

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeem G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Louisville Gas & Electric Company and
Kentucky Utilities Company

Docket Nos. ER02-2560-005
ER02-2560-006

ORDER ON REHEARING AND DIRECTING A FURTHER COMPLIANCE FILING

(Issued February 6, 2007)

1. In this order, the Commission grants in part and denies in part the requests for rehearing of Gallatin Steel Company (Gallatin) and East Kentucky Power Cooperative, Inc. (East Kentucky) of the Commission's Order Affirming Remand Decision.¹ The Commission also directs a further compliance filing with a revised refund report.

I. Requests for Rehearing

A. Background

2. Kentucky Utilities Company (KU) and East Kentucky are parties to an Interconnection Agreement which allows each to use the other's transmission system to avoid costly duplication of facilities. KU and East Kentucky also entered into a Transmission Agreement for transmission service to Gallatin; Gallatin is an East Kentucky load, but is located on KU's system. The Transmission Agreement was likewise designed to avoid the cost of duplicate facilities.

3. After the Agreements were negotiated, KU merged with Louisville Gas & Electric Company (LG&E). LG&E/KU were transmission owning members of the Midwest

¹ *Louisville Gas & Electric Co.*, 116 FERC ¶ 61,215 (2006) (September 2006 Order.)

Independent Transmission System Operator, Inc. (Midwest ISO)², but the Agreements are “Grandfathered Agreements” under the Midwest ISO Open Access Transmission OATT (OATT),³ *i.e.*, transmission service outlined in the Agreements continues to be provided pursuant to the rates, terms and conditions of the Agreements and not the Midwest ISO OATT.⁴

4. In September 2002, LG&E/KU filed with the Commission a proposal to restructure the Agreements and essentially sought to “adjust the rates... under the Agreements so that the charges reflect the corresponding charges that [East Kentucky] would pay if it were a transmission customer of the Midwest ISO.” In amending the Agreements, LG&E/KU sought to “eliminate the under-recovery of their transmission revenue requirement, including the Midwest ISO charges that it is assessed for service provided under the Agreements.” The Commission accepted and suspended LG&E/KU’s proposed rate changes, made them effective November 18, 2002, subject to refund, and set them for hearing.⁵

B. Initial Decision

5. Following a hearing, the Presiding Judge issued an initial decision finding that: (1) LG&E/KU may not charge for ancillary services under the Agreements, other than Load Following and Regulation Service on loads that are not dynamically scheduled; (2) LG&E/KU may pass through the Midwest ISO Schedule 10 adder only for loads in

² During the period of service under the Agreements that are at issue in this proceeding, LG&E/KU were transmission owning members of Midwest ISO. However, as of September 1, 2006, they are no longer members of Midwest ISO.

³ The Midwest ISO OATT has been superceded by the Midwest ISO Open Access Transmission and Energy Markets OATT (TEMT). However, because the genesis of this proceeding pre-dates that change, we will use OATT for purposes of this order.

⁴ On July 21, 2006, the Commission accepted for filing a notice of cancellation for the Agreements, effective September 1, 2006. See *Kentucky Utilities Co.*, Docket No. ER06-1124-000 (July 21, 2006) (unpublished letter order). Therefore, the rates at issue in this proceeding are for the locked-in period of November 18, 2002 to September 1, 2006. In addition, LG&E/KU agreed to certain rate treatments for East Kentucky as part of their withdrawal from Midwest ISO. See *Louisville Gas & Electric Co.*, Docket No. ER06-519-000 (March 17, 2006) (unpublished letter order)

⁵ *Louisville Gas & Electric Co.*, 101 FERC ¶ 61,182 (2002) (Hearing Order).

excess of the base load amounts in the Agreements; (3) LG&E/KU may include a 50 basis point return on equity adder in rates for loads in excess of the base load amounts in the Agreements; (4) East Kentucky should be charged the regional through and out rate under the Midwest ISO OATT to import power to serve the base load amounts under the Agreements,⁶ but not to serve any loads for which the Midwest ISO OATT rate has been adopted for service under the Agreements; (5) LG&E/KU must eliminate the cost of the Virginia facilities from the transmission rates it charges under the Agreements; (6) LG&E/KU may not automatically pass through under the Agreements charges under any future schedules that are added to the Midwest ISO OATT but instead must make a new filing under section 205 of the Federal Power Act (FPA);⁷ (7) LG&E/KU may charge the Midwest ISO Schedule 9 rates for network service only for loads in excess of the base load amounts in the Agreements; and (8) LG&E/KU should be charged the rates in East Kentucky's OATT for service they take from East Kentucky in excess of the base load amounts in the Agreements.⁸

