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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND)
ELECTRIC COMPANY, INC. FOR AN)
ORDER APPROVING THE ESTABLISHMENT) CASE NO. 2008-00456
OF A REGULATORY ASSET)

ATTORNEY GENERAL'S FINAL COMMENTS AND RECOMMENDATIONS

BACKGROUND

On October 27, 2008, Louisville Gas & Electric Company ("LG&E" or "Company") petitioned the Kentucky Public Service Commission ("Commission" or "PSC") for an Accounting Order permitting the Company to accumulate and defer for recovery in rate proceedings before the Commission incremental expenses incurred to repair damage and restore service to its customers following Hurricane Ike.

On September 14, 2008, the remnants of Hurricane Ike hit the service territories of LG&E and its sister utility, Kentucky Utilities Company ("KU"), causing significant damage to the Companies' distribution facilities and leaving many of the Companies' customers without power.

LG&E currently estimates that its incremental Hurricane Ike-related operation and maintenance ("O&M") expenses will be approximately $24.111 million. This total O&M expense amount is based on actual and estimated costs incurred to date and reasonable estimates of contingencies.[1]

Due to the very high costs of insurance premiums covering storm damage to distribution and transmission systems, LG&E declined to carry such insurance. As a result, LG&E has not received, and will not receive, any insurance proceeds to offset its Hurricane Ike damage costs.

[1] While the current O&M expense estimate includes estimated expenses and contingencies, the Company will only seek recovery for actual costs incurred and not for any estimates or contingencies. The Company anticipates that the majority of actual costs will be known in early January 2009 with final actual costs known on or about March 31, 2009 (response to PSC-2-3)

It is LG&E's position that the Hurricane Ike-related incremental O&M expenses of $24.111 million should receive deferral and amortization treatment because these expenses are to be considered extraordinary.

LG&E has proposed that the deferred storm damage expenses be amortized in rates over a 5-year period, starting with the rate effective date of its pending rate case, Case No. 2008-00252.

SUMMARY OF ATTORNEY GENERAL'S RECOMMENDATIONS

Based on his analysis of the issues in this proceeding, the Attorney General has the following recommendations:

1. LG&E's claimed incremental Hurricane Ike-related O&M expense amount of $24.111 is overstated and, on a corrected basis, should amount to $22.668 million – see Schedule AG-1 (LGE).

2. LG&E's incremental Hurricane Ike-related O&M expense amount (whether the Company-claimed amount of $24.111 million or the corrected amount of $22.668 million) should be considered extraordinary and warrants Regulatory Asset treatment. The PSC should issue an Accounting Order for the deferral and future amortization of LG&E's incremental Hurricane Ike-related O&M expenses.

3. The incremental Hurricane Ike-related O&M expense amount was incurred in September 2008, 5 months beyond the end of the test year ended April 30, 2008 in LG&E's pending rate case, Case No. 2008-00252. It therefore represents an "out-of-period" event for which the cost should not be recognized for ratemaking purposes in Case No. 2008-00252.

4. The Attorney General recommends that the Regulatory Asset for LG&E's appropriate Hurricane Ike-related O&M expense amount be amortized in rates over a 5-year period with no rate base treatment for the unamortized balance, to become effective in LG&E's next base rate case.

DISCUSSION OF RECOMMENDATIONS

1. *LG&E's claimed incremental Hurricane Ike-related O&M expense amount of $4.111 million is overstated and, on a corrected basis, should amount to $22.668 million – see Schedule AG-1 (LGE).*

As shown in the first column of the attached Schedule AG-1 (LGE), lines 1 – 15, LG&E has claimed a total gross O&M expense of $25,282,568, consisting of internal labor costs for LG&E, KU and SERVCO employees; outside contractor costs; and various other costs, including a contingency cost. LG&E then determined that of this total gross O&M expense amount of $25,282,568, an amount of $1,171,915 does not represent real incremental costs as these costs are already embedded in LG&E's current rates. Thus, the net incremental Hurricane-Ike related cost amount claimed by LG&E is $24,110,653 ($25,282,568 - $1,171,915).

