

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Louisville Gas and Electric Company
and Kentucky Utilities Company

Docket No. ER02-2560-004

v.

East Kentucky Power Cooperative, Inc.

ORDER DENYING REQUESTS FOR REHEARING

(Issued June 1, 2005)

1. Louisville Gas & Electric Company (Louisville Gas) and Kentucky Utilities Company (Kentucky Utilities) (collectively, Louisville Gas/Kentucky Utilities), East Kentucky Power Cooperative, Inc. (East Kentucky), and the Gallatin Steel Company (Gallatin) all filed separate requests for rehearing of the Commission's December 22, 2004 Order affirming in part and reversing in part an initial decision and establishing further hearing procedures.¹ In this order, we deny Louisville Gas/Kentucky Utilities', East Kentucky's and Gallatin's requests for rehearing. This order benefits customers because it assures that the rates, terms and conditions of the Interconnection Agreement and the Transmission Agreement are just and reasonable.

Background

2. Kentucky Utilities 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. In May 1995, Kentucky Utilities and East Kentucky amended the Interconnection Agreement to fix the charges for service for so-called base load amounts for an initial ten-year period. In February 1995, Kentucky Utilities and East Kentucky entered into a Transmission Agreement for transmission service to Gallatin. The Transmission Agreement was designed to avoid costly duplicate facilities.

¹ *Louisville Gas & Electric Company*, 109 FERC ¶ 61,330 (2004) (December 22, 2004 Order).

3. After the Interconnection Agreement and Transmission Agreement (collectively, Agreements) were negotiated, Kentucky Utilities merged with Louisville Gas. While Louisville Gas/Kentucky Utilities now are transmission owning members of the Midwest Independent Transmission System Operator, Inc. (Midwest ISO), the Agreements are “grandfathered agreements” under the Midwest ISO Open Access Transmission Tariff (OATT), and transmission service continues to be provided under the Agreements.

4. In September 2002, Louisville Gas/Kentucky Utilities filed with the Commission a proposal to restructure the Agreements to: (1) increase the rates paid by East Kentucky to the same rate Louisville Gas/Kentucky Utilities established as their zonal rate under Attachment O of the Midwest ISO OATT; (2) add charges for ancillary services equal to the rates that Louisville Gas/Kentucky Utilities charge for ancillary services for their pricing zone under the Midwest ISO OATT, and pass through the costs that Louisville Gas/Kentucky Utilities incur under Schedule 10 of the Midwest ISO OATT (the Midwest ISO administrative cost adder); and (3) allow the automatic pass-through under the Agreements of charges under any future schedules that are added to the Midwest ISO OATT.

5. Louisville Gas/Kentucky Utilities essentially sought to “adjust the rates for certain transmission services provided to [East Kentucky] 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.”² In amending the Agreements, Louisville Gas/Kentucky Utilities sought to “eliminate the under-recovery of their transmission revenue requirement, including the Midwest ISO charges that they are assessed for service provided under the Agreements.”³

6. The Commission accepted and suspended Louisville Gas/Kentucky Utilities’ proposed rates and set the proposed rates for hearing.⁴

7. The Presiding Judge addressed eight issues.⁵ The Presiding Judge found that: (1) Louisville Gas/Kentucky Utilities may not charge for ancillary services under the Agreements, other than Load Following and Load Regulation Service on loads that are not dynamically scheduled; (2) Louisville Gas/Kentucky Utilities may pass through the Midwest ISO Schedule 10 adder only for loads in excess of the base load amounts in the

² *Louisville Gas & Electric Company, Kentucky Utilities Company*, 101 FERC ¶ 61,182 (2002).

³ *Id.*

⁴ *Id.*

⁵ *Louisville Gas & Electric Company and Kentucky Utilities Company*, 106 FERC ¶ 63,039 (2004) (Initial Decision).

Agreements; (3) Louisville Gas/Kentucky Utilities may include a 50 basis point return on equity ROE incentive adder (approved for use under the Midwest ISO OATT) in rates for loads in excess of the base load amounts in the Agreements;⁶ (4) East Kentucky should be charged the Regional Through & Out Rate under the Midwest ISO OATT only to import power to serve the base load amounts under the Agreements, not to serve any loads for which the Midwest ISO OATT rate has been adopted for service under the Agreements; (5) Louisville Gas/Kentucky Utilities must eliminate the cost of the Virginia Facilities from the transmission rates it charges under the Agreements; (6) Louisville Gas/Kentucky Utilities 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 FPA; (7) Louisville Gas/Kentucky Utilities 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) Louisville Gas/Kentucky Utilities 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. In its December 22, 2004 Order, the Commission affirmed in part and reversed in part the Presiding Judge's findings and established further hearing procedures. Specifically, the Commission affirmed, without further discussion, the Presiding Judge's findings with regard to issues (2), (3),⁷ (5), (6), and (7).

9. On issue (1), the Commission agreed that the Presiding Judge had correctly ruled that Louisville Gas/Kentucky Utilities cannot charge for ancillary services for base load amounts of transmission service (except for Load Following and Load Regulation Service, as noted above) under the Agreements. However, the Commission disagreed with the Presiding Judge's determination that, under the terms of the Agreements, Louisville Gas/Kentucky Utilities cannot charge East Kentucky a separate rate for ancillary services above base load amounts; Louisville Gas/Kentucky Utilities may charge East Kentucky for ancillary services above base load amounts. The Commission also disagreed with the Presiding Judge's finding that East Kentucky should not be charged for Schedule 1 service because it self-provides that service for its dynamically scheduled load; Louisville Gas/Kentucky Utilities may charge for such service.

