



DEPARTMENT OF THE ARMY
UNITED STATES ARMY LEGAL SERVICES AGENCY
901 NORTH STUART STREET
ARLINGTON VA 22203-1837



REPLY TO
ATTENTION OF

22 MARCH 2004

Regulatory Law Office
U4117

SUBJECT: In the Matter of Adjustment of Gas and Electric Rates of Louisville Gas
and Electric Company, KY PSC Case No. 2003-00433

Hon. Thomas M. Dorman
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

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COMMISSION

Dear Mr. Dorman:

In accord with the Commission's Order dated 14 January 2004, enclosed for filing find the original and eleven copies of the each of the prepared direct testimony and exhibits of Kenneth L. Kinchel and Thomas J. Prisco, expert witnesses on behalf of the consumer interest of the United States Department of Defense and other affected Federal Executive Agencies (hereinafter "DOD") and intervenor in the above styled proceeding. Enclosed is a computer diskette with an electronic copy of the text documents in MicroSoft Word and spreadsheet exhibits in Excel (XLS).

Copies of this pleading are being sent in accord with the Certificate of Service. Inquiries regarding this proceeding should be directed to the undersigned at the address above or at telephone number (703) 696-1646.

Sincerely yours

David A. McCormick
General Attorney

CF: Certificate of Service
Hon. Daniel M. Kininmonth, Fort Knox, KY

1 LG&E for natural gas also, because of the vast distribution system that the Government
2 owns, operates and maintains on-post. Because the Company is now earning a rate of
3 return of over 21% from special contract customers (Company Witness M. S. Beer,
4 Direct Testimony, page 8, Table 2), as compared to a system average of 3.56%, LG&E is
5 proposing no further increase in gas rates to special contract customers at this time.
6

7 **Q. PLEASE DESCRIBE THE ELECTRICITY AND NATURAL GAS**
8 **DISTRIBUTION SYSTEMS THAT THE GOVERNMENT HAS CONSTRUCTED**
9 **ON-POST.**

10 A. The Government has made a huge investment in both the electric and natural gas
11 distribution systems on-post. LG&E meters electricity delivered to Fort Knox at the low
12 side of its 138/34.5 kV Tip Top Substation and then transmits electric power over its sub-
13 transmission loop to seven 34.5 kV substations constructed by the Government and
14 located on the base. The entire electricity distribution system downstream of these
15 substations was also constructed by the Government. This consists of approximately 129
16 circuit-miles of overhead primary distribution line, 6 circuit-miles of underground
17 primary distribution line, numerous transformers and miles of secondary and service line.
18 The entire system has been privatized to Nolin Rural Electric Cooperative, but the
19 Government still pays Nolin to enhance, operate and maintain the system. LG&E does
20 not share in that cost.

21
22 Regarding natural gas, LG&E receives its gas from the Texas Gas Transmission System
23 (TGT) at a connection located on the Fort Knox reservation itself. This means that Fort
24 Knox could potentially by-pass LG&E completely by connecting its own distribution
25 system to TGT without leaving the base. Instead, TGT's 26 inch transmission pipeline

1 connects with two LG&E 8 inch high pressure pipelines, which then travel about 3 miles,
2 all on the Fort Knox reservation, to deliver gas to Fort's Knox's own distribution system.
3 Downstream of this LG&E connection with Fort Knox's distribution system, Fort Knox
4 constructed and still owns, operates and maintains all of the natural gas distribution
5 pipeline, meters and service lines, which deliver natural gas to about 2,000 buildings and
6 40,000 persons. One of the 8 inch high pressure pipelines of LG&E continues off the
7 base to service other nearby customers. Fort Knox also has on its reservation the
8 Muldraugh natural gas storage field, which is leased to LG&E, and is used to provide
9 storage for Fort Knox and other customers.
10

11 **Q. IS THERE ANY REASON WHY THE COMMISSION SHOULD BE**
12 **PARTICULARLY CONCERNED ABOUT THE 12.3% PROPOSED**
13 **ELECTRICITY PRICE INCREASE TO FORT KNOX?**

