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DOCKET NO. 2008-SC-000489
COURT OF APPEALS CASE NO. 2006-CA-001652-MR

THE UNION LIGHT, HEAT AND POWER COMPANY
n/k/a DUKE ENERGY KENTUCKY, INC.

APPELLANT

v.

On Appeal from Franklin Circuit Court
Civil Action No. 05-CI-00648

COMMONWEALTH OF KENTUCKY, ex rel.
JACK CONWAY, ATTORNEY GENERAL and
KENTUCKY PUBLIC SERVICE COMMISSION

APPELLEES

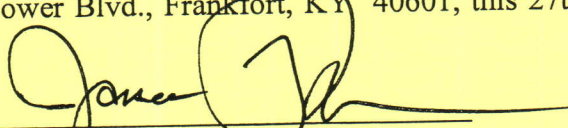
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that copies of Appellant's Reply Brief were served FedEx overnight delivery service upon Susan Stokley Clary, Clerk, Kentucky Supreme Court, 700 Capitol Ave., Frankfort, KY 40601, and via First Class Mail to Samuel Givens, Jr., Clerk, Kentucky Court of Appeals, 360 Democrat Dr., Frankfort, KY 40601; Hon. William Graham, Franklin Circuit Court Judge, 214 St. Clair St., Frankfort, KY 40601; Hon. Jack Conway, Attorney General, 1024 Capital Center Dr., Ste 200, Frankfort, KY 40601; Hon. David Edward Spenard, Assistant Attorney General, Office of the Attorney General, 1024 Capital Center Dr., Ste 200, Frankfort, KY 40601; David S. Samford, Public Service Commission, 211 Sower Blvd., Frankfort, KY 40601, this 27th day of August, 2009.


Counsel for Appellant

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It is undisputed that the PSC has approved economic development incentive rates (“EDRs”) for more than twenty years, and EDRs have long been employed as an essential tool for encouraging much-needed economic development. The Attorney General now seeks to undo two decades of administrative precedent, and deprive Kentucky of a valuable tool for creating jobs, based on a convoluted interpretation of the relevant statutes that renders multiple statutory provisions completely meaningless. In contrast to the widespread acceptance of EDRs in Kentucky and across the nation discussed in Appellants’ and the *Amici Curiae’s* opening briefs, the Attorney General fails to cite a single judicial or administrative decision in any jurisdiction (other than the Court of Appeals’ Opinion below) disapproving such rates. That silence speaks volumes.

I. The PSC’s and Circuit Court’s construction is the only reasonable interpretation of the relevant statutory provisions.

In construing statutes, it is this Court’s duty “above all else” to harmonize the law and give effect to all statutory provisions. *Shown v. Shown*, 233 S.W.3d 718, 721 (Ky. 2007). Of the two statutory interpretations presented to this Court, only the one advocated by Duke Energy Kentucky and the PSC gives effect to all relevant statutory provisions and adheres to the most natural reading of those provisions. KRS 278.030(1) broadly grants the PSC authority to prescribe “fair, just and reasonable rates” for utilities subject to its jurisdiction. KRS 278.030(3) makes clear that to be “fair, just and reasonable,” a utility’s rates need *not* be uniform for all customers under all circumstances. Rather, “every utility may employ in the conduct of its business suitable and reasonable classifications of its service, patrons *and rates*.” KRS 278.030(3) (emphasis added). KRS 278.170(1) then delegates to the PSC the authority to review such classifications to determine whether they “give any *unreasonable* preference or advantage to any person.” KRS 278.170(1)

(emphasis added). If so, the PSC must disapprove the preference. KRS 278.170(2) and (3), in turn, limit the PSC's authority to review rate preferences for "reasonableness" by clarifying that it is *per se* permissible for a utility to grant "free or reduced rate service" to any of the enumerated categories of customers listed in those sections.