10. On issue (4), the Commission disagreed with the Presiding Judge's finding that, just because the proposed rate for service under the Agreements is the same rate as the Midwest ISO OATT rate for load in the Louisville Gas/Kentucky Utilities' zone, East

⁶ In light of a subsequent court decision, the Commission is addressing the 50 basis point ROE incentive adder in Docket No. ER02-485-004. We will make our earlier approval of the 50 basis point ROE incentive adder subject to the outcome of that proceeding.

⁷ See *supra* note 6.

Kentucky should be entitled to service over the entire Midwest ISO system. Rather, the Commission determined that the appropriate solution is to adjust the proposed rate, to reflect an allocation of costs to the Agreements assuming that Louisville Gas/Kentucky Utilities did not provide access to its system under the Midwest ISO OATT. Given the state of the record on this issue, the Commission remanded this issue back to the Presiding Judge with directions to conduct further proceedings to address the issue of what adjustment to the proposed rate is necessary. Those proceedings are currently underway.

11. On issue (8), the Commission disagreed with the Presiding Judge that East Kentucky can only change the rates it charges for the service it provides under the Interconnection Agreement through a section 205 filing. The Commission determined that, since East Kentucky is not a public utility subject to the Commission's jurisdiction under section 201 of the Federal Power Act (FPA),⁸ the Commission has no power to entertain an East Kentucky section 205 filing regarding the rates it charges for the service it provides under the Interconnection Agreement.

12. On January 21, 2005, Louisville Gas/Kentucky Utilities, East Kentucky and Gallatin all filed separate requests for rehearing of the December 22, 2004 Order. On February 2, 2005, Louisville Gas/Kentucky Utilities filed an answer to East Kentucky's rehearing request.

Discussion

13. Pursuant to Rule 713(d) of the Commission's Rules of Practice and Procedure,⁹ answers to requests for rehearing are not permitted. Therefore, the Commission will reject Louisville Gas/Kentucky Utilities' answer to East Kentucky's request for rehearing.

A. Ancillary Services

Initial Decision

14. In the Initial Decision, the Presiding Judge found persuasive arguments by Staff that, because the parties entered into the Interconnection Agreement in 1995, before

⁸ 16 U.S.C. § 824 (2000).

⁹ 18 C.F.R. § 385.713(d) (2004).

Order No. 888 was issued,¹⁰ and before charges for ancillary services were generally unbundled from transmission service charges, the existing rates for base load amounts were intended to cover all charges for ancillary services (except for Load Following and Load Regulation Service for untelemetered loads). The Presiding Judge also found that the structure of the Agreements contemplated an intertwined mix of functions and facilities in which the parties would provide reciprocal ancillary services to each other at no charge to each other, (except where specifically delineated otherwise, as with untelemetered loads). The Presiding Judge also determined that, by dynamic scheduling, East Kentucky's load on Louisville Gas/Kentucky Utilities' system has been telemetered back to East Kentucky's control area, and East Kentucky performs the bulk, if not all, of the ancillary services (those represented by Schedules 1, 3, 5 and 6 of the Midwest ISO OATT.)¹¹ Conversely, Louisville Gas/Kentucky Utilities would perform the same ancillary services on their own load on the East Kentucky system that is telemetered back to their control area.¹² The Presiding Judge determined that, because East Kentucky has less untelemetered load on Louisville Gas/Kentucky Utilities' system than Louisville Gas/Kentucky Utilities has on East Kentucky's system, if cost was the determining factor, then contrary to Louisville Gas/Kentucky Utilities' assertion East Kentucky would be entitled to a rate increase. Therefore, the Presiding Judge ruled Schedule 1 cannot be charged to East Kentucky on any of the transmission supplied under the Agreements, even where the transmission exceeds the base load amounts.

15. As to reactive power service, the Presiding Judge found that it is undisputed that dynamic scheduling does not afford East Kentucky the opportunity to perform that service on its load on Louisville Gas/Kentucky Utilities' system that is telemetered to its

¹⁰ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs., Regulations Preambles January 1991-June 1996 ¶ 31,036 (1996), order on reh'g, Order No. 888-A, FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,048 (1997), 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).

¹¹ Schedule 1 provides for scheduling, system control and dispatch service, Schedule 3 provides for regulation and frequency response service, Schedule 5 provides for spinning reserve service, and Schedule 6 provides for supplemental reserve service.

¹² During the course of the hearing, Louisville Gas/Kentucky Utilities agreed not to charge for ancillary services under Schedules 3, 5, and 6. The Presiding Judge noted that Schedules 3, 5, and 6 were no longer an issue and only included for illustrating the principles that each party uses the other's systems for their loads.

control area. Rather, this service can only be performed by generation situated close to the transmission system carrying the load and, in this case, only Louisville Gas/Kentucky Utilities have generation close enough to their transmission system to perform the service. However, the Presiding Judge found, while Louisville Gas/Kentucky Utilities would be justified in charging for reactive power service if such service had been treated separately from the other ancillary services in the Agreements, they were not. Rather, as with the other ancillary services, such service was to be provided in reciprocal fashion.

