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October 27, 2008

RECEIVED

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PUBLIC SERVICE
COMMISSION

VIA HAND DELIVERY

Stephanie L. Stumbo
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

2008-00 457

RE: Application of Kentucky Utilities Company for an Order Approving the
Establishment of a Regulatory Asset

Dear Ms. Stumbo:

Enclosed please find and accept for filing the original and ten copies of Kentucky Utilities Company's Verified Application in the above-referenced matter. Please confirm your receipt of this filing by placing the stamp of your Office with the date received on the enclosed additional copies and return them to me in the enclosed self-addressed stamped envelope.

Should you have any questions please contact me at your convenience.

Sincerely,

W. Duncan Crosby III

WDC:ec

Enclosures

cc: Parties of Record in Case No. 2008-00251

400001.132420/548184.1

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

**APPLICATION OF KENTUCKY UTILITIES
COMPANY FOR AN ORDER APPROVING THE
ESTABLISHMENT OF A REGULATORY ASSET**

)
)
) **CASE NO. 2008-00457**
)
)

**VERIFIED APPLICATION OF
KENTUCKY UTILITIES COMPANY**

Kentucky Utilities Company ("KU" or "Applicant"), by counsel, hereby petitions the Kentucky Public Service Commission ("Commission") for an accounting order permitting KU to accumulate and defer for recovery in rate proceedings before the Commission its expenses incurred to repair damage and restore service to its customers following Hurricane Ike. In support of this Application, KU states as follows:

1. The full name and address of KU are: Kentucky Utilities Company, Post Office Box 32010, 220 West Main Street, Louisville, Kentucky 40232. KU is a Kentucky corporation authorized to do business in the Commonwealth of Kentucky.

2. KU is a utility engaged in the electric business. KU generates and purchases electricity, and distributes and sells electricity at retail in the following counties in Central, Northern, Southeastern and Western Kentucky:

Adair	Edmonson	Jessamine	Ohio
Anderson	Estill	Knox	Oldham
Ballard	Fayette	Larue	Owen
Barren	Fleming	Laurel	Pendleton
Bath	Franklin	Lee	Pulaski
Bell	Fulton	Lincoln	Robertson
Bourbon	Gallatin	Livingston	Rockcastle
Boyle	Garrard	Lyon	Rowan
Bracken	Grant	Madison	Russell
Bullitt	Grayson	Marion	Scott
Caldwell	Green	Mason	Shelby

Campbell	Hardin	McCracken	Spencer
Carlisle	Harlan	McCreary	Taylor
Carroll	Harrison	McLean	Trimble
Casey	Hart	Mercer	Union
Christian	Henderson	Montgomery	Washington
Clark	Henry	Muhlenberg	Webster
Clay	Hickman	Nelson	Whitley
Crittenden	Hopkins	Nicholas	Woodford
Daviess			

A certified copy of KU's Articles of Incorporation is on file with the Commission in Case No. 2005-00471, *In the Matter of: Application of Louisville Gas and Electric Company and Kentucky Utilities Company for Authority to Transfer Functional Control of their Transmission System*, filed on November 18, 2005, and is incorporated by reference herein pursuant to 807 KAR 5:001, Section 8(3).

3. This Application is filed pursuant to KRS 278.220, which authorizes the Commission to prescribe the accounting to be used by any public utility subject to its jurisdiction. The Commission requires KU to use and follow the Uniform System of Accounts ("USoA") as promulgated by the Federal Energy Regulatory Commission.

4. Communications regarding this Application should be addressed to:

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Senior Corporate Attorney
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5. On September 14, 2008, the remnants of Hurricane Ike blew through the service territories of KU and its sister utility, Louisville Gas and Electric Company (“LG&E”) (collectively, “Companies”), causing significant damage to the Companies’ distribution facilities and leaving hundreds of thousands of the Companies’ customers without power. Hurricane Ike made landfall on the Texas Gulf Coast on the morning of September 13, 2008, as a Category 2 Hurricane. By the late morning and afternoon of September 14, the extra-tropical remnants of Ike had moved to the Ohio Valley where they produced wind gusts to hurricane force. Gusts of up to 75 mph were recorded in Jefferson County, and gusts of up to 60 mph were recorded in Fayette County.

