COMMONWEALTH OF KENTUCKY
SUPREME COURT
2009-SC-000150

DUKE ENERGY KENTUCKY, INC.(f/k/a THE UNION LIGHT, HEAT & POWER CO.) — APPELLANT

V.

COMMONWEALTH OF KENTUCKY, ex rel. GREGORY D. STUMBO, ATTORNEY GENERAL and KENTUCKY PUBLIC SERVICE COMMISSION — APPELLEE

Appeal From Kentucky Court of Appeals
Case No. 2007-CA-001635
-and-
Appeal from Franklin Circuit Court
Consolidated Lead Case No. 06-CI-0269
Hon. Phillip J. Shepherd, Judge

APPELLEE ATTORNEY GENERAL'S BRIEF

Submitted by,

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Certificate of Service on Back of Cover

CERTIFICATE OF SERVICE

Pursuant to CR 76.12 (6), I hereby certify that on this 16th day of December, 2009, copies of the foregoing Appellee Attorney General's Brief were filed with the Clerk of the Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; and that copies were mailed via U.S. First Class Mail, postage pre-paid, to the following: Hon. Phillip J. Shepherd, Franklin Circuit Court Judge, Division One, 214 St. Clair Street, Frankfort, KY 40601; David S. Samford, Helen C. Helton, Gerald E. Wuetcher, Anita L. Mitchell, Kentucky Public Service Commission, 211 Sower Blvd., Frankfort, KY 40602, *Counsel for Appellant Kentucky Public Service Commission;* Sheryl G. Snyder, M. Holliday Hopkins, Jason P. Renzelmann, Frost Brown Todd LLC, 400 W. Market St. 32nd Floor, Louisville, KY 40202-3363 and John J. Finnigan, Jr., Duke Energy Services, Inc., 2500 Atrium II, P.O. Box 960, Cincinnati, OH 54201, *Counsel for Appellant Duke Energy Kentucky, Inc.*

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STATEMENT OF ORAL ARGUMENT

The Commonwealth believes oral argument would be helpful to the Court.

COUNTERSTATEMENT OF POINTS AND AUTHORITIES

I. COUNTERSTATEMENT OF THE CASE

Appellee Attorney General of the Commonwealth of Kentucky ["Appellee" or "Attorney General"] does not accept the Statement of the Case set forth in the brief of Appellant Duke Energy Kentucky, Inc. ["DEK"]; therefore, he tenders the following Counterstatement of the Case.

A. Background

On May 4, 2001, DEK,[1] an investor-owned utility, filed an application with the Kentucky Public Service Commission ["PSC" or "Commission"] pursuant to KRS 278.190 seeking approval for general rate increases.[2] The Attorney General, pursuant to KRS 367.150 (8) moved for and was granted intervention in that case to represent and be heard on behalf of the interests of DEK's ratepayers.

For many years prior to its 2001 filing, DEK and its predecessors had been aware of the need to replace aging portions of its system of natural gas mains made of cast iron and bare steel. DEK had in fact been engaged in a program to replace those segments of its mains, which was scheduled to be completed in fifty (50) years.[3] However, DEK's 2001 rate case filing included a plan [the Accelerated

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[1] *F/k/a* "Union Light, Heat & Power," or "ULH&P."

[2] *In re Adjustment of Gas Rates of Union Light, Heat & Power Co.*, Commission Case No. 2001-00092, the final Order of which was dated on Jan. 31, 2002 [hereinafter "Jan. 31, 2002 Order"], R.A. 1-165; copy attached as Appendix 5 to brief of Kentucky Public Service Commission in the PSC's companion appeal 2009-SC-134.

[3] Court of Appeals' Opinion, pp. 2, 12. *See also* pre-filed written direct testimony of DEK officials filed in the company's most recent general rate case *In Re Application of Duke Energy Kentucky, Inc. For an Adjustment of Rates,* PSC Case No. 2009-00202) of which this Court can take judicial notice, relevant excerpts of which are attached hereto as "Appendix F," providing further details of the history of this program. In sum, DEK testified that it has known since 1971 that the piping at issue needed to be replaced yet waited approximately thirty years to address a purported emergency. In particular, see testimony of: (a) Gary J. Hebbeler, pp. 21-25; (b) William D. Wathen, Jr., pp. 6-8; (c) Julia S. Janson, pp. 6-9. The entire testimony and other case documents can be accessed at: http://psc.ky.gov/pscscf/2009%20cases/2009-00202/.

Mains Replacement Program, or "AMRP"] under which the company, on its own initiative, sought to speed-up the replacement program so that it would be completed in ten (10) years. As a means of recovering its costs to be expended in completing the AMRP program, DEK sought to bypass the sole method provided in KRS Ch. 278 for recovering those types of costs, that of a general rate case, and instead sought PSC approval of the right to employ a new and unique surcharge that would appear on each customer's monthly utility bill by way of a separate line-item charge. This surcharge was known as "Rider AMRP." Rider AMRP was therefore designed to track the AMRP costs and automatically recover them through the surcharge, thus sidestepping the need for the statutorily provided-for general rate case review, and to instead recover the costs of the AMRP on a between-general-rate-cases basis.

The PSC authorized DEK to implement Rider AMRP for an initial three-year period, and to tender annual filing reviews of new AMRP costs during that period.[4] Significantly, Rider AMRP also allowed DEK to *automatically* recover both a *guaranteed* return on investment, and a return of each preceding year's net increase in plant investment incurred under the mains replacement program for the three years following the completion of the 2001 general rate case.[5] This return on investment was in addition to the general *opportunity* to earn a return on equity that DEK was allowed to earn under its general rates.[6] Rider AMRP thus allowed for the automatic,

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[4] Jan. 31, 2002 Order at 79-80.

[5] *Id.* at 79. *See also In Re Adjustment of Gas Rates of Union Light, Heat & Power Co.*,PSC Case No. 2005-00042, the final Order of which was dated Dec. 22, 2005, p. 70 [hereinafter "Dec. 22, 2005 Order"], R.A. 1-107; copy attached as Appendix 9 to PSC's brief in its companion appeal, 2009-SC-134.

[6] *See generally* Dec. 22, 2005 Order, pp. 64-73. The Rider AMRP approved by the Commission closely resembled the between general rate case capital cost recovery for environmental compliance specifically authorized by the General Assembly for electric utilities in KRS 278.183 ("Environmental Surcharge").

guaranteed reimbursement of the expense of and profit on these items, on an annual between-general-rate-case-basis, outside of the context of a general rate case.[7] Rider AMRP therefore shifted all risk for return on investment from DEK's shareholders to its ratepayers, and significantly increased ratepayers' costs by requiring them to pay *twice* for DEK's return on investment. Further, under Rider AMRP DEK did not begin collecting its actual AMRP-related costs – and the PSC did not review those actual costs -- until well-after the conclusion of the 2001 general rate case. Moreover, the PSC's truncated examination of those costs was necessarily limited to the single issue of those costs, in isolation from the company's overall financial status, thus depriving DEK's ratepayers of the comprehensive, thorough, and independent scrutiny required in a general rate case.

The PSC approved each of DEK's annual applications for adjustments to Rider AMRP. The Attorney General appealed each such ruling to the Franklin Circuit Court. On February 25, 2005, DEK filed its next general rate case, this time seeking approval of Rider AMRP for the remaining portion of the AMRP Program.[8] While DEK's 2005 rate case was pending, the Kentucky Legislature passed HB 440,[9] which created a new, express right for utilities to recover costs for investment in natural gas pipeline replacement programs.

The PSC then concluded DEK's 2005 rate case, and re-approved its Rider AMRP. In doing so, the PSC concluded that it had authority for the re-approval

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[7] In general rate cases, the Commission gives regulated utilities only an opportunity to earn an allowed rate of return. Actual rates of return may vary depending on various circumstances, e.g., prevailing economic conditions.

[8] Case No. 2005-00042; *see* Dec. 22, 2005 Order, pp. 64-73, in which the PSC re-approved Rider AMRP.

[9] 2005 Ky. Acts Ch. 148, portions of which would later be codified as KRS 278.509.

under both its general ratemaking powers and under the newly-enacted KRS 278.509. The Attorney General appealed the PSC's re-approval of Rider AMRP to the Franklin Circuit Court.[10]

On June 1, 2009 DEK filed its first general rate case in over four (4) years.[11] DEK's public testimony filed in that case summarized the current state of the AMRP Program, and acknowledged: (a) the AMRP Program is scheduled to be completed in 2010; and (b) DEK did not recover any costs under Rider AMRP since the conclusion of its 2005 rate case. Instead, DEK now plans to seek recovery of its costs incurred to date under the AMRP Program in its pending 2009 rate case.[12] Curiously, however, both the PSC[13] and DEK[14] continue to assert before this Court that the company would face dire financial consequences without Rider AMRP. The nature of the Appellants' motives for this particular argument is thus unclear. Regardless, at no time during the prosecution of the instant appeal, nor during the life of the AMRP Program did DEK ever submit any filings to the PSC indicating that its financial status ever deteriorated in any manner. In fact, during that time frame all evidence indicates DEK was able to absorb the costs of the AMRP Program without any insurmountable financial hardship. The company's continuing viability and **profitability** throughout the history of this case speaks loudly to this point.

B. The Rulings of the Franklin Circuit Court and Kentucky Court of Appeals

[10] Action No. 06-CI-269, appealing Dec. 22, 2005 Order in PSC Case 2005-00042 (R.A. 1-107).
[11] PSC Case No. 2009-00202, *In re: Application of Duke Energy Kentucky, Inc. for an Adjustment of Gas Rates.*
[12] *See* Appendix F attached hereto.
[13] PSC Brief, 2009-SC-000134, p. 2.
[14] DEK Brief, 2009-SC-000150, pp. 2-4.