16. The Presiding Judge found that it could not be determined from the record of this case which parties end up with most of the costs under these reciprocal arrangements and dynamic scheduling when accounting for all of the ancillary services. The Presiding Judge found that Louisville Gas/Kentucky Utilities failed to justify unraveling the reciprocal nature of the Agreements to charge the Midwest ISO rates on any of the individual ancillary services, other than Load Following and Load Regulation Service on untelemetered loads, which are treated differently under section 6.08 of the Interconnection Agreement. Therefore, the Presiding Judge determined that Louisville Gas/Kentucky Utilities cannot “cherry-pick” for which ancillary services to charge East Kentucky, without showing that they incur substantially more costs than East Kentucky for those services.¹³ The Presiding Judge concluded accordingly that Louisville Gas/Kentucky Utilities cannot apply Schedule 2 charges to any transmission for untelemetered loads under the Agreements, even in excess of base load amounts. However, the Presiding Judge did conclude that Louisville Gas/Kentucky Utilities are able to charge the Midwest ISO Schedule 1 and 2 rates on all untelemetered load under the Agreements, even base load (amounting to 2 MW).

December 22, 2004 Order

17. In the December 22, 2004 Order, the Commission partially agreed with the Presiding Judge’s findings, and rejected certain findings regarding the ancillary services covered under the Agreements. Specifically, the Commission found that Louisville Gas/Kentucky Utilities cannot charge for ancillary services for base load amounts of transmission service because the Interconnection Agreement clearly states that those rates are fixed for the initial ten years of the agreement, according to section 15.02(c). The charge for Load Following and Load Regulation Service for load that is not dynamically scheduled was clearly specified as a separate charge, which made sense to the Commission because it was largely self-provided by East Kentucky, so that the charge would only apply to the portion of East Kentucky’s base load where Louisville Gas/Kentucky Utilities provided the service. The Commission also agreed that Schedule 1 and 2 services were not self-provided by East Kentucky and therefore must be provided by Louisville Gas/Kentucky Utilities for all load for which they provide transmission

¹³ See Initial Decision at P 50.

service to East Kentucky. The Commission concluded that there was no reason for the parties to deviate from the prevailing practice of including ancillary service charges in the basic transmission charge for those services.

18. However, the Commission disagreed with the Presiding Judge's finding that, under the terms of the Interconnection Agreement, Louisville Gas/Kentucky Utilities cannot charge East Kentucky a separate rate for ancillary services above base load amounts. The Commission found that, because section 15.02(c) only fixed specific rates for base load amounts for the initial ten-year period, and stated that all other charges including those for load above base load were subject to Louisville Gas/Kentucky Utilities' unilateral right to file under section 205 of the FPA,¹⁴ Louisville Gas/Kentucky Utilities were entitled to file to modify the rates for service above base load amounts. The Commission stated that although past practice may have been to provide ancillary services for services above base load amounts on a "return in kind" or exchange basis, nothing precluded the abandonment of that practice. The Commission also determined that, under Louisville Gas/Kentucky Utilities' proposal, each party will charge the other party for all of the ancillary services provided, and the party that incurs substantially more costs will be compensated for the difference. Therefore, the Commission disagreed that Louisville Gas/Kentucky Utilities needed to show which party incurred more costs to find the proposal just and reasonable as the Presiding Judge suggested.

19. The Commission also disagreed with the Presiding Judge's finding that East Kentucky should not be charged for Schedule 1 service because it self-provides that service for its dynamically scheduled load. The Commission found that, although East Kentucky dynamically schedules its load, Louisville Gas/Kentucky Utilities must provide services to monitor their system, dispatch their system, and direct the redispatch of resources, as necessary, and those services cannot be self-provided by East Kentucky through dynamic scheduling. Therefore, the Commission concluded that Louisville Gas/Kentucky Utilities have appropriately exercised their right under the contract to seek to modify it and that this was consistent with Order No. 888.¹⁵

Requests for Rehearing

20. Louisville Gas/ Kentucky Utilities seek rehearing of the Commission's findings in the December 22, 2004 Order that the ancillary services provisions under the Interconnection Agreement are not subject to their unilateral right to propose changes under section 205 of the Federal Power Act. Louisville Gas/Kentucky Utilities argue that

¹⁴ Redlined Copy of the Interconnection Agreement and Supplement No. 9 (entered into on June 26, 1998) section 15.02(c), LG&E/KU Exhibit No. 2.

¹⁵ See December 22, 2004 Order at P 28.

the contract is clear and not ambiguous, and that the Commission erred in resorting to extrinsic evidence, i.e. general industry practices prior to Order No. 888, to support its interpretation. Louisville Gas/Kentucky Utilities state that there is a reasonable interpretation of the Interconnection Agreement based on the plain meaning of the contract and this interpretation demonstrates that Louisville Gas/Kentucky Utilities may unilaterally propose changes to the rates for ancillary services under the contract.

21. More specifically, Louisville Gas/Kentucky Utilities state that the Commission erred in resorting to extrinsic evidence about “prevailing practices” in the industry in order to conclude that compensation for ancillary services is included in the rates for base load amounts of service that are fixed for the initial ten-year term of the Interconnection Agreement. They cite to references in the contract to Kentucky Utilities’ transmission tariff, which contained separate pricing provisions for transmission and ancillary services. They state that references to the pre-existing tariff were made with intent and precision in the provisions of the Interconnection Agreement dealing with compensation for ancillary services and transmission services.

