

140 FERC ¶ 61,039
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

Kentucky Utilities Company

Docket No. ER12-1574-000

ORDER ACCEPTING FOR FILING AND SUSPENDING NOTICE OF
TERMINATION AND ESTABLISHING SETTLEMENT JUDGE PROCEDURES

(Issued July 17, 2012)

1. On April 19, 2012, Kentucky Utilities Company (Kentucky Utilities) filed a Notice of Termination of an Amended and Restated Contract for Electric Service (Agreement) between Kentucky Utilities and the Benham Electric System (Benham). In this order, we accept for filing and suspend the Notice of Termination, subject to a further Commission order, and institute settlement judge procedures to facilitate resolution of the issues.

I. Background

2. Kentucky Utilities is a regulated public utility based in Lexington, Kentucky, which serves customers in 77 Kentucky counties and five counties in Virginia. Kentucky Utilities currently provides wholesale full requirements service to Benham and ten other municipalities in the Commonwealth of Kentucky, and partial requirements to the City of Paris, Kentucky.¹

3. The City of Benham is located in Harlan County, Kentucky, near the Virginia border. Benham is an instrument of the City of Benham and the Benham Plant Board. Benham has just over 300 retail electric customers, including the City of Benham's government. Benham purchases wholesale electric power from Kentucky Utilities, and then resells it at retail to the residents of the City of Benham.²

¹ Notice of Termination at 4.

² *Id.*

4. In 2008, Kentucky Utilities filed to change its rates for its municipal customers, including Benham, from stated, static rates to formula rates. Among other things, Kentucky Utilities revised the Agreement such that Kentucky Utilities could require Benham to provide Performance Assurance if Benham was late in making payments.³

5. Kentucky Utilities states that between October 2010 and August 2011, Benham failed to make payments in full of invoiced amounts. On August 3, 2011, Kentucky Utilities sent a letter to Benham requesting Performance Assurance no later than August 15, 2011. Kentucky Utilities states that it also informed Benham that Kentucky Utilities would waive its right to Performance Assurance if Benham paid past-due amounts in full. On August 15, 2011, Benham made a partial payment of \$20,000, but still carried an outstanding balance of \$87,484.28. Kentucky Utilities states that Benham also failed to provide the requested Performance Assurance, which, according to Kentucky Utilities, constitutes an Event of Default under the Agreement.⁴ Accordingly, on August 16, 2011, Kentucky Utilities provided Benham with a letter notifying Benham of its intent to terminate the Agreement on the later of August 16, 2012 (i.e., one year from the date of the letter) or 30 days after any necessary approval by the Commission was received.

6. Kentucky Utilities states that, at the same time that it provided notice to Benham, Kentucky Utilities filed a Complaint and Petition for Declaration of Rights against Benham in the Franklin Circuit Court that sought judgment entitling Kentucky Utilities to terminate the contract on the basis that an event of default had occurred. On March 26, 2012, the Franklin Circuit Court issued an opinion stating that it lacked jurisdiction to opine on Kentucky Utilities' right to terminate the Agreement, and that ultimate approval of the termination rests with the Commission. Kentucky Utilities states that the court did note that "[t]he record clearly demonstrates that such payment was not made, as admitted by Benham."⁵

³ Performance Assurance is defined in the Agreement as "collateral in the form of either cash or an irrevocable letter(s) of credit in form and substance acceptable to Seller, which collateral, or other security is equal to two (2) times the highest Monthly bill submitted to Buyer by Seller within the twelve (12) month period prior to Seller requesting such Performance Assurance in accordance with Section 6.4.1 [of the Agreement]." Section 6.4 of the Agreement provides, in part, that "[i]f Buyer fails to pay an invoice in full by the Due Date. . . Seller may provide Buyer with written notice requesting Performance Assurance."

⁴ Notice of Termination at 5-6.

⁵ *Id.*

7. On April 19, 2012, Kentucky Utilities filed the Notice of Termination with the Commission, with a requested effective date of August 16, 2012. However, Kentucky Utilities requested that the Commission defer action on the Notice of Termination in order to give the parties 30 days to avail themselves of the Commission's Dispute Resolution Services. Kentucky Utilities committed to report back to the Commission on the outcome of these discussions.

