

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF GAS AND ELECTRIC RATES)
OF LOUISVILLE GAS AND ELECTRIC COMPANY) CASE NO. 10064

O R D E R

Petitions requesting rehearing of the Commission's July 1, 1988 Order have been filed by Louisville Gas and Electric Company ("LG&E"), Attorney General's Office, Utility and Rate Intervention Division ("AG"), Kentucky Industrial Utility Customers ("KIUC"), and Office of Kentucky Legal Services Programs, Inc. ("Residential Intervenors"). A Notice Of Intent Not To Request Rehearing was filed by Jefferson County, Kentucky. In addition, KIUC filed a Response to the AG's and the Residential Intervenors' Petitions for Rehearing and LG&E filed a Response to KIUC's Application for Rehearing. The Commission has carefully considered all the petitions and the responses, and the evidence of record, and hereby finds that rehearing should be granted on those issues as provided for in this Order. Further, the Commission herein approves a surcharge plan to enable LG&E to recover for the period from May 20, 1988 through July 1, 1988, the revenue increase approved by the Commission's July 1, 1988 Order.

Commission Jurisdiction To Order Refunds

KIUC's petition argues that the Commission lacks jurisdiction to issue a "final" rate Order which authorizes new rates that are

"subject to refund." Consequently, KIUC claims that only a prospective rate adjustment can be made in Case No. 10320, An Investigation of Electric Rates of Louisville Gas and Electric Company to Implement a 25 Percent Disallowance of Trimble County Unit No. 1. Therefore, KIUC argues that the 25 percent Trimble County disallowance ordered on July 1, 1988 in this rate case must be implemented now.

KIUC cites no statutory provision or case law to support its position. An analysis of KRS 278 et seq. reveals no provision which even arguably prohibits a rate order from being conditioned upon further review and refund. To the contrary, the Commission's authority to so condition rates is a necessary power implicit in the legislative mandate that utility rates be "fair, just, and reasonable." KRS 278.030(1). The Commission has found in this case that the authorized rates are "fair, just, and reasonable" only if refunds are to be made in accord with the investigation and decision in Case No. 10320.

KIUC further argues that since the July 1, 1988 Order in this case is final, the revenue requirements and rates are incorrect because the Commission included the Trimble County CWIP in total capitalization. The Commission clearly recognized in that Order that the existing rates will be reduced subsequent to another proceeding in which the revenue requirements impact of the 25 percent cost disallowance of Trimble County will be determined. However, the Commission takes notice that it has granted LG&E's request for rehearing in Case No. 9934, A Formal Review of the Current Status of Trimble County No. 1. To protect KIUC's

interest in the event that the Order in Case No. 9934 is subsequently modified, the Commission will grant KIUC's request for rehearing. The rehearing on this issue will be held in abeyance pending the Commission's conclusion of the rehearing in Case No. 9934.

Management Information Systems

In its Order, the Commission decreased the test-year operating expenses by the \$2,475,092 associated with the development costs of LG&E's Management Information Systems. In addition, the Commission informed LG&E that subsequent to the date of the Order these costs should be capitalized and amortized or depreciated over a reasonable period of time. LG&E requests that the Commission reconsider this matter and provide for the recovery of and on the test year expense of \$2,475,092 associated with the Management Information Systems.

LG&E disagrees with the Commission's position that these costs should be capitalized but acknowledges the Commission's authority to require capitalization for rate-making purposes. However, LG&E argues that the Commission does not have the authority to disallow a return of the \$2,475,092 test year costs absent a finding of imprudency, waste or mismanagement. LG&E further states that if the Commission requires capitalization of these costs, then a provision should be made for the amortization of these costs and recognition should be given to these expenses for determining revenue requirements in this case.

The Commission has not disallowed LG&E recovery of these costs. The Commission stated in the Order that the costs incurred

during and prior to the test year have been expensed during those accounting periods. Therefore, these costs have previously been recovered by LG&E and should not be included in operating expenses to be recovered in future periods. The additional investment in Management Information Systems, subsequent to the test period, should be accumulated in a deferred debit account or charged to the appropriate plant accounts. Upon completion of the project, those costs will be amortized or depreciated in accordance with Commission accounting requirements. In future rate proceedings, the Commission will consider whether these costs should be included in revenue requirements in the same manner any capitalized cost is reviewed. In excluding the test period expense, the Commission has not denied recovery of any of LG&E's investment in Management Information System, but has merely reduced operating expenses in accordance with the position that future Management Information System costs will be capitalized rather than expensed. LG&E has advanced no further arguments which would alter the Commission's decision on this issue. Therefore, rehearing on this issue should be denied.