22. Louisville Gas/Kentucky Utilities also argue that there is a reasonable interpretation of the Interconnection Agreement that demonstrates that Louisville Gas/Kentucky Utilities may unilaterally propose changes to the rates for ancillary services under the contract. Louisville Gas/Kentucky Utilities state that compensation for ancillary services is provided entirely outside of section 8.03 of the contract (setting forth the rate for transmission service for base load amounts, which Louisville Gas/Kentucky Utilities concede they cannot seek to unilaterally modify).

23. Louisville Gas/Kentucky Utilities state that section 6.07 of the contract provides for the reciprocal provision of ancillary services, on a “return in kind” basis. As a result of this reciprocal “return in kind” provision of ancillary services by each control area operator, Louisville Gas/Kentucky Utilities assert, no rates are specified for the ancillary services provided under the contract. Louisville Gas/Kentucky Utilities state that there are two exceptions to these provisions for “return in kind” of ancillary services under the contract. The first provision addresses the provision of load following and load regulation service for each party’s untelemetered load, under section 6.08 of the contract, which provides rates for settlement of such service on a cash basis, rather than a “return in kind” basis. The second provision is in section 2.02(h) of the contract, involving reactive power service, and provides that the parties will establish a committee with authority to establish operating procedures and schedules with respect to the provision of reactive power service by one party to the other and proper charges, if any, for the use of facilities carrying reactive power loads.

24. Louisville Gas/Kentucky Utilities state that these explicit provisions for compensation for ancillary services belie the Commission’s interpretation of the contract that compensation for ancillary services is covered by the fixed rate for transmission

service in section 8.03 of the contract. They state that this interpretation is supported by the plain language of section 8.03, which provides that the rates set forth there are for “transmission service”. They state that this interpretation of the contract is further supported by the language of section 15.02(c) of the contract, which fixes the rate for base load amounts in section 8.03; Louisville Gas/Kentucky Utilities point out that section 15.02 of the contract expressly states that it is fixing the rate “solely with respect to said charges for area load service for base load amounts” set forth in section 8.03. They state that the use of this phrase means that the parties clearly recognized the presence of other charges to which they could be subject under the contract. Finally, Louisville Gas/Kentucky Utilities also note that the provision of ancillary services on a “return in kind” basis in section 6.07 does not distinguish between base load amounts of service and above base load amounts. The reason, it states, is that ancillary services are required for all amounts of load served under the Interconnection Agreement.

25. East Kentucky states that the December 22, 2004 Order reversed the Presiding Judge’s findings with respect to application of ancillary service rates to load in excess of base load amounts without record support or reasoned decision-making. East Kentucky argues that the Commission is eliminating the reciprocal arrangement and expanding the services covered by the Agreements, by permitting Louisville Gas/Kentucky Utilities to charge for ancillary services. East Kentucky argues that the December 22, 2004 Order incorrectly determined that Louisville Gas/Kentucky Utilities may charge East Kentucky for ancillary services on loads in excess of base load amounts by incorrectly finding that Louisville Gas/Kentucky Utilities had a right to file under section 205 of the Federal Power Act. Finally, East Kentucky argues that the Commission’s decision to allow ancillary service charges expands the scope of service under the Interconnection Agreement, which it states is inconsistent with the Commission’s decision in the December 22, 2004 Order to not expand the scope of transmission service under the Agreements to include Midwest ISO-wide service.

26. Gallatin seeks rehearing of the Commission’s reversal of the Presiding Judge’s finding that Louisville Gas/Kentucky Utilities cannot charge East Kentucky separate rates for ancillary services. Gallatin notes that the decision to reverse the Presiding Judge was made without Louisville Gas/Kentucky Utilities presenting evidence that they provide any ancillary services to East Kentucky under the terms of the Agreements or that they incur costs that the proposed rates are designed to recover to provide service to East Kentucky. Gallatin asserts that Louisville Gas/Kentucky Utilities bore the burden to provide evidence supporting their requested ancillary services rates and that the Commission’s decision ignores Louisville Gas/Kentucky Utilities’ failure to meet that burden. Gallatin argues that the Commission cannot find that the rates are just and reasonable based merely on Louisville Gas/Kentucky Utilities’ right to unilaterally file under section 205 of the Federal Power Act and that the Commission did not support its conclusion that there is no need for Louisville Gas/Kentucky Utilities to show which party incurs more costs for providing ancillary services. Gallatin also argues that the

Commission did not come to grips with the fact that, under Order No. 888, Schedule 1 service can only be performed by the control area operator and that East Kentucky is the control area operator for its loads served off of Louisville Gas/Kentucky Utilities' system under the agreements. Finally, Gallatin argues that the Commission failed to discuss Schedule 2 rates, and Louisville Gas/Kentucky Utilities presented no evidence as to what extent they provide Schedule 2 ancillary service for loads that are telemetered back to East Kentucky's control area.

Commission Decision

27. The Commission denies Louisville Gas/Kentucky Utilities', East Kentucky's, and Gallatin's requests for rehearing on these issues.

