

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF THE UNION LIGHT,)
HEAT AND POWER COMPANY TO ADJUST) CASE NO. 91-370
ELECTRIC RATES)

O R D E R

On February 10, 1992, The Union Light, Heat and Power Company ("ULH&P") filed a petition requesting authority to record on its books as a deferred debit the increase in purchased power expense to be incurred as a result of a decision by the Federal Energy Regulatory Commission ("FERC") to allow increased rates for purchased power to become effective subject to refund on February 13, 1992. The increased rates for purchased power were requested by Cincinnati Gas and Electric Company ("CG&E"), the parent and wholesale power supplier of ULH&P. ULH&P also requested authority to accrue a carrying charge on the purchased power expense so deferred and to recover such deferrals through rates in this rate case.

By Order dated February 13, 1992, the Commission found that the petition raised issues related to the Commission's denial of ULH&P's prior request for an interim rate increase and invited the parties to file response and reply comments. Response comments were filed by the Attorney General's office, Utility and Rate Intervention Division ("AG"), CO-EPIC, and Newport Steel Corporation ("Newport Steel"). The intervenors argued numerous

procedural and substantive reasons why the Commission should neither approve ULH&P's request for accounting deferrals nor grant interim rate relief. In its reply comments, ULH&P argued that it could not financially incur the increased power expense absent a procedure for current or future rate recovery. ULH&P further stated that should the Commission decline to adopt the proposed accounting deferrals, it requested a hearing pursuant to KRS 278.190(2) to seek interim rate relief.

On March 4, 1992, the Commission ordered ULH&P to file prepared testimony in support of its request for interim rate relief and scheduled the issue to be heard at the commencement of the previously scheduled hearing on March 17, 1992. ULH&P filed direct testimony on March 10, 1992. The testimony discussed the current financial condition of ULH&P and the anticipated changes to that condition as a result of currently incurring increased purchased power expenses without the ability to recover those increased expenses through retail rates. During the hearing on March 17, 1992, the AG presented testimony in opposition to ULH&P's request for interim rate relief.

Due to the immediacy of this issue, an expediting briefing schedule was established and briefs were filed by ULH&P, the AG, and Newport Steel on March 30, 1992.

BACKGROUND

On November 4, 1991, ULH&P filed an application for authority to implement new electric rates designed to produce increased electric revenues of \$29.7 million annually. Of this requested annual increase, \$25 million was designed to recover ULH&P's

increased purchased power expense, with the remainder to recover other expenditures and to allow an opportunity to earn a reasonable return for its investors. ULH&P's new rates had an effective date of December 4, 1991. Pursuant to KRS 278.190(2), at any time before the new rates become effective, the Commission may suspend the new rates for up to five months for the purpose of holding a hearing concerning the reasonableness of the new rates. By Order dated November 25, 1991, the Commission determined that further proceedings were necessary to determine the reasonableness of the new rates and suspended such rates for five months through May 3, 1992.

ULH&P requested the Commission to reconsider that decision, specifically requesting the Commission to authorize an increase in ULH&P's retail electric rates to coincide with any increase in purchased power expense which the FERC might allow to become effective prior to May 3, 1992. ULH&P noted that although the FERC had not yet allowed CG&E to increase its rates for power purchased by ULH&P, such action was expected in the near future. In denying reconsideration, the Commission's December 17, 1991 Order noted that since ULH&P had not proposed any rates to recover only the anticipated increase in purchased power expense, there were no rates that if allowed to become effective without suspension would track only the increase in purchased power expense. The Commission further stated that when new rates are filed its authority was limited to either allowing them to become effective or suspending them. However, the Commission reminded ULH&P that all or a portion of the new rates could be implemented

during the suspension period if the Commission found that ULH&P's "credit or operations will be materially impaired or damaged by the failure to permit said rates to become effective during said five (5) months' period" KRS 278.190(2).

DISCUSSION

A review of the procedural history of this case leads the Commission to find that its November 25, 1991 Order suspending ULH&P's new rates was reasonable and in the public interest. Since at that time the FERC had taken no action on CG&E's request to implement increased purchased power rates, the failure to suspend ULH&P's new rates would have unjustly enriched ULH&P by recovering a non-existent increase in purchased power expense from its retail customers. In fact, by letter dated November 27, 1991, the FERC notified CG&E that its application for increased purchased power rates was deficient in several aspects and would not be accepted for filing until the deficiency was cured. CG&E's application was subsequently accepted by the FERC and the increased purchased power rates allowed to become effective subject to refund on February 13, 1992.

The Commission is an administrative agency and its authority is derived from KRS Chapter 278, et seq. Once a utility files new rates, and the Commission elects to suspend those rates pursuant to KRS 278.190(2) and to hold a hearing to determine their reasonableness, interim rate relief can be granted only as provided by statute. As previously cited, KRS 278.190(2) authorizes all or a portion of new rates to become effective during the suspension period only when the Commission finds that

absent such interim relief the utility's credit or operations will be materially impaired or damaged.

ULH&P's purchased power expense is a monthly, recurring expenditure. As part of the overall level of rates requested in this case, ULH&P seeks to recover the recurring level of this expense. By its proposed accounting deferral, ULH&P also seeks to recover the expenses incurred between February 13, 1992 and May 3, 1992. Under the circumstances of this case, the Commission has no authority to grant ULH&P's request which is tantamount to a retroactive recovery of a monthly, recurring expense.