6. The Commission affirmed in part and reversed in part the Presiding Judge's findings and established further hearing procedures.⁹

⁶ "The Presiding Judge explained that when East Kentucky imports energy from Midwest ISO transmission owners other than [LG&E/KU] to serve loads under the Agreements, it currently pays the [regional through and out rate] in addition to the charges under the Agreements, and, thus, is subjected to rate pancaking. The Presiding Judge found that it would be unfair, discriminatory, and duplicative for [LG&E/KU] to adopt the Midwest ISO OATT rate for service under the Agreements and deny East Kentucky the elimination of rate pancaking for use of the Midwest ISO transmission system." *Louisville Gas & Electric Co.*, 109 FERC ¶ 61,330 at P 29 (2004) (December 2004 Order), *reh'g denied*, 111 FERC ¶ 61,323 (2005) (June 2005 Rehearing Order).

⁷ 16 U.S.C. § 824d (2000).

⁸ *Louisville Gas & Electric Co.*, 106 FERC ¶ 63,039 (2004) (Initial Decision).

⁹ December 2004 Order, 109 FERC ¶ 61,330; June 2005 Rehearing Order, 111 FERC ¶ 61,323.

7. As to issue 4,¹⁰ the Commission disagreed with the Presiding Judge's explanation that East Kentucky is now entitled to service over the entire Midwest ISO system because the proposed rate was the same as the Midwest ISO OATT rate for load in the LG&E/KU zone. The Commission stated that "the appropriate solution is not to expand the scope of service under the Agreements to include access to the entire Midwest ISO system. Rather, the appropriate solution is to adjust the proposed rate, to reflect an allocation of costs to the Agreements assuming that LG&E/KU did not provide access to its system under the Midwest ISO OATT."¹¹ The Commission then remanded this issue back to the Presiding Judge to determine what adjustment to the proposed rate is necessary.

C. Remand Decision

8. On November 16, 2005, following a further hearing, the Presiding Judge issued the Remand Decision on the sole remaining issue: determining the appropriate adjustment to the rate proposed by LG&E/KU for transmission service to East Kentucky under the terms of the Agreements.¹²

9. In the Remand Decision, the Presiding Judge concluded that: (1) the Midwest ISO Attachment O formula rates which LG&E/KU proposed to use here are multi-zonal rates which presume the right of the customer to service over the entire Midwest ISO system at a single, non-pancaked rate; (2) on all amounts of service covered by the Agreements, including amounts of service in excess of the base load amounts, LG&E/KU offered only single-zone service over their own transmission system; (3) East Kentucky was denied the right to multi-zonal service under the Agreements; (4) LG&E/KU's proposed rates are calculated as though they provided multi-zonal service (although, as noted, LG&E/KU provided only single-zone service to East Kentucky); (5) the Presiding Judge proposed a methodology to adjust the rates to recognize that single-zone service was provided to East Kentucky by adding "source" throughput to the "sink" throughput that is already included in the denominator of the rate equation; (6) by adjusting the rates in this manner (and multiplying them by the amount of East Kentucky's throughput), LG&E/KU will have apportioned its costs of service to East Kentucky to properly reflect the service

¹⁰ In the December 2004 Order, the Commission affirmed the Presiding Judge on issues (2), (3), (5), (6), and (7), affirmed the Presiding Judge in part on issue (1), and disagreed with the Presiding Judge on issues (4) and (8).

¹¹ December 2004 Order, 109 FERC ¶ 61,330 at P 32.

¹² *Louisville Gas & Electric Co.*, 113 FERC ¶ 63,022 (2005) (Remand Decision).

provided to East Kentucky under the Agreements; (7) LG&E/KU should be required to demonstrate that they have adjusted their proposed rates by adding this source-only throughput¹³ to the denominator of the rate equation (or must revert to the rates already provided in the Agreements, which are currently applied to the base load amounts under those Agreements); and (8) any proposed rate that does not take into account the costs of service that should be attributed to source transactions and, instead, apportions them to East Kentucky, would not reflect the single-zone service that is provided to East Kentucky and thus would be unjust and unreasonable.¹⁴