28. We are not persuaded by Louisville Gas/Kentucky Utilities' arguments that the references in the original Interconnection Agreement to Kentucky Utilities' transmission tariff demonstrate the intent of the parties that the rates for transmission service in section 8.03 of the Interconnection Agreement include no compensation for ancillary services. The references to Kentucky Utilities' transmission tariff that Louisville Gas/Kentucky Utilities cite appeared in two places in the original Interconnection Agreement. First, the reference appeared in section 8.02 addressing imposed transmission service – transmission service to the load of a party to which its own transmission system connects but which becomes isolated from that party's transmission system so as to cause the load to be served from, or to use, the other party's transmission system. Section 8.02 provided that, in the event that East Kentucky imposes a load of such nature upon Kentucky Utilities, East Kentucky shall purchase transmission service from Kentucky Utilities under Kentucky Utilities' transmission tariff. Section 8.02 does not address charges for service for area load service – service to loads connected solely to and supplied by the other's transmission system – which is the subject of section 8.03. Rather, it essentially addresses the treatment of transmission service that is not provided under the Interconnection Agreement, but that will instead be provided under Kentucky Utilities' transmission tariff. Therefore, this reference does not have a bearing on the rates for area load service under section 8.03, either for base load amounts or amounts above base load levels, as Louisville Gas/Kentucky Utilities suggest.

29. The second reference to Kentucky Utilities' transmission tariff that Louisville Gas/Kentucky Utilities cite is section 6.08 of the original Interconnection Agreement, which provided that East Kentucky shall purchase Load Following and Load Regulation Service from Kentucky Utilities under the applicable provisions of Kentucky Utilities' transmission tariff for service to East Kentucky's untelemetered loads on the Kentucky Utilities system. Again, we do not agree that this demonstrates that intent of the parties that the rates for transmission service in section 8.03 of the Interconnection Agreement do not cover compensation for ancillary services. In the December 22, 2004 Order, we found that it made sense for the parties to price Load Following and Load Regulation

Service separately because this service was self-provided for telemetered loads and each party only needed to purchase the service for its untelemetered loads. In contrast, Schedule 1 and Schedule 2 services were not self-provided and must be purchased from the other party for all load served from the other party's transmission system and, therefore, there was no reason to unbundle compensation for these services from the base transmission service charge.

30. In addition, the version of Kentucky Utilities transmission tariff cited by Louisville Gas/Kentucky utilities was pending at the Commission on May 11, 1995, the date that the Interconnection Agreement was executed, and was not accepted by the Commission and did not take effect until after the Interconnection Agreement was executed.¹⁶ Moreover, the previous version of Kentucky Utilities' transmission tariff, which was pending the outcome of a hearing at the time that the Interconnection Agreement was executed, was protested specifically for failure to address ancillary services.¹⁷ Therefore, the existence of Kentucky Utilities' transmission tariff does not conclusively demonstrate that the parties had adopted a practice at the time that the Interconnection Agreement was executed that rates for all ancillary services were to be separate from the base transmission rates in section 8 of the Interconnection Agreement, in contrast to prevailing practices in the industry at that time.

31. We also disagree with Louisville Gas/Kentucky Utilities' argument that the Commission's interpretation of the contract in the December 22, 2004 Order (that the rate in section 8.03 includes compensation for Schedule 1 and Schedule 2 services) conflicts with provisions in the contract for cash compensation for Load Following and Load Regulation Service, for an operating committee to develop operating procedures for reactive power support and proper charges for provision of reactive power support, or for compensation for other services on a "return in kind" basis. We have already addressed in the December 22, 2004 Order and above why separate charges for Load Following and Load Regulation Service do not conflict with our conclusions with respect to Schedule 1 and Schedule 2 service. With respect to the provisions in section 2.02(h) for an operating committee to address charges for reactive power support service, there is no indication in the contract what form such charges would take or whether such charges would be accomplished through adjustments to the rates in section 8.03 or elsewhere. Moreover, the provisions in section 15.02 of the Interconnection Agreement fixing the rate in section 8.03 for base load amounts do not preclude the parties from modifying such rates on a mutually agreeable basis. Thus, we do not find that the Commission's interpretation of the contract is in conflict with section 2.02(h).

¹⁶ See *Kentucky Utilities Company*, 71 FERC ¶ 61,250 (1995) (order issued May 31, 1995, accepting and suspending tariff to take effect June 1, 1995).

¹⁷ See *Kentucky Utilities Company*, 69 FERC ¶ 61,260 at 61,996 (1994).

32. Finally, with respect to provisions for “return in kind” of ancillary services in section 6.07, we find that these provisions establish operating responsibilities for each control area operator but do not definitively address what form compensation will take for the control area services that each party provides the other. While the obligations set forth therein and silence regarding compensation conceivably could be construed as an agreement to return services on an “in kind” basis, section 6.07 does not explicitly provide for an exchange of services with no monetary compensation. Therefore, the Commission reasonably concluded that, given the prevailing practice in the industry at the time to not separately state charges for ancillary services, compensation for such service would already be provided through the rate for base load amounts of service in section 8.03. Therefore, we clarify that, while, in the December 22, 2004 Order, we stated that the Interconnection Agreement may have provided for “return in kind” of ancillary services, the more correct characterization of the contract is that it does not explicitly set forth provisions for compensation for Schedule 1 and Schedule 2 service beyond that already provided by section 8.03. In the absence of such additional express language, the Commission reasonably relied on the prevailing practice in the industry at the time in finding that the rate for transmission service for base load amounts in section 8.03 would include compensation for Schedule 1 and Schedule 2 service.