On August 1, 2007, the Franklin Circuit Court entered its Opinion and Order ["Opinion and Order"],[15] reversing the PSC order that approved Rider AMRP.[16] The Franklin Circuit Court also ruled that the PSC lacked the inherent or implied authority to engage in interim single-issue rate adjustments except when done with specific statutory authorization.[17] That court further specifically found, among other things, that: (a) the PSC may not allow a surcharge without specific statutory authorization;[18] (b) the recovery of expenses in the interim between rate cases is a right not encompassed in the PSC's general power;[19] (c) the PSC has no inherent authority to perform interim single-issue rate adjustments because such a mechanism would undermine the statutory scheme;[20] and (d) outside a general rate case there is no context in which to consider any expense.[21]

On November 7, 2008, the Kentucky Court of Appeals issued its unanimous, clear and concise ruling ["Opinion"] which was fully consistent with KRS Ch. 278 and existing precedent. The Opinion held, **as a matter of law**, that the PSC lacked the authority to approve Rider AMRP prior to the enactment of KRS 278.509.[22] The Court of Appeals' holding in that regard is central to the instant appeal. As will be discussed at length in the following Argument, the Attorney General will point out the numerous instances in which DEK has mischaracterized the Court of Appeals' holding.

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[15] R.A. 240-48, Aug. 1, 2007 Opinion and Order; copy attached hereto as "Appendix G.".
[16] *Id.* at 8.
[17] *Id.* at 5 - 7.
[18] *Id.* at 7.
[19] *Id.* at 6.
[20] *Id.*
[21] *Id.* at 7.
[22] Court of Appeals Opinion at 18; copy attached hereto as "Appendix H."

II. ARGUMENT

THE COURT OF APPEALS CORRECTLY HELD AS A MATTER OF LAW THAT PRIOR TO THE ENACTMENT OF KRS 278.509, THE PSC LACKED AUTHORITY TO ALLOW DEK TO IMPOSE THE SURCHARGE FOR COLLECTION OF AMRP PROGRAM COSTS

KRS Ch. 278 establishes a comprehensive scheme governing utility rates and services. KRS 278.030 establishes the right of every utility to receive fair, just and reasonable rates for the services it renders. The PSC's authority over rates is established in KRS 278.040. The procedure to be followed when a change in rates is sought is set out in KRS 278.180 and 278.190. When a utility files new rates that are to become applicable to all customers, those new rates constitute a general adjustment in rates, and the utility must comply with 807 KAR 5:001 § 10.[23] KRS 278.192 establishes the test year to be utilized in support of requests for general rate increases under KRS 278.190. KRS 278.270 authorizes the PSC to adopt and order the implementation of new rates at the conclusion of its investigation if warranted. These provisions are all designed to establish fair, just and reasonable base rates as a function of the utility's **overall** financial picture in the general rate case.[24]

Absent a court ruling suspending or vacating a PSC order establishing rates, KRS Ch. 278 provides that once base rates are established, they continue in effect even in the face of changes in the utility's actual costs and revenues, until: (1) the utility decides circumstances have so changed that it no longer has an opportunity to earn a fair return on its investment and applies for an increase in base rates; or (2) the

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[23] *See, e.g., In Re Louisville Gas & Elec. Co.*, Ky. PSC Case No. 2004-00459, and *In Re Kentucky Utilities*, Case No. 2004-00460 (2005 WL 1163147) Joint Order of April 15, 2005 at p. 3 (copy attached hereto as "Appendix C").
[24] *Id.*

PSC or another party seeks to reduce the utility's rates because they are unreasonable.[25]

In addition to statutes governing the general rate case, KRS Ch. 278 contains many other specific statutes through which the legislature authorizes expedited, specialized cost recovery for gas, water, sewer, electric, and telephone utilities for certain specified expenses, services, and programs.[26]

Utilizing language that simply could not be clearer and any more unambiguous, the Court of Appeals found that its review of the instant appeal was limited solely to questions of law:

> "The question of whether the PSC exceeded its statutory authority is a question of law that we review *de novo*. . . The issues presented by this appeal involve statutory interpretation; thus, they are **purely questions of law** subject to *de novo* review."[Emphasis added] [27]

Moreover, the Court of Appeals correctly applied well-established precedent in reaching the basic, immutable proposition that the PSC is a state administrative agency of limited authority, noting:

> "Although the PSC is granted broad authority to regulate public utilities, it remains a creature of statute and "has only such powers as granted by the General Assembly."" [28]

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[25] *See* KRS 278.390; 278.270; 278.180; and 278.260.

[26] One of those statutes, KRS 278.509, is at issue only indirectly in the instant appeal because the broadly-stated, central issue is whether the PSC had authority to approve Rider AMRP prior to the enactment of that statute.

[27] Opinion at 6-7 (*citing Cincinnati Bell Telephone Co. v. Kentucky Public Service Com'n*, 223 S.W.3d 829, 836 (Ky.App. 2007)). DEK's brief, at p. 14, mischaracterizes the Court of Appeals' finding by stating that a PSC order is unlawful "only" if it violates a statute or constitutional provision. *See* Opinion, p. 6. This argument must fail because the Court of Appeals held that the PSC violated the law by exceeding its statutory authority; i.e., there was no statute at issue to be violated. Acceptance of DEK's position would be tantamount to allowing a state agency to do as it pleases absent a specific statute prohibiting the contemplated conduct.

[28] *Id.* at 6, *quoting PSC v. Jackson Co. Rural Elec. Co-op., Inc.*, 50 S.W.3d 764, 767 (Ky. App. 2001)("Thus, any issue involving the PSC's authority is necessarily one of statutory analysis.") (*also citing Boone County Water & Sewer Dist. v. PSC,* 949 S.W.2d 588, 591 (Ky. 1997)).

Given the clear state of the law, the Court of Appeals reached the only holding it could have:

> "We conclude that the PSC cannot authorize the imposition of a surcharge for the main replacement program proposed by Duke without specific statutory authorization."[29]

A. THE PSC IS AN ADMINISTRATIVE AGENCY OF LIMITED AUTHORITY

In an analysis covering several pages, the PSC in its Order of Dec. 22, 2005[30] reiterated that it had ruled prior to the enactment of KRS 278.509 that it possessed authority to establish a surcharge for the single-issue Rider AMRP and to unilaterally create procedures outside of a general rate case for periodically reviewing and amending the surcharge. In so holding, the PSC clearly exceeded the scope of its authority. The statutes governing the PSC clearly make no provision authorizing the PSC to establish the Rider AMRP surcharge and to conduct annual hearings to adjust that surcharge to recover post-general rate case costs.

> The legislative grant of power to regulate rates will be strictly construed and will neither be interpreted by implication nor inference. . . . In fixing rates, the Commission *must* give effect to all factors which are prescribed by the legislative body, but may not act on a matter which the Legislature has not established. *South Cent. Bell Tel. Co. v. Util. Regulatory Comm'n*, 637 S.W.2d 649, 653 (Ky. 1982)[emphasis in original; citations omitted].

When a statute prescribes the procedures that an administrative agency must follow, the agency may not add to or subtract from those requirements. *Public Service Comm'n of Kentucky v. Attorney General of the Com.*, 860 S.W.2d 296, 298 (Ky. App. 1993)(citations omitted). The PSC's actions in allowing DEK to surcharge for its AMRP expenses and profit on those expenses were a naked attempt to add to

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[29] *Id.* at 12.
[30] Dec. 22, 2005 Order, pp. 64-69.

its authority. Only the Kentucky Legislature can establish the parameters of the PSC's authority. The Court of Appeals thus correctly found, as a matter of law, that the PSC had exceeded its scope of authority.[31]

Furthermore, the Court of Appeals took note that KRS Ch. 278 is replete with statutes ["expedited recovery statutes"] that **affirmatively and expressly** establish both cost recovery and alternative single-issue rate treatment outside of a general rate case.[32] Moreover, this Court in *Kentucky Indus. Util. Customers v. Kentucky Utilities Co.*, 983 S.W.2d 493 (Ky. 1998)["*KIUC*"], upheld the validity of one such statute, KRS 278.183.[33]

The Ch. 278 expedited recovery statutes include the following: KRS 278.183 (which, *inter alia*: (1) authorizes recovery of environmental compliance costs via surcharge; and (2) requires the PSC to conduct a hearing within six months of the application, and specifies the matters to be considered therein); KRS 278.012, 278.015 and 278.023 (authorizing rate increases for water and sewer districts and associations without prior Commission action in the event of water wholesaler rate increases, and special rate recovery procedures for certain projects); KRS 278.130 (requiring the PSC to approve requests for rate increases to recover the annual PSC assessment and limiting the hearing thereon to solely that issue); KRS 278.285 (authorizing the development and implementation of demand side management

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[31] Opinion, p. 7 ("The issues presented by this appeal involve statutory interpretation; thus, they are purely questions of law subject to *de novo* review."); *see also id.*, pp. 12, 18.
[32] Opinion, pp. 8-9, n.2.
[33] In *KIUC, supra* at 500 [copy attached hereto as "Appendix I"], this Court held in part that the right to recover environmental compliance costs through a surcharge without filing a general rate case was a new right established by the enabling statute at issue in that case, KRS 278.183. Only those costs allowed by the statute may be recovered by that particular surcharge. *Id.* at 500.

("DSM") and home energy heating assistance programs and specifying that DSM cost recovery mechanisms may be considered in either a general rate case or separate proceeding); KRS 278.455 (authorizing a reduction in a generation and transmission cooperative's rates, based on certain conditions); KRS 278.516 (alternative rate recovery for telecommunications providers); and KRS 278.509.

These nine (9) expedited recovery statutes in KRS Ch. 278 thus establish both cost recovery rights and *a non-general rate case* means by which the cost recovery is to occur. The expedited recovery statutes provide an unequivocal and unambiguous expression of the Legislature's intent that it -- and it alone -- will dictate the instances and circumstances in which the PSC can consider cost recovery mechanisms that are to take effect outside of a general (base) rate case. Any holding supporting the PSC's apparent claim that it possesses some sort of nebulous, undefined *inherent* authority to make this determination would be not only directly contrary to the clearly evinced Legislative intent in this regard, but just as importantly would establish a ***third*** type of administrative authority never recognized under and repugnant to this Court's precedents, the Kentucky Revised Statutes, nor in the Kentucky Constitution.