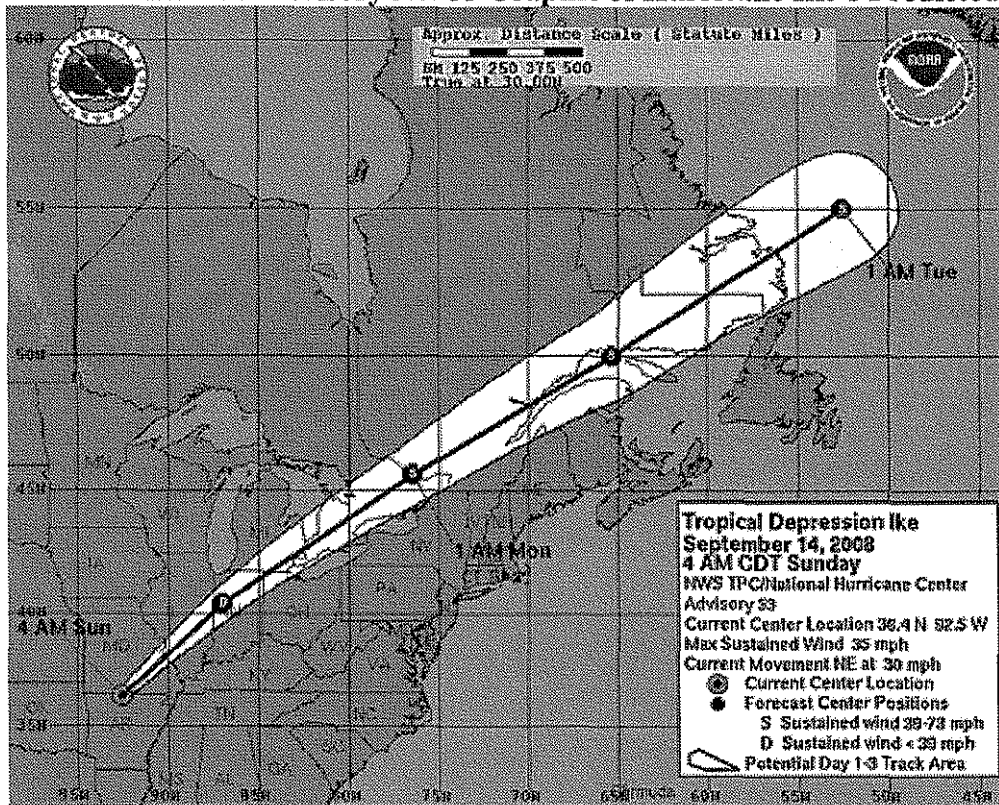
The September 14 windstorm caused the largest documented electric outage in the history of LG&E and widespread electric outages in areas served by KU. In the immediate aftermath of the windstorm, over 300,000 LG&E customers – approximately 75% of all LG&E customers – were without electricity. Likewise, the windstorm left 76,000 KU customers – approximately 15% of all KU customers – without electricity. To the best of the Companies’ knowledge, these service interruptions, combined with those experienced by the customers of other electrical utilities and cooperatives throughout Kentucky, constitute the largest power outage in the history of the Commonwealth. Indeed, the extent and severity of the damage caused Governor Beshear to declare a state of emergency in Kentucky on September 14, 2008, allowing federal assistance to be provided in thirty-three counties, most of which are in the Companies’ service territories.¹

6. The Companies fully utilized the best available resources to monitor the approaching extra-tropical remnants of Hurricane Ike. Those resources did not forecast anything resembling the hurricane-force winds experienced in the Ohio Valley. Rather, an extraordinary combination of atmospheric conditions created conditions that even the best weather prediction

¹ See <http://kyem.ky.gov/>.

