S. and the “signed” agreement with the PPL Corporation are irrelevant to these proceedings. This is simply not true; consideration of ultimate ownership has been actively “in-play” since the Companies filed their rate applications. Therefore, E.ON AG’s intent and actions to change the ultimate ownership are clearly relevant.

2. The Joint Response’s Discussion of the “Known and Measurable” Framework Underscores the Problem with the Situation.

The purpose of a test period is to justify the reasonableness of a proposed general increase in rates.⁸ As noted in the Motion to Dismiss, when an item in the test period does not reflect reasonably expected, normal, on-going operations, then adjustments

⁶ See, for example, Item 50 (a) of Commission Staff’s 2nd Request for Information in Case No. 2009-00548, Order dated 1 March 2010 (in which Staff asks Avera how E.ON AG obtains capital) and Item 50 (a) of Commission Staff’s 2nd Request for Information in Case No. 2009-00549, Order dated 1 March 2010.

⁷ See, for example, instruction in Order of procedure, Case No. 2009-00548, dated 19 January 2010.

⁸ KRS 278.192 (1).

may be appropriate.⁹ There are, however, limits to the ability to adjust a test period. One limit is that the adjustment must be “known and measurable,” and it appears that the Attorney General and the Joint Response are in agreement on this point.¹⁰

The Attorney General’s disagreement with the Joint Response relates to what happens in a scenario, such as is present in these proceedings, in which post-test period developments cause the historical test periods to become unreliable *and* when the use of the “known and measurable” adjustment process cannot serve to render the test periods reflective of intended or anticipated normal, on-going operations.

Per the Joint Response, it appears that the Companies simply want to ignore the post-test period developments concerning the ultimate ownership of the Companies because the nature and the extent of E.ON AG’s intent, actions, and the agreement with PPL Corporation upon LG&E and KU are not yet well-defined or capable of quantification. It is a request for the rate-making process to bury its head in the sand.

In reply: The purpose of the test year is to justify the reasonableness of the proposed increase in rates. It follows that when there is a post-test year development that renders the test year unreliable for this purpose, the test year must either be adjusted so that it reflects normal, on-going operations, or it must be disregarded. Here, it cannot be adjusted. The Attorney General cannot agree to characterize the

⁹ Motion to Dismiss, page 4.

¹⁰ Joint Response, page 3. “The relevant Commission regulation allows for adjustments to be made to a utility’s historical test year data, but only when such adjustments are ‘known and measurable.’”

development relating to the Companies' ultimate ownership as irrelevant; likewise, he cannot agree to term it immaterial and of no consequence to the reliability of the test periods being utilized to justify the reasonableness of these rates.

3. The Attorney General's Utilization of the Guidance Contained in *Energy Regulatory Commission v. Kentucky Power Company* Accords with the Language of the Decision and Commission Precedent.

In his Motion to Dismiss, the Attorney General, referencing *Energy Regulatory Commission v. Kentucky Power*, 605 S.W. 2d 50 (Ky.App. 1980), states that there is no presumption that the information set forth in an application for a change in rates is reasonable for setting rates.¹¹ The Joint Response contends that this is a misstatement.¹² In reply, the Attorney General admits that the reference is not well-developed in the Motion; there is no presumption that the Companies' evidence is sufficient.

The starting point is the portion of the paragraph that does not appear to be in dispute. The burden of proof to show that a proposed increase in a rate or charge is just and reasonable is upon the applicant. This is set forth in statute: KRS 278.190 (3). The principle that applicants before an administrative agency have the burden of proof is also recognized in case law: *Energy Regulatory Commission v. Kentucky Power*, 605 S.W.2d 46, 50 (Ky.App. 1980); and *Lee v. International Harvester Co.*, 373 S.W.2d 418 (Ky. 1963).¹³

¹¹ Motion to Dismiss, page 2.

¹² Joint Response, page 5.