14 A. Yes. An independent commission, called BRAC 2005, has been formed to review all
15 DOD installations for potential base closure and functional realignment and to make
16 recommendations to be announced in 2005. This action is authorized by Congress under
17 the Defense Base Closure and Realignment Act of 1990. The final selection criteria to be
18 used by the committee were published on February 12, 2004 in the Federal Register at
19 69FR 6948. These criteria call specifically for the cost of operations to be used in
20 determining how to functionally realign or where to close military installations.
21

22 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

23 A. The purpose of my testimony is to address, on behalf of DOD, both return on equity
24 (ROE) and rate design issues in this proceeding, concerning both natural gas and electric
25 service of LG&E. Company Witness R. G. Mr. Rosenberg proposed an ROE for electric

1 operations of 11.25% (Direct Testimony, p. 53); I propose 10.0%. Mr. Rosenberg
2 proposed an ROE for natural gas service of 11.5% (Direct Testimony, p. 64); I propose
3 10.5%. Mr. Thomas Prisco, another DOD witness in this proceeding, has incorporated
4 my ROE recommendations into his analysis, which calls for a reduction in revenue
5 requirements from the level sought by the Company.

6
7 Later in my testimony, I will generally support the criteria for allocation of increased
8 revenue requirements by rate class as proposed by the Company for both natural gas and
9 electricity, but will recommend that all customers in the Special Contract class be given
10 an equal percentage increase in electricity billings. Finally, I will recommend that the
11 Commission reject certain unnecessary and onerous changes in the terms and conditions
12 for natural gas transportation service that are being proposed by the Company.

13
14 **Q. WHAT CALCULATIONS DID YOU PERFORM TO MEASURE THE ROE FOR**
15 **BOTH ELECTRIC AND NATURAL GAS OPERATIONS OF LG&E?**

16 **A.** I performed the three types of statistical tests for both natural gas and electric service that
17 are normally used to determine the market return on equity for a utility company in
18 regulatory proceedings such as this, namely, the discounted cash flow analysis (DCF),
19 the industry risk premium (RP) analysis and the capital asset pricing model (CAPM) test.

20
21 Because I generally agreed with the criteria used by Company Witness Rosenberg for
22 selection of comparable utilities, I used the same grouping of electric and gas comparable
23 utilities, but with two modifications. I eliminated CH Energy Group from the list of
24 comparable electric utilities because *Value Line* is projecting no growth in earnings and
25 dividends for this company over the next five years. The DCF analysis would therefore

1 be biased on the downside because this company would have a DCF-based ROE less
2 than the cost of utility debt. Mr. Rosenberg found this to be true also (Direct Testimony,
3 p. 23, footnote), but retained CH Energy Group for use in other tests. Because CH
4 Energy was not suitable for use in applying the DCF test, I dropped the company from
5 the comparable group for all tests.

6
7 I added Piedmont Natural Gas Company back into the list of comparable natural gas
8 utilities because its merger with North Carolina Natural Gas Company has closed. Any
9 significant effect of the merger due to speculation in the price of the utility's common
10 stock would therefore have been eliminated. This potential effect was the only reason
11 that Mr. Rosenberg dropped the company from the comparable group. (See Answer b
12 and c to LG&E Response to First Data Request of the Attorney General, Question No.
13 121).

14
15 **Q. DID YOU PERFORM THE SAME MODEL TESTS FOR ROE THAT MR.**
16 **ROSENBERG PERFORMED?**

17 A. No, there are major differences. For one, I used the constant growth model for the DCF
18 analysis, while Mr. Rosenberg used a two-stage model. He argued that the two-stage
19 model is needed because the "industry is in a state of flux" (Direct Testimony, p. 19). His
20 two stage model uses current growth projections for the utility group for only five years,
21 after which he assumes a new growth period lasting for 195 years based on growth in
22 nominal GDP, expected industry growth, or "sustainable growth" on an individual
23 company basis as computed from *Value Line* data.