resources did not identify far enough in advance to make a meaningful difference in the Companies' preparations. For example, in the morning hours immediately preceding the September 14 windstorm's arrival in the Companies' service territories, the National Weather Service was predicting winds not unusual for the region. As of 5:00 AM EDT, September 14, National Oceanographic and Atmospheric Administration ("NOAA") Advisory Number 53 (issued 4:00 AM CDT) predicted Hurricane Ike would be downgraded to a tropical depression with maximum wind speeds falling below 39 mph, which would pass to the north of Kentucky, as shown in the figure below:

Figure 1: NOAA/NWS Advisory No. 53 Graphic of Hurricane Ike's Predicted Path



The extra-tropical remnants of Hurricane Ike combined with a cold front crossing the Ohio Valley to cause extremely strong surface winds to blow through the KU and LG&E service

areas.² This resulted from very strong winds around 3000-6000 feet above the ground (50-80 mph), i.e., a low-level jet associated with and ahead of the remnants of Ike, being directed downward to the surface as surface heating (due to some sunshine) resulted in steep low-level lapse rates (temperatures decreasing rapidly with height from the surface to the level of these maximum winds). Such lapse rates allowed winds aloft to mix down to the surface causing the strong, damaging wind gusts. This phenomenon typically is common with severe thunderstorms, although in this case, there were no actual or forecast thunderstorms at all associated with the strong winds.

7. Although the storm's track and intensity were significantly different than forecasted, the Companies began their response quickly. Through the day-and-night efforts of the Companies' personnel and contractors beginning on September 14, the Companies were able to resume normal distribution operations on September 24. At their peak, these restoration efforts were carried out by 2,943 employees and contractors, which is the largest number of personnel the Companies have ever utilized in a service restoration effort. Among these were 14 LG&E and approximately 40 contractor line technicians, and a number of contract tree trimmers previously sent to assist with the Hurricane Gustav restoration effort in the Gulf Coast. On the night of September 14, the Companies contacted the utilities these personnel were assisting to advise that the personnel and resources the Companies had provided would need to leave on Monday morning to join the Companies' restoration effort.

8. Repairing such extraordinary, significant, and widespread damage was costly, and far exceeded average annual storm-related costs. KU currently estimates that its Hurricane Ike-related operations and maintenance costs will be approximately \$2.6 million. (A schedule

² NOAA National Weather Service – Wind storm of September 14, 2008;
http://www.crh.noaa.gov/lmk/?n=sep_14_08

detailing KU's Hurricane Ike repair costs charged to operation and maintenance expense is attached hereto as Exhibit 1.) These costs are estimates based on actual and estimated costs incurred to date and reasonable estimates of contingencies.

9. Because property and casualty insurance for distribution and transmission storm damage is prohibitively expensive, KU does not carry such insurance. As a result, KU has not received, and will not receive, any insurance proceeds to offset its Hurricane Ike damage costs.

10. KU's Hurricane Ike-related costs are extraordinary and far exceed the amount of storm damage cost currently embedded in base rates, \$1,442,144,³ or proposed to be included in KU's pending rate case, \$2,639,782.⁴ Moreover, KU's other storm damage costs for calendar year 2008, already over \$5.7 million in operations and maintenance costs, far exceed the amount embedded in base rates.

11. KU asks the Commission to permit it to accumulate as a regulatory asset and defer for future recovery its actual Hurricane Ike-related operations and maintenance costs in the appropriate accounts. The measures KU took to restore service, and the costs related thereto, were reasonable and prudent, and should therefore be recoverable as a necessary cost of providing electric service to KU customers. If approved, KU will hold its deferred costs in Account No. 182.3, Other Regulatory Assets, until such time as the Commission considers them in a rate proceeding.⁵

12. If the Commission grants KU's requested accounting treatment for its Hurricane Ike costs, it will have only a small impact on customers when the Commission subsequently

³ See *In the Matter of: An Adjustment of the Rates, Terms, and Conditions of Kentucky Utilities Company*, Case No. 2003-00434, Testimony of S. Bradford Rives at Exh. 1, Ref. Sched. 1.14 (Dec. 29, 2003); *In the Matter of: An Adjustment of the Rates, Terms, and Conditions of Kentucky Utilities Company*, Case No. 2003-00434, Order at 34-35 (June 30, 2004).

