COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| APPLICATION OF KENTUCKY UTILITIES COMPANY FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET | ) ) ) | CASE NO. 2008-00457 |

O R D E R

On October 27, 2008, Kentucky Utilities Company ("KU") filed an application seeking authority to establish a regulatory asset based on its operation and maintenance ("O&M") 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, KU states that 76,000 of its customers, or roughly 15 percent of KU's customer base, were without electricity as a result of the windstorm. KU also states that, at their peak, the service restoration efforts of it and its sister company, Louisville Gas and Electric Company ("LG&E"), involved more than 2,900 employees and contractors. KU further states that the $2.56 million cost of repairing the resulting damage exceeds the $1.44 million storm damage expense currently embedded in its base rates. Coupled with its other 2008 storm damage expenses of $5.7 million, KU argues that the additional cost of repairing the windstorm related damages will greatly exceed the $2.6 million storm damage cost it is currently proposing to be included in base rates in its pending rate case.[1]

[1] Case No. 2008-00251, Application of Kentucky Utilities Company for an Adjustment of Base Rates.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), and the Kentucky Industrial Utility Customers, Inc. ("KIUC") 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 KU. 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 KU and the AG on December 17, 2008. The case now stands submitted for decision.

KU APPLICATION AND POSITION

At the time of its application, KU estimated that its Hurricane Ike-related operation and maintenance costs would exceed $2.5 million. Citing the magnitude of these costs, KU requests permission to accumulate its actual Hurricane Ike-related costs as a regulatory asset and to defer such costs for future rate recovery. KU 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.

KU relies upon two prior Commission decisions granting similar accounting treatment to both KU and LG&E for extraordinary storm damages. In Case No. 2003-00434,[2] KU was allowed to defer and amortize a portion of its 2003 ice storm

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

damage expenses. In Case No. 6220,[3] LG&E was authorized to defer and amortize storm-related costs in the aftermath of the 1974 tornado.

In the instant case, KU claims that such accounting treatment will allow it to make appropriate adjustments on its books of account and prevent it from recording its extraordinary storm-related costs as expenses on its books for calendar year 2008.

KU 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, KU 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."[4] In its application and in responses to Commission Staff data requests, KU states that it will only seek recovery of actual costs incurred and not for any estimates of contingencies.[5] In its response to Commission Staff's supplemental data request, KU 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 actual costs will be known by January 2009.

## AG COMMENTS AND RECOMMENDATIONS

The AG asserts that KU's Hurricane Ike-related O&M expenses are not extraordinary and do not warrant regulatory asset treatment. The AG maintains that

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

[4] See paragraph 16 on page 9 of KU's October 27, 2008 application.

[5] As of October 31, 2008, KU's actual costs were approximately $2.0 million; response to Item 4.d. of Commission Staff's First Data Request.

the estimated $2.56 million of KU's Hurricane Ike-related expenses amount to only .30 percent of KU's total O&M expense for the 12-month period ended September 30, 2008. Based on this measurement, the AG concludes that KU's Hurricane Ike-related costs do not qualify as an extraordinary item warranting regulatory asset treatment.

Rather than permitting the creation of a regulatory asset, the AG recommends that the pertinent expenses should become part of KU's normalized storm damage expense adjustment starting in KU's next rate case.

Although the AG opposes the creation of a regulatory asset, he does comment on the amount of the asset proposed by KU and offers two adjustments which reduce the proposed amount by slightly more than $100,000, to approximately $2.45 million. The first adjustment 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 AG recommends that the $335,000 offset against KU's storm-related costs for the normal level of labor costs incurred for the KU employees involved in the LG&E service restoration effort should, instead, be an offset against LG&E's storm-related costs.

The AG's second adjustment relates to KU's normally incurred labor costs in the amount of $409,000 which KU included as an offset against the labor costs it charged to expense for storm-related work. The AG contends that $437,000 which has been identified as straight time labor which KU normally capitalizes should be added to the offset proposed by KU resulting in a total offset of $846,000.

Lastly, the AG recommends that KU should not be allowed to seek rate recovery of the requested deferred costs until its next rate case because it incurred the costs related to Hurricane Ike outside of the test year proposed in its currently pending rate case.

## DISCUSSION

KU's Hurricane Ike-related storm damage, customer service outages, and service restoration costs are significant. Together with its pre-Hurricane Ike-related 2008 storm damage costs, they reflect an amount roughly three times as much as KU proposes be included in rates in its pending rate case. While not as many customers were without power in the KU service territory as in LG&E's service territory, 76,000 is nonetheless a significant number of customers to be without electric service. The issue, in this instance, is whether the amount of storm-related costs is sufficiently significant to justify being capitalized, with the opportunity for future rate recovery, rather than being expensed in the year incurred. The Commission concludes that the impact of KU's Hurricane Ike-related storm damage costs is sufficiently significant to warrant the creation of a regulatory asset. Therefore, the Commission will authorize KU to establish a regulatory asset for accounting purposes based on its actual storm-related costs for its damages and service restoration incurred in conjunction with the Hurricane Ike-related storm of September 14, 2008.

