COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

GENERAL ADJUSTMENT IN ELECTRIC AND GAS RATES OF THE LOUISVILLE GAS AND ELECTRIC COMPANY	)))	CASE NO. 8616

ORDER ON REHEARING

On April 11, 1983, the Commission granted the Louisville Gas and Electric Company ("LG&E") a rehearing on three issues adjudicated in the Commission's Order entered March 2, 1983, on LG&E's general rate request. The rehearing, held on May 3 and 12, 1983, afforded LG&E the opportunity to present additional evidence in support of its position with respect to the partial denial of its labor adjustment, its level of coal inventory and a load forecasting consultant. Intervenors of record participated in the rehearing and three customers presented statements in opposition to LG&E's request.

LG&E presented evidence of the circumstances surrounding the negotiating of its labor contract in an attempt to justify the reasonableness of its 1982 wages increase of 10 percent for union and non-union non-exempt employees. These negotiations took place more than two years ago, and it was LG&E's contention that a 12 percent cap and a 10 percent minimum on future cost of living increases were reasonable and prudent decisions at that time under the circumstances of the negotiation. The

Commission's concern is that the 10 percent minimum became applicable at a time when the CPI was 5 percent, and under LG&E's proposed treatment would be borne entirely by the ratepayers who did not participate in or have any representation in the negotiations. When the cost of decisions are borne entirely by the ratepayers, there may be less incentive to negotiate vigorously than there would be in a competitive enterprise where the company's profits would be directly affected. It is not possible in the regulatory context to determine whether a competitive enterprise would have acted differently; however, one method of insuring that wage increases and other similar costs will not be looked at as items to simply be passed through to the consumer, is to attempt to treat the company as the market would. Given the general moderation of wage increases in the economy as a whole and the level of the Consumer Price Index, the Commission is of the opinion that this can be best done by applying the methodology adopted in the original Order, since in a competitive environment prices would reflect the costs borne by competitors, and would not automatically be increased to cover a higher cost experienced by one competitor. Therefore, the Commission affirms its Order entered March 2, 1983, with respect to the partial disallowance of LG&E's wage adjustment.

LG&E's rate application sought recovery of carrying charges associated with the test year end level of coal inventory which was a 118-day supply at a projected summer peak burn rate of 12,000 tons per day. The Commission's Order entered March 2, 1983, found this inventory level to be excessive. For ratemaking purposes the Commission utilized a 105-day supply, which is the midpoint of LG&E's goal of a 90 to 120-day supply, and LG&E's actual 13-month test year average burn rate of 9,247 tons per day. On rehearing, LG&E admitted that its test year end coal inventory was excessive and proposed the use of a target level of 105-day supply at the projected summer peak burn rate of 12,000 tons per day.

LG&E also presented evidence of its active efforts to manage its coal supply inventory. The Commission is pleased to know that LG&E has taken steps in this area but there is substantial room for additional management effort. In particular, the Commission expects LG&E to develop a formal cost-benefit analysis of its coal inventory level and to incorporate such an analysis in all future rate applications.

In spite of LG&E's efforts to manage its coal inventory, it still proposes to maintain a 105-day inventory sufficient to burn 12,000 tons per day when the actual burn rate was only 9,247 tons per day for the 13-month average test period. LG&E has failed to convince the Commission that it is reasonable to charge its customers for 105-day supply of coal at the projected summer peak burn rate of 12,000 tons per day. Therefore the Commission will affirm its finding that a 105-day coal supply at the 13-month average test year burn rate of 9,247 tons per day is reasonable for ratemaking purposes.

The rehearing with respect to the load forecasting consultant was granted conditioned upon LG&E's reassertion of any complaints within 10 days of a May 18, 1983, conference in Case No. 8666, An

Investigation Into Alternative Load Forecasting Methods and Planning Considerations for the Efficient Provision of Electric Generation and Transmission Facilities. LG&E appeared and participated in that conference on the load forecasting consultant. Since it did not reassert complaints within that period, LG&E has waived its right to a further evidentiary hearing on this issue. Accordingly, the Commission will affirm its Order entered March 2, 1983.

The Commission further finds that the load forecasting study mandated in this proceeding is closely related to the investigation to be performed in Case No. 8666 and that economies would be achieved by transferring the study to Case No. 8666.

Upon a review of the Commission's Order entered March 2, 1983, the Commission finds that a typographical error has resulted in the omission of two lines of text from page 29. The corrected page is attached to this Order and numbered 29A.

<u>Summary</u>

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. LG&E has failed to present sufficient evidence to support its arguments that its 1982 wage adjustment should be fully allowed as a ratemaking expense and that its test year end level of coal inventory is reasonable and proper.

2. LG&E has not reasserted any complaints regarding the load forecasting consultant within 10 days of the May 18, 1983, conference.

3. The Commission's Order entered March 2, 1983, should be modified by deleting page 29 and inserting page 29A, appended hereto.

IT IS THEREFORE ORDERED that the Commission's Order entered March 2, 1983, be and it hereby is modified in accordance with Finding No. 3 and affirmed in all other respects.

IT IS FURTHER ORDERED that the load forecasting study mandated in this proceeding by Order entered March 2, 1983, be and it hereby is transferred to Case No. 8666.

Done at Frankfort, Kentucky, this 5th day of July, 1983.

PUBLIC SERVICE COMMISSION

Chairman

Katherine Randall
Vice Chairman

Commissioner

ATTEST:

Secretary

between the composite cost of equity and Moody's AA-rated bond yields from 1975 to 1981 was 3.86 percentage points. 44/ Adding this spread to LG&E's bond yields produced the range of returns on equity proposed by Mr. Monteau. 45/ The supplement to Mr. Monteau's schedule 13 showed a cost of equity of 16.58 percent determined by FPC methodology and a spread between Moody's AA-rated bonds and the cost of equity of 2.63 percentage points. 46/ Due to improvements in the money markets, Mr. Monteau subsequently reduced his recommended range of returns on equity to 16 to 17 percent. 47/

Mr. Monteau primarily relied upon an interest rate sensitivity analysis, also known as a risk premium analysis. The spread he developed varied from a high of 4.71 percentage points in 1975 to a low of 2.03 percentage points during the 3 months ended August 31, 1982. 48/ Mr. Monteau did not perform a discounted cash flow analysis of any kind for LG&E. In response to a data request at the hearing, Mr. Monteau performed a discounted cash flow calculation for LG&E using the FPC methodology. For the 3 months ended October 1982, the indicated cost of equity for LG&E was 15.44 percent and the forecasted cost of equity was 15.39 percent. 49/ In his cost of equity analysis, Mr. Monteau made no allowance for the inclusion of 100 percent construction work in progress ("CWIP") in LG&E's rate base without an allowance for funds used during construction ("AFUDC") offset. Dr. Weaver stated that this treatment of CWIP made LG&E relatively less risky than a firm that did not include CWIP in the rate base or had an AFUDC offset. 50/ The price of LG&E's common equity has improved since the test year. Since the first quarter of