

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF GAS RATES FOR THE)
UNION LIGHT, HEAT, AND POWER COMPANY) CASE NO. 92-346

O R D E R

This matter arises upon the September 25, 1992 filing of a motion to dismiss by the Attorney General of the Commonwealth of Kentucky, by and through his Utility and Rate Intervention Division ("AG"). The basis for the motion to dismiss is that The Union Light, Heat and Power Company ("ULH&P") has chosen an historic test year ending June 30, 1992 and proposed certain pro forma adjustments in its rate application. The AG argues that the recently enacted KRS 278.192(1) provides for the use of only two types of test years, either entirely historical or a future test period. He states the use of an historical test year with pro forma adjustments, since not specifically authorized by the statute, is prohibited. The AG argues that an historical test year which includes pro forma adjustments, such as that filed by ULH&P, violates KRS 278.192(1) and (3) and that accordingly ULH&P's rate application should be dismissed. Intervenor, CO-EPIC, et al., joins in the AG's motion.

ULH&P filed a memoranda contra on October 15, 1992 responding that the statutory scheme set forth in Chapter 278 contemplates that fair, just and reasonable rates would be set by the Commission on a prospective basis. ULH&P further argues that the new

statutory provision cited in support of the AG's motion to dismiss does not address the propriety nor the impropriety of any adjustments to the test year, whether historic or future. ULH&P notes the Commission has traditionally permitted adjustments for known and measurable changes to test year data and that nothing in the newly enacted statute requires the Commission to reject any proposed adjustment.

After consideration of the motion to dismiss, the memoranda contra, matters of record and being otherwise sufficiently advised, the Commission finds that the motion to dismiss should be denied for the reasons set forth below.

KRS 278.192 recognizes the use of a test year either based upon historical or forecasted data. At issue before this Commission is the propriety of utilizing an historical test year with proposed pro forma adjustments. Generally, pro forma adjustments restate the test year for actual occurrences not expected to recur or for events that are expected to occur but which did not exist in the test year. Pro forma adjustments can include 1) normalizing adjustments which restate the test period for abnormal conditions; 2) annualizing adjustments which adjust for events that affect a partial period; 3) out of period adjustments which assign events to the proper period; 4) attritional adjustments which recognize changing conditions including known and measurable changes; and 5) reclassifications which move items above or below the line. These adjustments may be proposed by the utility or Intervenors or may be made by the

Commission when necessary to restate the test period to reflect normal conditions. When these adjustments are made, the rates set by the regulatory body will provide the utility the opportunity to sustain its operations under "normal" operating conditions.

Accepting arguendo the AG's position that the statute precludes any pro forma adjustments to the historic test year data, the resulting rate setting process would not comport with KRS 278.030 which provides that a utility may demand, collect and receive fair, just and reasonable rates. Under the AG's position, no adjustments would be permitted to normalize for abnormal conditions or events occurring during the test period. As an example, if in the historical test period a large industrial customer left the utility's system and no adjustment could be made to the utility's actual test period experience, the result would be an overestimation of future revenues and rates would be set too low. Conversely, if a large industrial customer were added during the historical test period and no adjustments could be made, future revenues would be underestimated and rates would be set in excess of the level needed to adequately compensate the utility. Either example would result in unfair, unjust and unreasonable rates. The same arguments could be made for other types of adjustments such as power plant maintenance, outside services, injuries and damages, weather normalization, etc. Surely, this is not the intended result of KRS 278.192.

The Commission sets rates prospectively. Rates should be designed to produce a fair and reasonable rate of return on used and useful utility properties after adjustments are made for known and measurable changes, normalization adjustments, reclassifications, etc. If the statute was construed to prohibit these adjustments, the rates set by the Commission would be valid only for the historic period under review. Rates could be insufficient or excessive due to known changes in conditions, occurring during or after the test year, which would have an impact on the period during which the rates are to be collected. Neither result would be fair, just, nor reasonable for the utility or its customers.

The Commission has substantial discretion in the treatment of rate issues and has traditionally accepted the use of an historic test period with adjustments to reflect appropriate known and measurable changes. KRS 278.192 contains no prohibition to the Commission's traditional practice. To construe the statute as advocated by the AG would be contradictory to the Legislature's intent in enacting KRS 278.192 and would be a drastic and unwarranted departure from past Commission practice which could result in utilities receiving, and customers paying, rates that are unfair, unjust and unreasonable.

On November 5, 1992, the AG filed a motion to hold this proceeding in abeyance pending a ruling on the motion to dismiss. Inasmuch as the Commission is denying the AG's requested dismissal, the motion to hold this proceeding in abeyance is also denied.

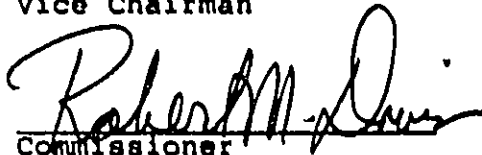
IT IS THEREFORE ORDERED that the motion to dismiss and motion to hold in abeyance be and they hereby are denied.

Done at Frankfort, Kentucky, this 12th day of November, 1992.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director