33. However, since the Interconnection Agreement only fixes the rates for transmission service up to the base load amounts, Louisville Gas/Kentucky Utilities may seek changes to the rates for transmission above the base load amounts, including separate charges for Schedule 1 and Schedule 2 service. The rates sought by Louisville Gas/Kentucky Utilities for ancillary services above the base load amounts are the rates in effect under the Midwest ISO OATT.

34. The Midwest ISO OATT Schedule 1 rate is a formula rate approved in Opinion No. 453¹⁸ based on each transmission owner’s actual costs of providing Schedule 1 service, and is applicable to transmission service under the Midwest ISO OATT without regard to whether load served by such service is telemetered to a different control area. We reject East Kentucky and Gallatin’s arguments that the Schedule 1 rate should not apply to telemetered load, because Order No. 888 provides that Schedule 1 service can only be performed by the control area operator and East Kentucky is the control area operator for its telemetered loads that happen to be located on Louisville Gas/Kentucky Utilities’ system. As we recounted in the December 22, 2004 Order:

¹⁸ *Midwest Independent Transmission System Operator, Inc., et al.*, Opinion No. 453, 97 FERC ¶ 61,033 (2001), *order on reh'g*, Opinion No. 453-A, 98 FERC & 61,141 (2002), *order on remand*, 102 FERC ¶ 61,192 (2003), *reh'g denied*, 104 FERC ¶ 61,012 (2003), *aff'd sub nom. Midwest ISO Transmission Owners, et al. v. FERC*, No. 02-1121, *et al.* (D.C. Cir. July 16, 2004).

In Order No. 888, the Commission required that the transmission provider that operates a control area offer, and that the transmission customer must take and pay for, Schedule 1 service.¹⁹ In Order No. 888-A, the Commission clarified that these requirements do not change when transmission service is taken for load that is dynamically scheduled and that, when load is dynamically scheduled from one control area to another, both control areas must provide Schedule 1 service.²⁰

Thus, in the case of dynamically scheduled load, two control area operators are essentially responsible, the operator of the system on which the load is physically located and the operator of the system on which the load is electrically located through telemetering and dynamic scheduling. This simply reflects the fact that dynamically scheduling involves transmission service spanning at least two control areas, with generation located in one control area and load located in a different control area. The requirement in Order No. 888-A that both control areas must provide Schedule 1 service reflects this fact. Telemetering allows East Kentucky to match its generation on its system with its load located on the Louisville Gas/Kentucky Utilities system on a moment to moment basis, as if the load were located in its own control area, enabling it to self-provide regulation, imbalance and reserve services, i.e., Schedules 3, 4, 5 and 6. However, such telemetering does not obviate the need for Louisville Gas/Kentucky Utilities to provide transmission service over its facilities for the delivery from East Kentucky's resources to East Kentucky's dynamically scheduled load, including ancillary services, such as Schedule 1 service, necessary to support such transmission service.

35. With respect to the proposed rate for Schedule 2 service, in Order No. 888, the Commission stated that a transmission provider, or the operator of the control area in which a transmission provider is located, cannot avoid supplying reactive power to a transmission customer and a transmission customer cannot avoid taking reactive power from the transmission provider.²¹ While the Commission found that a customer may be able to self-supply Schedule 2 service in specific circumstances, in Order No. 888-A, the Commission found that the control area operator must be able to control the dispatch of reactive power from the customer's generators in order for the customer to self-supply Schedule 2 service.²² However, the record indicates that neither East Kentucky nor Louisville Gas/Kentucky Utilities have given such control over their respective

¹⁹ Order No. 888 at 31,715-16.

²⁰ Order No. 888-A at 30,235-36.

²¹ Order No. 888 at 31,716.

²² Order No. 888-A at 30,228.

generating facilities to the other.²³ Therefore, we reject the suggestion by East Kentucky that it self provides reactive power service. Moreover, trial staff sponsored a cost of service study and testimony supporting the proposed rate, and East Kentucky does not contest that cost support.²⁴

36. However, the 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 rates in the December 22, 2004 Order, and will not do so until the remanded proceeding is complete.

37. Finally, we disagree with East Kentucky's argument that the Commission's decision to include ancillary service charges expands the scope of service under the Interconnection Agreement, which it states is inconsistent with the Commission's decision in the December 22, 2004 Order to not expand the scope of service to include Midwest ISO-wide service. The Commission did not expand the scope of service under Interconnection Agreement. Rather, it simply found reasonable Louisville Gas/Kentucky Utilities' proposal to separately state rates for certain ancillary services in these circumstances.

B. Midwest ISO Schedule 10 Charges

Initial Decision

38. The Schedule 10 charge is designed to recover the Midwest ISO's costs associated with investment and expenses to run the ISO. In the Initial Decision, the Presiding Judge found that Louisville Gas/Kentucky Utilities may pass through the Midwest ISO Schedule 10 charge to East Kentucky, but only for loads in excess of base load amounts. The Presiding Judge reasoned that the Schedule 10 adder was conceptually part of the basic transmission rate and subsumed within the basic transmission rate under the Interconnection Agreement and that, therefore, the adder cannot be added to what was already in place and grandfathered.²⁵

December 22, 2004 Order

39. In the December 22, 2004 Order, the Commission affirmed the Presiding Judge's finding that the Schedule 10 charge should not apply to base load amounts.