¹³ See, for example, *In the Matter of: Patricia Conner Complainant v. Bellsouth Telecommunications, Inc.*, Case No. 2005-00220, Order dated 19 May 2006; and *In re: Kentucky Power Company dba American Electric Power*, Case No. 2002-00475, Order dated 17 July 2003, page 2.

Now, consider the following discussion in Commission Case No. 2002-00475.

As the applicant in this case, Kentucky Power bears the burden of proof. *Energy Regulatory Commission v. Kentucky Power Co.*, Ky.App. 605 S.W. 2d 46 (1980). The fact that the only testimony presented was from the applicant in support of the transfer does not require the Commission to approve the transfer. The Commission may analyze and weigh all the evidence, including that adduced during discovery and at the hearing and find it insufficient to meet the applicant's burden.¹⁴

Further, consider the following discussion from Commission Case No 8836.

The burden of proof for the necessity of any change in the approved [depreciation] rates rests entirely with Kentucky-American. It is not necessary, as claimed by Kentucky-American's counsel, that this Commission or anyone else prove that the proposed change is inappropriate.¹⁵

Lastly, compare the discussion appearing in *Energy Regulatory Commission*.

In the instant proceeding the Commission functioned as a quasi-judicial body hearing and weighing evidence in order to make the required finding that a grant or denial of the certification would best serve the public interest. Applicants before an administrative agency have the burden of proof. *Lee v. International Harvester Co.*, 373 S.W.2d 418 (1963).

Later, the Court again citing to *Lee v. International Harvester* states:

Standing alone, unimpeached, unexplained and un rebutted testimony may or may not be so persuasive that it would be clearly unreasonable for the **board**¹⁶ to be convinced by it [emphasis added]. *Lee, supra*.¹⁷

¹⁴ *In re: Kentucky Power Company dba American Electric Power*, Case No. 2002-00475, Order entered 17 July 2003, page 2.

¹⁵ *In the Matter of: Notice of Adjustment of the Rates of Kentucky-American Water Company*, Case No. 8836, Order dated 20 December 1983, page 9.

¹⁶ The Attorney General is not in agreement that this portion of the Opinion in *Energy Regulatory Commission* is directed to the circuit court's role. In reply to the Joint Response (page 6), the Attorney General submits that if the Court had intended for this statement to be a construction of the circuit court's role, it would not have cited *International Harvester* as authority for the point. Rather, by reference to the preceding sentences in the Opinion, the discussion matches an analysis of the Commission in its capacity as a quasi-judicial body by pointing out that, as such, the Commission is not an "adversary" and

These three discussions convey the same message regarding the assignment of the burden of proof and its nature. The applicant has the burden, and there is no presumption that the information set forth by an applicant, even in a situation in which it is the *only evidence* in the record, is sufficient. The burden of proof is upon the applicant to demonstrate that its evidence is sufficient.

As to the assertion in the Joint Response that the language in *Energy Regulatory Commission* is *dicta*,¹⁸ regardless of its characterization, the language describes the nature of the burden of proof before the Commission. Additionally, in passing, there is no theory of law preventing the Commission from using its guidance, which, as reflected in Commission precedent since the publication of the Opinion, the Commission has done. The evidence of an applicant before the Commission does not carry with it any presumption that it is sufficient. The applicant must prove it sufficient.

And, on this point, this is why the Attorney General does not find the observation in the Joint Response that “the records of evidence in these proceedings are voluminous,”¹⁹ a compelling statement. Quantity alone does not equate to sufficiency. If the applications and records omit any discussion of the consequence of E.ON AG’s

discussing the theory of a prima facie case *before the agency*, not the circuit court. It appears that the use of *International Harvester* by the Court in *Energy Regulatory Commission* is for the purpose of addressing the Commission’s hearing and weighing of evidence in the quasi-judicial proceeding. This position is supported by the fact that the Court of Appeals uses a different case, *Lee v. Tucker*, 365 S.W.2d 849 (Ky. 1963) in instructing the circuit court regarding its role.

