COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET	)))	CASE NO. 2008-00456

<u>O R D E R</u>

On October 27, 2008, Louisville Gas and Electric Company ("LG&E") filed an application seeking authority to establish a regulatory asset based on its operation and maintenance costs incurred in connection with restoring electric service to its customers following the September 14, 2008 windstorm that hit much of Kentucky in the wake of Hurricane Ike. In its application, LG&E states that over 300,000 of its customers, or roughly 75 percent of LG&E's customer base, were without electricity as a result of the windstorm. It also states that, at their peak, the service restoration efforts of it and its sister company, Kentucky Utilities Company ("KU"), involved more than 2,900 employees and contractors. LG&E indicates that the cost of repairing the resulting damage far exceeded its average annual storm-related costs.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), and the Kentucky Industrial Utility Customers, Inc. were granted intervention in this proceeding. A procedural schedule was established which provided for two rounds of discovery and afforded the parties an opportunity to request a hearing or informal conference. The AG and Commission Staff each issued two rounds of data requests to LG&E. After discovery was completed, the parties filed a joint motion requesting permission to file written comments in lieu of a hearing. That motion was granted and written comments were filed by LG&E and the AG on December 17, 2008. The case now stands submitted for decision.

LG&E APPLICATION AND POSITION

At the time of its application, LG&E estimated that its Hurricane Ike-related operation and maintenance (O&M) costs would exceed $24.1 million. Citing the magnitude of these costs, LG&E requests permission to accumulate its actual Hurricane Ike-related costs as a regulatory asset and to defer such costs for future rate recovery. LG&E contends that the measures it took to restore service, and the related costs, were reasonable and prudent, and should be recoverable as a necessary cost of providing electric service to its customers.

LG&E relies upon two prior Commission decisions granting similar accounting treatment to both LG&E and KU for extraordinary storm damages. In Case No. 2003-00434,[1] KU was allowed to defer and amortize a portion of its 2003 ice storm damage expenses. In Case No. 6220,[2] LG&E was authorized to defer and amortize storm-related costs in the aftermath of the 1974 tornado.

In the instant case, LG&E claims that such accounting treatment will allow it to make appropriate adjustments on its books of account and, therefore, not record its extraordinary storm-related costs as expenses on its books in calendar year 2008.

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[1] An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company (Ky PSC, June 30, 2004).

[2] General Adjustments in Electric and Gas Rates of Louisville Gas and Electric Company (Ky PSC, February 28, 1975).

LG&E requests approval of its request by no later than December 31, 2008 to avoid distortion in its financial statements. If its request is not granted until 2009, LG&E claims it "will have to record its Hurricane Ike-related operations and maintenance cost as expenses in 2008, artificially depressing its operating income in that year and artificially increasing it in calendar year 2009."[3] In its application and in responses to Commission Staff data requests, LG&E states that it will only seek recovery of actual costs incurred and not for any estimates or contingencies.[4] In its response to Commission Staff's supplemental data request, LG&E indicated that, while some minimal actual costs may not be known until the end of the first quarter of 2009, it anticipates the majority of its actual costs will be known by January 2009.

AG'S COMMENTS AND RECOMMENDATIONS

The AG agrees that LG&E's Hurricane Ike-related O&M expenses are extraordinary in nature and warrant regulatory asset treatment. However, the AG argues that LG&E has overstated its Hurricane Ike-related expenses by more than $1.4 million. Based upon the AG's own calculations and adjustments, LG&E's storm related expenses should amount to $22.7 million as opposed to the $24.1 million proposed by LG&E. The AG nonetheless concludes that both figures are extraordinary in magnitude, amounting to almost 4 percent of LG&E's total O&M

[3] See paragraph 16 on page 9 of LG&E's October 27, 2008 application.

[4] As of October 31, 2008, LG&E's actual costs were $18.1 million: response to Item 4.d. of Commission Staff's First Data Request.

expenses for the 12 months ended April 30, 2008, which is the test year in LG&E's pending rate case.[5]

The AG recommends three adjustments to the $24.1 million in O&M expenses included in LG&E's request to create a regulatory asset. The first of these adjustments is based on the internal labor costs of KU, which were charged to LG&E as a result of KU employees working on the restoration of service to LG&E's customers. The amount of KU labor charged to LG&E is $1,537,000 of which $756,000 has been identified as KU's estimated overtime labor for its involvement in Hurricane Ike-related activities for LG&E.[6] The AG claims the difference between these amounts, $781,000, should be recognized as an offset against LG&E's storm-related costs.

The two other adjustments relate to normally incurred labor costs which LG&E included as offsets against the labor costs it charged to expense for storm-related work. The amount to which the AG objects totals $661,000 and has been identified by LG&E as straight time labor costs it normally capitalizes.

The AG recommends that the appropriate amount of incremental expenses incurred by LG&E in connection with the service outages and restoration efforts in the wake of Hurricane Ike should be included in a regulatory asset account to be amortized to LG&E's ratepayers in future rates. However, the AG disagrees with

[5] Case No. 2008-00252, Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Base Rates, filed August 7, 2008.

[6] In its application in Case No. 2008-00457, Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset, KU included an offset against its storm-related costs for "KU labor / transportation charged to LG&E Storm" of $335,500.

LG&E's plan to propose that the resulting amortization expense be considered in the rate case presently pending before the Commission. The AG contends that LG&E should not be allowed to seek rate recovery of the deferred costs until its next rate case because it incurred the costs related to Hurricane Ike after the test year proposed in its current rate case.

