COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| THE APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR APPROVAL OF AN AMENDED COMPLIANCE PLAN FOR PURPOSES OF RECOVERING THE COSTS OF NEW AND ADDITIONAL POLLUTION CONTROL FACILITIES AND TO AMEND ITS ENVIRONMENTAL COST RECOVERY SURCHARGE TARIFF | ) | CASE NO. 2000-386 |

O R D E R

On April 25, 2001, the Kentucky Industrial Utility Customers, Inc. ("KIUC") filed an application for rehearing on two issues arising from the Commission's April 18, 2001 Order approving Louisville Gas and Electric Company's ("LG&E") amended environmental surcharge compliance plan and LG&E's environmental surcharge tariff as modified in that Order. LG&E filed a petition for reconsideration and a response to KIUC's application for rehearing on April 30, 2001.

Based on the requests for rehearing and response, the Commission makes the following findings on the issues raised.

Inclusion of Short-Term Debt in Capital Structure

KIUC requests that the Commission revise the overall rate of return calculations as shown in Appendix A to the April 18, 2001 Order to include the short-term debt balance reported by LG&E in Case No. 2001-054.[1] KIUC notes that the Commission originally excluded the short-term debt from the calculations because of questions

[1] Case No. 2001-054, The Annual Earnings Sharing Mechanism Filing of the Louisville Gas and Electric Company.

concerning the nature of the notes payable to associated companies reported as short-term debt in Case No. 2001-054, but indicated a willingness to reconsider the exclusion pending LG&E's response to data requests in that case.[2] KIUC states that the responses to that data request indicate that the notes payable to associate companies reflect LG&E's participation in a money pool with its parent holding company. KIUC notes that the money pool financing is a form of short-term debt authorized by the Securities and Exchange Commission and argues that this debt should be included in the calculation of the overall rate of return used for environmental surcharge purposes.

In its response to KIUC, LG&E agrees with KIUC, noting that the necessary data responses have been filed which demonstrate that the money pool financing should be included in the calculation of the overall rate of return. LG&E notes that its evidence, and the position of KIUC, strongly support modifying the April 18, 2001 Order to include the cost of short-term debt in the calculation of LG&E's capital structure. LG&E further observes that any adjustment to the May 2001 environmental surcharge billing can be undertaken during the applicable 6-month surcharge review proceeding.[3]

The Commission reaffirms its finding in the April 18, 2001 Order that short-term debt should be included in the determination of the overall rate of return applied to LG&E's 2001 Plan Rate Base. The Commission further finds that LG&E's participation in the money pool constitutes an acceptable form of short-term debt financing, and it is reasonable to include this item as short-term debt in the determination of the overall rate

[2] See April 18, 2001 Order at 26 and footnote 57.

[3] LG&E's and KU's Petition for Reconsideration and Response to KIUC's Application for Rehearing at 4-5.

of return. The Commission notes that until the data responses in Case No. 2001-054 were received, there had been no disclosure by LG&E that the notes payable to associated companies reflected financing using the money pool. Until that disclosure was made, the Commission could not determine the reasonableness of including those particular notes payable to associated companies in the calculation of the overall rate of return.

Therefore, rehearing is granted and the Commission will modify the April 18, 2001 Order by recalculating the overall rate of return to be applied to the 2001 Plan Rate Base, as shown in Appendix A to this Order. The overall rate of return shown in Appendix A should be applied to all surcharge filings subsequent to the date of this Order. Any adjustments resulting from this change in the overall rate of return should be addressed during the appropriate 6-month surcharge review proceeding.

Inclusion of Accounts Receivable Financing

KIUC objects to the Commission's inclusion of LG&E's accounts receivable financing in the determination of the blended cost of long-term debt. KIUC states that it appears the intent of the Commission was to pass through to ratepayers the benefits of the low cost accounts receivable financing consistent with the representations made by LG&E when that financing was approved by the Commission. However, KIUC argues that the accounts receivable financing must be reflected in the surcharge capital structure in order for the benefits to be flowed through to ratepayers.[4]

LG&E also contends that the April 18, 2001 Order is in error by including the balance of the accounts receivable financing in the principal or outstanding debt

[4] KIUC Application for Rehearing at 5-6.

amounts when calculating the overall weighted average cost of long-term debt. LG&E joins KIUC's request to include the accounts receivable financing in the calculation of the environmental surcharge capital structure. LG&E argues that if the accounts receivable financing is not included in the capital structure, the Commission should eliminate the accounts receivable balances when determining the weighted average cost of long-term debt.[5]

The Commission finds that rehearing should be granted on this issue. Until its application for rehearing, KIUC had not advocated the use of the overall rate of return for the 2001 Plan Rate Base. Rather, KIUC had argued that the accounts receivable financing should be reflected as short-term debt for environmental surcharge purposes.[6] Until its response to KIUC's application for rehearing, LG&E had only advocated the recognition of the accounts receivable financing in the calculation of the weighted average cost of long-term debt.[7] Because of the significance of this issue, the Commission believes that additional information is needed before a final decision can be made. Therefore, LG&E and KIUC should provide responses to the questions contained in Appendix B to this Order no later than June 15, 2001.