⁴ *In the Matter of: Application of Kentucky Utilities Company for an Adjustment of Base Rates*, Case No. 2008-00251, Testimony of S. Bradford Rives at Exh. 1, Ref. Sched. 1.18 (July 29, 2008).

⁵ KU anticipates that, if the Commission grants its requested accounting treatment of Hurricane Ike costs, KU will request amortization and rate recovery of those costs in KU's pending base rate proceeding.

approves amortization and rate recovery of the regulatory asset. For example, if the Commission approved a five-year amortization and recovery of KU's Hurricane Ike-related regulatory asset, a residential customer using 1,000 kWh per month would see a bill increase of less than \$1.00 per month.

13. The Commission has approved such treatment for extraordinary storm damages for each of the Companies in the past. In its June 30, 2004 Final Order in Case No. 2003-00434, the Commission allowed KU to defer and amortize the portion of its 2003 ice storm damage expenses that it had not already recovered through insurance payments and KU's Earnings Sharing Mechanism.⁶ In its order approving an increase in KU's base rates, the Commission addressed KU's request for deferral and amortization of its ice storm expenses, stating: "Given the nature and significance of the event, the Commission believes that KU's proposal to defer and amortize over 5 years the February 2003 ice storm [expenses] is reasonable."⁷

Likewise, in a 1975 LG&E rate case, the Commission approved nearly all of LG&E's proposed adjustments to operating revenue and expenses, including (1) a reduction in test year operating expenses of the total amount of expenses LG&E incurred to repair damage from the 1974 tornado, and (2) an increase to test year operating expenses of one-fifth that amount, representing one year's worth of a five-year amortization of tornado-related expenses.⁸

14. Granting such treatment in this case will allow KU to make appropriate adjustments on its books of account for the regulatory asset and prevent KU from having to record its extraordinary storm operations and maintenance costs as expenses on its books.

⁶ *In the Matter of: An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company*, Case No. 2003-00434, Order at 39-41 (June 30, 2004).

⁷ *Id.* at 40.

⁸ *In the Matter of: General Adjustments in Electric and Gas Rates of Louisville Gas and Electric Company*, Case No. 6220, Testimony of Joseph A. Steltenpohl at 10 and Exh. 7, Sched. D (Feb. 28, 1975).

Statement of Financial Standards (“SFAS”) No. 71, *Accounting for the Effects of Certain Types of Regulation*, addresses regulatory assets, states in relevant part:

Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

- a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.
- b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate adjustment clause, this criterion requires that the regulator’s intent clearly be to permit recovery of the previously incurred cost.

If at any time the incurred cost no longer meets the above criteria, that cost shall be charged to earnings.⁹

To comply with SFAS No. 71, KU respectfully requests the Commission to state explicitly in its order that it is authorizing KU to accumulate in a regulatory asset and defer for future recovery the actual amounts, and accruals for estimated amounts until actual costs can be determined, of extraordinary operations and maintenance expenses KU incurred to repair damage and restore service to customers following Hurricane Ike in a regulatory asset recorded in Account No. 182.3, Other Regulatory Assets.

15. If the Commission approves KU’s requested regulatory asset treatment of its Hurricane Ike-related operations and maintenance expenses, KU will perform the following journal entries:

⁹ Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation*, at ¶ 9 (2008).

Table 1: Journal Entries for Regulatory Asset Treatment of Hurricane Ike Expenses	
<u>Debits</u>	<u>Credits</u>
<ul style="list-style-type: none"> • Acct. 182.3 - Other Regulatory Assets 	<ul style="list-style-type: none"> • 58x - Electric Distribution Operations Expenses • 59x - Electric Distribution Maintenance Expenses • 907 - Customer Service & Informational Operations Expenses • 925 - Administrative & General Operations Expenses - Injuries and Damages

16. KU further requests that the Commission approve its requested accounting treatment at the earliest possible date, and no later than December 31, 2008, so that the Company can reflect the necessary adjustments on its books for the year ending December 31, 2008. This is necessary to avoid distortion in KU's financial statements, the accuracy of which it is important to maintain. If the Commission does not grant KU's requested relief until 2009, KU will have to record its Hurricane Ike-related operations and maintenance costs as expenses in 2008, artificially depressing its operating income in that year and artificially increasing it in calendar year 2009. To avoid such distortion to its financial records, KU respectfully requests the Commission to issue an order granting its requested relief no later than December 31, 2008.