8. On May 21, 2012, Kentucky Utilities reported back to the Commission that no agreement could be reached during the 30 day period and requested that the Commission set the comment date to June 13, 2012.⁶

II. Filing

9. Kentucky Utilities argues that the only thing for the Commission to do in this proceeding is to enforce the terms of the Agreement by accepting termination. Kentucky Utilities explains that it is undisputed that an Event of Default occurred under the Agreement.⁷ Kentucky Utilities notes that section 6.4 of the Agreement provides that Kentucky Utilities may request Performance Assurance from Benham in the event that Benham fails to pay an invoice in full by the Due Date. According to Kentucky Utilities, Benham failed to pay its invoices on time from October 2010 to September 2011 and then failed to provide Kentucky Utilities with the required Performance Assurance within the requested time frame. Accordingly, Kentucky Utilities sent Benham a notice of termination on August 16, 2011.⁸

10. Kentucky Utilities maintains that the Commission should not look beyond the Agreement itself in coming to a decision in this proceeding. Kentucky Utilities notes that the Supreme Court has previously observed that, in wholesale markets, the party charging the rate and the party charged are sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a just and reasonable rate.⁹ Kentucky Utilities further adds that both the courts and the Commission have held that the clear, unambiguous terms of a contract must be given their full force and effect. Here, according to Kentucky Utilities, in light of the fact that both parties agree that there is an Event of Default, all that the Commission needs to do is allow Kentucky Utilities to

⁶ Kentucky Utilities Dispute Resolution Status Report at 1.

⁷ Notice of Termination at 9.

⁸ *Id.* at 9-10.

⁹ *Id.* at 10-11 (citing *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527 (2008)).

enforce its rights and terminate the contract.¹⁰ Kentucky Utilities maintains that denying its request to terminate the Agreement would effectively reestablish the extra-contractual obligation to serve wholesale requirements customers that the Commission eliminated in Order No. 888.¹¹

11. Kentucky Utilities maintains that Benham has failed to honor its contractual obligations and that requiring Kentucky Utilities to continue to provide service would be unduly preferential. Kentucky Utilities states that Benham failed to bring its account current for almost a full year and, while Kentucky Utilities has tried to work with Benham, Kentucky Utilities does not have an obligation to continue to provide service and cannot do so in light of the fact that Benham was unable and/or unwilling to keep its accounts current and provide Performance Assurance within the time period requested. Although Kentucky Utilities recognizes that Benham has experienced financial hardship in recent years and that Benham's financial difficulties may make it more difficult to find an alternative supplier,¹² Kentucky Utilities argues that Benham's financial status does not provide a sufficient basis for requiring Kentucky Utilities to serve Benham while allowing Benham to avoid its obligations to Kentucky Utilities. According to Kentucky Utilities, preventing it from terminating its Agreement with Benham would provide a benefit not available to its other customers, including its other 11 municipal customers that pay their bills on time or provide Performance Assurance when requested. Kentucky Utilities also expresses concern about the effect that rejecting the Notice of Termination

¹⁰ *Id.* at 11.

¹¹ *Id.* at 11-13 (citing *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, at 31,805, 31,809 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, at 30,354-30,355, *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002)).

¹² Nevertheless, Kentucky Utilities maintains that there are a wide variety of supply options available to Benham, including the installation of small, diesel-fired generation behind the meter, purchasing energy from public power or municipal entities, purchasing energy from a private company, or joining together with other municipal entities to purchase power on a collective basis. Notice of Termination at 14. Kentucky Utilities contends that, while Benham may claim that it is unable to identify and negotiate with an alternative supplier because of its small size and limited resources, this does not mean that Kentucky Utilities must bear Benham's financial risk in perpetuity. *Id.*

would have on Benham's future performance as well as the performance of Kentucky Utilities' other customers.¹³

12. Finally, Kentucky Utilities acknowledges that it has an obligation under the Agreement to make a filing to remove construction work in progress (CWIP) charges from Benham's rates. Kentucky Utilities explains that section 4.1.3.4 of the Agreement provides that, when either party exercises its right to fully or partially terminate service, within 60 days of the terminating party providing its notice of termination, Kentucky Utilities is required to make a section 205 filing with the Commission to modify the rate formula for the customer's charges and request approval to cease collecting CWIP charges from the customer for that portion of service that is being terminated. Kentucky Utilities admits that it should have made this filing on October 17, 2011. Kentucky Utilities states that, once a final termination date is known, Kentucky Utilities will address this requirement on compliance, including issuing a refund to Benham for CWIP collected from Benham since October 17, 2011, plus interest.¹⁴

III. Notice of Filing and Responsive Pleadings

13. Notice of the Notice of Termination was published in the *Federal Register*, 77 Fed. Reg. 27,221 (2012), with comments, protests, and interventions due on or before June 4, 2012. On May 21, 2012, Kentucky Utilities filed a request for an extension of time for interventions and comments to June 13, 2012, which was subsequently granted. On June 13, 2012, Benham filed a protest and motion to intervene. On June 25, 2012, Kentucky Utilities filed an answer to Benham's protest. On July 5, 2012, Benham filed an answer to Kentucky Utilities' answer.