KU has stated that if a regulatory asset is authorized, it intends to amortize the costs deferred and include the amortization expense for rate-making purposes in its pending rate case. 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 at this time. The Commission finds that LG&E's Hurricane Ike-related costs should not be considered for rate recovery until such time as the Commission's review of the utilities disaster preparedness and storm restoration efforts have been completed.

The Commission will not adopt the AG's proposed adjustments to the amount included in the proposed regulatory asset. The offset of normally incurred KU labor costs included in the costs KU charged to LG&E, are, as stated, costs normally incurred by KU, not LG&E. As such, those normal labor costs are correctly offset against KU's storm-related costs.

As for the adjustment related to amounts identified by KU as "straight time labor costs it normally capitalizes," the Commission agrees with the AG that KU's response to the AG's data request on this subject is confusing. The confusion, however, concerns the part of the response which refers to "the straight time capital labor cost that would have been <u>expensed</u> by the employees during normal operations."[6] (Emphasis added). Given KU's need for a decision in this matter at a time that will allow KU to reflect the regulatory asset on its books for calendar year 2008, and understanding that opportunity for a more in-depth review of KU's Ike-related storm damage costs will occur in a future KU rate case, the Commission will make none of the AG's recommended adjustments in this case. Those adjustments,

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[6] Item 3.c. of KU's December 4, 2008 response to the AG's supplemental data request. (Emphasis added).

along with any others that may be subsequently raised, will be considered in a future KU rate case in conjunction with a request for rate recovery of the deferred storm related expenses.

## SUMMARY

The Commission finds that KU should be allowed to create and record a regulatory asset for accounting purposes in the amount of $2.56 million, which it proposed in its application. KU has stated that it will only seek recovery for actual costs incurred and not for any estimates or contingencies.[7] 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 $2.56 million asset authorized herein. In the event total actual costs exceed that amount, the amount of the regulatory asset will be capped at the $2.56 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. KU'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

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[7] Item 2 of KU's November 19, 2008 response to Commission Staff's initial data request.

much of Kentucky experienced on September 14, 2008, in the aftermath of Hurricane Ike is reasonable and should be approved.

2. KU may establish a regulatory asset for accounting purposes in the amount of $2.56 million for its Hurricane Ike-related costs. This amount may be adjusted downward if KU's final actual costs are less than $2.56 million but is the maximum that may be included in the regulatory asset in the event the final actual costs exceed $2.56 million.

3. KU should file with the Commission the accounting entries it makes to establish and record the regulatory asset. KU 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 will not be considered until the Commission has completed its review of the disaster preparedness and storm restoration efforts of KU and other utilities under our jurisdiction.

IT IS THEREFORE ORDERED that:

1. KU is authorized to establish a regulatory asset for accounting purposes in the amount of $2.56 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, KU shall adjust the amount of the asset downward if the total is less than $2.56 million.

3. KU 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 shall be considered in a future base rate case 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

DISSENTING OPINION OF
VICE CHAIRMAN JAMES W. GARDNER

Because KU's Hurricane Ike-related costs of $2.5 million cannot be considered extraordinary, or significant, for a company the size of KU, I respectfully dissent and would deny KU's request to establish a regulatory asset based on the costs it incurred to restore service following Hurricane Ike. Through October 31, 2008, KU had incurred actual service restoration costs of $2 million and estimated that it would incur additional costs of approximately $550,000. The recording of such an amount as an expense in 2008 would not artificially depress KU's operating income for 2008 nor would it materially impair KU's overall financial condition. While such an expense would reduce KU's net income from what it otherwise would be, after recognizing the related income tax impact, KU's net income would be approximately $1.6 million less as a result of the costs related to Hurricane Ike. Accordingly, KU's costs associated with its Hurricane Ike restoration efforts are not sufficiently significant to warrant regulatory asset treatment.

James W. Gardner, Vice Chairman
Kentucky Public Service Commission

ATTEST:

Executive Director

Paul D Adams
Office of the Attorney General Utility & Rate
1024 Capital Center Drive
Suite 200
Frankfort, KY  40601-8204

Honorable W. Duncan Crosby III
Attorney at Law
Stoll Keenon Ogden, PLLC
2000 PNC Plaza
500 W Jefferson Street
Louisville, KY  40202-2828

Honorable Michael L Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OH  45202

Honorable Allyson K Sturgeon
Attorney at Law
E.ON U.S. Services, Inc.
220 West Main Street
Louisville, KY  40202