The KRS Ch. 278 expedited recovery statutes demonstrate unequivocally that when the Legislature intends for the PSC to authorize special cost recovery and alternative ratemaking mechanisms and procedures outside of a base rate case, the Legislature can and does speak quite clearly, and includes those procedures in the enabling legislation when it so desires. By no stretch of the imagination did the Legislature make any statement in this regard prior to the enactment of KRS

278.509. In fact, the passage of that statute itself speaks volumes about the *absence* of PSC authority in this regard. As the learned Franklin Circuit Court Judge put it:

> "The fact that KRS 278.509 was enacted suggests that the existing authority of the PSC did not allow interim hearings on single issues. Similarly, in KRS 278.183 the Legislature created an interim review mechanism for the environmental surcharge. It is a well-known rule of construction that legislation should not be construed to lack meaning, but rather that the legislature intends to do something by its action [citations omitted]. While the legislature may speak to clarify existing authority, enactment of prior interim review statutes supports the construction that the legislature is creating new authority. Statutory creation of a mechanism for interim review of a cost would be unnecessary if the PSC possessed such implied authority inherently."[34]

Prior to the enactment of KRS 278.509, no other provision of Ch. 278 granted the Commission the express authority to impose single-issue surcharge rate increases for mains replacement costs. In fact, the Court of Appeals affirmatively and expressly held that the PSC had no authority prior to the enactment of KRS 278.509 to authorize Rider AMRP, concluding: "Because we reject Duke's contention that such authority existed prior to the enactment of KRS 278.509, logic dictates that the General Assembly did not validate a nonexistent right or power."[35] Absent specific enabling legislation otherwise, the matter can only be resolved via a general rate case, per 278.190.[36] Therefore, the PSC exceeded its legal authority by authorizing Rider AMRP prior to the enactment of KRS 278.509.

DEK's assertions that the enactment of KRS 278.509 was evidence of legislative intent to clarify that the PSC already possessed the inherent power to authorize Rider AMRP, and was an endorsement of the those actions on behalf of

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[34] R.A. 240-48, Aug. 1, 2007 Franklin Circuit Court Opinion & Order, pp. 5-6.
[35] Opinion, at 13.
[36] *See, KIUC, supra.*

PSC, is wholly meritless. On eight (8) separate prior occasions, the Kentucky Legislature clearly demonstrated its intent that the expedited recovery statutes were necessary because the PSC *lacked* that particular authority. DEK can cite to just one individual legislator's comments regarding only one particular statute for the proposition that KRS 278.509 somehow clarified "existing" authority. The passage of those eight (8) prior statutes speaks much louder than the voice of a single legislator commenting on one bill. Either the PSC possessed that authority, or it did not. KRS 278.030 and 278.040 clearly do not encompass that right. Any ruling stating that the PSC possessed that authority prior to the enactment of KRS 278.509 will of necessity mean that the PSC possesses not just necessarily implied authority, but also inherent authority – a type of power Kentucky has heretofore never recognized. The Court of Appeals correctly found, as a matter of law, that the PSC did not have the authority to implement Rider AMRP prior to the enactment of KRS 278.509.

More importantly, DEK's argument is premised upon the assumption that the Legislature did not intend to delegate to the PSC only what is set forth in the statutes; rather, it intended to delegate ALL of the Legislature's authority and power in the area of ratemaking to the PSC. According to DEK, this virtually unfettered and undefined authority is curtailed **only** by express statutes, and the PSC can indeed do whatever it wishes as long as the contemplated action is not expressly precluded by statute. DEK's argument is therefore, *ipso facto,* that the PSC possesses a third class of authority never before recognized in Kentucky jurisprudence: ***inherent authority***, an authority far greater than and vastly different from the judicially-recognized

necessarily implied authority. No controlling precedent has ever established such authority on behalf of a Kentucky administrative agency.

In fact, the issue of whether a delegation of legislative power yields such unfettered power for the Public Service Commission was settled by Kentucky's highest court **decades ago**. In *Public Service Comm'n v. Cities of Southgate and Highland Heights*, 268 S.W.2d 19 (Ky. 1954)(discussed in greater detail, *infra*), the Court, in ruling on a claim of necessarily implied authority, also addressed the scope of the PSC's necessarily implied power:

> "However, the appellee cities would have us extend the implication [necessarily implied authority] so as include the power in the commission to determine whether public ownership is more beneficial than private ownership, and to determine under whose ownership the lowest rates may be achieved. The latter two questions address themselves to basic public policy, upon which we feel an express legislative declaration is required. **From a mere grant of power to regulate rates and service, we are unwilling to imply a declaration of policy that not only must rates be reasonable, but the type of ownership that will provide the lowest rates is the only type of ownership that will be permitted to operate a utility service."** *Id.* at 21 [emphasis added].

The Court in *Cities of Southgate and Highland Heights* thus clearly held that the mere delegation of authority to the PSC not only did not imbue it with the inherent authority the PSC now claims, but indeed that delegation *alone* was not enough to even trigger the PSC's necessarily implied authority.

Thus, the issues in the instant appeal can be wholly resolved on the basis of well-settled Kentucky law. Despite DEK's attempts to divert attention from the core issues in the instant appeal, the Court of Appeals correctly focused on the controlling authority:

> "The Commission's powers are purely statutory; therefore, when a statute prescribes a precise procedure, an administrative agency may not add to such provision. *South Central Bell Telephone Co. v. Utility Regulatory Com'n*, 637 S.W.2d 649, 653 (Ky. 1982). In the context of the grant of power to the PSC, the authority granted is limited by the enabling statute:
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> > [T]he legislative grant of power to regulate rates will be strictly construed and will neither be interpreted by implication nor inference. It will be strictly construed. 73 C.J.S., Public Utilities, § 41, p. 1080. In fixing rates, the Commission *must* give effect to all factors which are prescribed by the legislative body, but may not act on a matter which the legislature has not established, *id.*, Sec. 41, (c)(aa) p. 1093. We have held that the Commission's powers are purely statutory.[37]

In its vigorous pursuit of the instant appeal, DEK unmistakably seeks a ruling granting the PSC inherent authority under KRS 278.030 and 278.040. Such a ruling would doubtlessly enable the PSC to grant additional single-issue expedited cost recovery provisions which, just like Rider AMRP, are not authorized per statute. Such a ruling would enhance the financial standing of DEK, and that of the *amici* in the companion appeal, all with as little transparency as possible.

In fact, DEK argues that as long as the "end" is fair, just, and reasonable rates as required under KRS 278.030, then the PSC can indeed utilize any means it wishes as long as not directly contrary to law. Regardless of which party asserts this argument -- DEK, the PSC or the *amici* in the companion appeal -- it simply does not work, and this argument for expanding the Commission's jurisdiction has been consistently rejected.. No one can simply erase the enormous body of case law concerning the limits of Commission jurisdiction and the fundamental principle of necessarily implied authority. An exercise of necessarily implied authority must be

[37] Opinion, p. 6, *citing* and *quoting South Central Bell Telephone Co. v. Utility Regulatory Comm'n*, 637 S.W.2d 649, 653 (Ky. 1982).

necessary because one of the agency's express powers is inadequate to allow it to accomplish its mandated mission. *Cities of Southgate and Highland Heights, supra.*

Quite simply, this was never the case with Rider AMRP. Throughout the prosecution of this appeal, DEK has confused the Kentucky Legislature's grant of "exclusive jurisdiction" in KRS 278.040 (2) with the concept of unfettered ultimate authority. DEK's argument is indeed premised on the mistaken notion that the PSC's authority is co-extensive with that of the Kentucky Legislature.[38] The Kentucky Legislature's grant of authority to the PSC is largely unremarkable. The scope of that authority, by application of many controlling precedents cited herein, is nothing greater than that of any other administrative agency that is granted exclusive jurisdiction. The term "exclusive jurisdiction" simply means that no other administrative body in Kentucky can exercise the jurisdiction given to the PSC. That phrase does not mean that the PSC's authority is co-extensive with that of the Kentucky Legislature. DEK thus misapplies the concept of "exclusive jurisdiction." The Commission has been granted exclusive jurisdiction to regulate utility rates and service, and this grant has been recognized by the judiciary with regard to the proper forum for advancing claims relating to rates or service. *Carr v. Cincinnati Bell, Inc.*, 651 S.W.2d 126 (Ky. App. 1983). It has not been recognized as a principle through which the Commission may enlarge its legislatively-determined authority.[39]

The PSC cannot simply "make it up as it goes along." To the contrary, Kentucky courts have always held that the PSC is an administrative agency of

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[38] *See, e.g.,* DEK Brief, p. 16.

[39] *See Cities of Southgate and Highland Heights, supra.*(ability of PSC to decide basic public policy questions requires express authorization from legislature).

limited authority. *Boone County Water & Sewer Dist. v. PSC*, 949 S.W.2d 588, 591 (Ky. 1997).

B. THE PSC'S APPROVAL OF RIDER AMRP PRIOR TO ENACTMENT OF KRS 278.509 VIOLATED THAT AGENCY'S OWN POLICY AGAINST SINGLE-ISSUE RATEMAKING

In authorizing Rider AMRP prior to the enactment of KRS 278.509, the PSC engaged in single-issue ratemaking. One of the most important principles of proper ratemaking is that of "matching" all of the components in the ratemaking formula. In other words, at the time rates are set or changed, *all* of the ratemaking components that determine a utility's revenue requirement within a defined test period must be considered and subjected to regulatory review. Any fixing of rates between-general-rate-cases without statutory authorization thus violates this matching principle because it permits the utility to eventually change its future rates based on the consideration of only *one or a few* variables in isolation from the company's overall financial status.[40] KRS Ch. 278 is based in part on recognition of the matching principle.

In fact, the PSC has a well-established policy against single-issue ratemaking, having previously ruled:

> Simply stated, the pending applications appear to be requests for the Commission to engage in single-issue rate-making by focusing exclusively on one or more closely related items of revenue and expense, to the exclusion of all other items of revenue and expense. **Although the Commission has, in limited instances, previously engaged in single-issue rate-making, those instances were either specifically authorized by statute or the result of a unanimous agreement by all parties with approval by the Commission.** While the General Assembly has authorized single-issue rate-making for recovery of the Commission's annual assessment and the costs of its consultants (KRS 278.130),

[40] *See, e.g., KIUC., supra* at 498.

