COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

LOUISVILLE GAS AND ELECTRIC COMPANY S ANNUAL EARNINGS SHARING MECHANISM FILING FOR CALENDAR YEAR 2002	)))	 CASE NO. 2003-00076

O R D E R

On February 28, 2003, Louisville Gas and Electric Company (LG&E) filed its third annual Earnings Sharing Mechanism (ESM) calculations. LG&E s current ESM filing covers its financial results from the 2002 calendar year. LG&E determined that its rate of return on common equity for calendar year 2002 was 7.56 percent,[1] which is below the lower limit of the deadband in the ESM mechanism. Based on the results for calendar year 2002, LG&E calculated that under its ESM it was entitled to collect $13,630,202 from ratepayers during the period April 2003 through March 2004.[2] LG&E

[1] Annual ESM Filing for calendar year 2002, filed February 28, 2003, Form 1c.

[2] In the February 28, 2003 filing, LG&E determined that $13,646,758 needed to be collected from ratepayers. On April 16, 2003, LG&E filed calculations reflecting the balancing adjustment for the 2001 ESM mechanism. The balancing adjustment was a reduction of $16,519. On May 22, 2003, LG&E filed a revised ESM calculation for calendar year 2002, which corrected errors discovered while responding to data requests. In the May 22, 2002 filing, LG&E reflected the impact of combining the balancing adjustment for 2001 with the revised 2002 ESM mechanism calculations. This results in the total to be collected from ratepayers of $13,630,202. See Annual Earnings Sharing Mechanism Balancing Adjustment, Form 1a, filed April 16, 2003.

began collecting the $13,630,202 through a monthly ESM factor applied to bills rendered on and after April 1, 2003.[3]

The Attorney General, by and through his Office of Rate Intervention (AG), and the Kentucky Industrial Utility Customers, Inc. (KIUC) sought and were granted intervention in this proceeding.

On April 17, 2003, the Commission issued an Order establishing a procedural schedule that provided for data requests and an informal conference. On July 29, 2003, the Commission ordered the intervenors to file by August 21, 2003 either verified prepared testimony, a request for an evidentiary hearing, or a request to submit this case for adjudication based on the existing record without an evidentiary hearing. All of the intervenors requested to submit the case based on the existing record, and no objections were filed to any of LG&E s calculations. Therefore, the case is ready for decision.

BACKGROUND

LG&E s ESM was established as part of the Commission s Order in Case No. 1998-00426.[4] Under the ESM mechanism, a deadband was established in the

[3] The ESM Factor shown in the February 28, 2003 filing was 2.323 percent. This factor was applied to customer bills for 1 month. The April 16, 2003 filing, which reflected the impact of the balancing adjustment from the 2001 ESM calculations, resulted in a new ESM Factor of 2.320 percent. The May 22, 2003 filing reflected the correction of errors in the ESM calculations submitted in the February 28, 2003 filing. However, the correction of the errors did not result in a change in the ESM Factor of 2.320 percent. See Annual ESM Filing for calendar year 2002, filed February 28, 2003, Form 1; Annual Earnings Sharing Mechanism Balancing Adjustment filed April 16, 2003, Form 1a; and Revised Annual ESM Filing for calendar year 2002, filed May 22, 2003.

[4] Case No. 1998-00426, Application of Louisville Gas and Electric Company for Approval of an Alternative Method of Regulation of Its Rates and Service, final Order dated January 7, 2000.

range of 100 basis points above and 100 basis points below the 11.5 percent rate of return on common equity authorized in that case. When the rate of return on common equity achieved in a calendar year is above the deadband, LG&E must return to ratepayers 40 percent of the amount by which its actual earnings exceed its earnings at the upper limit of the deadband. When the rate of return on common equity achieved in a calendar year is below the deadband, LG&E is permitted to collect from ratepayers 40 percent of the amount by which its actual earnings fall below the level of earnings at the lower limit of the deadband.

LG&E determined that its ESM-adjusted net operating income for calendar year 2002 was $76,758,790, while the lower limit of the deadband reflected a net operating income of $97,066,843.[5] Under the ESM, 40 percent of the earnings deficit is to be recovered from LG&E s ratepayers. The ratepayers share of the earnings deficit, after grossing up for taxes and recognition of the 2001 balancing adjustment, results in a collection from ratepayers of $13,630,202 during the period of April 1, 2003 through March 31, 2004.[6]

[5] Revised Annual ESM Filing for calendar year 2002, filed May 22, 2003, Form 1.

[6] Id., Form 1 and Form 1a. The earnings deficit was $20,308,054, which is the difference between the ESM-adjusted net operating income of $76,758,790 and the net operating income reflected by the lower limit of $97,066,843. The ratepayers share of the earnings deficit is 40 percent of the $20,308,054 or $8,123,222. The ratepayers share is grossed up for taxes using a factor of .595251, which results in a revenue adjustment of $13,646,721. The balancing adjustment from calendar year 2001, a reduction of $16,519, is subtracted from the revenue adjustment, resulting in the final revenue adjustment to be collected from ratepayers of $13,630,202.

ANALYSIS

The Commission has examined LG&E s ESM filings for calendar year 2002 and the ESM-related adjustments made to the 2002 operations and finds that they are accurate and consistent with the Commission s decisions in LG&E s two previous ESM annual filings. Therefore, the Commission finds that the ESM factor of 2.320 percent should be approved as determined by LG&E.

The Commission notes that LG&E s ESM was established for a 3-year period with the intent that it would create an incentive to LG&E to improve its performance. Having now seen the results of LG&E s performance over the past 3 years, the Commission is unsure if the ESM is actually providing the incentive that was intended. While LG&E s ESM earnings in 2000 exceeded $122.0 million, and in 2001 exceeded $105.7 million, they dropped precipitously in 2002 to under $76.8 million. Although LG&E s performance under its ESM is a significant concern, another docket has already been initiated to review the question of whether LG&E s ESM should be extended. Thus, we will focus on these concerns in that docket.

IT IS THEREFORE ORDERED that:

1. LG&E s ESM calculations for calendar year 2002 are accurate and consistent with previous ESM filings.

2. The revised ESM factor of 2.320 percent is approved.

Done at Frankfort, Kentucky, this 20th day of November, 2003.

By the Commission

ATTEST:

Executive Director