Thrift Savings Plan

In its Order, the Commission stated that the cost of certain changes in LG&E's benefits package should not be borne by LG&E's ratepayers and reduced test-year operating expenses accordingly. LG&E has requested that the Commission reconsider the portion of the reduction associated with the newly instituted Thrift Savings Plan and increase operating expenses by \$429,137.

LG&E argues that this plan was part of a comprehensive benefit improvement package for non-union employees and that if LG&E had granted an equivalent amount of salary adjustment the Commission would have routinely allowed this amount as a proper labor expense. LG&E further states that the disallowance of this expense penalizes the company for attempting to achieve added efficiency through careful and purposeful design of its entire compensation benefits package.

As was stated in the Order, when considered as a whole, the work-force related recommendations of the Management Audit indicate the need for a thorough, comprehensive evaluation of LG&E's organizational structure, as well as its compensation and benefit packages. Specific recommendations in the Human Resources' section of the Management Audit direct LG&E to evaluate the compensation and benefits programs, and to annually review health insurance and other benefits programs to insure their cost effectiveness. LG&E has addressed these recommendations in a very narrow manner focusing on salary compression problems, executive officer benefit considerations, and health insurance considerations. The record in this case provides no evidence that LG&E has conducted a thorough reevaluation of its entire benefits package as indicated by the Management Audit recommendations. In fact, the non-union employees' benefit improvement package appears to be designed more to maintain their benefit levels in comparison to those of the union employees rather than in response to the Management Audit recommendations. LG&E's contention that the increased cost would have been routinely passed on if included in wage increases is

without merit. The Commission has previously disallowed adjustments that reflect excessive wage increases, including a disallowance for LG&E in Case No. 8616, General Adjustment in Electric and Gas Rates of Louisville Gas and Electric Company. The adjustment in this case to the Thrift Savings Plan is the equivalent of such an adjustment and in direct contradiction to LG&E's position that any wage increases are routinely accepted.

The Commission is of the opinion that the ratepayers of LG&E should not bear the cost of the Thrift Savings Plan or any of the other costs associated with fringe benefits disallowed in the Order until such time as LG&E has completed a thorough, comprehensive reevaluation of its entire compensation and benefits programs. Therefore, rehearing should be denied on this issue.

Year-End Volumes of Business Adjustment

The Commission recalculated both the revenue and expense portions of LG&E's proposed adjustments to annualize year-end volumes of business. LG&E has requested that the Commission reconsider the expense portion of its calculation to incorporate the revenue reduction resulting from the decrease in rates ordered by the Commission in Case No. 9781, The Effects of the Federal Tax Reform Act of 1986 on the Rates of Louisville Gas and Electric Company, Order dated June 11, 1987. LG&E has not challenged the Commission's methodology but argues that the calculation of the adjusted operating ratio used to determine the expense portion of the adjustment should have reflected the revenue reduction ordered in Case No. 9781 and should have reflected the transfers between rate schedules.

The Commission is of the opinion that rehearing should be granted on this issue. Therefore, LG&E should file any evidence it deems necessary to support the arguments in its Petition regarding this issue.

Additional Interest Expense

The Commission computed an interest adjustment by applying the cost rates applicable to the long-term debt and short-term debt components of LG&E's capital structure as adjusted to reflect the JDIC and extraordinary property loss allocations. LG&E has requested that an adjustment be made to increase revenue requirements to reflect a debt capital rate of 7.71 percent.

LG&E argues that by applying the overall cost of capital to the adjusted debt component of the capital structure denies LG&E recovery of interest expense attributable to items other than long-term debt and trust demand notes. LG&E provides a calculation showing the interest rate on long-term debt including other interest as 7.76 percent rather than the 7.67 percent used by the Commission. LG&E provides two methodologies for determining the additional interest expense which would increase the adjustment made by the Commission by either \$553,036 or \$505,764.

In determining the appropriate allowable interest costs, the Commission has utilized LG&E's long-term debt and short-term debt determined to be reasonable, and the applicable cost rates. LG&E stated in its Petition for Rehearing that it concurs in the determination of the interest expense for long-term debt and trust demand notes. LG&E's August 31, 1987 Monthly Report reflects that

the other interest expense it seeks to include in this adjustment consists of the following:

Interest on Customer Deposits	\$104,441
Interest on Federal Income Tax Deficiencies	384,831
Interest on Other Tax Deficiencies	2,537
Interest on Gas Refunds	6,095
Interest on Deferred Compensation	<u>7,860</u>
TOTAL	<u>\$505,764</u>

In determining revenue requirements for a private utility the Commission provides for revenue to recover the reasonable operating expenses of the utility and the required return on capital. Other interest expense is a non-operating income deduction which is considered "below the line" or not includable in determining revenue requirements from ratepayers. Likewise, other non-operating income items such as interest and dividend income, rental income and other miscellaneous non-operating income items are not considered sources of revenue in determining revenues required from ratepayers.