WHEREFORE, Kentucky Utilities Company respectfully requests that the Commission issue an order at the earliest possible date, and no later than December 31, 2008, granting it authority to:

1. Accumulate and defer for future recovery the actual amounts and accruals for anticipated amounts of extraordinary operations and maintenance expenses KU incurred to repair

damage and restore service to customers following Hurricane Ike in a regulatory asset recorded in Account No. 182.3, Other Regulatory Assets; and

2. Apply the proposed accounting treatment to make appropriate adjustments on its books of account for the year ending December 31, 2008.

Dated: October 27, 2008

Respectfully submitted,



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Louisville, Kentucky 40202
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Counsel for Kentucky Utilities Company

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

SS:

The undersigned, **Valerie L. Scott**, being duly sworn, deposes and says she is Controller for Kentucky Utilities Company, that she has personal knowledge of the matters set forth in the foregoing testimony and exhibits, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

Valerie L. Scott

VALERIE L. SCOTT

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 27th day of October, 2008.

Kimberly M Walters (SEAL)

Notary Public

My Commission Expires:

9/11/2012

EXHIBIT 1
Ike Storm Restoration Estimate
September 14, 2008

	LG&E	KU
	O&M Expense	O&M Expense
Internal Employee Labor - LG&E Employees	\$ 2,294,228	\$ -
Internal Employee Labor - KU Employees	1,536,963	1,343,001
Internal Employee Labor - SERVCO Employees	754,490	39,266
<i>Subtotal Employee Labor</i>	<hr/> 4,585,681	<hr/> 1,382,267
Linemen Contractors	12,328,452	473,538
Tree Trimming Contractors	2,315,000	315,000
Public Safety Response Team (PSRT) Contractors	1,662,402	-
Call Center Contractors	100,000	
<i>Subtotal Contractors</i>	<hr/> 16,405,854	<hr/> 788,538
Materials / Other Non Labor Costs	2,075,404	252,456
Oil Spill Clean Up	20,000	470,000
Costs Associated with Tom Sawyer and Broadbent Arena Staging Areas for Contractors	107,437	-
Contingency	2,088,192	678,460
	<hr/>	<hr/>
Total Distribution Cost Projection (10/1 Estimate Used for September Accrual)	\$ 25,282,568	\$ 3,571,721
<u>Estimated Amount Considered Normal Operations:</u>		
Contractor Resource Costs - PSRT	(124,714)	(59,265)

EXHIBIT 1
Ike Storm Restoration Estimate
September 14, 2008

	LG&E O&M Expense	KU O&M Expense
Contractor Resource Costs - Operations	(149,418)	-
Contractor Resource Costs - Call Center	(20,000)	-
Internal Employee Resource Costs - LG&E Labor/Transportation charged to LG&E Storm	(625,565)	-
Internal Employee Resource Costs - KU Labor/Transportation charged to LG&E Storm	-	(335,459)
Internal Employee Resource Costs - SERVCO Labor/Transportation charged to LG&E Storm	(239,866)	(198,430)
Internal Employee Resource Costs - KU Labor/Transportation charged to KU Storm	-	(409,009)
Internal Employee Resource Costs - SERVCO Labor/Transportation charged to KU Storm	(12,352)	(14,156)
Total Estimated Amount Considered Normal Operations	(1,171,915)	(1,016,319)
Total Company Cost Projection - Net Impact	\$ 24,110,653	\$ 2,555,402

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Verified Application was served via U.S. mail, first-class, postage prepaid, this 27th day of October 2008 upon the following persons:

Dennis G. Howard II
Lawrence W. Cook
Assistant Attorneys General
Office of the Attorney General
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