COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

A FORMAL REVIEW OF THE CURRENT STATUS)
OF TRIMBLE COUNTY UNIT NO. 1) CASE NO. 9934

O R D E R

BACKGROUND

On July 21, 1988, Louisville Gas and Electric Company ("LG&E") filed a petition for modification or rehearing of the Commission's July 1, 1988 Order. LG&E's petition is based on two points. First, LG&E contends that a disallowance of 25 percent of Trimble County with no evidence of imprudence constitutes confiscation. Second, LG&E indicates that if the July 1, 1988 Order and the July 19, 1988 Order in Case No. 10320,[1] which was initiated to implement the future disallowance, are modified to delete any reference to disallowance, and if the Orders state that any reduction in revenue requirement is for a limited period of time, then the Commission will have more options available for its consideration in Case No. 10320.

On August 10, 1988, the Commission issued an Order granting LG&E's petition for rehearing to the extent that all parties were granted the opportunity to file written briefs on the two points raised by LG&E in its petition.

---

1 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.

SUMMARY OF BRIEFS

In response to the Commission's Order, briefs were filed by all parties and are summarized below.

LG&E's brief indicates that if the "disallowance" approach is abandoned and a "broader range of options" is adopted, the Commission will be able to accomplish its purposes in ways that are fair, legal, and in the ratepayers' interest. Also, LG&E's brief cautions that the July 1, 1988 Order contains constitutional pitfalls that should be remedied prior to proceeding to Case No. 10320.

Kentucky Industrial Utility Customers ("KIUC") stated in its brief that the July 1, 1988 Order is supported by substantial and specific evidence of imprudence, is reasonable, and does not constitute confiscation of LG&E's property. Further, KIUC commented that the word "disallowance" should not be stricken and the Commission should not "broaden its options" as requested by LG&E.

The Attorney General, through his Utility and Rate Intervention Division ("AG"), stated in his brief that the Commission's July 1, 1988 Order is sound and based on evidence of record and should not be modified. However, the AG states that the Commission may want to clarify the wording related to the term "disallowance" so that the focus in Case No. 10320 will be on substance and not semantics.

Save the Valley, Inc. ("STV") stated that it finds the July 1, 1988 Order to be well-founded and based on the record. However, STV also requests in its brief that the Order be modified

to require that Trimble County not be built or, in the alternative, it be delayed several years.

Jefferson County agrees with the July 1, 1988 Order, but it is concerned that LG&E will immediately appeal an adverse decision. Therefore, it recommends that the July 1, 1988 Order be amended to state specifically that the record in all previous cases related to Trimble County was considered in arriving at the conclusion in the Order. Then Case No. 9934 should be reopened on this limited issue of the consideration of the record in the other Trimble County cases.

REVIEW OF LEGAL ISSUES

LG&E's brief argues that a utility has a constitutional right to earn a return of and a return on all capital that has been prudently invested. Absent a finding of imprudency, LG&E claims that the Commission cannot disallow, for rate-making purposes, any portion of the capital invested in the Trimble County facility. Contrary to these claims, neither the U.S. Supreme Court nor the Kentucky Supreme Court has adopted the so called "prudent investment" test.

The applicable U.S. Supreme Court standard is the "end result" test, as set forth in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944). In Hope the Court said that, "[I]t is the result reached not the method employed which is controlling. It is not the theory but the impact of the rate order which counts." The U.S. Court of Appeals, District of Columbia Circuit, explained that the Hope decision takes

precedence over the prudent investor standard. The D.C. Circuit stated that,

> We emphasize that we do not hold that a taking occurs every time a prudent investment is made but not included in the rate base.... Under Hope, as we have stated repeatedly, the only circumstances under which there is a possibility of a taking of investors' property by virtue of rate regulation is when a utility is in the sort of financial difficulty described in Justice Douglas' opinion.... But absent the sort of financial hardship described in Hope, there is no taking, and hence no obligation to compensate, just because a prudent investment has failed and produced no return.

Jersey Central Power and Light Co. v. FERC, 810 F.2d 1168, 1181 (D.C. Cir. 1987). These rate-making theories were recently confirmed by the United States Supreme Court. In Duquesne Light Company v. Barasch, 488 U.S. _____, 120 L.Ed.2d 646 (1989), the Court rejected adoption of the prudent investor standard by stating that,

> We think that the adoption of any such rule would signal a retreat from 45 years of decisional law in this area which would be as unwarranted as it would be unsettling.... The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since Hope Natural Gas.... The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors.