As the AG argued, the change in rates that ULH&P has given notice of pursuant to KRS 278.180(1) are the rates designed to produce an annual increase in electric revenues of \$29.7 million. This amount includes only the monthly, recurring increase in purchased power expense and does not include recovery of the \$5.3 million to be incurred for this expense between February 13, 1992 and May 3, 1992. In addition, the newspaper notice of the proposed rates and estimated amount of increase per customer class, published by ULH&P pursuant to 807 KAR 5:011, Section 8(2), did not include rates in excess of \$29.7 million to recover the deferred portion of ULH&P's increased purchased power expense. For these reasons, recovery of the increased purchased power expense from the date of this Order through May 3, 1992 can be authorized only if ULH&P has satisfied its statutory burden of proof in accordance with KRS 278.190(3) by demonstrating a material impairment or damage to its credit or operations in the absence of interim rate relief.

ULH&P's direct testimony consisted of seven pages of narrative and a one page schedule of financial ratios for calendar years 1990 actual, 1991 actual, and 1991 adjusted. ULH&P maintains that absent a recovery of the increase in purchased power expense, its earnings would decrease significantly, it would become more difficult to secure needed financing, and it would fall below its first mortgage bonds' minimum indenture interest coverage ratio requirements. The financial ratios were apparently included to demonstrate financial impairment.

At the outset the Commission notes that ULH&P failed to provide any workpapers, calculations, or documents to support the financial ratios included in the one page schedule.¹ Despite this substantial and material shortcoming, the Commission has examined the limited evidence on credit impairment submitted by ULH&P. Our review discloses that in determining that the increases in purchased power expense between February 13, 1992 and May 3, 1992 would be \$5.3 million, ULH&P simply divided the proposed annual increase of \$25 million by 12 and then multiplied by two and a half.² While this methodology assumes that ULH&P purchases power in equal quantities each month, in actuality such purchases vary considerably from the summer and winter peaks to the spring and fall valleys. Since the time at issue here covers the end of

¹ Transcript of Evidence ("T.E."), March 17, 1992, pages 74 and 75.

² Id., page 9.

winter through mid-spring, ULH&P's actual purchases should be less than average. However, ULH&P's approach to determining the impact of the power cost increase does not recognize this factor.

ULH&P claims that absent an accounting deferral or interim rate relief the financial community will perceive ULH&P as having additional risk which will result in increased financing costs.³ However, ULH&P failed to quantify the amount of the increase. ULH&P also requested that the final rates approved in this case be sufficient to recover the proposed expense deferrals plus a carrying charge on such deferrals. However, ULH&P has neither quantified the period of recovery of the deferral nor the carrying charge rate.⁴

The Commission finds that ULH&P has failed to meet the statutory burden of proof to demonstrate that its credit or operations will be materially impaired or damaged absent interim rate relief. ULH&P's evidence, taken in its entirety, falls far short of persuading the Commission that any portion of the new rates should be allowed to become effective during the suspension period. ULH&P's rudimentary financial analysis, being based on 1991 actual operating results, is not reflective of conditions reasonably expected to occur during the 5-month rate suspension period that ends May 3, 1992. In addition, ULH&P failed to file

³ Mosley Direct Testimony, March 10, 1992, pages 2 and 4.

⁴ T.E., pages 70 through 73.

any monthly financial information that might show the financial impairment necessary to warrant interim rate relief.

Furthermore, there was no evidence to reflect the impact of the increase in purchased power expense on the cash flow of ULH&P. The very nature of ULH&P's proposal to establish an accounting deferral while incurring and actually paying the monthly increases in expense belies ULH&P's concern regarding any adverse impact on its short run cash flow.

The Commission also recognizes that as a result of the subsidiary/parent relationship that exists between ULH&P and its power supplier, CG&E, as well as the sharing of management personnel, ULH&P has known for at least a year that CG&E would request an increase in purchased power rates to recover the costs associated with the Zimmer Generating Station. Despite this knowledge, absolutely no steps were taken by ULH&P to implement any short run cost savings measures in an effort to minimize the financial impact.⁵ To the contrary, ULH&P has proceeded with a "business as usual" attitude, refusing to even delay discretionary expenditures, such as increases in wages and salaries for its officers and other salaried personnel, made during the suspension period.⁶

Further, the Commission notes that CG&E filed an application with the Public Utilities Commission of Ohio on or about April 1,

⁵ Id., pages 65 through 70.

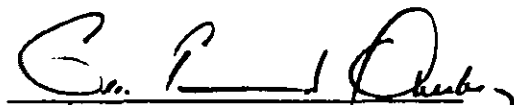
⁶ Id., pages 67 through 70.

1991 to increase retail electric rates in Ohio. ULH&P clearly had adequate time to file an application in Kentucky to increase rates to coincide with the anticipated FERC increase in purchased power without the need for interim rate relief. ULH&P's delay in seeking rate relief in Kentucky is but one additional indicator that any financial impact during the suspension period will be minimal.

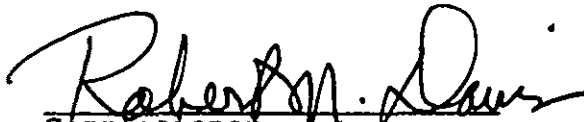
IT IS THEREFORE ORDERED that ULH&P's request for authority to record its increase in purchased power expense as a deferred debit or, alternatively, for interim rate relief be and it hereby is denied.

Done at Frankfort, Kentucky, this 17th day of April, 1992.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:



Executive Director