

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

LOUISVILLE GAS AND ELECTRIC COMPANY S)
ANNUAL EARNINGS SHARING MECHANISM) CASE NO.
FILING FOR CALENDAR YEAR 2001) 2002-00071

and

KENTUCKY UTILITIES COMPANY S ANNUAL)
EARNINGS SHARING MECHANISM FILING FOR) CASE NO.
CALENDAR YEAR 2001) 2002-00072

O R D E R

On December 23, 2002, the Louisville Gas and Electric Company (LG&E) and the Kentucky Utilities Company (KU) filed a motion requesting the Commission to approve a Settlement Agreement that is intended to operate as a full and complete resolution of these two unconsolidated cases. LG&E and KU, along with the Office of the Attorney General (AG), the Kentucky Industrial Utility Customers, Inc. (KIUC), and the Lexington-Fayette Urban County Government (LFUCG), are parties to the unanimous Settlement Agreement.¹ None of the parties requested a hearing on the motion to adopt the Settlement Agreement.

BACKGROUND

On March 1, 2002, LG&E and KU filed their second annual Earnings Sharing Mechanism (ESM) calculations. Both companies used the monthly average

¹ LFUCG is a party in Case No. 2002-00072 only.

capitalization in their ESM calculations for year 2001. As applied by LG&E and KU, their monthly average capitalization used a 13-month average, consisting of the months of December 2000 through December 2001. LG&E and KU adjusted their actual monthly capitalization totals to reflect two items that had been addressed in 2001 as part of a prior comprehensive settlement agreement (Global Settlement).² First, depreciation expense for the 12 months of 2001 was adjusted retroactively to January 2001 to reflect the reduction in expense agreed to in the Global Settlement. Second, the March 2001 write-off of Workforce Reduction costs was reversed and adjustments were included to retroactively reflect the Workforce Reduction costs as deferred debits for LG&E and KU.

After reflecting these adjustments, LG&E determined that its rate of return on common equity was below the lower limit of the deadband in the ESM mechanism and that it should collect \$966,721 from ratepayers during the period April 2002 through March 2003. It began collecting that amount through a monthly ESM factor applied to bills rendered on and after April 1, 2002. Similarly, KU determined that its rate of return on common equity was within the deadband in the ESM mechanism. Based on this result, KU would not collect from or return to ratepayers any funds.

KIUC argued that no provision of the Global Settlement specifically authorized LG&E and KU to adjust their monthly capitalization to retroactively reflect the Workforce

² The Global Settlement was entered into by LG&E, KU, KIUC, and the AG, and approved by the Commission on December 3, 2001. The Global Settlement resolved five cases pending before the Commission concerning the calculations under the ESM mechanism, approval of new depreciation rates, and the accounting for and ESM recognition of the 2001 Workforce Transition Separation Program (Workforce Reduction) at LG&E and KU.

Reduction deferred debits as if they were booked in March 2001, when in fact the deferred debits were not booked until December 2001. Since the Global Settlement does contain a specific authorization to retroactively book the new depreciation rates, KIUC contended that the absence of a similar provision applicable to the Workforce Reduction adjustment expressed an intent that such adjustment not be booked retroactively. By excluding the retroactive adjustment, KIUC determined that LG&E's rate of return on common equity fell within the ESM deadband and no amounts should be collected from LG&E ratepayers. Similarly, KIUC determined that KU's rate of return on common equity was above the upper limit of the ESM deadband, and that KU should return \$1,378.077 to ratepayers.

The parties agreed that the Commission should decide on the basis of briefs the issue of whether the Global Settlement authorized the retroactive booking of the Workforce Reduction Adjustment. In its October 16, 2002 Orders, the Commission found that the Global Settlement did not authorize LG&E and KU to adjust their monthly capitalization to retroactively reflect the Workforce Reduction and that KIUC's calculation of the ESM for 2001 appeared reasonable. Because KIUC's calculations had been filed as an attachment to its brief, the Commission directed LG&E and KU to refile their ESM calculations for 2001 based on the elimination of the retroactive adjustments for the Workforce Reduction.

On October 28, 2002, LG&E and KU filed their revised ESM calculations for 2001 reflecting the effects of the Commission's October 16, 2002 Order. KU determined that its rate of return on common equity was above the ESM deadband and that it needed to

return \$1,364,543³ to its ratepayers. LG&E determined that its rate of return on common equity was within the ESM deadband, that no amounts were due from ratepayers, and that it had already collected \$584,244⁴ from ratepayers that should be refunded. LG&E and KU determined the appropriate ESM factors to apply to customers bills to return these amounts to ratepayers between November 2002 and March 2003.