> environmental costs (KRS 278.183), and demand side management costs (KRS 278.285), there is no provision of law authorizing a rate case focused exclusively on MISO-related revenues and expenses. . . .[41] [emphasis added].

Thus, the PSC's actions in authorizing Rider AMRP prior to the enactment of KRS 278.509 violated its own policy against single-issue ratemaking, since it was not specifically authorized by statute and was not the result of a unanimous agreement by all parties.

The policy against single-issue ratemaking is based on the sound premise that the complex science of utility ratemaking requires a detailed, thorough examination of a utility's revenues, costs and rate structures, all in their totality. Any examination limited to only a small aspect of those elements could easily be taken out of context and present a distorted or even false picture of the company's overall financial status. Indeed, the thorough examination that a general rate case affords provides many benefits to the utility's customers, while still portraying the company's status in the most accurate light possible. By way of hypothetical example, those benefits could include items such as offsetting of new increased costs the utility seeks to recover by decreases in other costs such as: (a) recognizing changes in depreciation and reductions in labor costs; or (b) in times of less expensive financing, decreasing the interest rates on debt and declining returns on equity. If the consumer is required to pay the increased costs the utility seeks to recover in addition to the old rates based on old costs the utility no longer incurs, those old rates could give the utility unwarranted profits.

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[41] *In Re Louisville Gas & Elec. Co.*, and *In Re Kentucky Utilities*, *supra* at n. 23.

When the PSC authorized and conducted truncated hearings limited to the single-issue of costs incurred under Rider AMRP, it thus received a necessarily distorted view of the company's overall financial status. Doubtlessly, this is exactly what DEK wanted. The possibility of receiving a *guaranteed* return on its large capital investment was likely something DEK did not want to miss. Statutes require and customers deserve to have complex utility costs assessed and scrutinized in the most accurate light possible. Hence, there is a need to observe and uphold the precedent against single-issue ratemaking.

Not surprisingly, DEK argues *contra* to the well-established policy against single-issue ratemaking, asserting that nothing in Ch. 278 requires an examination of every aspect of a utility's financial condition to effect a change in rates.[42] Apparently, DEK wishes to sidestep the very detailed requirements that the PSC wisely put into place which a utility must make public whenever it files for a general change in rates (*see* 807 KAR 5:001 § 10).

Rider AMRP thus constituted single-issue ratemaking for which the Commission had no statutory authority in which to engage. More importantly, DEK throughout the prosecution of the instant appeal appears intent on forsaking this well-founded policy, instead now arguing essentially that the PSC possesses *inherent* authority to do whatever it wishes, as long as the contemplated action is not expressly forbidden in existing law. Should this Court overturn the Court of Appeals' Opinion, one sure consequence will be that the PSC will be emboldened to fully ignore its own policy against single-issue ratemaking, a policy that is firmly rooted

[42] DEK brief, p. 26.

and wholly consistent with its instructions in KRS Ch. 278, in favor of a policy that will consider the regulation of rates on a utility-by-utility and case-by-case basis. Certainly, such an empowerment for arbitrary and capricious regulation is foreign to Kentucky's administrative law.

C. THE COMMISSION HAD NO IMPLIED AUTHORITY TO ORDER CREATION OF RIDER AMRP PRIOR TO ENACTMENT OF KRS 278.509

The PSC is an administrative agency of limited authority, and its powers are purely statutory.[43] When a statute prescribes the procedures that an administrative agency must follow, the agency may not add or subtract from those requirements.[44]

> "'Administrative agencies derive their power and authority from other sources. They are agents of those principals and cannot act beyond the intended grant of authority. Generally, the authority comes from a delegation by the legislative branch . . . to perform some duty assigned to it by the legislature, and hence agencies have only such authority as is delegated by the legislature. From this, we derive a basic concept that an agency cannot act outside its delegated authority.' . . . The Kentucky courts have not been as deferential toward administrative agency power as have the federal courts and have struck down legislative delegations as recently as 1996. *See Flying J Travel Plaza v. Com., Transp. Cabinet*, Ky., 928 S.W.2d 344 (1996)."[45]

Nonetheless, it is equally well-settled law in Kentucky that administrative agencies possess not only their expressed enumerated powers, but also those that are necessarily implied to accomplish their expressly enumerated powers. "Powers of administrative boards and agencies are those conferred expressly or by necessary or fair implication . . . . It is a general principle of law that where the end is required,

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[43] *Public Service Comm'n. v. Jackson Co. Rural Elec. Co-op., Inc., supra* at 797 (*citing Boone County Water, supra);Cincinnati Bell Tel. Co. v. Kentucky Public Service Comm'n,* 223 S.W.3d 829, 836 (Ky. App. 2007); *accord*, 73B C.J.S. *Public Utilities* § 159 (2007)(A public utilities commission possesses only that authority conferred expressly by statutes, or by necessary or fair implication, but has no inherent powers (citations omitted)).

[44] *Union Light, Heat & Power Co. v. Public Service Comm'n,* 271 S.W.2d 361 (Ky. 1954).

[45] 1999 Ky. Op. Atty. Gen. 2-46 (OAG 99-2), p. 6, (*quoting* Koch, *Administrative Law & Practice* § 12.13, p. 170 (2d ed. 1997)).

the appropriate means are implied."[46]

Kentucky's courts have explicitly included the PSC within this well-recognized, fundamental tenet of law, a fact which DEK has only vaguely acknowledged throughout the prosecution of the instant appeal, and that only in an incomplete and selective manner.[47] The *amici* brief filed in the Court of Appeals[48] cited numerous Kentucky decisions[49] which upheld agency actions based on necessarily implied authority. Yet in each such case, a common thread emerges clearly -- and quite starkly: in each case, it was found the agency simply could not carry out its mandated mission without the exercise of implied authority, thus the necessity thereof. That clear thread of being strictly necessary to carry out the agency's mandated mission is woefully missing from the PSC's actions at issue in the instant appeal.

Thus, in each of the following cases implied authority was found necessary to fulfill the administrative agency's express mandate: a health board was found to have the implied authority to purchase a building from which it conducted its operations (even though no express authority existed);[50] a jailer's responsibilities included the duty to cooperate with other agencies to provide humane medical treatment, even

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[46] *Ashland-Boyd County Health Dept. v. Riggs,* 252 S.W. 2d 922, 923 (Ky. 1952)[emphasis added].
[47] *Croke v. Public Serv. Comm'n of Ky.*, 573 S.W.2d 927, 929 (Ky. App. 1978)("The Public Service Commission's powers are purely statutory; like other administrative boards and agencies, it has only such powers as are conferred expressly or by necessary or fair implication.")(*citing City of Olive Hill v. Public Serv. Comm'n,* 305 Ky. 249, 203 S.W.2d 68 (1947), overruled on other grounds, *McClellan v. Louisville Water Co.*, 351 S.W.2d 197 (Ky. 1961)).
[48] Corrected Brief of *Amici Curiae*, 2007-CA-001635.
[49] *Id.* at pp. 8-10; *see especially* n. 19.
[50] *Ashland–Boyd County, supra* at 923-924.

though he was not expressly required to do so;[51] when a county fiscal court attempted to execute its statutory duty to revise precinct boundaries, the court found the agency had the implied authority to spend money to pay its commissioners to gather the necessary data and produce a report, and to pay for newspaper publication of the changes based on the report;[52] and a school board can set aside funds for students' recreation, although that power was not expressly authorized.[53]

In *Public Service Comm'n v. Cities of Southgate and Highland Heights*, 268 S.W.2d 19, 21 (Ky. 1954),[54] the PSC was found to have implied authority to approve the sale of a utility in order to fulfill its statutory obligation of insuring adequate utility service.[55] The Court found that:

> "It is true that the governing statute, KRS Chapter 278, does not in express terms confer jurisdiction upon the Public Service Commission to pass upon sales of utility systems. However, we are of the opinion that jurisdiction is *implied necessarily* from the statutory powers of the commission to regulate the service of utilities . . if a sale were made to a purchaser incapable of carrying on the service, the sale would be the practical equivalent of a **discontinuance of service.** The [PSC] . . . in order to carry out its responsibility, must have the opportunity to determine whether the purchaser is ready, willing and able to continue providing adequate service."[56] [emphasis added]

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[51] *County of Harlan v. Appalachian Reg. Healthcare, Inc.*, 85 S.W. 3d 607, 611 (Ky. 2002)("Not to require the jailer to cooperate with other officials in providing the necessary services **would produce an absurd result** and frustrate the system envisioned by the legislature.")[emphasis added].

[52] *Jefferson County ex rel Grauman v. Jefferson County Fiscal Court*, 301 Ky. 405, 192 S.W.2d 185 (1946)("The power to appoint necessary attendants upon the court is inherent in the court in order to enable it to perform properly the duties delegated to it by the Constitution." *Id.* at 186).

[53] *Dodge v. Jefferson County Bd. of Educ.*, 298 Ky. 1, 181 S.W.2d 406, 407 (1944).

[54] Copy attached hereto as "Appendix D."

[55] *But cf. Public Service Comm'n of Kentucky v. Attorney General of Com.*. 860 S.W.2d 296, 298 (Ky. App. 1993), which **refused to find authority which the PSC deemed was necessarily implied** (". . . the PSC's attempt to use the provisions of KRS 278.255 as a basis for allocating the cost of the merger study to the respondent Water Districts exceeds the statutory authority granted to the PSC . . . If the General Assembly had intended the cost of the merger study under KRS Chapter 74 to be funded like a management audit under KRS 278.255, such provision could easily have been specifically included in the language of Chapter 74. It was not." *Id.* at 298.).

[56] *Public Service Comm'n v. Cities of Southgate and Highland Heights. supra* at 21.

Significantly, however, the court in *Cities of Southgate and Highland Heights, supra,* limited the PSC's necessarily implied powers, refusing to find that the agency had authority to determine whether public ownership was more beneficial than private, and which type of ownership would result in the lowest rates. *Id* at 21.