While LG&E apparently did include the other interest expense in determining its proposed revenue requirements, there was no testimony presented by LG&E as to why the traditional rate-making methodology should not be employed in this case. If items of this nature are to be considered for inclusion in cost of service, a showing must be made that the costs were ongoing, recurring at the test year level, and that some benefit is being realized by the ratepayers. No evidence of this nature has been presented in this case. Therefore, the Commission is of the opinion that rehearing

on this issue should be granted to give LG&E an opportunity to present evidence in support of its methodology.

Retirements of SDRS and Gas Plant

In its Order, the Commission determined that the early retirement of certain sulfur dioxide removal systems ("SDRS") and the abandonment of three underground gas storage fields ("gas plant") should have been recorded by LG&E as extraordinary property losses. The Commission instructed LG&E to establish deferred asset accounts and begin an amortization of those assets. In addition, the Commission reduced LG&E's rate base and capital to reflect the retirements and abandonments as extraordinary property losses.

LG&E has requested reconsideration of the SDRS and gas plant adjustments on the basis that it was denied due process. Specifically, LG&E argues that it had no notice that its capital would be reduced by the same amount as its rate base to reflect the extraordinary property loss adjustments. The adjustment to capital did not allow LG&E a return on the retired utility plant. LG&E claims the capital adjustment was a change in Commission policy, that LG&E was not given proper notice of the change, and the resulting lower return was confiscatory and unlawful.

In its Petition, LG&E has offered explanations of why the retirements and abandonments do not constitute extraordinary property losses. LG&E has cited sections of Accounting Principles Board Opinion No. 30, Securities and Exchange Commission Staff Accounting Bulletin No. 72, and Statement of Financial Accounting Standards No. 90 to support its position.

While the Commission does not find merit in LG&E's argument that it was not given notice that an adjustment for the extraordinary retirements was under consideration, the Commission will grant rehearing on this issue to allow LG&E to present additional evidence as to why the adjustment should not be made to capitalization to reflect the adjustments to rate base.

Edison Electric Institute ("EEI") Dues

In its Order, the Commission excluded all membership dues paid by LG&E to EEI from allowable operating expenses for rate-making purposes. The dues were excluded because LG&E failed to show that its membership in EEI was of direct benefit to LG&E's ratepayers. Although LG&E supplied a list of the benefits it received from EEI membership, it did not demonstrate that the benefits were received by LG&E ratepayers.

LG&E's Petition requests the Commission to reexamine the benefits of EEI membership. A copy of the list of benefits previously supplied was attached to LG&E's Petition. The list contains 13 benefits and services received by LG&E as an EEI member. While LG&E contends that the benefits received by the company are also benefits received by its ratepayers, it did not offer any new or additional evidence on this issue.

The Commission is of the opinion that rehearing should be granted on this issue. The Commission has performed the reexamination requested by LG&E and finds that there is still no evidence to support a finding that the ratepayers receive any benefit from EEI membership. Despite LG&E's belief that the membership benefits pass through to its ratepayers, LG&E still has not

demonstrated the benefits to its ratepayers. Based upon this reexamination, the Commission finds that no additional revenues should be granted to LG&E arising from the issue of EEI dues.

Rate of Return

LG&E's Petition requested the Commission to reconsider LG&E's allowed rate of return. LG&E contends that as a result of the Commission's July 1, 1988 Order there has been a negative impact on LG&E's cost of capital. LG&E based its request on the Hope mandate which requires that the impact of rate orders be viewed in their entirety. The Commission is of the opinion that LG&E should be granted an opportunity to present additional evidence in support of its position. Therefore, rehearing will be granted on this issue.

Gas Revenue Increase and Gas Revenue Allocation

The AG and the Residential Intervenors have petitioned the Commission for rehearing on the amount of the gas revenue increase granted LG&E and the impact of the increase on the residential class of consumers. Both parties, in separate yet similar petitions, contend that when purchased gas costs, which are not a part of this case, are excluded from total normalized gas and transportation revenues, the overall increase in gas revenues is 18.1 percent and the increase in the G-1 residential gas revenues is 30 percent. Furthermore, both parties argue that such a large allocation to the residential class is inconsistent with the Commission's principles of rate continuity, stability, and gradualism.

In its response to the Petitions for Rehearing of the AG and Residential Intervenors, KIUC contends that rehearing should be denied since "the magnitude of the [gas] rate increase to the Residential class represents a very modest movement by that class towards its cost-of-service." KIUC also contends that at the Commission approved rates, the residential class is still being subsidized by all other ratepayers.