On November 4, 2002, KIUC requested rehearing on the issue of whether interest should be included on the refunds required by the October 16, 2002 Orders. On November 6, 2002, LG&E and KU filed a joint petition for rehearing, claiming that the Commission erroneously interpreted the Global Settlement and that the October 16, 2002 Orders arbitrarily provided customers with a double rate benefit from the same Workforce Reduction expense.

LG&E and KU filed a joint response in opposition to KIUC's rehearing request arguing that, depending on the Commission's ruling on their petition for rehearing, KIUC's arguments were either moot or unwarranted because LG&E and KU were in compliance with their respective ESM tariffs. KIUC responded to LG&E's and KU's joint petition for rehearing by arguing that the Commission did not commit the error claimed by LG&E and KU and that the double rate benefit argument was based on using hypothetical, rather than actual, common equity levels as required for the ESM.

On November 25, 2002, the Commission granted both rehearing requests. A procedural schedule was established that provided for the filing of direct testimony,

³ KU's October 28, 2002 Filing, ESM Filing Form 1.

⁴ LG&E's October 28, 2002 Filing, ESM Filing Form 1a.

response testimony, and supporting documentation by LG&E, KU, and KIUC on the rehearing issues.

SETTLEMENT AGREEMENT

At the request of LG&E and KU, an informal conference was held at the Commission's offices on December 6, 2002 to discuss the rehearing issues and explore the potential for resolving those issues through a settlement. Additional discussions were subsequently held among the parties, which resulted in the filing of a Settlement Agreement on December 23, 2002. The Settlement Agreement, a copy of which is attached hereto as Appendix A, was entered into by all parties and is intended to resolve all the rehearing issues.

Under the Settlement Agreement, the refunding period will be the 5 months from November 1, 2002 through March 31, 2003.⁵ LG&E will refund \$440,557⁶ to customers, while KU will refund \$1,023,407.⁷ The refunds will be reduced by amounts already refunded in November and December 2002 pursuant to our October 16, 2002 Order. The ESM factors applied to customer bills from January 2003 through March 2003 will reflect this reduction. LG&E and KU will not be required to pay interest on these refunds.⁸

The Settlement Agreement also addresses LG&E's and KU's calculations for 2002. It provides that LG&E and KU will use their actual per book capitalization for

⁵ Article 1.0, Section 1.1.

⁶ Article 1.0, Section 1.2 and Settlement Agreement Exhibit 1.

⁷ Article 1.0, Section 1.3 and Settlement Agreement Exhibit 2.

⁸ Article 1.0, Section 1.4.

December 2001 and previously approved adjustments in determining the 13-month average capitalization used to calculate their ESM filings for 2002.

ANALYSIS

The Commission has reviewed the Settlement Agreement and finds that its terms are in accordance with the law and do not violate any regulatory principle. Resolving by settlement the rehearing issues eliminates the possibility of extended rehearing and appeal proceedings and provides certainty concerning the amounts to be refunded to customers. The Settlement Agreement also provides certainty concerning how LG&E and KU will calculate their 13-month average capitalization in their upcoming ESM filings for 2002. The Settlement Agreement is a product of arm s-length negotiations among capable, knowledgeable parties, is in the public interest, and results in a reasonable resolution of all outstanding issues in these cases. Therefore, the Commission will approve the Settlement Agreement in its entirety as a full and complete resolution of all issues pending on rehearing in these cases.

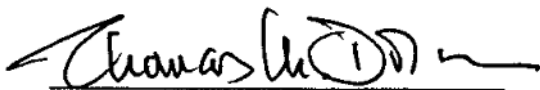
IT IS THEREFORE ORDERED that:

1. The December 23, 2002 Settlement Agreement, set forth in Appendix A and incorporated herein by reference, is approved in its entirety as a full and complete resolution of all issues pending on rehearing in these cases.
2. LG&E and KU shall file revised tariffs within 5 days of the date of this Order to adjust their ESM factors based on the terms of the Settlement Agreement.
3. Case Nos. 2002-00071 and 2002-00072 are hereby closed.

Done at Frankfort, Kentucky, this 28th day of February, 2003.

By the Commission

ATTEST:

A handwritten signature in black ink, appearing to read "Charles H. [unclear]", written over a horizontal line.

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NOS. 2002-00071 AND 2002-00072
DATED February 28, 2003

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