In the instant appeal, there is no evidence that authorizing Rider AMRP prior to the enactment of KRS 278.509 was necessary to carry-out the PSC's enumerated authority. As part of a multi-billion-dollar, multi-state conglomerate, DEK was well-equipped to absorb the costs of the AMRP Program until the time for the filing of its next base rate case approached. In fact, four (4) years have passed since DEK's last rate case, and during the pendency of the instant appeal DEK has filed a new base rate case in which it seeks to recover the costs of the AMRP program incurred from 2005 to the present time. This fact amply and conclusively establishes that while there may well have been a need to establish the AMRP *Program* itself, there clearly was no need to establish *Rider* AMRP, which would have allowed DEK to recover costs outside of the test year (and without examining the company's overall financial condition) established in a base rate case. There was never any threat to DEK's financial condition. The implementation of Rider AMRP was never necessary to ensure utility service. Therefore, the PSC lacked even the implied authority to authorize Rider AMRP. While having Rider AMRP was certainly more profitable to DEK and administratively convenient to the PSC, it was by no means necessary; hence, the PSC exceeded its authority by authorizing Rider AMRP prior to the enactment of KRS 278.509.

DEK makes abundant reference to the *National-Southwire*[57] ruling, in which the PSC approved a variable wholesale electric rate to a very large commercial client (an aluminum smelter) not regulated by the PSC.[58] In that case, the PSC found that, "Big Rivers' **future solvency** was inextricably linked to the health of the smelters," and that the variable smelter rate provided a fair resolution to Big Rivers' financial problems.[59] The *National-Southwire* court agreed with the PSC, and went so far as to add, "[t]he potential consequences of this situation for all parties and for **Western Kentucky** were **monstrous**."[60] Thus, the PSC in *National-Southwire* could not have met its statutory obligation of preventing discontinuance of utility service (in this case to tens of thousands of customers spread across an entire region of the Commonwealth) had it not produced an adequate resolution based on authority that was indeed necessarily implied.

In the instant appeal, however, the PSC prior to the enactment of KRS 278.509 had no authority – neither express nor implied -- to establish surcharge recovery for mains replacement programs. In 2001, the PSC ruled [61] that it had broad implied authority under KRS Ch. 278 to approve Rider AMRP, which was designed to grant cost recovery for capital additions made *after* rates found to be fair, just and reasonable had gone into effect. However, the Ch. 278 expedited recovery statutes, set forth above, which establish specific authority for ratemaking procedures other than general rate cases, belie DEK's claim that the PSC has always had authority to

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[57] *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503 (Ky. App. 1990)(copy attached hereto as "Appendix E").
[58] *Id.* at 505.
[59] *Id.* at 507-08 [emphasis added].
[60] *Id.* at 515 [emphasis added].
[61] *See,* Jan. 31, 2002 Order, pp. 75-76; this finding was reiterated in the 2005 rate case, Dec. 22, 2005 Order, p. 64.

engage in such ratemaking -- for if true, all the expedited recovery statutes are meaningless surplus.

But DEK even further mischaracterizes the Opinion's treatment of the holding in *National-Southwire, supra.* DEK alleges the Opinion concluded that the *National-Southwire* ruling was based on the facts of that case. Nothing could be further from the truth. By so claiming, DEK wishes to erase the well-settled judicially-established conditions (discussed in detail, above) placed upon the exercise of necessarily implied authority, thus converting that authority into inherent authority. The reality is that the Opinion distinguished *National-Southwire* on a legal basis, and found that an exercise of implied authority must, of course, be reviewed based on the facts of each unique case. The Opinion states, in unambiguous language:

> " . . . the [*National-Southwire*] court concluded that the PSC **had implied authority** to approve the proposed variable rate. *Id.* at 515. A contrary conclusion would have resulted in the inability of the PSC to ensure the continuation of electrical service. What can be gleaned from those cases approving fuel adjustment clauses and *National-Southwire* is that each court's approval was based on the unique facts of the case. The subject of the rate increase was not amenable to review *via* a general rate increase; thus, to set a "fair, just, and reasonable" rate required by statute, **the courts have held the authority to approve such rates outside the general rate procedure to be within the regulatory commission's implied authority."** [62]

By design, necessarily implied authority is intended to be exercised in very limited circumstances. A court reviewing an administrative agency's exercise of necessarily implied authority must determine whether the circumstances warranted the exercise of that power. *Cities of Southgate and Highland Heights, supra.* But

[62] Opinion at 11, *citing National-Southwire* at 515 [emphasis added].

that is only a portion of the reviewing court's analysis. That court then must apply the facts to the law, and determine whether -- as a matter of law -- the exercise of that authority was necessary and appropriate.

Furthermore, any analysis of the scope of the PSC's authority would be incomplete without a review of the enactment of KRS 278.183, as well as this Court's ruling in *KIUC, supra* interpreting that statute. Both the Franklin Circuit Court[63] and the Court of Appeals[64] cited that opinion which held:

> "The surcharge creates a new right for all electric utilities, that is, the right to recover expenses as well as a return on and a return of capital costs associated with environmental projects without filing a general rate case." *Id.* at 500 [emphasis added].

By the time the Commission made its 2001 ruling regarding Rider AMRP, this Court had already found in *KIUC, supra* that the right to surcharge recovery for electric utilities' capital costs related to environmental compliance is a substantive right that did *not* pre-exist the enactment of KRS 278.183. Quite simply, this right did not exist under the authority granted to the Commission to establish fair, just and reasonable rates pursuant to KRS 278.030. It took the enactment of KRS 278.183 to create that new right. ***In the same fashion, the right to surcharge recovery for gas utilities' capital costs related to mains replacement programs did not exist prior to the enactment of KRS 278.509.*** The Kentucky Legislature has repeatedly demonstrated through legislation that specifically authorizes surcharge recovery outside of a general rate case that when it *intends* such recovery, it *directs* such

[63] R.A. 240-48, Aug. 1, 2007 Franklin Circuit Court Opinion & Order, pp. 5-6.
[64] Opinion, pp. 17.

recovery. It did not do so prior to the enactment of KRS 278.509, and no special grounds existed warranting the exercise of the PSC's necessarily implied authority.

DEK also objects that the Court of Appeals failed to give deference to what DEK states is the PSC's "long-standing history of approving surcharges." Yet the only cases to which DEK cites this Court are those in which the imposition of a surcharge was an appropriate exercise of the PSC's necessarily implied authority to carry out its mandate: the uninterrupted provision of utility service.

DEK asserts that the PSC has previously authorized surcharges for capital costs, citing this Court to a prior PSC decision, *In Re Application of Farmdale Dev. Corp.* (Case No. 2006-00028).[65] In that case, Farmdale, as operator of a sewage treatment plant, filed an application pursuant to an alternative rate filing procedure authorized in the PSC's administrative regulations for small utilities [66] seeking approval of a rate increase and of a surcharge to cover capital costs associated with replacement of facilities necessary for the continuation of services to its customers.[67] The PSC specifically found that the surcharge was necessary to "maintain the continuity and reliability of the services provided to its customers."[68] Yet in a closely-related case in which Farmdale filed for and obtained a Certificate of Convenience and Necessity for those <u>*same*</u> repairs (and which DEK fails to cite),[69] Farmdale stated that it did not have the capital necessary for the repairs, that the

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[65] *In re Application of Farmdale Development Corp*, 2006-00028.
[66] 807 KAR 5:076.
[67] *In re Application of Farmdale Development Corp., supra*, Order dated April 11, 2007, pp. 3, 5, attached hereto as "Appendix A", numerical §§ 2, 3 and 6.
[68] *Id.*, numerical § 2.
[69] *In re Application of Farmdale Development Corp. for a Certificate of Convenience and Necessity, Authority to Make Repairs and Surcharge for Same,* Case No. 2006-00209, petition attached hereto as "Appendix B."

improvements were necessary to make the waste water system operational, and that the surcharge was necessary in order to secure financing for the improvements.[70] Thus the utility in *Farmdale*, just as in *National-Southwire*, *supra* was facing a **discontinuance of service** to all of its customers. But for the surcharge in *Farmdale*, that utility would have been forced out of business, which would lead to another "monstrous result."[71] Therefore, the approval of a surcharge to fund capital construction in *Farmdale* was an appropriate exercise of the PSC's necessarily implied authority to prevent discontinuance of service. In the case *sub judice*, however, DEK never faced a discontinuation of service to all – or even *any* – of its customers.

DEK then continues to attempt to convince the Court that the PSC has a history of allowing surcharges for capital costs by citing *In Re Application of Verna Hills, Ltd. for an Emergency and Permanent Rate Increase*, PSC Case No. 9484.[72] Just as in *Farmdale, supra*, DEK has again seriously mischaracterized the nature and findings of this case. In *Verna Hills*, the utility: (a) had filed bankruptcy;[73] (b) was seriously deficient and service was impaired; and (c) its unstable financial condition was due in part to an extended period of neglect by its management. Further, the Commission found that: ". . . [it] is allowing the surcharge only because it appears to be the only viable course of action . . . Abandonment is out of the question since

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[70] *Id.*, p. 4.
[71] *National-Southwire*, *supra* at 515.
[72] DEK has attached a copy of the PSC's final order in that case, dated May 9, 1986, as Tab I to its brief.
[73] In a closely related case, *In re An Investigation of the Condition of Verna Hills, Ltd.*, (PSC Case No. 9389) the PSC noted that the utility's president and sole stockholder had also filed a personal bankruptcy proceeding. Order dated Nov. 8, 1985, pp. 1-3. That order can be viewed online at: http://psc.ky.gov/order_vault/Orders_1980-1988/Orders_1985/19009389_11081985.pdf

sewer service is essential to the ratepayers."[74] Clearly, *Verna Hills* stands as yet another example of the PSC's proper exercise of its necessarily implied authority to keep a utility in operation – it had nothing at all to do with approving surcharges for capital costs.