10. The Commission affirmed the Presiding Judge's Remand Decision. Specifically, the Commission found that the Remand Decision was well-reasoned and the Commission affirmed and adopted all of the Presiding Judge's findings and conclusions. The Commission also rejected East Kentucky's proposed rate adjustment, finding that the proposal amounted to an impermissible expansion of service under the Agreements. The findings in the September 2006 Order required LG&E/KU to adjust their rate in the way proposed by the Presiding Judge and to refund to East Kentucky the resulting difference, with interest. The rates under the Agreements thus should reflect the single-zone service LG&E/KU is providing. The Commission further found that, to the extent that LG&E/KU is unwilling or unable (due to lack of sufficient data) to implement their proposed rate with the required adjustment, the proposed rate is unjust and unreasonable and is therefore rejected. If the proposed rate is rejected, service under the contracts would be provided under the Agreements' pre-existing rates.¹⁵

II. Discussion

A. Requests for Rehearing

11. East Kentucky requests rehearing of the September 2006 Order, arguing that, by rejecting East Kentucky's claim that it was entitled to take Midwest ISO-wide service, the Commission disregarded its prior orders and policy requiring the elimination of rate pancaking under grandfathered contracts. East Kentucky also argues that the Commission mischaracterized its remand proposal as an impermissible expansion of

¹³ For purposes of this order, source-only throughput includes those transactions that source on the LG&E/KU system but sink elsewhere in Midwest ISO and which LG&E/KU currently does not include in the denominator of its proposed formula rate.

¹⁴ See Remand Decision, 113 FERC ¶ 63,022 at P 98.

¹⁵ September 2006 Order, 116 FERC ¶ 61,215 at P 30.

service under the Agreements and failed to consider record evidence supporting its proposal.

12. Gallatin requests rehearing of the September 2006 Order, arguing that the Commission's decision conflicts with previous orders and is unsupported by record evidence. It asserts that among the Commission's errors in the September 2006 Order by allowing LG&E/KU to charge for ancillary services under the Agreements, permitting the recovery of the Midwest ISO Schedule 10 charges and concluding that the rates at issue should reflect single-zone service rather than Midwest ISO-wide service and thus, rejecting East Kentucky's proposal.

B. Rejection of the Remand Proposal

13. East Kentucky argues that the Commission's rejection of its remand proposal is contrary to record evidence and Commission orders that called for eliminating the effects of rate pancaking. Under East Kentucky's proposal, it would take service under the Agreements when it needs single-system service, and would take Midwest ISO OATT service when it needs Midwest ISO-wide service. Of particular relevance, when East Kentucky takes Midwest ISO-wide service, LG&E would refund to East Kentucky any charges under the Agreements. Thus, East Kentucky's proposal permits East Kentucky to obtain and pay for Midwest ISO-wide service under the Midwest ISO OATT without also paying a rate under the Agreements on the same transactions. East Kentucky argues that currently it is paying more than other similarly situated Midwest ISO customers because it is being charged both the Midwest ISO regional through and out rate for delivering power from Midwest ISO resources to its load on the LG&E/KU system and a single-system rate.

14. East Kentucky argues that the Commission improperly rejected this approach, even though Commission Trial Staff, LG&E/KU and the Presiding Judge had endorsed it.

15. Gallatin argues that the Commission erred in rejecting East Kentucky's proposal. Gallatin also argues that when the Presiding Judge found that a proper adjustment of the rate required evidence that was not in the record, the Commission should have required LG&E/KU, having failed to meet their burden of proof, to reinstate the pre-existing rates under the Agreements. Gallatin argues the decision to instead require a compliance filing with the necessary information was erroneous and was not reasoned decision making.

16. The Commission disagrees with both East Kentucky and Gallatin. The Presiding Judge properly dealt with the only issue remanded to him by the Commission and that issue did not include or require consideration of East Kentucky's remand proposal. In this regard, East Kentucky's assertion that the Presiding Judge "supported" its remand proposal is incorrect and misleading. East Kentucky admits that, "The Remand Proposal

was not adopted by the Presiding Judge on the basis that it was beyond the scope of the remand proceeding.... [East Kentucky] respectfully views the Presiding Judge's conclusion that the proposal was beyond the scope of the remand proceeding to be in plain error that required reversal."¹⁶ In this regard, as well, the Presiding Judge clearly understood the scope of his responsibilities in stating that "in clear and unambiguous language, the Commission rejected [proposals to eliminate pancaking] the first time around...."¹⁷ The Presiding Judge also made it clear that "there is much to commend the Commission's policy of not conferring the benefits of an ISO on those utilities that choose not to abrogate their [grandfathered agreements] and join one."¹⁸

17. In addition, East Kentucky describes the effect of its proposal: LG&E/KU would refund charges paid by East Kentucky under the Agreements that it argues were improperly pancaked on top of the Midwest ISO OATT charges paid by East Kentucky on the same transactions (*i.e.*, for those transactions in which East Kentucky serves its load on the LG&E/KU system with resources located in the Midwest ISO). Again, however, the Presiding Judge correctly explained in the Remand Decision that:

[T]he December 2004 Order rules out requiring LG&E/KU to eliminate pancaking or basing refunds on the concept of its elimination. It would not only be unseemly, but in utter defiance of the Commission Order, for me to persist in interpreting [Midwest ISO] documents as entitling all of LG&E/KU's customers to multi-zonal service through [Midwest ISO's] transmission system because of LG&E/KU's membership in [Midwest ISO] or requiring, in any event, that LG&E/KU eliminate pancaking on transactions on which it charges a multi-zonal rate. The Commission made it clear that my mandate is to adjust the rates in accordance with the service that LG&E/KU actually provided – not to adjust the service to the rates or base a refund on a conceptualization of any such adjustment in service.¹⁹

Thus, as the Presiding Judge correctly found, and the Commission again explained in the September 2006 Order, East Kentucky's proposal went beyond the Commission's clear directive to adjust the rate in the Agreements to match the service provided, and instead

¹⁶ East Kentucky request for rehearing at 18 n.11.

¹⁷ Remand Decision, 113 FERC ¶ 63,022 at P 81.

¹⁸ *Id.* P 82.

¹⁹ Remand Decision, 113 FERC ¶ 63,022 at P 96.

was yet a further attempt by East Kentucky to expand the service available to it under the Agreements.

18. In sum, since this issue did not fall within the limited scope of the remand proceeding, it was not error for the Commission to reject East Kentucky's remand proposal and affirm the Presiding Judge's remand decision that did the same thing. As the Presiding Judge pointed out, the Commission already had addressed that issue and it was not necessary to revisit it.

19. In any event, East Kentucky's concerns about the correct rate level are now moot. As we discuss below, LG&E/KU has chosen to revert back to the pre-existing rates rather than make the required changes to their proposed formula rate. In this regard, the Commission stated in the September 2006 Order that, to the extent LG&E/KU would not or could not make the required adjustments, then the Commission rejected the proposed formula rate in favor of the pre-existing rates. Any revisions that East Kentucky believes are required to make the proposed rates just and reasonable are no longer at issue.

20. In response to Gallatin's argument that the Commission erred in requiring LG&E/KU to make a compliance filing, rather than reinstate the pre-existing rates, we disagree. The Commission did not require LG&E/KU to support its proposed rates through a compliance filing; rather the Commission required that LG&E/KU demonstrate in their compliance filing that they had made the adjustment outlined by the Presiding Judge and affirmed by the Commission.²⁰ To the extent LG&E/KU would not or could not make that adjustment, then the Commission rejected the proposed formula rate so that the rate would revert back to the pre-existing rate.²¹ In any event, the relief requested by Gallatin is that LG&E/KU to revert back to the pre-existing rates. LG&E/KU's compliance filing, as discussed further below, indicates that LG&E/KU will return to the pre-existing rates under the Agreements. Therefore, this issue is moot.

21. Accordingly, we deny the requests for rehearing on these matters.

C. Midwest ISO Schedule 10 Charges

22. East Kentucky argues that the Commission improperly dismissed East Kentucky's proposal to eliminate the Midwest ISO administrative cost adders from the Agreements as a departure from the Commission's directive in the December 2004 Order to price

²⁰ September 2006 Order, 116 FERC ¶ 61,215 at P 34.

²¹ *Id.*

service under the Agreements “assuming that [LG&E/KU] did not provide access to its system under the Midwest ISO OATT.”²² East Kentucky further argues that the Commission failed to provide any explanation or support for its conclusion that the assessment of Midwest ISO Schedule 10 charges on both base loads and loads in excess of base loads is well established, except to cite to Paragraph 97 of the December 2004 Order and Trial Staff’s Brief Opposing Exceptions, even though there is no Paragraph 97 in the December 2004 Order.²³

23. Gallatin states that the Commission erred in finding in the September 2006 Order that East Kentucky should pay Midwest ISO Schedule 10 charges for both base load amounts and amounts above base-load. Gallatin argues that this statement in the September 2006 Order is contrary to the Commission’s previous orders, and that the Commission failed to resolve the conflict or explain the basis for requiring the payment of Midwest ISO Schedule 10 charges when Gallatin argues there is no Midwest ISO service.