IT IS THEREFORE ORDERED that:

1. Rehearing is granted on the issue of revising the overall rate of return applied to LG&E's 2001 Plan Rate Base to include short-term debt. The April 18, 2001

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[5] LG&E's and KU's Petition for Reconsideration and Response to KIUC's Application for Rehearing at 3.

[6] April 18, 2001 Order at 21-22.

[7] Id. at 21 and 25.

Order is modified to reflect the revised overall rate of return as shown in Appendix A, attached hereto.

2. LG&E shall use the revised overall rate of return set forth in Appendix A in its monthly surcharge filings submitted after the date of this Order. Any adjustments to the May 2001 environmental surcharge filing resulting from the change in the overall rate of return applied to the 2001 Plan Rate Base shall be addressed in the appropriate 6-month environmental surcharge review.

3. Rehearing is granted on the issue of whether LG&E's accounts receivable financing should be included in its environmental surcharge capital structure.

4. LG&E and KIUC shall individually file responses to the questions set forth in Appendix B to this Order no later than June 15, 2001. LG&E and KIUC shall file an original and 8 copies of their responses, with a copy to all parties of record.

Done at Frankfort, Kentucky, this 14th day of May, 2001.

By the Commission

ATTEST:

Wm H Bowker

Deputy Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2000-386 DATED MAY 14, 2001

## Calculation of the Overall Rate of Return for the 2001 Plan Rate Base

The calculation of this overall rate of return for the 2001 Plan Rate Base is based on the financial information provided by LG&E in Case No. 2001-054, Form 1(b).

Overall Rate of Return –
Weighted Average Cost of Capital as of December 31, 2000

| | Adjusted Electric Capitalization | Percent of Total | Annual Cost Rate | Weighted Cost of Capital |
|---|---|---|---|---|
| Short-Term Debt | 98,582,402 | 7.41% | 6.840% | .51% |
| Long-Term Debt | 479,993,778 | 36.07% | 5.380% | 1.94% |
| Preferred Stock | 81,849,882 | 6.15% | 5.748% | .35% |
| Common Equity | 670,137,530 | 50.37% | 11.500% | 5.79% |
| Totals | 1,330,563,592 | 100.00% | | 8.59% |

Overall Rate of Return –
Adjusted for Income Tax Gross-Up

$$ROR + (ROR – DR) (TR/(1 – TR))$$

ROR = .0859
DR = .0245
TR = .403625 [Federal rate = 35.00%; State rate = 8.25%]
1 – TR = .596375

Overall Rate of Return, Adjusted for Income Tax Gross-Up =
.0859 + (.0859 - .0245)(.403625/.596375) = .0859 + .0416 = .1275

Overall Rate of Return, Adjusted for Income Tax Gross-Up = 12.75%

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2000-386 DATED MAY 14, 2001

REQUEST FOR INFORMATION FROM LG&E AND KIUC

1. Provide the references in the record of this case, prior to the requests for rehearing, where LG&E and KIUC proposed and supported the inclusion of the accounts receivable financing in the capital structure of LG&E.

2. Provide information concerning how other regulatory commissions have treated accounts receivable financing for purposes of determining a utility's capital structure and weighted cost of capital.

3. Two approaches have been presented concerning the proper manner to provide the benefits of accounts receivable financing to LG&E's ratepayers. The approach established in the Commission's April 18, 2001 Order requires the recognition of the accounts receivable financing in the calculation of the weighted average cost of long-term debt, with both the outstanding balance of the financing and the associated interest expense included. The alternative approach incorporates the accounts receivable financing as a component of LG&E's capitalization and capital structure utilized to determine the overall rate of return.

a. Explain which approach provides the appropriate level of benefits to LG&E's ratepayers.

b. Assume for purposes of this request that LG&E has total company accounts receivable financing outstanding of $75 million at 5 percent on December 31, 2000. Calculate the overall rate of return as of December 31, 2000, using both approaches. Base the calculations on the capitalization and capital structure information contained in Case No. 2001-054. Since the $75 million is for the total company, include the calculations showing the allocation of the accounts receivable financing between LG&E's electric and gas operations.