14. In its protest, Benham acknowledges that it failed to provide the requested Performance Assurance required under the Agreement and that this constituted an Event of Default.¹⁵ Benham claims, however, that its inability to pay Kentucky Utilities was an isolated incident resulting from staffing issues and computer failure and that it has taken steps to ensure that these issues will not reoccur.¹⁶ Benham argues that it paid what it could at the time and has paid every other bill from Kentucky Utilities during the 50 years that Benham has taken service from Kentucky Utilities (even if occasionally late, but paid with interest).

¹³ *Id.* at 13-14.

¹⁴ *Id.* at 15.

¹⁵ Benham Protest at 1.

¹⁶ *Id.* at 4-6.

15. Benham argues that Kentucky Utilities is required to demonstrate that terminating the Agreement would be just and reasonable and that Kentucky Utilities has failed to do so. In particular, Benham contends that it would not be just and reasonable to terminate the Agreement because it has paid all past due amounts. Benham states that the Agreement is an “evergreen contract” under which either party may give five years notice of termination, but that Kentucky Utilities is limited in exercising “self help” and terminating the Agreement on shorter notice for breach or otherwise.¹⁷ Benham states that termination of the Agreement would be disastrous, as Benham would not be able to find an alternative supplier. Benham asserts that termination of the Agreement can be approved only where there is an assurance of continued electric supply and that Kentucky Utilities has failed to show that Benham can obtain replacement supply at all, much less within any time period shorter than the Agreement’s five-year notice requirement.¹⁸

16. Additionally, Benham alleges that Kentucky Utilities’ actions are anticompetitive because Kentucky Utilities only pursued its claim against Benham after a proposed deal to purchase Benham’s electrical system fell through. Benham explains that many Benham city officials were convinced during the spring of 2011 that the only available option was to sell their electric system to Kentucky Utilities.¹⁹ Benham states that Kentucky Utilities sent a letter informing Benham that Kentucky Utilities’ forbearance on demanding Performance Assurance would end if Benham did not approve the sale by August 9, 2011 after Kentucky Utilities learned that the Benham City Council might be reconsidering its support for the deal.²⁰ Shortly thereafter, the Benham City Council rejected a resolution approving the sale of Benham’s electric system.

17. Benham states that, on August 3, 2011, Kentucky Utilities sent Benham a letter requesting that Performance Assurance in the amount of \$145,117.88 be posted by August 15, 2011 or, in the alternative, if Benham were able to pay all its outstanding

¹⁷ *Id.* at 2. Benham states that the Commission explained in Order No. 888 that while it was revising in some respects its regulation concerning the need to file for approval for termination of service, the Commission stated that it was “continu[ing] to require prior notice of cancellation or termination for any power sales contract that is proposed to be cancelled or terminated for a reason other than by the contract’s own terms (*such as a self-help provision related to, for example, a billing dispute*)[.]” *Id.* at 17 (citing Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,806 (emphasis in original)).

¹⁸ *Id.* at 3, 29-30.

¹⁹ *Id.* at 6.

²⁰ *Id.* at 8.

bills, with interest, by this date that Performance Assurance would be waived.²¹ Benham explains that it was not able to pay the outstanding amounts or provide the Requested Performance Assurance. On August 15, 2011, Benham states that it: (1) made a partial payment of \$20,000; (2) explained the steps Benham was taking to bring its account current; and (3) requested an additional 30 days for payment.²² On August 16, 2011, Benham states that Kentucky Utilities sent Benham a notice of termination and filed suit in state court.²³ Benham notes that it paid its invoice on September 2, 2011, in full with interest, a mere three weeks after the August 15, 2011 deadline. Regardless, Benham states that Kentucky Utilities refused Benham's request to rescind its August 16, 2011 notice of termination or withdraw its state court lawsuit.²⁴ Benham argues that had Kentucky Utilities granted Benham the requested 30 days there would have been no need for the instant filing.²⁵