24. As an initial matter, we note that the Schedule 10 issue before us in this proceeding is limited to the period from November 18, 2002 to April 1, 2005, the date Schedule 23 to the Midwest ISO OATT became effective.²⁴ The Commission in a separate proceeding on Schedule 23 found that the Midwest ISO Transmission Owners (including LG&E/KU) could pass-through Schedule 10 charges to customers under certain grandfathered agreements (including the Agreements at issue here) because the Midwest ISO Transmission Owners had demonstrated that Schedule 10 charges are associated with new and different services that are not already contemplated in grandfathered agreements.²⁵ The Commission recognized this finding when it explained in the June 2005 Rehearing Order in this proceeding that LG&E/KU may recover Schedule 10 charges from East Kentucky on all service provided under the Agreements

²² East Kentucky request for rehearing at 20 (referring to December 2004 Order, 109 FERC ¶ 61,330 at P 32).

²³ *Id.* at 21.

²⁴ Separately, we note that the Agreements at issue in this proceeding terminated effective September 1, 2006. *See supra* note 4.

²⁵ *See, Transmission Owners of the Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,339 (Schedule 23 Order), *order on reh’g*, 113 FERC ¶ 61,122 (2005) (Schedule 23 Rehearing Order).

as a result of the Commission's acceptance of Schedule 23 to the Midwest ISO OATT, effective April 1, 2005.²⁶

25. In addition, for the period from November 2002 to April 2005, the Commission's prior orders established that, as part of LG&E/KU's overall proposal to change the rates in the Agreements, they may assess Schedule 10 charges for service above base load amounts. In the Initial Decision, the Presiding Judge found that LG&E/KU could not pass-through Schedule 10 charges for base load service because the rate for base load service was fixed. The Presiding Judge explained that the Schedule 10 charges are conceptually a part of the base transmission rate and is necessarily subsumed within the basic transmission rate that is fixed under the Interconnection Agreement, which covers all costs, direct and indirect, including administrative costs.²⁷ Consequently, the Schedule 10 charges cannot be added to what has been fixed by contract and is now grandfathered.²⁸ However, the Presiding Judge also found that as a cost of providing transmission on the Midwest ISO facilities, the LG&E/KU could pass-through Schedule 10 charges as part of LG&E/KU's overall proposal to modify the non-fixed rate for service above base load amounts.²⁹

26. The Commission in the December 2004 Order affirmed without further discussion the Presiding Judge's finding that LG&E/KU could pass-through the Schedule 10 charges for loads in excess of the base load amounts in the Agreements.³⁰ The Commission denied rehearing of this finding in the June 2005 Rehearing Order, but noted, as discussed above, that as of April 1, 2005, LG&E/KU could recover Schedule 10 charges for all service under the Agreements pursuant to Schedule 23.³¹ Thus the Presiding Judge correctly noted in the Remand Decision that the issue of Schedule 10 charges was considered in both the Initial Decision and the December 2004 Order and was not part of

²⁶ See, June 2005 Rehearing Order, 111 FERC ¶ 61,323 at P 42 (referring to the Schedule 23 Order).

²⁷ Initial Decision, 106 FERC ¶ 63,039 at P 51.

²⁸ *Id.*

²⁹ *Id.* P 52.

³⁰ December 2004 Order, 109 FERC ¶ 61,330 at P 8-9 (based on P 51-52 of the Initial Decision).

³¹ June 2005 Rehearing Order, 111 FERC ¶ 61,323 at P 38-42.

the limited remand.³² The Commission's statement, in the September 2006 Order, that it had been established that East Kentucky should pay the Midwest ISO Schedule 10 charges on base load amounts, was in error; we did not intend to revisit our finding in our prior orders that LG&E/KU could not pass through Midwest ISO Schedule 10 charges on base load amounts prior to April 1, 2005. Thus, as part of LG&E/KU's proposal to change their rates, the matter has already been resolved. We find that nothing in East Kentucky's or Gallatin's requests for rehearing that provide us sufficient reason to revisit the issue.³³

27. In addition, the decision to allow LG&E/KU to pass through Schedule 10 charges for service above base load amounts no longer applies because, as discussed below, LG&E/KU are reverting to their pre-existing rates under the Agreements. As a result, we find that for the period from November 18, 2002 until April 1, 2005, LG&E/KU may not pass-through Schedule 10 charges for service above base load amounts. The previous decision to allow LG&E/KU to pass-through the Schedule 10 charges for service above base load amounts was based on an analysis of the formula rate that they proposed, which was simply the Midwest ISO OATT Attachment O formula rate. The Attachment O rate does not recover costs assessed or incurred under Schedule 10. It was reasonable to allow LG&E/KU to pass-through the Schedule 10 charge in addition to its proposed formula rate because there was no possibility of double recovery of Schedule 10 charges.³⁴ However, we cannot allow LG&E/KU to pass-through the Schedule 10 charges in addition to their pre-existing rates for service above base load amounts, prior to April 1, 2005, for the same reason LG&E/KU could not pass-through such charges in addition to the pre-existing rates for base load amounts during that same time period.