While the Commission continues to be of the opinion that the gas cost-of-service study filed by LG&E provides an adequate starting point for rate design, the Commission is concerned about adhering to the principles of rate continuity and gradualism. Therefore, the Commission will grant rehearing on the issue of the allocation of the gas revenue increase to the rate classes. As to the request for rehearing on the overall gas revenue increase, the AG and Residential Intervenors have failed to provide any support for the request; therefore, the Commission will deny that portion of the petition.

Forfeited Discounts

The Residential Intervenors requested rehearing on its proposal to eliminate the collection of forfeited discounts. Since this issue was not addressed in the July 1, 1988 Order, the Commission will grant rehearing on the proposal to eliminate the forfeited discount.

Residential Electric Rate Structure

The Residential Intervenors requested rehearing on Mr. Kinloch's proposed residential electric inverted rate design and further requested that LG&E be ordered to file as a part of its

next rate case a cost-based inverted rate design. The Commission will deny rehearing on this issue but will require LG&E to address the inverted rate design and report back to the Commission in its next rate case.

Further, LG&E should be prepared in its next rate case to demonstrate that its rate design for the residential class meets the requirements as set forth in its determination on the declining block rate standard in Administrative Case No. 203, The Determinations With Respect to the Rate-making Standards Identified in Sections 111(d)(1)-(6) of the Public Utility Regulatory Policies Act of 1978.

Gas Customer Charge

The AG requested rehearing on the gas division residential customer charge. The AG argues that the authorized customer charge is too high and violates principles of rate gradualism, rate stability, and the avoidance of rate shock. The Commission will allow rehearing on this issue to further explore these rate-making principles.

Rate Surcharge

The Commission's July 1, 1988 Order approved new, higher rates to be effective for service rendered on and after May 20, 1988. To enable LG&E to collect the increased rates for the period of May 20, 1988 through June 30, 1988, the Commission directed LG&E to file a surcharge plan. LG&E's proposed plan is that the surcharge should be billed and collected during one month. The actual billing deficiency for each customer is based upon actual consumption during the period. The surcharge would be

set out as a separate line item billing charge on each customer's bill. LG&E claims that the level of increased revenue authorized by the Commission will produce a surcharge with a negligible impact on ratepayers. However, LG&E did suggest that while the revenue impact of the plan is minimal, it would consider collecting the surcharge over a 2-month period.

Responses to the surcharge plan were filed by the AG, the Residential Intervenors, and Jefferson County, Kentucky. All of the responses recommend that the surcharge be collected over a 2-month period to mitigate any potentially adverse rate impact. The Commission is also concerned with the impact that the surcharge may have on LG&E's ratepayers, particularly if the surcharge is to be added to the August and September bills. The bills for these months cover the traditionally highest months of power consumption -- July and August. Consequently, the Commission finds that LG&E's surcharge plan should be approved but that the surcharge should be evenly billed during the 2 off-peak months of October and November.

IT IS THEREFORE ORDERED that:

1. Rehearing be and it hereby is granted on the issues of adjusting revenue requirements to reflect exclusion of 25 percent of Trimble County CWIP, year-end volumes of business, retirements of SDRS and gas plant, additional interest expense, rate of return, gas revenue allocation, forfeited discounts, and gas customer charge.

2.* Rehearing be and it hereby is denied on the issues of management information systems, thrift savings plan, gas revenue increase, and residential electric rate structure.

3. Rehearing be and it hereby is granted on the issue of EEI dues and the Commission's July 1, 1988 Order disallowing rate recovery of EEI dues be and it hereby is affirmed.

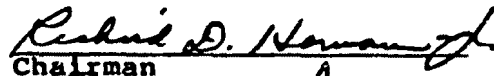
4. LG&E's surcharge plan as modified herein to be collected during the 2-month billing period beginning October 1, 1988 be and it hereby is approved.

5. LG&E shall file testimony on the rehearing issues no later than August 22, 1988; Intervenors shall file testimony, if any, no later than September 1, 1988; and a hearing be and it hereby is scheduled for September 13, 1988, at 9 a.m., EDT., in the Commission's offices at Frankfort, Kentucky. LG&E shall give notice of the hearing in accordance with 807 KAR 5:011, Section 8(5).

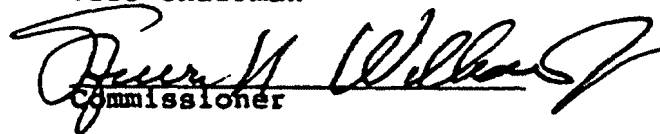
6. All provisions of the Commission's July 1, 1988 Order shall remain in full force and effect during the rehearing granted by this Order.

Done at Frankfort, Kentucky, this 10th day of August, 1988.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director