COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

JOINT APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY FOR AN ORDER APPROVING THE TRANSFER OF CERTAIN FINANCIAL ASSETS	))))	CASE NO. 2000-490

O R D E R

On November 7, 2000, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") filed a joint application for approval of the transfer of certain customer accounts receivable to subsidiary corporations. The petition was filed pursuant to commitments contained in Appendix A of the May 15, 2000 Order approving the merger of LG&E and KU with PowerGen plc.[1] However, LG&E and KU requested that if the Commission concludes that prior approval of the proposed transfer is not required under the terms of that Order, the Commission should declare that such approval is not required.

The only person requesting intervention was the Kentucky Industrial Utility Customers ("KIUC") and its request was granted by Order of November 21, 2000. At the request of the Applicants, the Commission conducted an informal conference on November 21, 2000. LG&E and KU stated at the conference that although their application requested approval of the sale of receivables by December 8, 2000, an

[1] Case No. 2000-095, Joint Application of PowerGen plc, LG&E Energy Corp., Louisville Gas and Electric Company, and Kentucky Utilities Company for Approval of a Merger, final Order dated May 15, 2000, Appendix A at 2, Commitment No. 8.

approval date of December 15, 2000 would still allow the sale to take place this year. A number of items of information was requested at the conference and the applicants filed their responses on November 30, 2000.

Under the proposed transaction, LG&E and KU will each sell a substantial majority of their retail customer accounts receivable to wholly owned subsidiaries who will then sell the receivables to financial institutions. Currently two banks have agreed to purchase the receivables for a 3-year term. Complete details of the transaction are contained in the application and exhibits.

LG&E and KU state that the sale of receivables will have no direct effect on customers. However, they indicate that the sale will benefit customers by reducing the applicants' future financing needs and increase their financial strength. The stated purpose of the program is to enable LG&E and KU to accelerate their receipt of cash from collection of customer accounts receivable, thereby reducing their dependence upon more costly sources of working capital. LG&E and KU state further that they will retain the ability to adjust or credit customer accounts after the receivables are sold, and the sale will have no direct or indirect effect on quality of service or their ability to satisfy customer demand. The relationships between LG&E and KU and their respective subsidiaries are designed so that LG&E and KU will receive all of the benefits from the transaction and the sales of receivables will qualify as off-balance sheet transactions, thereby producing the maximum benefits for LG&E and KU.[2]

On November 28, 2000, KIUC filed a motion to reject the application or, in the alternative, to establish a procedural schedule. The motion raised three issues. First,

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[2] Application at 3.

KIUC says that, contrary to the unsupported assertions in the application, the proposal will substantially harm ratepayers. KIUC contends that the proposal will raise the cost of capital by exchanging on-balance sheet financing for off-balance sheet financing and thereby increasing capital costs by lowering on-balance sheet debt. This will result in less sharing of excess earnings through LG&E's and KU's earnings sharing mechanism ("ESM"), and higher debt cost recovery through their environmental cost recovery mechanism ("ECR"). KIUC further argues that the loss that will be realized on the sale of the receivables, which consists of interest and bank fees reflected in the discount factor, will be recognized for accounting purposes in Account 930.2, which is an "above the line" operation and maintenance expense account, rather than a "below the line" interest expense account.

For its second issue, KIUC claims that by approving the proposed transaction, the Commission may unintentionally be ceding its jurisdiction and rate-making authority over the effects of the transaction in future rate-making proceedings, including the ESM and ECR. KIUC's third issue relates to LG&E's and KU's failure to include a provision to share any cost savings. KIUC contends that the cost savings of approximately $7.75 million annually should be reflected in the Applicants' revenue requirements pursuant to the ESM and ECR.

In the event the Commission decides to not reject the application, KIUC requests that a procedural schedule be established to allow for a thorough on-the-record review. KIUC also offered certain conditions that should be included in any order approving the transaction to prevent harm to ratepayers and to enable the proper quantification of the benefits in future ESM, ECR, and base rate proceedings.

On December 1, 2000, LG&E and KU filed a response to KIUC's motion. The response states that KIUC's motion is an attempt to muddy the record with erroneous rate-making contentions while ignoring the simple relief that the Applicants seek. LG&E and KU argue that the Commission for years has approved financing applications and certificates of convenience and necessity to construct generation facilities without any rate-making implications. The Applicants state further that approval of the proposed transaction would neither affect the Commission's ability to regulate them nor change the Commission's regulatory oversight of them. To remedy KIUC's concerns the Applicants propose that the Order approving the transaction state that such approval may not be construed to have any future rate-making implications.

