

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Louisville Gas & Electric Company and Kentucky
Utilities Company

Docket No. ER02-2560-007

ORDER GRANTING REHEARING AND DIRECTING FURTHER
COMPLIANCE FILING

(Issued July 20, 2007)

1. In this order, the Commission grants the requests for rehearing and clarification of Louisville Gas & Electric Company (LG&E) and Kentucky Utilities (KU) and of East Kentucky Power Cooperative (East Kentucky). The Commission also directs LG&E/KU to file a further compliance filing.

Background

2. 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 Steel Company (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 Interconnection Agreement and the Transmission Agreement (together, Agreements) were negotiated, KU merged with LG&E. LG&E/KU were transmission owning members of Midwest Independent Transmission System Operator, Inc. (Midwest ISO),¹ but the Agreements are "Grandfathered Agreements" under the Midwest ISO Open Access Transmission Tariff (OATT),² *i.e.*, transmission service outlined in the

¹ During the period 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.

² The Midwest ISO OATT has been superseded by the Midwest ISO Open Access
(*continued...*)

Agreements was provided pursuant to the rates, terms and conditions of the Agreements and not the Midwest ISO OATT.³

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 [] Midwest ISO.” In amending the Agreements, LG&E/KU sought to “eliminate the under-recovery of their transmission revenue requirement, including [] 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.⁴

A. Initial Decision and Remand 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 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,⁵ but not to serve any loads for which the Midwest ISO OATT rate has been

Transmission and Energy Markets Tariff (TEMT). However, because the genesis of this proceeding pre-dates that change, we will use OATT for purposes of this order.

³ 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).

⁴ *Louisville Gas & Electric Co.*, 101 FERC ¶ 61,182 (2002) (Hearing Order).

⁵ “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

(continued...)

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);⁶ (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.⁷

6. The Commission affirmed in part and reversed in part the Presiding Judge's findings and established further hearing procedures.⁸ As to issue 4,⁹ 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."¹⁰ 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).

⁶ 16 U.S.C. § 824d (2000).

⁷ *Louisville Gas & Electric Co.*, 106 FERC ¶ 63,039 (2004) (Initial Decision).

⁸ December 2004 Order, 109 FERC ¶ 61,330; June 2005 Rehearing Order, 111 FERC ¶ 61,323.

⁹ 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).

¹⁰ December 2004 Order, 109 FERC ¶ 61,330 at P 32.

Commission then remanded this issue back to the Presiding Judge to determine what adjustment to the proposed rate is necessary.

7. 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.¹¹ In the Remand Decision, the Presiding Judge concluded that: (1) the Midwest ISO Attachment O formula rates that 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; and (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). 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, and found that 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 provided to East Kentucky under the Agreements. The Presiding Judge concluded that LG&E/KU should be required to demonstrate that they have adjusted their proposed rates by adding this "source-only" throughput¹² 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 that 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.¹³

¹¹ *Louisville Gas & Electric Co.*, 113 FERC ¶ 63,022 (2005) (Remand Decision).

¹² 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.

¹³ See Remand Decision, 113 FERC ¶ 63,022 at P 98.

B. September 2006 Order

8. In an order issued on September 1, 2006, the Commission affirmed the Presiding Judge's Remand Decision.¹⁴ 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. Specifically, the Commission rejected East Kentucky's proposed rate adjustment, finding that the proposal amounted to an impermissible expansion of service under the Agreements.¹⁵ The Commission required LG&E/KU to adjust their proposed rate as recommended by the Presiding Judge and to refund to East Kentucky the resulting difference, with interest. The rates under the Agreements would thus reflect the single-zone service LG&E/KU was providing to East Kentucky under the Agreements. To the extent that LG&E/KU was unwilling or unable (due to lack of sufficient data) to make the required adjustments to their proposed rate, the Commission found that LG&E/KU's proposed rate was unjust and unreasonable, and was rejected. If the proposed rates were rejected, service under the contracts would be provided under the Agreements' pre-existing rates. Therefore, the Commission presented LG&E/KU with two compliance options: they could either (a) adjust the proposed rates as outlined by the Presiding Judge or (b) revert to charging their pre-existing rates.

9. The Commission in the September 2006 Order also found that LG&E/KU could charge East Kentucky for certain ancillary services for service above base-load amounts, even if LG&E/KU chose to revert to their original rates. In addition, the Commission stated that it was well-established that East Kentucky should pay the Midwest ISO Schedule 10 charges on both base-load and amounts above base-load.¹⁶

C. LG&E/KU Compliance Filing

10. On October 2, 2006, LG&E/KU made a compliance filing stating that they had chosen to revert to the pre-existing transmission rates. They also submitted a refund report that reflected their decision to go back to the previous rates, as well as the

¹⁴ *Louisville Gas & Electric Co.*, 116 FERC ¶ 61,215 (2006) (September 2006 Order.)

¹⁵ Under East Kentucky's proposal, it would pay the full Midwest ISO OATT rate for service provided under the OATT, and would pay the rate under the Agreements for service provided under the Agreements, but would not pay both rates for the same source-sink transactions.

