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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY UTILITIES)
COMPANY FOR AN ORDER APPROVING THE) CASE NO. 2008-00457
ESTABLISHMENT OF A REULATORY ASSET)

ATTORNEY GENERAL'S FINAL COMMENTS AND RECOMMENDATIONS

BACKGROUND

On October 27, 2008, Kentucky Utilities Company ("KU" 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 KU and its sister utility, Louisville Gas & Electric Company ("LG&E"), causing significant damage to the Companies' distribution facilities and leaving many of the Companies' customers without power.

KU currently estimates that its incremental Hurricane Ike-related operation and maintenance ("O&M") expenses will be approximately $2.555 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, KU declined to carry such insurance. As a result, KU has not received, and will not receive, any insurance proceeds to offset its Hurricane Ike damage costs.

It is KU's position that the Hurricane Ike-related incremental O&M expenses of $2.555 million should receive deferral and amortization treatment because these expenses are to be considered extraordinary.

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[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)

KU 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. 2008-00251.

SUMMARY OF ATTORNEY GENERAL'S RECOMMENDATIONS

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

1. KU's claimed incremental Hurricane Ike-related O&M expense amount of $2.555 should not be combined with LG&E's claimed incremental Hurricane Ike-related O&M expense amount of $24.111 million in considering whether the $2.555 million expense is extraordinary enough to warrant Regulatory Asset treatment.

2. KU's claimed incremental Hurricane Ike-related O&M expense amount of $2.555 is overstated and, on a corrected basis, should amount to $2.453 million – see Schedule AG-1 (KU).

3. KU's incremental Hurricane Ike-related O&M expense amount (whether the Company-claimed amount of $2.555 or the corrected amount of $2.453 million) is not extraordinary and does not warrant Regulatory Asset treatment. The PSC should not issue an Accounting Order for the deferral and future amortization of KU's incremental Hurricane Ike-related O&M expenses.

4. 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 KU's pending rate case, Case No. 2008-00251. It therefore represents an "out-of-period" event for which the cost should not be recognized for ratemaking purposes in Case No. 2008-00251.

5. Rather than permitting the incremental Hurricane Ike-related storm damage expense to be treated as a Regulatory Asset, the expense should become part of KU's normalized storm damage expense adjustment starting in KU's next base rate case.

DISCUSSION OF RECOMMENDATIONS

1. *KU's claimed incremental Hurricane Ike-related O&M expense amount of $2.555 million should not be combined with LG&E's claimed incremental Hurricane Ike-related O&M expense amount of $24.111 million in considering whether the $2.555 million expense is extraordinary enough to warrant Regulatory Asset treatment.*

In its Petition and in its responses to various data requests, KU is presenting the magnitude of the incremental Hurricane Ike-related costs on a combined basis for both KU and LG&E. For example, in its response to PSC-2-2, KU talks about the "27 million in operations and maintenance expenses associated with Hurricane Ike." In its consideration of KU's and LG&E's petitions for Regulatory Asset treatment of their respective Hurricane Ike-related costs, the Commission should address KU's claimed cost amount of $2.555 million separately from LG&E's claimed cost amount of $24.111 million. While KU and LG&E may be sister companies with a common parent company, they are separate operating entities and the Hurricane Ike-related costs should be separately addressed by the Commission in its determination as to whether the separate cost claims should be considered extraordinary.

2. *KU's claimed incremental Hurricane Ike-related O&M expense amount of $2.555 is overstated and, on a corrected basis, should amount to $2.453 million – see Schedule AG-1 (KU).*

As shown in the first column of the attached Schedule AG-1 (KU), lines 1 – 11, KU has claimed a total gross O&M expense of $3,571,721, consisting of internal labor costs for KU and SERVCO employees; outside contractor costs; and various other costs, including a contingency cost. KU then determined that of this total gross O&M expense amount of $3,571,721, an amount of $1,016,319 does not represent real incremental costs as these costs are already embedded in KU's current rates. Thus, the net incremental Hurricane-Ike related cost amount claimed by KU is $2,555,402 ($3,571,721 - $1,016,319).

The Attorney General recommends that two adjustments be made to KU's proposed cost offsets of $1,016,319. These two adjustments have the effect of increasing the cost offsets from $1,016,319 to $1,118,384 and decreasing the net incremental storm costs from $2,555,402 to $2,453,337.

The first recommended adjustment removes KU's proposed cost offset of $335,459 associated with the storm related internal labor of $1,536,963 that was charged by KU to LG&E [see Schedule AG-1 (LGE), line 2]. This cost offset should instead be treated as a cost offset to LG&E's Hurricane Ike-related O&M expenses.

The second recommended adjustment increases KU's proposed cost offset for internal KU labor charged to KU from $409,009 to $846,533. KU has proposed storm related internal labor expenses of $1,343,001 [see Schedule AG-1 (KU), line 1] and corresponding offsetting cost credits of $409,009 for labor costs that are presumed to be included in KU's current rates [see Schedule AG-1 (KU), line 14]. As explained in its response to AG-2-3(a)(b), the $933,992 difference between the total storm damage related internal labor cost of $1,343,001 and the $409,009 labor costs already embedded in KU's rates consists of $496,468 for estimated incremental overtime expenses and $437,524 for "estimated straight time labor costs that are normally capitalized." The difference between the total storm damage related internal labor cost of $1,343,001 and the labor costs already embedded in KU's rates should only be $496,468 for the incremental overtime expenses; therefore, the offset for labor costs already embedded in KU's current rates should amount to $1,343,001 less $496,468, or $846,533. The Attorney General does not believe that the Company's proposal to also treat as incremental costs the estimated $437,524 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 $437,524 item in its response to AG-2-3(c) is not only confusing, but also inadequately supported. The Attorney General believes that the $437,524 cost item proposed by the Company is not sufficiently known and measurable to be considered as an incremental storm-related expense.

