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. 2016-00393

ORDER

On November 14, 2016, Louisville Gas and Electric Company ("LG&E") filed an application seeking to establish a regulatory asset for the expense associated with terminating an interest rate swap with Bank of America Merrill Lynch ("Bank of America"). An informal conference ("IC") was held on November 22, 2016, to discuss LG&E's application at which time Staff requested certain documentation related to the proceeding as outlined in Staff's November 28, 2016 IC memorandum. LG&E filed the requested information on November 30, 2016, and provided additional information on December 7, 2016, following the termination of the interest rate swap. There are no intervenors in this proceeding, and the matter now stands submitted to the Commission for a decision.

BACKGROUND

LG&E had a variable-rate $25 million tax-exempt bond with a put date of December 1, 2016, obligating it to repay the current owner of the bond. LG&E received Commission approval in Case No. 2003-00299 to issue the bond and enter into interest rate management agreements.[1] LG&E had the option to either remarket the bond to other investors or redeem it. In order to protect against the risk of higher interest rates, LG&E entered into the interest rate

[1] Case No. 2003-00299, *Application of Louisville Gas and Electric Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations* (Ky. PSC Sept. 16, 2003).

swap with Bank of America.[2] Pursuant to the terms of the Master Agreement entered into between LG&E and Bank of America, LG&E was obligated to pay a fixed rate of interest to Bank of America in return for a floating rate of interest based on a percentage of the London Interbank Offered Rate.[3] LG&E terminated the interest rate swap on December 1, 2016, and a one-time termination payment of $9.409 million was due from LG&E to Bank of America.[4] LG&E provided an analysis which demonstrated that redeeming the bond and terminating the interest rate swap had a net present value cost that was approximately $3.617 million lower than the alternative cost of remarketing the bond.[5]

In support of its proposal to establish a regulatory asset for the termination of the interest rate swap with Bank of America, LG&E states that it terminated an almost identical rate swap with Wachovia Bank, N.A. and was permitted to establish and amortize a regulatory asset for the cost associated with the termination of the interest rate swap agreement as a condition of the stipulation and settlement in Case No. 2009-00549.[6] LG&E also references Case No. 2012-00102,[7] wherein the Commission exercised its discretion to approve the creation of a regulatory

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[2] Application, paragraph 5.

[3] See the November 30, 2016, Response of LG&E to the Information Requested at the Informal Conference held on November 22, 2016, Item 5.

[4] See the Supplemental Response of LG&E to the Information Requested at the Informal Conference held on November 22, 2016, Item 3.

[5] *Id.*

[6] Case No. 2009-00549, *Application of Louisville Gas and Electric Company for an Adjustment of Electric and Gas Base Rates* (Ky. PSC July 30, 2010).

[7] Case No. 2012-00102, *Request of Shelby Energy Cooperative for Approval to Establish a Regulatory Asset in the Amount of $443,562.75 and Amortize the Amount over Five (5) Years* (Ky. PSC Apr. 16, 2012).

asset when a utility had incurred an extraordinary or nonrecurring expense that, over time, would result in savings that fully offset the cost.[8]

LG&E maintains that its decision to terminate the interest rate swap results in an extraordinary, nonrecurring expense that could not have reasonably been anticipated.[9] Furthermore, LG&E states that it enters into interest rate swaps for the benefit of its customers to hedge against rising interest rates that can occur with variable rate debt.[10] LG&E argues that if regulatory asset treatment is not permitted, the entire expense will affect its earnings at once, and the resulting negative financial impact is an unreasonable and inequitable outcome, given that the interest rate swaps were entered into to benefit customers.[11] Finally, LG&E states that in its recently filed rate case, it has requested authorization to amortize the regulatory asset established to reflect the estimated payment since the exact amount was not known at the time the application was filed.

DISCUSSION

Having reviewed the record and being otherwise sufficiently advised, the Commission finds that the cost associated with the termination of the interest rate swap agreement with Bank of America is an extraordinary, nonrecurring expense that could not have been reasonably anticipated and that the termination of the interest rate swap results in savings that fully offset the cost.

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[8] Application, paragraph 8.

[9] Application, paragraph 9.

[10] *Id.*

[11] *Id.*, paragraph 10.

The Commission has previously approved regulatory assets for LG&E and other jurisdictional utilities.[12] Such approval has been granted when a utility has incurred: (a) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (b) an expense resulting from a statutory or administrative directive; (c) an expense in relation to an industry-sponsored initiative; or (d) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[13]

LG&E's request to establish a regulatory asset for the cost associated with the termination of the interest rate swap with Bank of America appears to be consistent with the first and fourth categories identified above.[14] Based on the nature of the cost and the analysis provided by LG&E showing an overall cost benefit of terminating the interest rate swap, the Commission will authorize LG&E to establish, for accounting purposes only, a regulatory asset of $9.409 million. Finally, we note that LG&E's pending rate case, Case No. 2016-00371,[15] includes a request to amortize and recover in rates the regulatory asset as requested herein for the estimated cost to terminate the interest rate swap.

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[12] The Commission approved the establishment of regulatory assets for Asset Retirement Obligation-related depreciation and accretion expenses for LG&E and Kentucky Utilities Company when those utilities adopted Statement of Financial Standards No. 143, *Accounting for Asset Retirement Obligations*, respectively, in Case No. 2003-00426, *Application of Louisville Gas and Electric Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003), and Case No. 2003-00427, *Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003).

[13] Case No. 2008-00436, *The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*. (Ky. PSC Dec. 23, 2008), final Order at 4.

[14] Application, paragraphs 8 and 9.

[15] Case No. 2016-00371, *Electronic Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates and for Certificates of Public Convenience and Necessity*, filed Nov. 23, 2016.

IT IS THEREFORE ORDERED that:

1. LG&E is authorized to establish a regulatory asset of $9.409 million.

2. The regulatory asset account established in this proceeding is for accounting purposes only.

3. The amount of the regulatory asset authorized herein that is to be considered for recovery in rates in Case No. 2016-00371 is $9.409 million based on the actual termination payment due to Bank of America as a result of the interest rate swap termination.

By the Commission

ENTERED
DEC 14 2016
KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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