²³ Tr. 229, lines 19-23.

²⁴ See Exh. EK-19 at 4, line 14-18.

²⁵ See Initial Decision at P 51.

Requests for Rehearing

40. Louisville Gas/Kentucky Utilities assert that the Commission erred by affirming the Presiding Judge's finding that the Midwest ISO Schedule 10 charge cannot be assessed for base load amounts of service. Louisville Gas/Kentucky Utilities assert that, contrary to the Presiding judge's finding, Schedule 10 costs cannot be considered part of the rate for base load amounts of transmission service under the Interconnection Agreement. They argue that under the Midwest ISO OATT itself, the Schedule 10 charge is separate from the schedules pertaining to transmission service and pertains to the cost of having an ISO, not the cost of providing transmission service. They also argue that it is not credible to argue that the Schedule 10 charge was contemplated at the time that the Interconnection Agreement was executed in 1995.

Commission Decision

41. We deny Louisville Gas/Kentucky Utilities' request for rehearing of the Commission's affirmation of the Presiding Judge's findings with respect to application of the Schedule 10 adder to base load amounts of service. We find that, based on the record in this proceeding, the Presiding Judge correctly found that Louisville Gas/Kentucky Utilities had not justified application of the Schedule 10 charge to base load amounts of service. Other than alluding to the fact that the Midwest ISO did not exist at the time that the Interconnection Agreement was executed, Louisville Gas/Kentucky Utilities did not establish in this proceeding that the services provided by the Midwest ISO and associated with the Schedule 10 adder are new or different services that are not included in the transmission service for base load in the Interconnection Agreement.

42. However, the Commission does note that it has recently approved a new Schedule 23 to the Midwest ISO OATT, that took effect April 1, 2005, through which the Midwest ISO transmission owners will pass through such charges to customers under grandfathered agreements, including the Interconnection Agreement.²⁶ In approving Schedule 23, the Commission found that the applicants had demonstrated that Schedule 10 charges are associated with new and different services that are not already contemplated in the grandfathered agreements. Thus, beginning April 1, 2005, Louisville Gas/Kentucky Utilities may recover recover such charges from East Kentucky for base load amounts of service pursuant to Schedule 23 of the Midwest ISO OATT.²⁷ .

²⁶ See *Transmission Owners of the Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,339 (2005), *reh'g pending*.

²⁷ *Id.* at P 50.

C. Regional Through and Out Rates

Initial Decision

43. In the Initial Decision, the Presiding Judge determined that whether or not East Kentucky paid Regional Through and Out Rates (RTOR) before Louisville Gas/Kentucky Utilities' proposed modifications to the Agreements, and also before East Kentucky's decision to import power from the Midwest ISO, is immaterial.²⁸ Instead, the Presiding Judge found that the material issue is that, under the proposed modifications East Kentucky would now pay essentially Midwest ISO transmission rates. The Presiding Judge concluded that it would be unfair, duplicative, and discriminatory to charge East Kentucky essentially the higher Midwest ISO transmission rate, but deny it the benefit of the elimination of rate pancaking. Accordingly, on all load served under the Agreements, the Presiding Judge determined that East Kentucky may not also be charged the Midwest ISO RTOR.

December 22, 2004 Order

44. In the December 22, 2004 Order, the Commission disagreed with the Presiding Judge's determination, finding that the issue in this proceeding is the just and reasonable rate for service under the Agreements. However, the Commission determined that a ruling on the just and reasonable rates was not possible based on the record developed to date, and therefore ordered the issue remanded to the Presiding Judge to conduct further proceedings to establish any necessary rate adjustment. (In addition, the Commission encouraged parties to settle this issue and noted that it could be resolved prospectively if East Kentucky accepted Louisville Gas/Kentucky Utilities' offer to allow East Kentucky to serve its contract loads under the Midwest ISO OATT.)

Requests for Rehearing

45. East Kentucky acknowledges the Commission's decision not to allow East Kentucky access to the entire Midwest ISO footprint, but instead to adjust the rates to reflect an allocation that assumes Louisville Gas/Kentucky Utilities is not providing access to the entire Midwest ISO footprint. East Kentucky also acknowledges that the Commission established further hearing procedures to determine the appropriate adjustment. Without knowing the outcome of the further hearing proceedings, East Kentucky believes nonetheless that an adjustment to the rates may be inconsistent with the elimination of rate-pancaking, and with the other findings of the December 22, 2004

²⁸ See Initial Decision at P 32.

Order. Therefore, East Kentucky reserves the right to seek rehearing of the Commission's decision on the applicability of the Midwest ISO RTOR for service to loads served under the Agreements, pending the outcome of the hearing proceedings.

46. Louisville Gas/Kentucky Utilities agree that the appropriate remedy for differences in transmission service is an adjustment in the proposed rate, but Louisville Gas/Kentucky Utilities believe that the Commission erred by remanding this issue for further proceedings.

Commission Decision

47. We deny East Kentucky and Louisville Gas/Kentucky Utilities' requests for rehearing on this issue. The December 22, 2004 Order remanded this issue back to the Presiding Judge. This issue is more appropriately addressed in the remanded proceeding before the Presiding Judge and therefore, we deny rehearing on this issue.