The Attorney General recommends that three adjustments be made to LG&E's proposed cost offsets of $1,171,915. These three adjustments have the effect of increasing the cost offsets from $1,171,915 to $2,614,165 and decreasing the net incremental storm costs from $24,110,653 to $22,668,403.

The first recommended adjustment increases LG&E's proposed cost offset for internal LG&E labor from $625,565 to $1,189,749. LG&E has proposed storm related internal LG&E labor expenses of $2,294,228 [see Schedule AG-1 (LGE), line 1] and corresponding offsetting cost credits of $625,565 for LG&E labor costs that are presumed to be included in LG&E's current rates [see Schedule AG-1 (LGE), line 17]. As explained in its response to AG-2-3(a)(b), the $1,668,663 difference between the total storm damage related internal LG&E labor cost of $2,294,228 and the $625,565 LG&E labor costs already embedded in LG&E's rates consists of $1,104,479 for estimated incremental overtime expenses and $564,184 for "estimated straight time labor costs that are normally capitalized." The difference between the total storm damage related internal LG&E labor cost of $2,294,228 and the LG&E labor costs already embedded in LG&E's rates should only be $1,104,479 for the incremental overtime expenses; therefore, the offset for labor costs already embedded in LG&E's current rates should amount to $2,294,228 less $1,104,479, or $1,189,749. The Attorney General does not believe that the Company's proposal to also treat as incremental costs the estimated $564,184 for *straight time labor costs that were booked as O&M expense during the storm repairs* but are capitalized under normal operations is reasonable or appropriate. The Company's explanation of the derivation of this $564,184 item in its response to AG-2-3(c) is not only confusing, but also inadequately supported. The Attorney General believes that the $564,184 cost item proposed by the Company is not sufficiently known and measurable to be considered as an incremental storm-related expense.

The second recommended adjustment is that a cost credit of $781,172 should be applied to LG&E's claimed cost of $1,536,963 for internal KU labor costs charged to LG&E due to Hurricane Ike. As shown on Schedule AG-1 (LGE) lines 2 and 18, while LG&E has claimed the internal KU labor costs of $1,536,963, it has not reflected a cost offset for the internal KU labor charges already embedded in KU's rates. As shown in the response to AG-2-4(a)(b) in KU's Case No. 2008-00457, the cost credit should be the difference between $1,536,963 and the estimated incremental overtime expense of $755,791, or an amount of $781,172.

The third recommended adjustment increases LG&E's proposed cost offset for internal SERVCO labor from $239,866 to $336,760. LG&E has proposed storm related internal SERVCO labor expenses of $754,490 [see Schedule AG-1 (LGE), line 3] and corresponding offsetting cost credits of $239,866 for SERVCO labor costs that are presumed to be included in LG&E's current rates [see Schedule AG-1 (LGE), line 19]. As explained in its response to AG-2-3(e), the $514,624 difference between the total storm damage related internal SERVCO labor cost of $754,490 and the $239,866 SERVCO labor costs already embedded in LG&E's rates consists of $417,730 for estimated incremental overtime expenses and $96,894 for "estimated straight time labor costs that are normally capitalized." The difference between the total storm damage related internal SERVCO labor cost of $754,490 and the SERVCO labor costs already embedded in LG&E's rates should only be $417,730 for the incremental overtime expenses; therefore, the offset for SERVCO labor costs already embedded in LG&E's current rates should amount to $754,490 less $417,730, or $336,760. The Attorney General does not believe that the Company's proposal to also treat as incremental costs the estimated $96,894 for straight time labor costs that were booked as O&M expense during the storm repairs but are capitalized under normal operations is reasonable or appropriate. The Company's explanation of the derivation of this $96,894 item in its response to AG-2-3(f) is not only confusing, but also inadequately supported. The Attorney General believes that the $96,894 cost item proposed by the Company is not sufficiently known and measurable to be considered as an incremental storm-related expense.