¹⁶ September 2006 Order, 116 FERC ¶ 61,215 at P 37-38.

Commission's previous determinations in this proceeding regarding ancillary service charges and Midwest ISO Schedule 10 charges (i.e., that they could assess these charges to East Kentucky under the pre-existing rates). The refund report showed that East Kentucky received a refund that totals \$1,612,830.15, including interest.

D. February 2007 Order

11. On February 6, 2007, the Commission granted in part and denied in part Gallatin and East Kentucky's requests for rehearing of the September 2006 Order affirming the Remand Decision, accepted LG&E/KU's decision to revert to the pre-existing rates under the Agreements, and directed LG&E/KU to make a further compliance filing with a revised refund report.¹⁷ On the Schedule 10 charges, the Commission noted that the issue before it in this proceeding was limited to the period from November 18, 2002 to April 1, 2005, the date Schedule 23 to the Midwest ISO OATT became effective. The Commission explained that, in a separate proceeding on Schedule 23, it 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. From April 1, 2005, LG&E/KU's recovery of Schedule 10 charges was pursuant to Schedule 23 and was outside the scope of this proceeding.¹⁸

12. The Commission also found that its 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. On reconsideration, the Commission found that it could not allow LG&E/KU to pass through the Schedule 10 charges on base load amounts, and also that LG&E/KU could not pass through Schedule 10 charges for service above base load amounts, prior to April 1, 2005. Since LG&E/KU had chosen to revert to the pre-existing rates, the Commission directed refunds to East Kentucky, with

¹⁷ *Louisville Gas & Electric Co.*, 118 FERC ¶ 61,086 (2007) (February 2007 Order).

¹⁸ February 2007 Order, 118 FERC ¶ 61,086 at P 24, 29 (citing *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), *affirmed*, *East Kentucky Power Coop. v. FERC*, No. 06-1003 (D.C. Cir. June 15, 2007) (concluding that the Commission's order on Schedule 23 comports with reasoned decision-making and denying East Kentucky's petition for review)).

interest, of any Schedule 10 charges assessed for the period from November 18, 2002 to April 1, 2005. The Commission found that after April 1, 2005, LG&E/KU's recovery of Schedule 10 charges was pursuant to Schedule 23 and was outside the scope of this proceeding.¹⁹

13. As to ancillary services, the Commission upon reconsideration found that LG&E/KU could not charge for Scheduling, System Control and Dispatch Service, or Reactive Supply and Voltage Control from Generation Sources Service in addition to the pre-existing rates. Since LG&E/KU had chosen not to make the required adjustment to their proposed rates and had instead reverted to their pre-existing rates, the Commission directed LG&E/KU to refund to East Kentucky the charges they assessed for these ancillary services.²⁰

Requests for Rehearing

14. On March 8, 2007, LG&E/KU filed its compliance refund report²¹ and a request for rehearing of the February 2007 Order. East Kentucky also filed a request for rehearing.

15. In their request for rehearing, LG&E/KU claim that the Commission in the February 2007 Order, without explanation and without notice, arbitrarily reversed a previously offered compliance option by disallowing certain Schedule 10 and ancillary service charges if LG&E/KU chose to revert to the pre-existing rates (which they did). LG&E/KU argue that this is a due process violation. To provide adequate due process, LG&E/KU state that the Commission must grant the following relief: (i) permit LG&E/KU to choose anew between the two clearly articulated compliance options; (ii) reinstate LG&E/KU's authority to collect Schedule 10 and ancillary service charges; and/or (iii) grant rehearing on aspects of the September 2006 Order, which LG&E/KU claim inappropriately reduced their originally-proposed rates.

16. LG&E/KU concede that they failed to seek rehearing within 30 days of the September 2006 Order.²² Nevertheless, they assert that their request is still permissible

¹⁹ February 2007 Order, 118 FERC ¶ 61,086 at P 24-29.

²⁰ *Id.* at P 32-33.

²¹ The Commission accepted the March 8, 2007 compliance refund report. *See Louisville Gas and Elec. Co.*, Docket No. ER02-2560-008 (April 5, 2007) (unpublished letter order).

because the FPA requires an application for rehearing of an order when it fundamentally modifies the results of an earlier order in a significant way adverse to the filing party, and before that party files a petition for judicial review. By describing all of the issues in this proceeding as “settled,” the Commission cannot now expect the Companies to have anticipated its reversal of those very issues.

17. LG&E/KU argue that they chose to revert to their original rates because they wished to assess Schedule 10 and ancillary service charges.²³ If the options have changed, so they argue, then due process requires that the Commission either provide LG&E/KU with an opportunity to re-evaluate and re-select options or reinstate the Schedule 10 and ancillary service charges.²⁴

18. In its rehearing request, East Kentucky asks the Commission to find that refunds of Schedule 10 charges collected under the Agreements apply until the Agreements expire (September 1, 2006) and are not limited to the April 1, 2005 effective date for Schedule 23. It notes that, under Schedule 23, Midwest ISO, and not LG&E/KU, bills customers directly for any applicable Schedule 10 charges. East Kentucky asserts that the Commission correctly found that Schedule 23 is outside the scope of this proceeding, and therefore any refunds LG&E/KU owe under the Agreements in this proceeding should not be limited by any charges East Kentucky may have to pay separately to Midwest ISO under Schedule 23.