DEK continues to mischaracterize the history of the PSC's dealings with surcharges by citing this Court to an unpublished opinion, *Armstrong v. PSC.*[75] Yet in that case, the Court of Appeals found:

> "We find more than ample evidence to sustain the imposition of the surcharge under the circumstances. . . It is a clear case of the [PSC] making the best of **an impossible situation.** There appears to have been **no reasonable alternative in insuring survival of the retail suppliers and uninterrupted service to the customers.**"[76]

Just as in *Verna Hills, supra* and *Farmdale, supra, Armstrong* is yet another example of the PSC properly exercising its necessarily implied authority to prevent discontinuance of utility service, so that the PSC can execute its important mandated mission.

Based on the foregoing authorities (and numerous other decisions), it is well-established law in Kentucky that administrative agencies such as the PSC possess those powers set forth by statute, as well as those powers **necessarily** implied to execute their **expressly enumerated** powers. In five cases -- *Cities of Southgate and Highland Heights, supra; National-Southwire, supra; Farmdale, supra*; *Verna Hills, supra*; and *Armstrong, supra*, the PSC was facing issues crucial to its central mission: continuation of utility service under unique circumstances. In the first two

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[74] *Verna Hills*, PSC Case No. 9484, pp. 7-9.
[75] DEK attached a copy of this unpublished decision to its brief at Tab L, but provided only a Lexis citation (1985 Ky. App. LEXIS 709). The Attorney General is only responding to this citation because DEK discusses it in its brief.
[76] *Id.* at p. 4 [emphasis added].

cases, courts upheld the exercise of implied authority because the PSC could not have fulfilled its statutorily-charged mission but for the exercise of authority ***unique*** to each case.[77]

Given the crucial nature of the mission the PSC fulfills, it needs to be prepared to respond to issues that fall outside of the express authority granted in its statutes. Well-settled Kentucky common law precedents do exactly that. Affirming the Court of Appeals' Opinion will leave the PSC with all the necessarily implied authority it needs to fully and adequately address risks of the nature of those found to exist in the precedents which approved the PSC's exercise of necessarily implied authority: direct and unambiguous threats outside of a utility's control which are great enough to cause system-wide cessation of utility service, whether through bankruptcy or otherwise. The Court of Appeals noted that:

> "The present controversy does not involve capital expenditures that are *unanticipated, fluctuating, or beyond Duke's control, or threaten its solvency*. To the contrary, aging mains are ordinary and within the realm of anticipated expenditures."[78]

By doing so, the Court of Appeals thus took into consideration the instances in which Kentucky courts have ruled upon administrative agencies' exercises of necessarily implied authority. The Court did not make up a new standard out of thin air, as DEK would seem to have this Court believe.

DEK's implementation of the AMRP Program never triggered any type of exigent circumstances such as would warrant the exercise of the PSC's necessarily implied authority. DEK was never facing bankruptcy. There was never any need for

[77] The PSC ruling in *Farmdale, supra* was never subjected to judicial challenge.
[78] Opinion, at 11-12 [emphasis added].

a unique remedy to prevent insolvency or any other "monstrous" result, as was the situation in *National-Southwire*. DEK unilaterally decided to increase the pace of its replacement program. Indeed, mains replacement is anything but a unique issue for a gas utility. Furthermore, DEK was always free to obtain cost reimbursement via a standard rate case. In fact, the Court of Appeals noted that the need for the AMRP Program was typical for a gas utility:

> "The present controversy does not involve capital expenditures that are unanticipated, fluctuating, or beyond Duke's control, or threaten its solvency. To the contrary, aging mains are ordinary and within the realm of anticipated expenditures. Additionally, unlike a fuel adjustment clause that permits the utility to pass the fluctuating fuel prices to its customers but from which it makes no additional profit, the replacement of the deteriorating mains is a pending long-term capital improvement that will increase the efficiency and value of Duke's assets. Duke was prepared to implement the program over a fifty-year period to be financed through general rate increases: The need for the AMRP Rider arose only after Duke, on its own initiative, decided to accelerate the program."[79]

By definition, the application of necessarily implied authority is legitimate *only* if it is in fact necessary. The issue of whether the exercise of that authority is legitimate must therefore depend in part upon an analysis of facts relevant to each unique case. Courts attempting to review agency action under a claim of implied authority thus must apply the law to the facts of each case to make the determination of whether the agency exceeded its authority. Doing so does not require interfering with or overturning any of the agency's factual findings. That analysis is, and always has been a question of law, and the Court of Appeals correctly found – as a matter of law – that the PSC did indeed exceed its authority.[80]

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[79] Opinion, at 11-12.
[80] Opinion, at 12.

Yet DEK asserts that the analysis should be limited in such a manner as to avoid questioning whether the Commission has exceeded its authority. Doubtlessly, DEK hopes for a ruling to this effect because such would enshrine its interpretation that the PSC -- unlike any other administrative agency in the Commonwealth -- possesses the heretofore unrecognized concept of ***inherent*** authority. Instead, the Court of Appeals exercised the proper analysis: if the PSC's attempted exercise of its necessarily implied authority is illegitimate – depending on the facts of each case – then as a matter of law it has exceeded its authority.[81]

Throughout the prosecution of this appeal, the Attorney General never sought to second-guess DEK as to the need for an accelerated replacement *program* (even though that need was created in large part as a result of the company's failure to adequately maintain its mains), and the reasonableness of the AMRP Program has never been at issue.[82] Rather, the sole issue is that DEK always had a means of seeking recovery for those costs: the traditional general rate case, expressly authorized by statute under KRS 278.030 and 278.190. While that statutory remedy may pose some procedural inconveniences, such has never been a justification for the unilateral, self-delegated and unprecedented expansion of administrative power.[83]

DEK, as has been its practice throughout the prosecution of this appeal, fails to delineate the source of the PSC's alleged authority to authorize Rider AMRP prior to the enactment of KRS 278.509. DEK is thus being disingenuous. Well-settled Kentucky jurisprudence establishes only two sources of administrative authority: that

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[81] *Id.*
[82] *See* n. 3, *supra.*
[83] 73B C.J.S. *Public Utilities* § 159 (2007), n. 12 (*citing, Cities of Austin, Dallas, Ft. Worth and Hereford v. Southwestern Bell Tel. Co.*, 92 S.W.3d 434 (Tex. 2002)).

which is expressed in statutes and administrative regulations, and such as can be necessarily implied. Since DEK has failed to identify which one of these two sources it continually refers to, it is obviously referring to another source not recognized under Kentucky law – that of *inherent* authority. The essence of DEK's argument is that the PSC can do whatever it wishes as long as: (a) it believes there is any remote connection with utility rates; and (b) the contemplated action is not contrary to express statutes / regulations, or common law precedents prohibiting that specific action.

Of course, any such construction of the PSC's powers is, in addition to being in conflict with controlling precedent, absurd, as it would convert the PSC into the first-ever Kentucky state administrative agency with undefined inherent authority. Should DEK's construction be given sanction in this Court, the near-infinite variety of illegal activities the PSC would have to avoid would require the adoption of an equally infinite number of new statutes expressly precluding such activities. Clearly, this result would re-write not only Kentucky utility law, but indeed Kentucky's administrative and constitutional law, as well, thus leading to an untenable legal and regulatory framework.

When considering rate issues in the context of a rate case, the PSC fulfills its statutory mission. The Court of Appeals and the Franklin Circuit Court were thus correct in finding that the PSC lacks authority to order recovery of expenses in the interim between rate cases,[84] and that it has no inherent authority to perform interim single-issue rate adjustments because such mechanisms undermine the statutory

[84] Opinion and Order at 6.

scheme.[85] The rulings of both courts were clear and unambiguous; no amount of word-smithing by DEK can ever change that immutable fact. There is simply no basis for DEK's argument that the Court of Appeals reached any aspect of its holding by analyzing the reasonableness of either the PSC's Orders at issue in this appeal, or of the Franklin Circuit Court's Opinion and Order. Because the PSC lacked authority, all other arguments asserted are moot and utterly irrelevant. Therefore, the PSC's orders establishing and reaffirming Rider AMRP were unlawful under KRS 278.410 (1).

D. THE APPROVAL OF RIDER AMRP DURING THE COURSE OF A GENERAL RATE CASE DOES NOT CLOAK IT WITH LEGITIMACY

DEK asserts that the fact Rider AMRP was created in the context of a general rate case, and that the PSC otherwise adhered to the statutes during the prosecution of that case somehow imbues Rider AMRP with a cloak of legitimacy. [86] Yet that allegation is wholly inaccurate.

First, the PSC in approving Rider AMRP blatantly ignored the mandate of KRS 278.192 and 807 KAR 5:001 § 10 (1), which when read *in pari materia* clearly limit cost recovery during a general rate case to solely those costs incurred during the mandated one-year test period. KRS 278.192 provides, in pertinent part: "For the purpose of justifying the reasonableness of a proposed general increase in rates, the commission **shall** allow a utility . . ." [emphasis added]. Even more importantly, the language of 807 KAR 5:001 § 10 (1) is indisputably *mandatory* in limiting the scope of cost recovery to those incurred during a one-year test period:

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[85] *Id.*

[86] KRS Ch. 278 does not confer any such authority.

> "All applications requesting a general adjustment in existing rates **shall** be supported by: (a) A twelve (12) month historical test period . . . or (b) A fully forecasted test period . . ." [emphasis added].

All of the costs that were to be incurred under Rider AMRP by their very nature fell well-beyond and outside of that one-year test-period which was utilized to develop DEK's rates during the 2001 and 2005 general rate cases relevant to the instant appeal. The PSC's failure to limit cost recovery to the mandated one-year test period governing the ratemaking process in this regard illustrates once again that this agency is under the mistaken impression that it possesses all authority to do whatever it wishes.

Contrary to DEK's argument, even though the Rider AMRP surcharge was "approved" during the course of a base rate case, it was activated outside of the test year. The PSC did not review the *actual* costs collected because those costs -- falling well-outside of the test year – were not incurred during the time that DEK's two general rate cases relevant to this appeal were still active and pending.