On December 6, 2000, KIUC filed a reply. KIUC states that while it disagrees with the arguments in the response of LG&E and KU, an acceptable resolution of this case would be for the Commission to approve the transaction and state that the approval will have no future rate-making implications. KIUC would accept this approach provided that the burden of proof is not shifted to ratepayers in any future proceedings. This, in KIUC's point of view, could be accomplished by segregating the effects of the transaction and requiring LG&E and KU in future proceedings to prove that such effects are reasonable for rate-making purposes.

The Commission finds that the sale of customer accounts receivable does require prior Commission approval under the terms of the May 15, 2000 Order in Case No. 2000-095. The sale of receivables over the next 3 years may result in cost savings for LG&E and KU, and such savings will benefit ratepayers. The transaction will be approved on a 3-year pilot basis on the condition that it does not result in any limitations on the Commission's future rate-making treatment of the revenues and expenses flowing from the transaction. This is consistent with past practice in that cases involving approval of transfer of assets, approval of financing, and approval of construction, do not generally contain rulings on the future rate-making treatment of the capital authorized or the assets constructed or acquired. In this instance, the Commission will approve the transaction with the condition that nothing in this Order precludes an intervenor or the Commission from investigating the rate-making impact of this transaction in the future and adjusting rates as necessary.

In the event that LG&E and KU decide to continue selling their respective receivables beyond the 3-year term approved herein, an application for authority to continue the transaction should be filed by July 1, 2003. That application should include a report of the effectiveness of the transaction including, but not limited to, a cost benefit analysis.

The Commission is also concerned that the transfer of accounts receivable without recourse to a nonregulated affiliate could limit our authority to enforce the revenue collection and discontinuation of service policies established by Commission regulation. LG&E and KU state that the subsidiaries purchasing the receivables will bear the risk of the uncollectibility of receivables, but will retain limited recourse against LG&E and KU. The transaction will be approved on the additional condition that the Commission's regulations regarding collection and termination of customer accounts will be adhered to in all respects by LG&E and KU and their respective subsidiaries as if no receivables had been sold, and there will be no limitation on the Commission's jurisdiction over collections and terminations due to the transaction. LG&E and KU must obtain prior Commission approval of any changes in billing, collection, and termination of service policies whether implemented by themselves or their subsidiaries.

The Commission also notes that the evidence demonstrates that the extent to which LG&E and KU will realize savings from this transaction may be minimal. Therefore, LG&E and KU should sell their respective receivables only if the sale results in no net increase in costs to ratepayers. In any future rate proceedings the burden will be on LG&E and KU to demonstrate that there will be no net increase in costs as a result of selling receivables.

Finally, the Commission has reviewed the proposed accounting for the transaction and finds that LG&E's and KU's proposal to record the interest and bank fees associated with the sale in Account No. 930.2 is inappropriate. Based upon a review of the Uniform System of Accounts, the Commission believes the interest costs associated with the sale of receivables should be recorded in Account No. 431, Other Interest Expense. Further, the Commission believes that the bank fees and other associated costs should be recorded in an account within the Other Income and Deductions category of the Uniform System of Accounts, account series 415 through 426.5. The Commission will leave the determination of the specific account within that category to LG&E's and KU's discretion. Regardless of the accounts used to record the interest, bank fees, and other costs associated with the sale of the receivables, LG&E and KU should maintain their records in such a manner that the effects of the transaction can readily be determined.

IT IS THEREFORE ORDERED that:

1. A 3-year transfer of the assets as described in the application of LG&E and KU is approved as a pilot program upon the conditions that:

a. Nothing in this Order shall preclude an intervenor or the Commission from investigating the rate-making impact of this transaction in the future and adjusting rates as necessary.

b. LG&E and KU and their respective subsidiaries shall adhere to the Commission's regulations regarding collection and termination of customer accounts in all respects as if no receivables had been sold.

c. There shall be no limitation on the Commission's jurisdiction over collections and terminations due to this transaction. LG&E and KU shall obtain prior Commission approval of any changes in billing, collection, and termination of service policies whether implemented by themselves or their subsidiaries.

d. LG&E and KU shall sell their respective receivables only if the sale results in no net cost increases to ratepayers. The burden shall be on LG&E and KU to demonstrate in future proceedings that there is no net increase in costs as a result of the Commission's approval of this petition.

e. LG&E and KU shall file an application no later than July 1, 2003 for approval to extend the 3-year term of the pilot program approved herein. Such application shall include the report described in the findings above.

2. LG&E's and KU's proposal to record the costs associated with the sale of receivables in Account No. 930.2 is denied. LG&E and KU shall record these costs in the accounts described within this Order.

Done at Frankfort, Kentucky, this 13th day of December, 2000.

By the Commission

ATTEST:

Executive Director