D. Virginia Facilities

December 22, 2004 Order

48. In the December 22, 2004 Order, the Commission affirmed, without further discussion, the Presiding Judge's findings with respect to the classification of the Virginia facilities. The Presiding Judge determined that Staff and East Kentucky made a *prima facie* case that the cost of certain Virginia facilities should be excluded from the transmission rates charged under the Agreements, based on testimony by a Louisville Gas/Kentucky Utilities witness in another proceeding that the facilities perform a distribution function and on an agreement between Louisville Gas/Kentucky Utilities and the Virginia Commission to reclassify these facilities to distribution. While Louisville Gas/Kentucky Utilities claimed that they subsequently performed a seven-factor test analysis showing that the facilities are, instead, appropriately classified as transmission, the Presiding Judge found that they had not submitted into evidence that seven-factor test, or sponsored as a witness the person responsible for that test. Therefore, the Presiding Judge found that the cost of the Virginia facilities must be excluded from the rates to be charged under the Agreements.

Requests for Rehearing

49. Louisville Gas/Kentucky Utilities argue that the Commission erred by affirming the Presiding Judge's finding that the Virginia facilities should be excluded from the transmission rates. Louisville Gas/Kentucky Utilities state that contrary to the Presiding Judge's findings, they did show that the facilities clearly perform a transmission function. First, Louisville Gas/Kentucky Utilities submit that the Virginia facilities are reflected as transmission in Louisville Gas/Kentucky Utilities' current Midwest ISO OATT

Attachment O. Second, Louisville Gas/Kentucky Utilities state that they have performed a preliminary seven-factor test as is required within 4 years of the start-up of the Midwest ISO and the facilities are classified as transmission facilities. Louisville Gas/Kentucky Utilities submit that their witness testified that the preliminary seven-factor test was conducted and that the facilities perform transmission functions. Consequently, Louisville Gas/Kentucky Utilities submit that they are collectively transmission costs, and are not proposing to collect local distribution costs in their transmission rates. Therefore, Louisville Gas/Kentucky Utilities argue that they proved that the Virginia facilities are appropriately classified as transmission and should be reflected in the transmission rate.

Commission Decision

50. The record before the Commission in this proceeding does not contain the specific evidence cited on rehearing by Louisville Gas/Kentucky Utilities; specifically, it does not contain the seven-factor test supposedly supporting reclassification of the facilities as transmission (nor have Louisville Gas/Kentucky Utilities shown that the Virginia Commission has considered or approved any such reclassification). Absent such evidence regarding the status of the Virginia facilities, the Commission cannot make a determination that such facilities should be classified as transmission. Accordingly, we deny rehearing.

E. East Kentucky's Rates

Initial Decision

51. The Presiding Judge determined that East Kentucky could not change its rates for service to Louisville Gas/Kentucky Utilities under the Interconnection Agreement unless East Kentucky made a section 205 filing with the Commission. Absent such a filing and determination from the Commission on the proposed rates, the Presiding Judge ruled that East Kentucky must continue charging Louisville Gas/Kentucky Utilities the rates in the East Kentucky OATT for service above the base load amounts.

December 22, 2004 Order

52. The Commission disagreed with the Presiding Judge's determination and ruled that East Kentucky is not subject to the Commission's authority under section 205, and so, no filing is required for East Kentucky to change its rates.

Requests for Rehearing

53. Louisville Gas/Kentucky Utilities request rehearing of the Commission's determination that East Kentucky can institute whatever rate changes it sees fit.

Louisville Gas/Kentucky Utilities argue that the Commission erred by not finding that East Kentucky's proposal to charge \$1.62/kW/month, reflecting the stated rate for point-to-point service under the East Kentucky OATT, is at odds with the structure and historic practice under the Interconnection Agreement. Louisville Gas/Kentucky Utilities argue that both Louisville Gas/Kentucky Utilities and East Kentucky should pay the same type of transmission rate and that having East Kentucky pay a network service rate while Louisville Gas/Kentucky Utilities pays a point-to-point rate is not comparable and does not maintain the structure and historic practice for reciprocal services under the Interconnection Agreement.

Commission Decision

54. We deny rehearing on this issue. As East Kentucky is not a public utility, it is not subject to Commission authority under section 205 and the Commission has no power to entertain or act on its section 205 filing.

The Commission orders:

Louisville Gas/Kentucky Utilities', East Kentucky's and Gallatin's requests for rehearing are hereby denied.

By the Commission. Commissioner Kelliher dissenting in part with a separate statement attached.

Linda Mitry,
Deputy Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Louisville Gas & Electric Company and
Kentucky Utilities Company

Docket No. ER02-2560-004

v.

East Kentucky Power Cooperative, Inc.

(Issued June 1, 2005)

Joseph T. KELLIHER, Commissioner *dissenting in part*:

I disagree with the portion of the Commission's decision finding that Louisville Gas and Kentucky Utilities may begin recovering Schedule 10 charges pursuant to Schedule 23 of the Midwest ISO's OATT from East Kentucky based on a determination in a prior Commission order that such charges constitute "new services."¹ I disagreed with the Commission's decision in that order that Schedule 10 services can be passed through to customers as new services.² Accordingly, I dissent from the portion of this order relying on the new services determination from that prior decision.

Joseph T. Kelliher

¹ Order at P 42 citing *Transmission Owners of the Midwest Independent Transmission System Operator, Inc.*, 110 FERC ¶ 61,339 (2005).

² *Id.* at 62,353 (Kelliher, dissenting).