Since the PSC lacked legal authority prior to the enactment of KRS 278.509 to implement Rider AMRP, the post-rate case hearings it conducted for the sole purpose of examining costs associated with Rider AMRP likewise lacked legal foundation. Those hearings also violated the PSC's own well-founded precedent against single-issue ratemaking.[87] The PSC thus attempted to vest itself with new powers, contrary to this Court's holding in *South Central Bell Telephone Co. v. Utility Regulatory Com'n*, 637 S.W.2d 649 (Ky. 1982), which held:

> "[T]he legislative grant of power to regulate rates will be strictly construed and will neither be interpreted by

[87] *See* this brief, p. 16, *supra*, regarding single-issue ratemaking.

> implication nor inference. It will be strictly construed. 73 C.J.S., Public Utilities, § 41, p. 1080. In fixing rates, the Commission *must* give effect to all factors which are prescribed by the legislative body, but may not act on a matter which the legislature has not established, *id.*, Sec. 41, (c)(aa) p. 1093. We have held that the Commission's powers are purely statutory." [88]

Rather than look to the well-settled Kentucky law, DEK cites this Court to authority from foreign jurisdictions for the proposition that the PSC should have authority to hold post-rate case single issue hearings. However, DEK's argument assumes the existence of legal authority to approve Rider AMRP in the first place. Such is not the case – there is no such legal authority. DEK further attempts to justify the post-rate case Rider AMRP hearings by comparing them to fuel adjustment clause hearings. Yet the latter are governed by a legislatively-approved administrative regulation,[89] one which this Court has also had occasion to approve.[90] Finally, by selectively comparing one state's utility laws to another's, DEK is attempting to compare apples with oranges. Such a cherry-picking approach has no application to Kentucky's scheme of utility law and the well-developed common law interpreting it. [91]

Yet DEK goes even further and would have this Court believe that the PSC could ignore the mandated one-year test period if it so chooses. In so asserting, DEK blatantly misquotes KRS 278.192 [92] by asserting that this statute merely reads that the PSC "may" allow a utility to use test year as the basis for its rate application.

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[88] *Id.* at 653 [emphasis in original].
[89] 807 KAR 5:056.
[90] *KIUC, supra.*
[91] *See, e.g., Commonwealth v. Nelson*, 841 S.W.2d 628, 631 (Ky. 1992)(cases from other jurisdictions are not decisive).
[92] DEK brief, p. 27.

Even more importantly, DEK would have this Court believe that restriction of cost recovery to a test year is somehow *optional*. While this argument certainly is creative, it is clearly contradicted by the plain, unambiguous language of KRS 278.192 and 807 KAR 5:001 § 10 (1). In fact, by presenting this type of argument, it appears DEK is defending the type of selective, confining assessment of those costs and issues that *it* wishes to be addressed as opposed to conducting an open, transparent and comprehensive examination of *all* relevant costs and issues, such as is only guaranteed through a general rate case.

DEK obviously welcomed such an expedited proceeding to recover such costs in isolation from its other costs, and apart from its overall financial condition. But what was likely the most attractive aspect of obtaining approval for Rider AMRP was the award of a *guaranteed* rate of return. In rate cases, the PSC gives utilities only the mere *opportunity* to earn a return on investment; thus the chance of a guaranteed return on investment would have greatly benefited the company's bottom line, and the improvement of its financial condition would not have come to light until its next base rate case filing.

Second, DEK proposes that the Court of Appeals confused the term "rate" with the change in the amount of the AMRP Rider surcharge. However, the Court of Appeals' Opinion never ventured into that subject, and indeed the law did not require it to do so. Instead, the Court appropriately confined its ruling to the *legal* issue of whether the PSC possessed legal authority to approve Rider AMRP prior to the enactment of KRS 278.509. The Court of Appeals correctly, unambiguously and resoundingly answered that question in the negative, finding:

"We conclude that the PSC cannot authorize the imposition of a surcharge for the main replacement program proposed by Duke without specific statutory authorization."[93]

Therefore, DEK's argument is irrelevant.

E. RIDER AMRP, UNLIKE THE FUEL ADJUSTMENT CLAUSE REGULATION, IS NOT A FORMULAIC RATE

The Court of Appeals carefully and unambiguously distinguished the legal basis for both Rider AMRP and the Fuel Adjustment Clause Regulation ["FAC"]. The Court noted, first, that the FAC is exactly that – an administrative regulation carrying the full force of law. This Court can take judicial notice that the Kentucky Legislature must in a lengthy process review and approve all administrative regulations prior to becoming legally effective. Thus, a detailed, objective process approved by the Kentucky Legislature exists for dealing with fuel adjustment costs. Second, the Court of Appeals noted that this Court: ". . . has specifically recognized with approval the prevailing view that separate rate proceedings for fuel adjustment expenses are valid."[94]

However, such cannot be said for the Rider AMRP authorized prior to the enactment of KRS 278.509. Rider AMRP was a mere tariff created by DEK and designed to capture fixed capital costs on an expedited basis. The PSC then approved Rider AMRP, despite lacking specific statutory authority upon which to base approval of such an expedited cost recovery mechanism that operated on a between-general-rate cases basis, and thus outside of the rate case test year mandated in KRS 278.192 and 807 KAR 5:001 § 10. Contrary to the assertions of DEK, the

[93] Opinion, at 12 [emphasis added].
[94] Opinion, at 10 *citing KIUC, supra* (citations omitted).

PSC and the *amici*, the Court of Appeals did not base its ruling on any *factual* or reasonableness-based distinctions. Instead, it emphasized the *legal* distinctions between the pre-KRS 278.509 Rider AMRP and the FAC. Neither DEK, the PSC nor the *amici* cite to any portion of the Opinion to support their assertions, and indeed cannot, for the Court never made any such holdings.

The contention of DEK, and of the PSC and the *amici* in the companion appeal, that Rider AMRP is merely a formulaic rate (involving factors subject to change, such as fuel costs) is misplaced. Rider AMRP was not designed to recover recurring, volatile current costs that could threaten a utility's solvency like those for fuel or gas supply. Rather, the fixed costs Rider AMRP considered are not volatile enough to threaten solvency; instead, such capital costs are readily ascertainable, planned-for and predictable. Rider AMRP bears no resemblance to the FAC, in which the utility passes-through inherently volatile fuel costs but earns no profit. A cursory review of the FAC reveals that it utilizes a formula based upon several variable costs. However, the AMRP Program was designed to recover costs associated with a long-term *capital* investment on which a return was sought. The Court of Appeals noted:

> "Additionally, unlike a fuel adjustment clause that permits the utility to pass the fluctuating fuel prices to its customers but from which it makes no additional profit, the replacement of the deteriorating mains is a pending long-term capital improvement that will increase the efficiency and value of Duke's assets."[95]

The nature of the costs Rider AMRP was designed to collect can also be distinguished on another basis. DEK always had control of the decision concerning

[95] Opinion at 12.

when and at what pace it would replace its mains. Yet DEK waited for decades to begin its AMRP Program, despite having known of the problem for decades.[96] As the Court of Appeals noted: "Duke was prepared to implement the program over a fifty-year period to be financed through general rate increases: The need for the AMRP Rider arose only after Duke, on its own initiative, decided to accelerate the program."[97] Thus the costs DEK sought to recover via the single-issue Rider AMRP were to a great extent *self-imposed*. Such can hardly be said to be true with regard to the fuel costs the FAC was designed to recover.

Furthermore, the Court of Appeals made careful note that its holding had absolutely no effect upon the Fuel Adjustment Clause Regulation:

> "So that our opinion is not misunderstood and to address the issues raised in the *amici curiae* brief, we reiterate that our decision is premised on the nature of the long-term capital improvements proposed by Duke as distinguished from fuel increases that are fluctuating and unanticipated. The latter have been approved by our Supreme Court and remain the law."[98]

DEK seems to argue that *all* utility costs should be thrown into a single pot and essentially homogenized, and that the significant public policy distinctions behind how the law treats different types of costs should be erased. Such has never been the case. Utilities encounter many different types of costs, with distinct natures and properties. The public policy behind the FAC is to enable utilities to respond to potential rapid fluctuations in fuel prices, and thus continue to provide utility service, **without facing the threat of bankruptcy**. Should DEK's meritless argument in this

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[96] *See supra* n. 3, and Appendix F.
[97] Opinion, p. 12. *See also id.*, pp. 2-3.
[98] Opinion at p. 19 [emphasis added]. *See also* the Court of Appeals' discussion, p. 10, in particular this Court's upholding of the validity of Fuel Adjustment Clauses; *citing KIUC, supra.*

matter prevail, then the entire utility regulatory framework would indeed be thrown on its face, leading to great unpredictability and uncertainty.

DEK also cites the Court to authority from foreign jurisdictions that uphold the validity of fuel adjustment clauses in those jurisdictions. However, the validity of Kentucky's FAC is clearly *not* before this Court or at issue in the instant appeal.