28. In addition, the Commission did not have before it in this proceeding a proposal to allow LG&E/KU to pass through Schedule 10 charges as costs associated with new services. LG&E/KU did claim in this proceeding that Schedule 10 charges were costs not contemplated at the time the Agreements were executed. That argument, while not inconsistent with a finding that the costs are associated with a new service, does not, in

³² Remand Decision, 113 FERC ¶ 63,022 at P 97.

³³ East Kentucky also noted that footnote 27 of the September 2006 Order incorrectly cites P 97 of the December 2004 Order. This was a typographical error, and footnote 27 should have cited P 97 of the Remand Decision, 113 FERC ¶ 63,022.

³⁴ That the Commission required the denominator of the proposed formula rate to be adjusted does not impact the separate finding that the proposed formula rate did not recover any costs that were also recovered through Schedule 10.

and of itself, support a finding that the costs are associated with a new service. That argument is fundamentally different from the case made by the Midwest ISO Transmission Owners in their Schedule 23 filing that Schedule 10 represents new services that were not, and could not have been, provided by the Midwest ISO Transmission Owners prior to the advent of the Midwest ISO.³⁵

29. Therefore, under their pre-existing rates, LG&E/KU may not recover Schedule 10 charges from East Kentucky. They must refund to East Kentucky, with interest, any Schedule 10 charges they assessed for the period from November 2002 to April 2005. After that, per the discussion above, LG&E/KU's recovery of Schedule 10 charges is pursuant to Schedule 23 and is outside the scope of this proceeding.

D. Ancillary Services

30. Gallatin argues that, separate from the issue of whether LG&E/KU may *charge* a rate for ancillary services, the Commission did not make a final finding on the *level* of the proposed ancillary service rates, and that the Commission's summary disposition of this issue in the September 2006 Order was an error. We will grant rehearing on this issue.

31. In the September 2006 Order, the Commission made the following determination:

[T]he proposed ancillary services charges are separate from the proposed formula rate and can still be implemented. Therefore, the Commission's findings regarding ancillary services for service above base load amounts under the Agreements still apply and the accepted rate for these services continues to be just and reasonable.³⁶

Gallatin correctly notes that this finding is inconsistent with the Commission's previous finding that adjustments to the proposed ancillary service rates to reflect an appropriate allocation of costs to the Agreements were to be considered as part of the remand proceedings.³⁷

³⁵ See Schedule 23 Rehearing Order, 113 FERC ¶ 61,122 at P 58.

³⁶ September 2006 Order, 116 FERC ¶ 61,215 at P 37.

³⁷ In response to concerns about the proposed ancillary service rates, the Commission stated in the June 2005 Rehearing Order, 111 FERC ¶ 61,323 at P 36:

(continued...)

32. Upon reconsideration, we find that the adjustment outlined by the Presiding Judge applies both to the base transmission rate *and* to the ancillary service rates. The Commission remanded the level of the proposed base transmission rates and the ancillary service rates.³⁸ As the Commission found in the September 2006 Order, the proposed rates under the Agreements had to be adjusted as outlined by the Presiding Judge in order to reflect the single-zone service being provided. The proposed rates for Scheduling, System Control & Dispatch Service (Scheduling Service) and Reactive Supply & Voltage Control from Generation Sources Service (Reactive Service) are the license plate zonal rates for the LG&E/KU zone under Schedules 1 and 2, respectively, of the Midwest ISO OATT. Rates for these ancillary services are designed in the same manner as the transmission rates under the Midwest ISO OATT (*i.e.*, there is no rate pancaking for Midwest ISO-wide service). Therefore, the proposed rates for these services need to be adjusted in the same way that the September 2006 Order required the proposed base transmission rates be adjusted.³⁹

33. The Commission gave LG&E/KU the option to revert back to their pre-existing rates if they were unable or chose not to adjust the proposed rates in the prescribed manner and to refund East Kentucky the difference, with interest, between what was charged under the Agreements and the pre-existing rates.⁴⁰ As discussed further below, LG&E/KU have chosen not to make the required adjustments to their proposed rates and instead are reverting back to their pre-existing rates under the Agreements. Since

[T]he Commission established further procedures to consider adjustments to the proposed rates to reflect an appropriate allocation of costs to the Agreements. Because this issue has been remanded, the Commission did not make a final finding as to the justness and reasonableness of these proposed [ancillary service] rates in the December 22, 2004 Order, and will not do so until the remanded proceeding is complete.