19. In addition, East Kentucky argues that the April 1, 2005 cut-off date for refunds is inappropriate because Schedule 23, by its own terms, applies only to the Interconnection Agreement and does not apply to the Transmission Agreement. As a result, for the Transmission Agreement, the Schedule 10 refunds should apply through September 1, 2006, the end of the term of the Transmission Agreement.

20. As regards the Interconnection Agreement, East Kentucky argues that LG&E/KU’s reversion to the pre-existing rates under the agreement applies from the refund effective date to the end of the term of the Agreement on September 1, 2006.²⁵ Because there was no change in the rates under the Interconnection Agreement on or after

²² LG&E/KU March 8, 2007 Request for Rehearing at 9.

²³ *Id.* at 11-12.

²⁴ *Id.* at 13.

²⁵ East Kentucky March 8, 2007 Request for Rehearing at 2.

April 1, 2005, East Kentucky argues that date is arbitrary and should be ignored. Instead, East Kentucky argues that the Commission's determination regarding refunds of Schedule 10 charges collected under the Interconnection Agreement should apply through September 1, 2006.

21. East Kentucky notes that, in the February 2007 Order, the Commission explained that LG&E/KU would recover Schedule 10 charges pursuant to Schedule 23 for the period after April 1, 2005.²⁶ East Kentucky argues that, even if Schedule 23 is a legitimate vehicle for collecting Schedule 10 charges (which it continues to oppose in its court appeal of the Commission's Schedule 23 orders), it is Midwest ISO, and not LG&E/KU, that would recover Schedule 10 charges under Schedule 23, as Midwest ISO bills customers directly. East Kentucky is also concerned that, should the U.S. Court of Appeals for the District of Columbia Circuit reverse the Commission's Schedule 23 orders, LG&E/KU might interpret the Commission's February 2007 Order as permitting it to pass Schedule 10 charges through to East Kentucky under the Interconnection Agreement for the period following April 1, 2005. East Kentucky requests, therefore, that the Commission remove the end-date for refunds, consistent with its finding that Schedule 23, and the collection of Schedule 10 charges under that schedule, is beyond the scope of this proceeding.

Commission Determination

22. We grant LG&E/KU and East Kentucky's requests for rehearing and clarification, as discussed below.

23. LG&E/KU request that, in order to address and remedy their claim that the Commission retroactively changed the terms of LG&E/KU's compliance with the September 2006 Order, the Commission should: (1) allow LG&E/KU to choose again between the compliance options offered in the September 2006 Order; (2) reinstate LG&E/KU's authority to collect Schedule 10 and ancillary services charges; and/or (3) allow LG&E/KU to charge the rates proposed in the September 2006 Order. In light of the determinations in the February 2007 Order, and the additional clarity provided as a result, we find that it is appropriate that LG&E/KU be given a further opportunity to either adjust the proposed rates or to revert to the pre-existing rates. We grant LG&E/KU's request for rehearing to allow them to choose anew between the two compliance options set forth in the September 2006 Order; *i.e.* (a) adjust the proposed rates as outlined by the Presiding Judge or (b) revert to charging their pre-existing rates.²⁷

²⁶ *Id.* at 3, 11.

²⁷ September 2006 Order, 116 FERC ¶ 61,215 at P 34-35; *accord* February 2007
(continued...)

We will require LG&E/KU to inform the Commission within 14 days of the date of this order which of the two options they have chosen, and to file their new adjusted rates, should they choose the former option, within 30 days of the date of this order.

24. We also grant East Kentucky's request to the extent discussed below. The Commission in the February 2007 Order did not find that LG&E/KU were permitted to charge East Kentucky for Schedule 10 charges under the Agreements, in addition to the pre-existing rates, after April 1, 2005. Rather, the Commission simply found that, after April 1, 2005, Schedule 23 was the vehicle by which Schedule 10 charges could be assessed, in addition to the pre-existing rates, and East Kentucky is correct that charges under Schedule 23 are assessed by Midwest ISO directly to customers and therefore Midwest ISO, and not LG&E/KU, would assess East Kentucky for any Schedule 10 charges under Schedule 23.

25. In response to East Kentucky's claim that Schedule 23 does not apply to the Transmission Agreement, we also clarify that the Commission did not intend to determine in this proceeding whether Schedule 23 does or does not apply to service LG&E/KU provides under either the Interconnection Agreement or the Transmission Agreement. Whether or not Schedule 23 applies is outside the scope of this proceeding.

The Commission orders:

(A) LG&E/KU's request for rehearing is hereby granted, as discussed in the body of this order.

(B) East Kentucky's request for rehearing is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.