Finally, the PSC cannot authorize single-issue cost recovery for future costs that it cannot directly consider for recovery in a general rate case. Such a rate would circumvent and render meaningless the limits placed on the costs to be considered in support of the general rate increase imposed by KRS 278.192. The rule of *Southeastern Land Co. v. Louisville Gas & Elec. Co.*, 262 Ky. 215, 90 S.W.2d 1, 3 (1936) -- what a utility is forbidden to do directly, it may not accomplish by indirection by way of resort to any device or subterfuge leading to the same result -- applies with equal force and effect to the PSC. Thus, a state agency that lacks authority to carry out a course of action cannot attempt to initiate that action via a claim of implied authority, nor can it unilaterally create a third type of undefined authority -- inherent authority -- which this Commonwealth has heretofore refused to recognize, to execute that course of action. The limits of the PSC's power are and always have been set by the Legislature.[99] Although the PSC clearly has many

[99] *See, e.g., Boone County Water v. Public Service Commission,* 949 S.W.2d 588, 591 (Ky. 1997)(*citing South Central Bell Tel. Co. v. Utility Reg. Comm'n, supra*); *Public Service Comm'n. v. Jackson Co. Rural Elec. Co-op., Inc.*, 50 S.W.3d 764, 767 (Ky. App. 2000); *Public Service Comm'n v. Attorney General of the Comm., supra* at 298; *Commonwealth v. Phon,* 17 S.W.3d 106,108 (Ky. 2000)(statutes should be construed in such a way that they do not become meaningless or ineffectual); *Hardin Co. Fiscal Court v. Hardin Co. Bd. of Health*, 899 S.W.2d 859, 861-62 (Ky. App. 1995).

ratemaking methodologies available to it, they are limited to those expressed in KRS Ch. 278, or such as can necessarily be implied.[100]

F. *CHEVRON* DEFERENCE IS IRRELEVANT TO THE INSTANT MATTER

The Court of Appeals held that in authorizing the pre-KRS 278.509 Rider AMRP, the PSC lacked any legal authority for doing so. The Court further held:

> "*Chevron* deference given to an administrative agency's interpretations of its governing statutes is not applicable where, as here, the statutes are clear and unambiguous. The statutes do not confer authority upon the PSC to approve the AMRP Rider."[101]

In *Chevron*, the U.S. Supreme Court held: "If the intent of Congress is clear, **that is the end of the matter**; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[102] Thus, *Chevron* deference to an agency's interpretation of its statutes is never applicable where construction of the relevant statutes is unambiguous. That is exactly the case in the appeal *sub judice*. Only where there is an ambiguity does *Chevron* deference even begin to come into play. The Court of Appeals found no such ambiguity to exist in this appeal. Simply stated, the Court cannot defer to an administrative agency's action that lacks legal foundation.[103]

Even if this Court should find any ambiguity, *Chevron* deference is still inapplicable to cases of first impression. Rider AMRP indeed constitutes a case of first impression; thus there is no long-standing agency interpretation at issue. Finally,

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[100] *See, National-Southwire Aluminum Co.,supra.*

[101] Opinion, p. 12 [emphasis added], *citing Chevron U.S.A., Inc v. Natural Resource Defense Council, Inc.*,467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984).

[102] *Chevron U.S.A., supra* at 843 [emphasis added].

[103] *See also, Hagan v. Farris*, 807 S.W.2d 488, 490 (Ky. 1991)(An agency's interpretation of a regulation is valid, however, only if the interpretation complies with the actual language of the regulation; KRS 13A.130 prohibits an administrative body from modifying an administrative regulation by internal policy or another form of action (citations omitted)).

Kentucky Courts will not allow a clearly erroneous construction to stand. *Homestead Nursing Home v. Parker,* 86 S.W.3d 424, 426 (Ky. App. 1999). A permissible construction thus cannot be one which lacks legal foundation.

DEK further asserts that the Court of Appeals erred by failing to cite a statute specifically prohibiting Rider AMRP, by finding the statutes to be "unambiguous," and not taking the PSC's interpretation of its statutes into consideration. However, the Court of Appeals' finding that the PSC exceeded the scope of its authority by approving Rider AMRP was not conditioned upon citing a statute that expressly prohibited the PSC from so doing. To accept this argument would of necessity require this Court to agree with the argument set forth by DEK, the PSC and the *amici* in the companion appeal that KRS Ch. 278 merely places limits on the PSC's authority and jurisdiction. The Court of Appeals correctly saw that adopting such a twisted perspective would enshrine the PSC with inherent authority, clearly contrary to the intent of the Kentucky Legislature, and with this Court's well-established common law precedents regarding the scope of administrative agencies' authority. From a more practical perspective, should DEK's argument prevail, the legislature would of necessity be forced to adopt an untold plethora of statutes to prohibit the universe of potential actions which the legislature does not wish for the PSC to pursue. Such an approach would be absurd.

The Court of Appeals correctly found that as a matter of law, it was required to undertake a *de novo* review to determine whether the PSC exceeded the scope of

its authority.[104] That Court's finding that the statutes at issue were unambiguous was thus the result of its appropriate review. After finding that the PSC exceeded the scope of its authority, the Court was not required to grant any deference – under *Chevron* or otherwise – to the PSC's interpretation of its statutes. Courts are not bound to accept the legal conclusions of an administrative body. *Epsilon Trading Co., Inc. v. Revenue Cabinet*, 775 S.W.2d 937, 940 (Ky. App. 1989). Moreover, the Kentucky Judiciary has the exclusive right to interpret the laws of the Commonwealth. *Lafferty v. Huffman*, 99 Ky. 80, 35 S.W. 123, 124 (1896).[105] The interpretation of a statute is a legal question. *Revenue Cab. v. Hubbard*, 37 S.W.3d 717, 719 (Ky. 2000). Since the PSC's actions in establishing Rider AMRP were in excess of its authority, they are patently and undeniably unlawful pursuant to KRS 278.410(1). [106] For these reasons, the Court of Appeals was not required to give deference to the PSC orders approving Rider AMRP, whether under the *Chevron* doctrine, or otherwise.

G. WHETHER THE OPINION WAS BENEFICIAL TO RATEPAYERS IS NOT AT ISSUE

DEK asserts that the ratepayers' interest is a factor this Court should consider in its decision regarding whether to affirm the Court of Appeals' Opinion. In so doing, DEK again attempts to divert this Court from the real issue: whether the PSC

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[104] Opinion, pp. 6-7, *citing Cincinnati Bell, supra* (*citing Com., Transportation Cabinet v. Weinberg,* 150 S.W.3d 75 (Ky.App.2004)).

[105] *See also, Traynor v. Beckham*, 116 Ky. 13, 74 S.W. 1105, 1106 (1903), and *LRC v. Brown*, 664 S.W.2d 907, 912 (Ky. 1984)(Interpretation of the law lies within the peculiar province of the Judiciary).

[106] *See also Public Util. Com'n v. City Pub. Serv. Bd. of San Antonio,* 53 S.W.3d 310, 316 (Tex.2001)(Texas Supreme Court gives weight to how the Public Utilities Com'n. interprets its statutes, but only if the interpretation is reasonable and not inconsistent with statute); *Massachusetts Hosp. Ass'n., Inc. v. Dept. of Medical Sec.*, 588 N.E.2d 679, 683 (Mass. 1992).

had legal authority to authorize Rider AMRP prior to the enactment of KRS 278.509. DEK instead continues to allege that the Court of Appeals based its Opinion on factual issues. Such was clearly not the case.

In making this assertion, DEK states: " . . . under the Court of Appeals' view, the PSC was required to sacrifice the interests of [DEK's] ratepayers,"[107] and that its ratepayers would have saved money by having expedited hearings. However, DEK neglected to mention facts that clearly distinguish the reality of the situation. First, there was never any requirement or need for DEK to file general rate cases on a yearly basis to recover the AMRP program costs. DEK's inaction in waiting for four (4) years to file its 2009 rate case clearly demonstrates such. Second, the costs DEK collected under Rider AMRP prior to its 2005 rate case may well have been far greater than the costs associated with a general rate case, because DEK would have made its ratepayers pay a **guaranteed** rate of return on all the construction work necessary to complete the AMRP program. That guaranteed rate of return, of course, was over and above the general opportunity to earn a rate of return that the PSC gives to DEK and other utilities in a rate case. Moreover, additional costs could have been incurred under the single-issue Rider AMRP because true costs would not have been evaluated in proper context. DEK fails to cite the court to any evidence in the record to support this argument Finally, DEK's "ends-justify-the-means" approach was expressly rejected in *South Central Bell Telephone Co. v. Utility Regulatory Com'n*, 637 S.W.2d 649 (Ky. 1982).[108] When the Commission's action violates

[107] DEK Brief, p. 39. Prior to the filing of the 2005 rate case, DEK, utilizing Rider AMRP collected costs incurred under the AMRP program. Following the conclusion of the 2005 rate case, DEK did not collect any AMRP program costs utilizing Rider AMRP.

[108] "[T]he legislative grant of power to regulate rates will be strictly construed and will

limits of the statutory framework established by the legislature, allegations that the action was beneficial to the ratepayers or in punishment of the utility are not trump cards to be played to sanction unlawful behavior. *South Central Bell*, *supra.*

More importantly, assertions of this nature go to reasonableness. The Court of Appeals' Opinion never made any findings regarding costs. Costs – a factual issue -- are *not* at issue in the instant appeal. Whether the PSC exceeded its authority – a legal issue – *is* at issue in this appeal. This Court should not accept DEK's veiled invitation to examine factual issues not at play.

III. CONCLUSION

In a sound, fully coherent ruling consistent with well-settled Kentucky law, the Kentucky Court of Appeals unanimously held, as a matter of law, that the PSC lacked authority to implement Rider AMRP prior to the enactment of KRS 278.509.

The PSC, like all administrative agencies, possesses necessarily implied authority to address threats to its mandated mission. The scope of threats which the PSC can address through the exercise of implied authority should, of necessity be limited to those that pose direct and unambiguous threats, outside of a utility's control, great enough to cause system-wide cessation of utility service, whether through bankruptcy or otherwise. No threat even remotely of that magnitude was ever at issue in the instant appeal.

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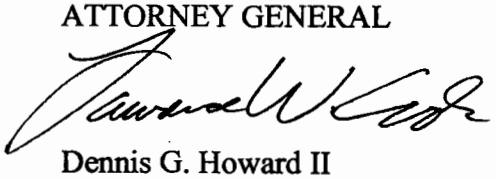
neither be interpreted by implication nor inference. It will be strictly construed. . . In fixing rates, the Commission *must* give effect to all factors which are prescribed by the legislative body, but may not act on a matter which the legislature has not established . . . We have held that the Commission's powers are purely statutory." *Id.* at 653.

The fact that the PSC initially authorized Rider AMRP in a general rate case does not cure the defect of having no legal authority to authorize Rider AMRP. Since the PSC lacked legal authority to authorize Rider AMRP, the Court of Appeals was not required to give deference of any type or sort to any PSC interpretation of its authority.

WHEREFORE, Appellee the Attorney General of the Commonwealth of Kentucky respectfully requests that this high Court **AFFIRM** the Opinion of the Kentucky Court of Appeals.

Respectfully submitted,

JACK CONWAY
ATTORNEY GENERAL



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