³⁸ The Presiding Judge noted that LG&E/KU itself argued that the “reasonable” reading of the Commission’s December 2004 Order is that the matter in issue on remand is specifically transmission and ancillary service rates. (Remand Decision, 113 FERC ¶ 63,022 at P 22).

³⁹ Because rates for Regulation and Frequency Response Service, Spinning Reserve Service, and Supplemental Reserve Service are not subject to rate pancaking under stand-alone individual transmission owner tariffs, no similar adjustment to these rates is required.

⁴⁰ September 2006 Order, 116 FERC ¶ 61,215, at Ordering Paragraph (C).

LG&E/KU did not previously charge for Scheduling Service or Reactive Service under the Agreements, they will have to refund to East Kentucky the charges they assessed for these ancillary services.

III. Compliance Filing

A. Background

34. In the September 2002 filing, LG&E/KU proposed an overall rate increase under the Interconnection Agreement and submitted an amended Interconnection Agreement with new rates, terms, and conditions under which LG&E/KU and East Kentucky agree to use each other's system. The Interconnection Agreement recognized that, in addition to the service LG&E/KU provides to East Kentucky under the Interconnection Agreement, East Kentucky provides transmission service to LG&E/KU for their loads that are served off of the East Kentucky system. Therefore, the proposed Interconnection Agreement provided for a similar rate increase for the services East Kentucky provides LG&E/KU. The Commission in the Hearing Order accepted and suspended LG&E/KU's proposed rate changes, made them effective November 18, 2002, subject to refund, and set them for hearing.

35. In the hearing, East Kentucky argued that LG&E/KU do not have the authority under section 205 of the FPA to establish the rates East Kentucky charges under the Interconnection Agreement. East Kentucky also asserted that the rate proposed by LG&E/KU was too low and proposed to charge LG&E/KU a stated rate of \$1.62/kw-month based on the rate in East Kentucky's non-jurisdictional, reciprocity OATT. East Kentucky contended that this would remedy flaws in LG&E/KU's methodology and would be just and reasonable.

36. In response to the dispute over the rate East Kentucky charges under the Interconnection Agreement, the Commission in the December 2004 Order noted that East Kentucky is a generation and transmission cooperative that holds Rural Utilities Service debt and, as such, is not a public utility subject to the Commission's jurisdiction under section 205 of the FPA. Thus, the Commission found that it has no power to entertain an East Kentucky section 205 filing regarding the rates it charges for the services it provides under the Interconnection Agreement.⁴¹

37. As discussed in greater detail above, the Commission in the September 2006 Order directed LG&E/KU to make adjustments to their transmission rates in accordance

⁴¹ December 2004 Order, 109 FERC ¶ 61,130 at P 36.

with the Presiding Judge's recommendations. Alternatively, if LG&E/KU were unable to or chose not to adjust the proposed rate, they could revert back to the pre-existing transmission rates under the Agreements and to refund East Kentucky the difference, with interest, between what was charged under the formula rate, as proposed, and what would have been charged under the pre-existing contract rates.⁴²

38. On October 2, 2006, LG&E/KU made a compliance filing stating that they have chosen to revert back to the pre-existing transmission rates. They also submitted a refund report that reflects their decision to go back to the previous rates, as well as the Commission's previous determinations in this proceeding regarding ancillary service charges and Midwest ISO Schedule 10 charges. The refund report shows that East Kentucky will receive a refund that totals \$1,612,830.15, including interest.

B. Notice of Filing, Interventions, Protests and Answers

39. Notice of the LG&E/KU compliance filing was published in the *Federal Register*, 71 Fed. Reg. 71,198 (2006), with interventions or protests due on or before October 24, 2006. East Kentucky and Gallatin filed timely protests. On November 15, 2006, LG&E/KU filed an answer to the protests. On November 30, 2006, East Kentucky filed an answer to LG&E/KU's answer.

1. Protests

40. In its protest East Kentucky claims that the refund proposed by LG&E/KU is too low and it is instead due a refund of \$1,800,554.13. East Kentucky claims that the difference is due to various calculation and data errors, as well as LG&E/KU's failure to accurately apply certain of the Commission's directives in this proceeding. In total, East Kentucky proposes 11 adjustments to the refund report – 5 related to the Interconnection Agreement, 5 related to the Transmission Agreement, and 1 related to the interest calculation.