In sum, the AG recommends that LG&E's request for the creation of a regulatory asset be approved with the cost amortized over five years for rate-making purposes, subject to his proposed adjustments and deferring the rate recovery until LG&E's next base rate case. The AG also recommends, consistent with past Commission rate-making practice, that there be no rate base treatment of the unamortized portion of the deferred cost.

DISCUSSION

LG&E's Hurricane Ike-related storm damage and service restoration costs are clearly extraordinary in nature and could have a significant impact on its financial results, depending on the accounting treatment they are afforded. The number of customers without electric service- more than 300,000 - dictated an extraordinary effort on the part of LG&E to restore service, an effort which resulted in it incurring an extraordinary level of costs. Based on the results of operations for the 12 months ended September 30, 2008, LG&E's estimate of $24.1 million in storm-related costs is equal to nearly 20 percent of its utility operating income for the period. Given the nature and impact of these costs on LG&E's 2008 financial statements, the Commission will authorize LG&E to establish a regulatory asset for accounting purposes based on its actual storm-related costs for its damages and service restoration incurred as a result of the Hurricane Ike-related storm.

LG&E has stated that if a regulatory asset is authorized, it intends to amortize the costs deferred as part of the regulatory asset for which it seeks authority and include the amortization expense for rate-making purposes in its pending rate case.[7] The Commission notes that it has initiated a review of how LG&E, KU, and other affected utilities responded to Hurricane Ike. The review is examining not only the efforts to restore electric power and telephone service, but also preparation for major outages, communication with customers and coordination with local governments. That review is currently ongoing. The Commission finds that LG&E's Hurricane Ike-related costs should not be considered for rate recovery until such time as it has completed its review of the utilities' disaster preparedness and storm restoration efforts.

The Commission will not adopt the AG's proposed adjustments to the amount included in the proposed regulatory asset. Whatever the appropriate amount of the offsets of normally incurred KU labor costs included in the labor costs KU charged to LG&E, those are normally incurred costs of KU, not LG&E. As such, those normally incurred labor costs will appropriately be offset against KU's storm-related costs.

As for the two adjustments related to amounts identified by LG&E as "straight time labor costs it normally capitalizes," the Commission agrees with the AG that the data response provided by LG&E to the AG's data request on this subject is

[7] Case No. 2008-00252, Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Base Rates, filed August 7, 2008.

confusing. The confusion, however, concerns the part of the data response which refers to "the straight time capital labor cost that would have been <u>expensed</u> by the employees during normal operations."[8] (Emphasis added). Given LG&E's need, which the AG has recognized, for a decision in this matter at a time that will allow LG&E to reflect the regulatory asset on its books for calendar year 2008, and understanding that opportunity for a more in-depth review of LG&E's Ike-related storm damage costs will occur in a future LG&E rate case, the Commission will make none of the AG's recommended adjustments in this case. Those adjustments, along with any others that may be subsequently raised, will be considered in a future LGE rate case in conjunction with a request for rate recovery of the deferred storm related expenses.

SUMMARY

We conclude that LG&E should be allowed to create and record a regulatory asset for accounting purposes in the amount of $24.1 million, which it proposed in its application. LG&E has stated that it will only seek recovery for actual costs incurred and not for any estimates or contingencies.[9] The actual amount of all costs which make up the asset will become known during the first quarter of 2009. A downward adjustment to the amount of the regulatory asset will be necessary if total actual costs are less than the $24.1 million asset authorized herein. In the event total actual costs exceed that amount, the amount of the regulatory asset will be capped at the $24.1

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[8] Item 3.c. of LG&E's December 4, 2008 response to the AG's supplemental data request.

[9] Item 2 of LG&E's November 19, 2008 response to Commission Staff's initial data request.

million we are authorizing with this Order. The Commission would not be meeting its regulatory responsibilities if, under the circumstances of unusual or extraordinary storm damage costs, it were to authorize the creation of an "open-ended" regulatory asset that did not limit the amount that could be included in the asset.

FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that:

1. LG&E's request for authority to establish a regulatory asset based on the costs it incurred for storm damages and service restoration due to the windstorm which much of Kentucky experienced on September 14, 2008, in the aftermath of Hurricane Ike is reasonable and should be approved.

2. LG&E may establish a regulatory asset in the amount of $24.1 million for its Hurricane Ike-related costs. This amount may be adjusted downward if LG&E's final actual costs are less than $24.1 million but is the maximum that may be included in the regulatory asset in the event the final actual costs exceed $24.1 million.

3. LG&E should file with the Commission the accounting entries it makes to establish and record the regulatory asset. LG&E should file these entries in the record of this case no later than January 31, 2009.

4. The issues of amortization and rate recovery of the regulatory asset authorized by the Order should not be considered until the Commission has completed its review of the disaster preparedness and storm restoration efforts.

IT IS THEREFORE ORDERED that:

1. LG&E is authorized to establish a regulatory asset in the amount of $24.1 million based on its costs for storm damages and service restoration due to the windstorm of September 14, 2008, in the aftermath of Hurricane Ike.

2. As its total actual Hurricane Ike-related costs become known, LG&E shall adjust the amount of the asset downward if the total is less than $24.1 million.

3. LG&E shall file the accounting entries it makes to establish and record the regulatory asset authorized herein as described in Finding No. 3 of this Order.

4. The issues of amortization and rate recovery of the regulatory asset authorized herein will not be considered until after the Commission completes its review of the disaster preparedness and storm restoration efforts of the utilities under its jurisdiction.

Done at Frankfort, Kentucky, this 22nd day of December, 2008.

By the Commission

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