¹⁷ *Energy Regulatory Commission v. Kentucky Power*, 605 S.W.2d 46, 50 (Ky.App. 1980). Further, with regard to this quote, the Attorney General does not believe that there was any intent by the Court of Appeals to modify *Lee v. International Harvester*.

¹⁸ Joint Response, page 6.

¹⁹ Joint Response, pages 1, 2, and see page 6.

intent and actions to sell E.ON U.S. as well as any discussion of the agreement with PPL Corporation, then how can the remaining body of evidence be sufficient? It certainly is not through any presumption. It could only be sufficient if the Commission finds that the post-test period developments are irrelevant or, arguably, immaterial. With regard to the latter, it is difficult to understand how the Commission could make such a finding in the absence of discovery.

4. Dismissal is Permissible Under KRS Chapter 278.

The statement in the Joint Response that “the power to dismiss a rate application without prejudice but against the utility’s will robs the utility of its due process right to be heard and to have the Commission issue a final order on the merits of its rate application before being deprived of what would otherwise be its right to put its proposed rates into effect at the end of ten months,”²⁰ describes an unqualified right that does not exist in KRS Chapter 278. The statement that the rate applications may only be terminated by one of three events once the Commission accepts cases and later sets them for a hearing²¹ is not accurate.

The Commission may dismiss a rate application upon good cause such as when a utility refuses to submit information necessary to determine the reasonableness of its proposed rate.²² Hence, KRS 278.190 does not provide an unqualified right to be heard

²⁰ Joint Response, page 10; see also page 9.

²¹ Joint Response, page 9.

²² *In the Matter of: Application of W&W Service Company for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Case No. 2004-00079, Order dated 29 September 2004;

or obtain a final order on the merits of the rate application as suggested by the Joint Response. In this instance the Companies are unable to submit the necessary information to determine the reasonableness of the proposed rates.

In response to any suggestion that dismissal is only appropriate upon a finding of non-compliance or misconduct, if the time-frame for determining an application permitted adequate time to develop the record, then dismissal would seem inappropriate in the absence of non-compliance or misconduct. Here, however, there is not sufficient time. Thus, whether it is because the applicant is unwilling or whether it is due to the fact that the applicant is unable, dismissal of an application is a remedy for an insufficient record. Therefore, the Attorney General does not agree with the Joint Response's suggestion that the Companies have a right to have their rate applications heard on the merits in this circumstance, a circumstance created by E.ON AG's decision to sign an agreement for transferring E.ON U.S.²³

5. The Attorney General May Utilize the Public Statements Regarding the Agreement with PPL Corporation.

The existence of the intent of E.ON AG to divest itself of E.ON U.S. LLC is not hypothetical.²⁴ The fact of the intent is manifest in the agreement through which PPL Corporation seeks to acquire E.ON U.S., a transfer case filed with this Commission on

²³ Further, even if it hears the applications on their merits, the Commission is authorized to deny either or both if it finds the evidence insufficient.

²⁴ Joint Response, page 10. In an attempt to distance themselves from the natural, logical consequences of the stated intent of E.ON AG, the Joint Response speaks in terms of a "hypothetical merger." "Pending merger" is a far better description.

28 May 2010. The Attorney General does not argue that the transfer will be approved²⁵ (or even that it should be approved). Rather, if it is approved it stands to result in a material change in both KU and LG&E. The Attorney General is trying to determine the nature of the anticipated change but cannot do so in a meaningful way and without prejudicial harm to the Attorney General under the deadlines imposed by KRS 278.190.

Because the records in the rate applications are barren with regard to E.ON AG's intent (what E.ON AG anticipates) and the possible impacts due to the agreement with PPL Corporation, the Attorney General sought information regarding the transaction through the press releases of PPL Corporation. This is by no means a novel or unreasonable avenue for garnering information regarding a merger agreement.²⁶

The point is not whether E.ON AG and PPL Corporation will be approved. The point is that it is inconsistent for E.ON AG to pursue one goal for LG&E and KU before this Commission in the transfer case while asking the Commission to ignore its request for approval of the transfer in the rate proceeding. Again, while the parties to the PPL transaction have been discussing the impact of the transaction to the normal, on-going operations of KU and LG&E to the audience in the investment community, the parties to the PPL transaction have left the rate-making arena relatively quiet if not

²⁵ Motion to Dismiss, page 3.