2. *LG&E's incremental Hurricane Ike-related O&M expense amount (whether the Company-claimed amount of $24.111 million or the corrected amount of $22.668 million) should be considered extraordinary and warrants Regulatory Asset treatment. The PSC should issue an Accounting Order for the deferral and future amortization of LG&E's incremental Hurricane Ike-related O&M expenses.*

Whether one considers LG&E's claimed incremental Hurricane Ike-related O&M expense amount of $24.111 million or the Attorney General's recommended corrected cost balance of $22.668 million, both represent cost amounts of such magnitude that they should be considered extraordinary. Both amounts are almost 4% of LG&E's total O&M expenses of approximately $617 million for the 12-month period ended April 30, 2008.

The Attorney General therefore agrees with LG&E's proposal to include the appropriate amount of incremental Hurricane Ike-related in a Regulatory Asset account to be amortized in future rates to LG&E's ratepayers.

In order for LG&E to be able to book the Regulatory Asset in the year that the Hurricane Ike-related cost was incurred, the Attorney General also recommends that the Commission issue the Accounting Order for the cost deferral no later than December 31, 2008.

3. *The incremental Hurricane Ike-related O&M expense amount was incurred in September 2008, 5 months beyond the end of the test year ended April 30, 2008 in LG&E's pending rate case, Case No. 2008-00252. It therefore represents an "out-of-period" event for which the cost should not be recognized for ratemaking purposes in Case No. 2008-00252.*

LG&E has proposed that the Hurricane Ike-related cost amount be deferred as a Regulatory Asset and amortized in rates over a 5-year period starting with the rate effective date of its pending rate case, Case No. 2008-00252.

LG&E argues that this proposed treatment is consistent with the Commission-approved ratemaking treatments of the costs associated with KU's February 2003 ice storm and LG&E's 1974 tornado. For both the KU 2003 ice storm costs and LG&E 1974 tornado costs, the Commission approved deferral and 5-year rate amortization treatment in the KU and LG&E base rate cases that were ***then*** pending.

However, KU's February 2003 ice storm cost and LG&E's 1974 tornado costs occurred within, and were included as O&M expenses in, the test years of the ***then-pending*** KU and LG&E base rate cases. For that reason, the Commission ruled that these non-recurring expenses should be removed from the test year O&M expenses in those rate cases and, instead, ordered that these expenses be deferred and amortized over 5 years.

The circumstances surrounding the Hurricane Ike-related costs are different than those present for the above-referenced KU ice storm and LG&E tornado costs. Specifically, the Hurricane Ike-related costs are not included in the test year in LG&E's current rate case, Case No. 2008-00252. Rather, they were incurred in September 2008, almost 5 months after the April 30, 2008 test year-end in LG&E's current rate case. They therefore represent "out-of-period" costs that did not exist during the test year and should not receive rate recognition because to do so would violate the important principle that all ratemaking components should be appropriately matched within the context of a test year.

In summary, while the AG recommends that a Regulatory Asset be established for LG&E's Hurricane Ike-related cost, the amortization of this Regulatory Asset should not be reflected in the rates to be established in LG&E's current rate case; rather this rate amortization should start with the rate effective date of LG&E's next rate case.

4. *The Attorney General recommends that the Regulatory Asset for LG&E's appropriate Hurricane Ike-related O&M expense amount be amortized in rates over a 5-year period with no rate base treatment for the unamortized balance, to become effective in LG&E's next base rate case.*

For the reasons explained in the previous recommendation number 3, because the Hurricane Ike-related costs represent "out-of-period" costs, they should not be recognized for ratemaking purposes in LG&E's current base rate case. However, the Company has indicated that it will likely file another rate case in 2010 to recover costs related to Trimble County Unit 2. In that next base rate case, LG&E will have the opportunity to reflect in rates the amortization of the deferred Hurricane Ike-related cost.

The Attorney General agrees with LG&E's proposed 5-year amortization period of the deferred cost. In accordance with prior Commission rate making policy, the Attorney General also recommends no rate base treatment for the unamortized deferred cost.

Respectfully submitted,
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Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Stephanie Stumbo, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

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