Similarly, the Kentucky Supreme Court never adopted the "prudent investment" test in reviewing Commission rate orders. In Commonwealth ex rel Stephens v. South Central Bell, Ky., 545 S.W.2d 927, 930 (1976), the Court held that,

> The federal and state constitutions protect against the confiscation of property, not against a mere reduction of revenue. Rates are non-confiscatory, just and reasonable so long as they enable the utility to

> operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed....

Kentucky's highest court has also confirmed the Commission's authority to exclude from rate base the cost of over-adequate facilities, notwithstanding the absence of any finding of imprudency. See Fern Lake v. PSC, Ky., 357 S.W.2d 701 (1962). ("[W]e believe the Commission properly refused to include the cost of over-adequate facilities in the rate base.") Similarly, the Court stated in Blue Grass State Telephone Co. v. PSC, Ky., 382 S.W.2d 81, 82 (1964), that, "If it is established that the price paid is grossly excessive or that the facilities purchased are not entirely usable, then the rate base should be adjusted accordingly." This decision again recognized the Commission's authority to exclude costs from rate base without a determination that the utility's actions were imprudent.

Thus, the Commission concludes that a finding of imprudency is not necessary to support its decision to disallow 25 percent of Trimble County for rate-making purposes.

CLARIFICATION OF THE TERM "DISALLOWANCE"

In the first ordering paragraph of the Commission's July 1, 1988 Order, it states that a "disallowance of 25 percent of Trimble County shall be accomplished through a rate-making alternative, which will assure the ratepayers of LG&E that they will receive the benefits of the reduced revenue requirements which would result if LG&E sold a 25 percent joint ownership interest in Trimble County as described in its Capacity Expansion Study-1987." This language clearly indicates that the 25 percent

of Trimble County to be excluded from rate base includes both the costs and the asset. Consequently, 25 percent of the output of Trimble County is available for LG&E to use to generate additional revenues from wholesale sales. This is unlike the situation in other jurisdictions where the ratepayers receive 100 percent use of the asset but only pay for a fraction of the cost of the asset in rates. LG&E retains control over the 25 percent of Trimble County disallowed to use as its management sees fit.

Further, it would be entirely consistent with the Commission's Order to include in rate base the 25 percent of Trimble County which was disallowed, if, at a later date, LG&E can make an affirmative demonstration that the capacity is the best available alternative to meet its projected demands. At this time it is impossible for the Commission to determine if and when LG&E will need the additional Trimble County capacity. Thus, the Commission concludes that it would be unreasonable to establish any set period of time for the reduced revenue requirement due to the disallowance to remain in effect.

SUMMARY

The Commission finds that LG&E's arguments to modify the July 1, 1988 Order are unpersuasive. There is no confiscation of LG&E's property. The disallowed portion of Trimble County remains with the company and stockholders for their use. Also, there is no need at this time to limit the period of time for the disallowance since LG&E is not precluded from petitioning the Commission, at a later date, and demonstrating the need and cost

justification to include the disallowed portion of Trimble County in rate base.

FINDINGS AND ORDERS

After consideration of the evidence of record and being advised, the Commission is of the opinion and finds that:

1. LG&E's petition for modification or rehearing of the Commission's July 1, 1988 Order in this case should be denied, except to the extent such Order is clarified herein.

2. The Commission's July 1, 1988 Order as clarified herein is reaffirmed in all respects.

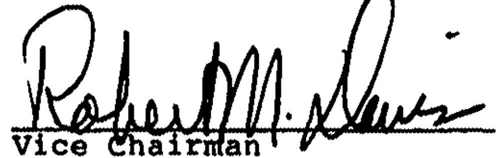
BE IT SO ORDERED.

Done at Frankfort, Kentucky, this 20th day of April, 1989.

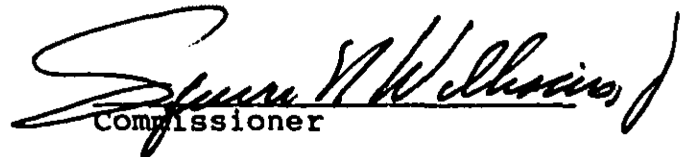
PUBLIC SERVICE COMMISSION

Did not participate.

Chairman



Vice Chairman



Commissioner

ATTEST:

Executive Director