18. Benham points out that the Commission, in Order No. 888, decided to retain the requirement that parties file a notice of termination with the Commission prior to terminating a contract so that the Commission can "be assured that transmission owners are not exerting market power in termination of transmission contracts."²⁶ Benham argues that this is relevant here because Kentucky Utilities and Louisville Gas & Electric Company do not have market-based rate authority within their combined balancing authority area due to the fact that they possess market power.²⁷

19. Benham also argues that the Notice of Termination has been effectively nullified by Kentucky Utilities' admitted failure to make a filing, within 60 days, removing CWIP from Benham's rates "[i]f either [p]arty exercises its rights to...terminate service under [the] Agreement[.]"²⁸ Benham states that on this ground alone Kentucky Utilities failed to comply with the applicable contractual obligations of the Agreement.

²¹ *Id.* at 8, 10.

²² *Id.* at 8-9. Benham states that it also made an additional payment of \$10,000 on August 31, 2011. *See id.* at 11.

²³ *Id.* at 9.

²⁴ *Id.* at 11-12.

²⁵ *Id.* at 10-11.

²⁶ *Id.* at 17-18 (citing Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,806).

²⁷ *Id.* at 32 (referring to *Louisville Gas & Electric Co.*, 85 FERC ¶ 61,215 (1998)).

²⁸ *Id.* at 30-31.

20. In the event the Commission does not reject the Notice of Termination, Benham requests that the instant proceeding be set for hearing in order to determine the causes and consequences of the proposed termination of service. Benham specifically requests that the hearing examine whether the proposal to terminate service to Benham comports with the statutory standard (i.e., that it is just, reasonable, and not unduly discriminatory or preferential) and whether the proposal constitutes an abuse of market power or is otherwise anticompetitive.²⁹

21. In its answer, Kentucky Utilities notes that Benham has acknowledged that an Event of Default has occurred and that the Agreement provides for early termination under the circumstances. Kentucky Utilities argues that Benham has not provided any reason that the Agreement should not be given its full force and effect.³⁰

22. Kentucky Utilities asserts that Benham is asking the Commission to disregard the filed rate in favor of Benham's emotional, equitable arguments and that Benham's protest mischaracterizes certain facts and omits others. In particular, Kentucky Utilities states that Benham overlooks the fact that it has had trouble paying its bills in the past and that Benham is still unable to produce audited financial statements or a business plan, cannot get a letter of credit to support its operations, and has failed to file state-required financial disclosure forms despite Benham's efforts to get its house in order.³¹ Additionally, Kentucky Utilities states that it pursued the possibility of acquiring Benham's system at Benham's request as a means of settlement and that Kentucky Utilities demanded Performance Assurance after Benham decided not to pursue the deal because Kentucky Utilities did not have any alternative.³² Kentucky Utilities also states that Benham's arguments that alternative supply is difficult to find are at odds with 15 years of open access transmission service provided under tariffs required by the Commission and that the real issue is that the price Benham pays under the Agreement may be much lower than what it will find in the market.³³ Kentucky Utilities further states that Benham has failed to provide any evidence that Kentucky Utilities' motives in terminating the Agreement are anticompetitive.³⁴

²⁹ *Id.* at 35-36.

³⁰ Kentucky Utilities June 25 Answer at 7-8, 9-10.

³¹ *Id.* at 15-17.

³² *Id.* at 17-20.

³³ *Id.* at 20-22.

³⁴ *Id.* at 23-24.

23. Kentucky Utilities explains that, while it is using its answer to set the record straight, it believes that the various arguments raised by Benham are irrelevant to the issues in this proceeding (i.e., that there was an Event of Default under the Agreement and that the Agreement provides for early termination in such circumstances). Additionally, although Kentucky Utilities believes that Benham has had sufficient time to find an alternative supplier, Kentucky Utilities states that it is willing to extend the termination date to the earlier of the date that Benham is able to switch over to a new supplier or December 31, 2013.³⁵ Kentucky Utilities states that it would facilitate this extension by filing rates on compliance that would clarify that Kentucky Utilities would not have an obligation to serve Benham beyond the earlier of the date that Benham is able to switch over to a new supplier or December 31, 2013.