The Attorney General's interpretation, by contrast, results in significant portions of these statutes being read wholly out of existence. For example, in arguing that KRS 278.030(3) does not authorize reasonable differences in customer rates, the Attorney General simply repeats the Court of Appeals' erroneous statement that "KRS 278.030 addresses customer classifications, but does not deal with the rates those customers pay." (AG's Br. at 13 (quoting Amended Opinion at 10)). This statement nullifies the word "rates" in KRS 278.030(3), which expressly permits "suitable and reasonable classifications of its service, patrons *and rates*." (emphasis added). Like the Court of Appeals, the Attorney General's statutory interpretation relies on simply ignoring the presence of the word "rates" in this section.

The fact that KRS 278.030(3) permits reasonable classifications in "rates" – in addition to reasonable customer classifications – renders irrelevant the Attorney General's argument that the PSC's April 19, 2005 Order did not create a new "customer classification." That argument fails for other reasons as well. The Attorney General argues that the PSC did not create a new "customer classification" because the EDR was enacted in the form of a rider to existing non-residential tariffs, and EDR customers' rates and services would otherwise continue to be governed by their existing tariffs. But the Attorney General cites no authority holding that a valid "customer classification" can only be created by a new separate tariff, rather than by a rider to customers' existing tariffs.

The commonly understood meaning of the word "classification" is merely "[a]n

arrangement into groups or categories on the basis of established criteria.” BLACK’S LAW DICTIONARY at p. 249 (6th ed. 1990). The category of customers who satisfy the criteria for one of Duke Energy’s economic development riders is a “classification” of customers within this common definition. The Attorney General’s argument merely illustrates the hollow formalism of his statutory interpretation. Under the Attorney General’s view, Duke Energy Kentucky apparently would be permitted to offer economic development rates to certain customers if it did so in one or more wholly separate tariffs creating new “customer classifications,” but not through the use of a rider that merely amends certain aspects of Duke’s existing tariffs for a category of qualifying customers. That interpretation elevates form over substance and is not supported by any precedent or statutory language.

The Attorney General’s interpretation also renders KRS 278.170(1) a nullity. If KRS 278.170(2) and (3) define the only situations where a preferential rate may be given, then there is no purpose for KRS 278.170(1)’s general delegation of authority to the PSC to determine whether a utility has, “as to rates..., give[n] any *unreasonable* preference or advantage to any person.” A statutory direction to determine if a practice is “unreasonable” is a delegation to “the administrative body, presumably expert in this field, [to] decide what are the relevant factors or standards.” *Louisville & N. R. Co. v. Kentucky R. R. Com’n*, 314 S.W.2d 940, 943 (Ky. 1958). Under the Attorney General’s interpretation, there is no room for the PSC to apply its expertise; it merely determines if the customer falls within one of the categories in KRS 278.170(2) or (3).

The Attorney General relies on a semantic distinction between KRS 278.170(1)’s use of the phrase “preference[s]” “as to rates” and KRS 278.170(2)-(3)’s reference to “free or reduced rate service,” and argues that “KRS 278.170(1) does not address free or reduced rate service.” (AG’s Br. at 18). This distinction is untenable. Under any reasonable

definition of the word “preference,” providing “free or reduced rate service” would constitute a “preference” “as to rates.” Indeed, it is hard to imagine many types of rate “preference[s]” that could not be characterized as “reduced rates.”

The legislative history also refutes the Attorney General’s attempt to distinguish rate “preferences” under KRS 278.170(1) from “free or reduced rate service” under KRS 278.170(2) and (3). As originally enacted in 1934, what are now subsections (1) and (2) were combined in a single paragraph,¹ with the sentences joined by a proviso, thus making clear that the first sentence granted the PSC general authority to approve reasonable rate differentials and the second sentence restricted the PSC’s power to disapprove rate differentials in those enumerated situations:

No utility shall as to rates or service make or grant any unreasonable preference or advantage to any corporation or person or subject any corporation or person to any unreasonable prejudice or disadvantage. **Provided, that nothing herein contained shall prevent any utility from granting free or reduced rate service to its officers . . . ; nor . . . to the United States, or to charitable and eleemosynary institutions and persons engaged in charitable and eleemosynary work; nor . . . for the purpose of providing relief in times and cases of flood, general epidemic, pestilence or other calamitous visitation.**²

The fact that what is now KRS 278.170(2) was originally expressly stated as a specific *exception* to the broader authority to review rate “preference[s]” for reasonableness completely refutes the Attorney General’s argument that these two subparts of the same statutory section deal with wholly different subjects.

The Attorney General attacks a strawman when he argues that the PSC’s plenary ratemaking authority is not an “unconditional grant for the Commission to do as it sees fit.” (AG’s Br. at 14). Duke Energy Kentucky does not contend (and need not contend)

¹ Subsection (3) was added by amendment in 1996.

² 1934 Ky. Acts Ch. 145 § 5(e), codified as § 3952-32 Kentucky Statutes Annotated (attached as Appendix 3 to Duke Energy Kentucky’s Opening Br.) (emphasis added).

that the PSC's ratemaking powers are unlimited. Under KRS 278.030(1), the rates prescribed by the PSC must be "fair, just and reasonable." And under KRS 278.030(3), any differences or classifications in rates must also be "reasonable" and based on the nature, quality, quantity, time, or purpose of the use or some "other reasonable consideration." KRS 278.170(1) mandates that no rate granting an "unreasonable preference" or "unreasonable prejudice or disadvantage" may be approved. The PSC's determinations on these issues are subject to judicial review. But the Attorney General does not argue that EDRs violate any of these express limitations on rate classifications or preferences. The Attorney General does not contend that economic development is not a "reasonable consideration" on which to make a rate classification, or that EDRs grant an "unreasonable preference." Indeed, the Attorney General's brief expressly disclaims any contention the PSC's orders are "unreasonable," rather than "unlawful."³

Consequently, the Attorney General's argument that the PSC "is a creature of statute" is question-begging. In approving the Duke Energy Kentucky's EDR, the PSC was acting pursuant to its authority to set "fair, just and reasonable rates" under KRS 278.030(1). The express power to set "rates" confers broad "legislative and administrative discretion" to the PSC in designing rates that "fairly balance the conflicting interests of the [utility] and the consumer" in each situation. *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503, 515, 510 (Ky. Ct. App. 1990). Unless a rate order is unjust or unreasonable, or violates some other express statutory limitation, it should be presumed to be within the PSC's broad and express statutory ratemaking authority. *Id.*

South Central Bell Telephone Co. v. Utility Regulatory Commission, 637 S.W.2d 649 (Ky. 1982), is inapposite for much the same reason. There, the PSC prescribed rates

³ AG's Br. at 30-31.

that were below the level determined “just and reasonable” as a punishment for poor service, in violation of the express limitation in KRS 278.030(1) that rates be “fair, just and reasonable,” and also failed to comply with the express statutory procedures for hearing complaints related to service. No such violation of an express limitation on the PSC’s ratemaking authority has been identified here. None of the other cases cited by the Attorney General concerning limitations on the PSC’s powers involved *rate orders*, which is not surprising given the PSC’s broad express statutory authority to set rates.⁴

II. The PSC orders relied upon by the Attorney General do not support the Court of Appeals’ interpretation of KRS 278.170.

The Attorney General cites three prior orders of the PSC denying requests by water districts to provide free service under KRS 278.170 as evidence that the PSC has adhered to the Attorney General’s interpretation of KRS 278.170 in the past. The Attorney General has misread those orders. In fact, these decisions are completely consistent with the statutory interpretation advanced by the PSC and Duke Energy Kentucky in this case.