41. The adjustment that produces the largest increase in the refunds, \$132,009.39, is the elimination of a credit that was based on the difference between what LG&E/KU actually paid to East Kentucky for service under the Interconnection Agreement and what LG&E/KU would have paid to East Kentucky based on East Kentucky's prior rate. Under the Agreements, LG&E/KU and East Kentucky provided reciprocal transmission service to each other. Each month, LG&E/KU would calculate the amount owed by LG&E/KU to East Kentucky, which they would credit against the amounts owned by

⁴² September 2006 Order, 116 FERC ¶ 61,215, at Ordering Paragraphs (B) & (C).

East Kentucky to LG&E/KU. East Kentucky contends that it does not need to provide a credit to LG&E/KU because East Kentucky properly charged LG&E/KU the \$1.62/kW-month rate that it proposed as part of the hearing process (the \$1.62 rate) instead of its prior, lower rate.

42. Gallatin in its protest states that its concerns are the same as those raised by East Kentucky and it therefore incorporates and adopts East Kentucky's protest as its own.

2. Answers

43. In its answer, LG&E/KU state that they will make all but one of the 11 adjustments that East Kentucky proposed. They also filed a revised refund report that reflected those adjustments, showing an additional \$31,964.26 in refunds, for a total refund amount of \$1,644,794.41. However, LG&E/KU object to the adjustment that involves the transmission rate that LG&E/KU pays to East Kentucky for transmission service over the East Kentucky transmission system.

44. LG&E/KU disagree with this proposed adjustment for several reasons: 1) East Kentucky's use of the \$1.62 rate in the refund adjustment conflicts with the determination in the December 2004 Order that the Commission has no authority to consider a rate change for transmission service that East Kentucky provides to LG&E/KU; 2) the \$1.62 rate is null and void as a result of LG&E/KU's decision to revert to the pre-existing transmission rates; and 3) East Kentucky's proposal to use the \$1.62 rate is deficient because it does not comply with the notice requirements in the Interconnection Agreement.

45. In East Kentucky's answer to LG&E's answer, East Kentucky notes that LG&E/KU on their own accord began paying the \$1.62 rate in November 2004. In addition, LG&E/KU's payment of that rate was uncontested as reflected by the invoices that LG&E/KU themselves prepared. East Kentucky also disputes the claim that use of the \$1.62 rate does not comply with the terms of the Interconnection Agreement. Thus, East Kentucky argues that LG&E/KU must calculate the refund using the \$1.62 rate.

C. Discussion

1. Procedural Matters

46. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept LG&E/KU's answer to the protests because it has provided information that assisted us in our decision-making process. We will also

accept East Kentucky's answer to LG&E/KU's answer because it has provided information that assisted us in our decision-making process.

2. Commission Determination

47. The only refund issue in dispute relates to the rates that East Kentucky charges LG&E/KU under the Interconnection Agreement. LG&E/KU propose to apply a credit to the refunds they owe to East Kentucky in an amount equal to the difference between the \$1.62 rate that it has been paying to East Kentucky since November 2004 and East Kentucky's prior rate. LG&E/KU essentially assert that because they are reverting to their pre-existing rates, East Kentucky should do the same and should pay LG&E/KU a refund based on the difference between the \$1.62 rate and East Kentucky's prior rate. As explained in the December 2004 Order, we have no power to entertain an East Kentucky section 205 filing regarding the rates it charges for the service it provides under the Interconnection Agreement. Accepting LG&E/KU's proposal to use East Kentucky's prior rate would require us to make a finding on a rate that is non-jurisdictional, which is beyond our authority.

48. As a result, our refund directive can only apply to the rate LG&E/KU charge East Kentucky for service under the Agreements. LG&E/KU have chosen to revert back to their pre-existing rates and they therefore must refund to East Kentucky, with interest, the full amount they owe as a result of this decision and cannot reduce the refunds by any amount it paid to East Kentucky but that it now disputes. If LG&E/KU wishes to dispute the difference between the \$1.62 rate that it paid East Kentucky and East Kentucky's prior rates, the compliance and refund report phase of this proceeding is not the place for them to do so; they may pursue the matter in an appropriate court. Therefore, the Commission directs LG&E/KU to make refunds of all amounts collected in excess of the pre-existing rates, together with interest calculated pursuant to 18 C.F.R. § 35.19a (2006). In addition, as discussed above, LG&E/KU must also refund, with interest, the amounts it collected under the Agreements for Scheduling Service and Reactive Service, and the amounts associated with the pass-through of Schedule 10 charges prior to April 1, 2005.

The Commission orders:

(A) East Kentucky's and Gallatin's requests for rehearing are hereby granted in part and denied in part.

(B) LG&E/KU are hereby directed to make a further compliance filing with a revised refund report within 30 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.