COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY FOR THE ACQUISITION OF TWO COMBUSTION TURBINES	)))))	CASE NO. 2000-294

O R D E R

Louisville Gas and Electric Company and Kentucky Utilities Company ("LG&E and KU") filed their application on July 7, 2000 for a Certificate of Public Convenience and Necessity for the acquisition of two combustion turbines ("CT") and a Certificate of Environmental Compatibility pursuant to KRS 278.025. The total estimated cost is approximately $108 million. An unregulated affiliate of LG&E and KU, LG&E Capital Corp. ("Capital Corp."), purchased the two CTs with the understanding that they will be transferred to LG&E and KU if the requested certificates are granted.

One CT is 133 MW from Asea Brown Boveri and will be constructed at KU's E.W. Brown generating station in Mercer County, Kentucky at a cost of $46.4 million. The second CT is 151 MW from Siemens Westinghouse Power Corp. at a cost of $62.2 million and will be constructed at LG&E's Paddys Run generating station in Jefferson County, Kentucky. LG&E and KU stated that the CTs are needed to reliably supply increasing customer loads, and the acquisition of the two CTs is the most reasonable least cost option compared to relying only on purchase power to serve the projected loads.

The Attorney General and Kentucky Industrial Utility Customers were granted intervention, and a hearing was held at the Commission's offices on September 6, 2000. Neither of the intervenors raised any objection to the acquisition of the two CTs. On September 1, 2000, the Commission received a letter from the Natural Resources and Environmental Protection Cabinet stating that the proposed CTs will be environmentally compatible.

The CTs will be operated on gas and can be retrofitted in the future, if needed, to burn oil or natural gas. The CTs are expected to operate mainly in the summer months and occasionally during the winter. Therefore, LG&E and KU anticipate gas availability, both at E.W. Brown and Paddys Run, to be high during the summer. Further, gas can be stored under pressure in the gas pipeline at E.W. Brown. This will allow the new CT at E.W. Brown to run for eight hours in case the gas is not available, while the existing CTs could be run on oil since they have dual fuel capabilities (oil and gas).

Based on the evidence of record and being sufficiently advised, the Commission finds that the acquisition of the two CTs is the least cost option to reliably serve LG&E's and KU's customer loads. Therefore, LG&E and KU should be granted a Certificate of Public Convenience and Necessity and Environmental Compatibility for the proposed CTs.

Transfer Pricing of CTs

LG&E and KU have requested that the Commission waive the requirement to transfer the CTs at the lesser of cost or fair market value, as provided in LG&E Energy's Corporate Policies and Guidelines for InterCompany Transactions ("Corporate

Guidelines"), and approve the transfer of the CTs at cost.[1] LG&E and KU contend that, based on existing construction schedules, the majority of the construction of the CTs will likely occur after the Commission's decision in this proceeding. If the requested certificates are granted, LG&E and KU state that the existing work orders will be transferred to the utilities prior to the majority of the construction. The construction already completed by the time of transfer will have no measurable impact on either the cost or fair market value of the CTs, and the cost at the time of transfer will be less than fair market value. LG&E and KU note that under the Corporate Guidelines and these circumstances, the transfer of the CTs at cost would be appropriate.[2]

The Commission is not persuaded that there is a need to waive the requirements of the Corporate Guidelines. Given the timing of the Commission's granting of the requested certificates, LG&E and KU appear to have determined that they can adequately demonstrate that the cost of the construction as of the date of transfer would be lower than the fair market value. Therefore, the Commission finds that the request to waive the requirements of the Corporate Guidelines concerning the pricing of the transfer of the CTs should be denied.

The Commission also finds that LG&E and KU should file their final determination of the cost and the fair market value of the transferred CTs within 30 days after the date of the transfer. All accounting entries made to the books of LG&E and KU relating to

[1] Willhite Testimony at 9.

[2] Response to the Second Data Request of Commission Staff to LG&E, dated August 11, 2000, Item 2.

the transfer of the CTs and the allocation between LG&E and KU of the cost of the CTs should also be filed with the Commission within 30 days of the transfer.

Governing Service Agreement

In Case No. 99-056[3] the Commission ordered that if LG&E or KU enter into a future project with another affiliate, similar to the CT project in that case, LG&E and KU must execute a service agreement or some other governing document based on the Corporate Guidelines that outlines the responsibilities, obligations, and rights of the parties. In this proceeding, LG&E and KU filed a Services Agreement executed with LG&E Energy concerning this CT project.[4] The provisions of the Services Agreement govern the use of any facilities, the transfer of any equipment or assets, and the furnishing of any services relating in any way to LG&E Energy's acquisition, installation, and operation of the CTs. However, the Services Agreement does not address the issues of which party has project oversight and administrative responsibilities. LG&E and KU acknowledge these issues are not specifically covered in the Services Agreement. However, LG&E and KU state that they are relying on the submission of written requests from LG&E Energy for these types of services, and that the pricing for these services is covered by the Services Agreement.[5]

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[3] Case No. 99-056, The Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Acquisition of Two 164 Megawatt Combustion Turbines, Final Order dated July 23, 1999.

[4] Willhite Testimony, Exhibit RLW-1.

[5] Transcript of Evidence, September 6, 2000.

The Commission finds that while the executed Services Agreement does address most of the concerns raised by the Commission in its decision in Case No. 99-056, it fails to document in writing the project oversight and administrative responsibilities. As we stated in Case No. 99-056, had the CT project involved an unaffiliated company, LG&E and KU would have insisted upon, and executed, a service agreement or some other governing document that would have detailed the responsibilities, obligations, and rights of the parties. The fact that the other party was an affiliate is not sufficient reason to deviate from sound business practices. While the Commission finds that the current Services Agreement is a major step in the right direction, the agreement is not as complete as it would have been had an unaffiliated party been part of the transaction. Therefore, the Commission will reiterate the finding in Case No. 99-056. In the future, should LG&E and KU enter into similar projects with affiliates, a service agreement or some other governing document should be executed. The document should be based on the Corporate Guidelines and adequately detail the responsibilities, obligations, and rights of all parties to the document.

IT IS THEREFORE ORDERED that:

1. LG&E and KU are granted a Certificate of Public Convenience and Necessity and a Certificate of Environmental Compatibility for the acquisition of the 133 MW CT and 151 MW CT from Capital Corp.

2. The request of LG&E and KU for a waiver of the Corporate Guidelines' requirement to transfer the CTs at the lower of cost or fair market value is denied.

3. Within 30 days of the date of the transfer of the CTs, LG&E and KU shall file the determination of the cost and fair market value of the CTs.

4. Within 30 days of the date of the transfer of the CTs, all accounting entries made to the books of LG&E and KU to record the transfer and allocation of cost of the CTs shall be filed.

5. In the event LG&E or KU enters into a future construction project with an affiliate, LG&E or KU shall execute a service agreement or some other governing document that is based on the Corporate Guidelines and that adequately outlines the responsibilities, obligations, and rights of the parties.

Done at Frankfort, Kentucky, this 16th day of October, 2000.

By the Commission

ATTEST:

Wm H Bowker

Deputy Executive Director