The Attorney General points out that in each of the orders, the PSC focused on whether the request was for one of the types of customers identified in KRS 278.170(2).⁵ But the Attorney General misconstrues the reason the PSC looked to KRS 278.170(2). The PSC did not purport to focus on KRS 278.170(2) because those customers are the *only* persons eligible for reduced rate service. Instead, the PSC looked to this provision because it had *already* determined, as a matter of policy, that it was “unreasonable” for water districts to grant free or reduced rate service because the cost of such service is

⁴ *Boone County Water & Sewer District v. Public Service Commission*, 949 S.W.2d 588 (Ky. 1997), addressed the PSC’s jurisdiction to regulate sanitation districts that are governed under KRS Chapter 220 and exempt from PSC regulation. *Public Service Commission v. Attorney General*, 860 S.W.2d 296 (Ky. App. 1993), involved the PSC’s attempt to charge a utility for merger studies. *Id.* at 298.

⁵ AG’s Br. at 8-9 (citing *In re Request of Bronston Water Association*, Case No. 2005-00060 (Ky. PSC Oct. 12, 2005) (APX A to AG’s Br.); *In re Request of Muhlenburg Water Dist. No. 3*, Case No. 2005-00435 (Ky. PSC March 8, 2006) (APX B to AG’s Br.); *In re Request of Dexter-Alamo Heights Water Dist.*, Case No. 2006-00346 (July 18, 2006) (APX C to AG’s Br.)).

borne by other ratepayers, not shareholders:

This Commission has *previously held that water districts and water associations should not be permitted to provide free water service* since they have no shareholders to which the foregone revenue can be charged. Unlike an investor-owned utility whose shareholders assume the cost of any free or reduced rate service, Bronston's ratepayers bear the cost of such service.

In re Request of Bronston Water Ass'n, Case No. 2005-60 at 3 (Ky. PSC Oct. 12, 2005) (APX A to AG's Br.) (quotation omitted) (emphasis added).

Because the PSC had already determined, as a matter of policy, that water districts could not "reasonably" provide free service, this service could not be approved pursuant to KRS 278.170(1). If such service were to be offered at all, the only basis for doing so would have to be KRS 278.170(2), which authorizes the utilities to offer free or reduced rate service to certain categories of customers irrespective of the PSC's reasonableness determination.

Thus, in the orders cited by the Attorney General, the PSC interpreted subsections (2) and (3) as a limitation on its authority to disapprove "unreasonable" rate preferences under KRS 278.170(1). That is precisely the interpretation advanced by the PSC in the present appeal.

III. The Court of Appeals' interpretation of KRS 278.170 is directly at odds with the decision in *National-Southwire*.

The Attorney General's efforts to distinguish *National-Southwire* are unavailing. That decision expressly held that prescribing special rates for two customers, in part based on consideration of the economic impact of those customers' business operations, was not impermissible rate discrimination under KRS 278.170. *National-Southwire*, 785 S.W.2d at 514. The Attorney General's argument that *National-Southwire* involved a "flexible rate" and not a "reduced rate" fails. The "flexible" nature of the rate in *National-Southwire*

ensured that the smelters would receive a rate below that charged to other customers (a “reduced rate”) when aluminum prices were low, and that those other customers would be charged a lower rate than the smelters (again, a “reduced rate”) when prices were high.

This simple fact illustrates the illusory nature of the distinction between rate “preferences” or “classifications” and “reduced rates” on which the Attorney General so heavily relies. Any time one category of customers is receiving a different rate than another, one will be paying a “reduced rate” relative to the other. The Attorney General’s statutory interpretation would not permit *any* rate differences between customers, other than for the categories specifically enumerated in KRS 278.170(2) and (3). *National-Southwire* unequivocally rejects this interpretation: “Even if some discrimination actually exists, Kentucky law does not prohibit it per se. According to KRS 278.170(1), we only prohibit ‘unreasonable prejudice or disadvantage’ or an ‘unreasonable difference.’” *National-Southwire*, 785 S.W.2d at 514.⁶

IV. The PSC’s long-standing interpretation is entitled to deference.

Even if the PSC’s statutory interpretation is not the only reasonable interpretation, it is still a permissible interpretation of the relevant statutes, and is entitled to deference. *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 843 (1984) (“[I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.”); *Louisville/Jefferson County Metro Gov’t v. TDC Group, LLC*, 283 S.W.3d 657, 661 (Ky. 2009); *Stumbo v. Kentucky Public Service Commission*, 243 S.W.3d 374 (Ky. App. 2007).