24. Kentucky Utilities contends that the fact that it has not yet made a filing regarding CWIP charges does not nullify its Notice of Termination, as nothing in section 4.1.3.4 of the Agreement indicates that such a filing is a prerequisite to termination. According to Kentucky Utilities, if Benham had been serious about claiming that Kentucky Utilities was in breach of the Agreement, it should have exercised its remedies, which would have included sending a demand letter, followed by contract termination, and a suit to recover the costs if Kentucky Utilities failed to comply.³⁶ Kentucky Utilities further contends that hearing and settlement proceedings are unnecessary at this point. Kentucky Utilities states that it does not believe that any additional time in formal settlement proceedings will bring the parties' positions closer together. In addition, Kentucky Utilities states that there is no dispute about the relevant facts and that an Event of Default has occurred and that Kentucky Utilities has a right to terminate the Agreement.³⁷

25. In its answer to Kentucky Utilities' answer, Benham reiterates arguments made in its protest. Benham explains that it never claimed that none of its payments in years past were submitted after the due date. Benham states, however, that extrapolating from that concern to a concern about Benham's financial health disregards all the changes that Benham has made since last summer. Additionally, it argues that Kentucky Utilities has failed to show that its alternative date for termination, December 31, 2013, would be just and reasonable. Among other things, Benham argues that Kentucky Utilities has provided no factual basis for concluding that an alternative supplier will be available to Benham on the timetable Kentucky Utilities seeks to impose.³⁸

³⁵ *Id.* at 3, 23.

³⁶ *Id.* at 24-25.

³⁷ *Id.* at 25-26.

³⁸ Benham July 5 Answer at 6-9.

IV. Discussion

A. Procedural Matters

26. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2011), Benham's timely, unopposed motion to intervene serves to make it a party to this proceeding.

27. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2011), prohibits an answer to a protest or answer unless otherwise ordered by the decisional authority. We will accept the answers filed by Kentucky Utilities and Benham in this proceeding because they have provided information that assisted us in our decision-making process.

B. Substantive Matters

28. Before it can approve a notice of termination, the Commission must, under section 205 of the Federal Power Act,³⁹ determine that the proposed termination is not unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. We need to examine what the proposed termination does, and what harm, if any, it causes.⁴⁰

29. Our preliminary analysis of Kentucky Utilities' proposed Notice of Termination indicates that the filing has not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. At the same time, however, we find that the parties may benefit from additional time to negotiate in addition to the 30 days that they utilized with the Commission's Dispute Resolution Service. Thus, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure,⁴¹ we will direct that a settlement judge be appointed to aid the parties in their efforts to reach a settlement. If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.⁴² We direct the parties to provide a status report on November 16, 2012 indicating the status of settlement discussions, including

³⁹ 16 U.S.C. § 824d (2006).

⁴⁰ See, e.g., *Allegheny Power Sys., Inc.*, 102 FERC ¶ 61,318, at P 9 (2003).

⁴¹ 18 C.F.R. § 385.603 (2011).

⁴² If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within three (3) days of this order. The Commission's website contains a list of Commission judges available for settlement proceedings and a summary of their background and experience (<http://www.ferc.gov/legal/adr/avail-judge.asp>).

whether a settlement has been reached. In the event that the parties reach a settlement before November 16, 2012, they may file a status report before November 16, 2012 notifying the Commission of that fact. Based on the content of that status report, the Commission will issue an order further addressing the merits of the Notice of Termination. Thus, in light of our analysis of the Notice of Termination and in order to give the parties time to engage in settlement discussions, we will accept the Notice of Termination, suspend it for five (5) months, to become effective January 16, 2013, subject to a further Commission order, and set it for settlement judge procedures,.

The Commission orders:

(A) Kentucky Utilities' notice of termination is hereby accepted for filing and suspended for a period of five (5) months, to become effective January 16, 2013, subject to a further Commission order.

(B) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2011), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within five (5) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within three (3) days of the date of this order.

(C) On November 16, 2012, the parties shall file a report with the Commission indicating the status of settlement discussions, including whether a settlement has been reached. In the event that the parties reach a settlement before November 16, 2012, they may file a status report before November 16, 2012 notifying the Commission of that fact. Additionally, within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. If settlement discussions continue, the settlement judge shall file a report at least every thirty (30) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement. The Commission hereby retains authority to terminate settlement discussions through a subsequent Commission order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.