3. *KU's incremental Hurricane Ike-related O&M expense amount (whether the Company-claimed amount of $2.555 or the corrected amount of $2.453 million) is not extraordinary and does not warrant Regulatory Asset treatment. The PSC should not issue an Accounting Order for the deferral and future amortization of KU's incremental Hurricane Ike-related O&M expenses.*

The approximate $2.5 million of KU's Hurricane Ike-related incremental O&M expenses only represents .30% of KU's total O&M expense amount of approximately $830 million[2] booked by the Company in the 12-month period ended September 30, 2008. Based on this measurement, the Attorney General does not believe that KU's Hurricane Ike-related cost of $2.5 million qualifies as an extraordinary item.

Furthermore, Rives Exhibit 1, Reference Schedule 1.18 in KU's pending base rate case, Case No. 2008-00251 shows that KU incurred the following storm damage expenses in the last 5 years:

- 2004	$4,120,000
- 2005	$2,538,000
- 2006	$4,114,000
- 2007	$2,035,000
- 12-mos. ended 4/30/08	$5,708,101

KU never considered these storm damage expenses to be so extraordinary as to warrant Regulatory Asset account treatment. Instead, KU simply included the above storm damage expenses in the determination of its normalized storm damage expenses[3] in its pending base rate case. By comparison, the Hurricane Ike-related costs of approximately $2.5 million are either substantially less than, or approximately equal to, KU's actual storm damage expenses booked in the last 5 years and are less than KU's requested normalized annual storm damage expense level of approximately $2.8 million requested by KU in its current rate case. These represent additional reasons why KU's proposal to receive extraordinary Regulatory Asset treatment for its approximate $2.5 million Hurricane Ike-related cost is unreasonable and should be rejected by the Commission.

4. *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,*

[2] Per response to AG-1-1(d).
[3] Based on an inflated average of actual storm damage expenses in the most recent 10-year period.

2008 in KU's pending rate case, Case No. 2008-00251. It therefore represents an "out-of-period" event for which the cost should not be recognized for ratemaking purposes in Case No. 2008-00251.

KU has proposed that the Hurricane Ike-related cost amount of approximately $2.5 million 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. 2008-00251.

KU 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. Because of that, 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 KU's current rate case, Case No. 2008-00251. Rather, they were incurred in September 2008, almost 5 months after the April 30, 2008 test year-end in KU'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, not only should the Commission deny Regulatory Asset deferral and amortization rate treatment for KU's Hurricane Ike-related cost, the cost should also not be added to the storm damage normalization adjustment on Rives Exhibit 1, Reference Schedule 1.18 in KU's pending base rate case, Case No. 2008-00251 for purposes of determining the Company's normalized storm damage expense amount in the current rate case.

5. *Rather than permitting the incremental Hurricane Ike-related storm damage expense to be treated as a Regulatory Asset, the expense should become part of KU's normalized storm damage expense adjustment starting in KU's next base rate case.*

For the reasons explained in the previous recommendation number 4, because the Hurricane Ike-related costs represent "out-of-period" costs, they should not be recognized for ratemaking purposes in KU'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, KU will have the opportunity to start recovering the Hurricane Ike-related cost amount of approximately $2.5 million by including the cost as part of KU's normalized storm damage expense amount.

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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this 17th day of December, 2008.

Assistant Attorney General

KENTUCKY UTILITIES COMPANY
ESTIMATED NET IKE STORM RESTORATION COSTS

	KU		Adjustment		AG	
	(1)					
Total Costs:						
1. Internal Labor - KU Employees	$ 1,343,001				$ 1,343,001	
2. Internal Labor - SERVCO Employees	39,266				39,266	
3. Subtotal Employee Labor	1,382,267				1,382,267	
4. Linemen Contractors	473,538				473,538	
5. Tree Trimming Contractors	315,000				315,000	
6. Subtotal Contractors	788,538				788,538	
7. Materials/Other	252,456				252,456	
8. Oil Spill Clean Up	470,000				470,000	
9. Contingency	678,460				678,460	
10. Subtotal	1,400,916				1,400,916	
11. Total Costs [L3+L6+L10]	3,571,721				3,571,721	
Cost Credits (Costs Embedded in KU's Current Rates):						
12. Contractor Costs	(59,265)				(59,265)	
13. Internal KU Labor Charged to LG&E	(335,459)	(2)	335,459	(2)	-	(2)
14. Internal KU Labor Charged to KU	(409,009)	(3)	(437,524)	(3)	(846,533)	(3)
15. Internal SERVCO Labor	(212,586)				(212,586)	
16. Total Offsetting Cost Credits	(1,016,319)				(1,118,384)	
17. Net Incremental Storm Costs [L11+L16]	$ 2,555,402		$ (102,065)		$ 2,453,337	

(1) KU Filing Exhibit 1 - Includes estimated costs

(2) The cost credit associated with the storm related internal KU labor costs of $1,536,963 charged by KU to LG&E (see Sch. AG-1 LGE, L2) should be reflected as a cost credit for purposes of determining LG&E's net incremental storm costs.

(3) Per response to AG-2-3(a)(b): the difference between the total storm related internal labor costs of $1,343,001 on line 1 and the labor costs already embedded in KU's current rates should only include the estimated incremental overtime expenses of $496,468 booked as a result of the storm. Thus, the offsetting cost credit should be $1,343,001 less $496,468 = $846,533.