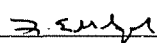
²⁶ See *In the Matter of: Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GMBH*, Case No. 2002-00018, Order dated 20 January 2002, Appendix B, page 13, Item 30 "Provide all press releases, Web site postings, and other forms of public information disseminated ... regarding the proposed merger since the execution of the Agreement and Plan of Merger."

silent with regard to the impact of the transaction on KU and LG&E expected normal, on-going operations.

WHEREFORE, the Attorney General Respectfully moves the Commission to dismiss, without prejudice, the instant cases.

Respectfully submitted,

JACK CONWAY
ATTORNEY GENERAL



DENNIS G. HOWARD, II
DAVID EDWARD SPENARD
LAWRENCE W. COOK
PAUL D. ADAMS
ASSISTANT ATTORNEYS GENERAL
1024 CAPITAL CENTER DRIVE
SUITE 200
FRANKFORT KY 40601-8204
T (502) 696-5453
F (502) 573-8315

Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

Lonnie E Bellar
E.ON U.S. LLC
220 West Main Street
Louisville, KY 40202

James T Selecky
BAI Consulting
16690 Swingley Ridge Road, Suite 140
Chesterfield, MO 63017

Honorable David C Brown, Esq.
Stites & Harbison, PLLC
1800 Providian Center
400 West Market Street
Louisville, KY 40202

Honorable Allyson K Sturgeon
Senior Corporate Attorney
E.ON U.S. LLC
220 West Main Street
Louisville, KY 40202

Iris G Skidmore
415 W. Main Street, Suite 2
Frankfort, KY 40601

Holly Rachel Smith
Hitt Business Center
3803 Rectortown Road
Marshall, VA 20115

Honorable Kendrick R Riggs
Stoll Keenon Ogden, PLLC
2000 PNC Plaza
500 W Jefferson Street
Louisville, KY 40202-2828

Steven A Edwards
Office of the Staff Judge Advocate
1320 Third Avenue, Room 215
Fort Knox, KY 40121-5000

Hon. Tom Fitzgerald
Kentucky Resources Council, Inc.
PO Box 1070
Frankfort, KY 40602

Honorable Robert M Watt, III
Monica Braun
STOLL KEENON OGDEN PLLC
300 West Vine Street; Suite 2100
Lexington, KY 40507-1801

Honorable Michael L Kurtz
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202

Robert A Ganton, Esq
U.S. Army Legal Services Agency
Regulatory Law Office
901 North Sturart Street, Suite 525
Arlington, VA 22203

Laurence J Zielke
Zielke Law Firm PLLC
1250 Meidinger Tower
462 South Fourth Avenue
Louisville, KY 40202-3465

Honorable Kimberly S McCann
William H. Jones, Sr.
VanAntwerp, Monge, Jones & Edwards
P. O. Box 1111
Ashland, KY 41105-1111

Dominic F Perella
Columbia Square
555 13th Street, NW
Washington, DC 20004

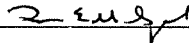
Carroll M Redford III
Miller, Griffin & Marks, PSC
271 W Short Street, Suite 600
Lexington, KY 40507

Honorable Gardner F Gillespie
Hogan & Hartson, L.L.P.
555 Thirteenth Street, N.W.
Washington, DC 20004-1109

Honorable Lisa Kilkelly
Legal Aid Society
416 West Muhammad Ali Boulevard
Suite 300
Louisville, KY 40202

Matthew R. Malone
Hurt, Crosbie & May PLLC
The Equus Building
127 West Main Street
Lexington, KY 40507

all on this 7th day of June, 2010.



Assistant Attorney General