⁶ The fact that *National-Southwire* involved an attempt to prevent a utility from insolvency is irrelevant to the Attorney General’s statutory argument. (*cf.* AG’s Br. at 21). The Attorney General claims that KRS 278.170(2) and (3) unambiguously prohibit any rate preferences other than for the customer categories enumerated in those subsections. Just as KRS 278.170(2) and (3) do not identify “economic development” as a basis for reduced rates, they also do not identify avoiding insolvency as providing such a basis.

The Attorney General argues that *Chevron* deference does not apply because “there was no ambiguity” that the plain language of subsection (2) and subsection (3) does not include economic development or brownfield redevelopment. (AG’s Br. at 24). But this misstates the issue. The question is not whether brownfields or job creation are included in KRS 278.170(2) and (3), but whether the enumerated categories in those provisions were intended to be exclusive. On that point, the statute is at least ambiguous.

The Attorney General’s argument that the PSC’s interpretation is not “long standing” is also unavailing. The PSC first issued guidelines for EDRs in 1988, after which their use quickly proliferated.⁷ The guidelines that were in place for most of the following twenty years were issued in industry-wide hearings in 1989, in which the Attorney General participated. Indeed, the tariff filing in this case did not seek new authority to offer EDRs to customers – since such rates had long been permitted by the PSC when set forth in individually negotiated special contracts.⁸ Rather, Duke Energy Kentucky simply sought PSC approval to include the terms of its offered EDRs in its publicly filed tariffs to increase awareness of the availability of EDRs among businesses considering locating in Kentucky. The only change in policy represented by the PSC’s April 19, 2005 order relates to that narrow question of whether the terms of EDRs may be made available in publicly filed tariffs, or whether they may only be included in individually negotiated special contracts. The Attorney General’s position in this appeal has nothing to do with this narrow question, but instead focuses on the underlying validity of any kind of economic development incentive rate. That issue has been decided as a

⁷ In re Investigation into the Implementation of Economic Development Rates by Electric and Gas Utilities, Case No. 327, Sep. 24, 1990 Order, at 1 (APX E to Duke Energy Kentucky’s Opening Br.).

⁸ *Id.*

matter of administrative practice in Kentucky for two decades.⁹

The PSC's orders in *Bronston Water Association, Muhlenberg County Water District No. 3* and *Dexter-Almo Heights Water District* are wholly consistent with its statutory interpretation here. Moreover, none of these cases involves EDRs, and they in no way undermine the PSC's long-standing policy of approving EDRs. The Attorney General's suggestion that the PSC has failed to adhere to its own precedents is baseless.

CONCLUSION

For the foregoing reasons, the Court of Appeals' decision should be **REVERSED** and the PSC's April 19, 2005 Order should be **UPHELD**.

Respectfully submitted,



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⁹ Furthermore, while it is true that a "long-standing" administrative interpretation is entitled to *particular* deference under Kentucky law, *Hagan v. Farris*, 807 S.W.2d 488, 490 (Ky. 1991), the Attorney General cites no authority for the proposition that an administrative interpretation must be of a certain vintage to receive *Chevron* deference. The only prerequisite for the application of *Chevron* deference is that the statute be silent or ambiguous on the point in question. *Chevron U.S.A.*, 467 U.S. at 843. When such ambiguity is present, the agency's interpretation is entitled to deference because of the agency's unique expertise with the subject matter of the statute, not simply because the agency's interpretation is old.