1 As a professional energy price forecaster for over 20 years, in my judgment, uncertainty
2 (and error) in your estimates is not reduced, but increases when you look out further in
3 time. I know of no reason why these two groups of utilities would begin a trendline five-
4 years from now similar to the long-term industry growth rate or the GDP growth rate.
5 After all, they were selected for peculiar characteristics that separated them out from the
6 industry and, as a utility, from the entire economy. The “sustainable growth” version of
7 his two-stage model has more merit, because it is based on individual company data, but
8 I see no reason why this “derived” growth rate for each company is more accurate than
9 the specific individual company growth rates provided by *Value Line*, on either a near-
10 term or long-term basis. If there is a discontinuity in growth rates for these companies, I
11 believe it has just occurred. As shown later in my testimony, there is a marked change
12 between the rather dismal growth rates experienced over the past five years and the
13 expected growth rates for the next five, particularly for electric utilities.

14
15 Furthermore, I do not believe that any rational analyst is looking out over 200 years
16 when they are deciding whether or not to purchase a utility stock. The constant growth
17 model is much simpler to use and doesn’t require such specific foresight. The large
18 uncertainty and potential error in estimating the appropriate growth rate over the next
19 five years for any individual firm dwarfs any supposed precision that could be gained by
20 adding in to the DCF calculation estimates for the next 195 years.

21
22 **Q. WERE THERE ANY OTHER DIFFERENCES IN THE ROE MODEL TESTS**
23 **THAT YOU APPLIED?**

24 A. Yes. I did not use the “empirical” formulation of the CAPM test, or the Comparable
25 Earnings analysis. I based my RP model on the difference between equity returns and

1 long-term Treasury bond returns, a “riskless” asset, not the difference between equity
2 returns and utility bonds, as did Mr. Rosenberg (Direct Testimony, p. 61). I also did not
3 employ the RP model that Mr. Rosenberg used which is based on the relationship of
4 utility authorized returns, utility bond yields and Treasury bond yields. I’ll explain each
5 decision.

6
7 The basis for the “empirical” formulation of the CAPM model that was provided by Mr.
8 Rosenberg was *Regulatory Finance: Utilities’ Cost of Capital*, a book written by Dr.
9 Roger A. Morin, PhD in 1994. (See Response to Question No. 1-101 of the Attorney
10 General.) On page 335, it is stated that the coefficients are based on an analysis of data
11 between 1926 and 1984. Thus, at best, the coefficients of the “empirical” model are
12 outdated. Furthermore, the underlying reasons for the differences between the estimates
13 by the “traditional” CAPM model and the “empirical” CAPM model are unknown. As
14 Dr. Morin explains on page 334, it could be “dividend yield, skewness, size, missing
15 assets, or constrained borrowing effects.” (Emphasis added)

16
17 On the other hand, Ibbotson Associates performs a rigorous, annually updated
18 formulation of the components of the standard CAPM model, including adjustments for
19 firm size, as published in its *Stock , Bonds, Bills and Inflation: Valuation Yearbook*.
20 Yet, Mr. Rosenberg presents the test results from each model with equal weight, and
21 incorrectly adds the Ibbotson Associates adjustment for size calculated for the
22 “traditional” CAPM model to the results of the “empirical” CAPM model also (Direct
23 Testimony, p. 60). In my judgment, the elegance of the theory underlying the
24 “traditional” CAPM model and the extent and timeliness of the research underlying the
25

1 data used to apply that model, make the “traditional” CAPM model results much more
2 credible.

3
4 I recommend that the Commission ignore the Comparable Earnings results presented by
5 Mr. Rosenberg. His argument (on page 48 of his testimony) that the comparison utilities
6 and LG&E specifically should be authorized a ROE equal to all unregulated and
7 regulated companies given by Value Line a Safety Factor of 2 is specious. The very
8 reason he went to all the trouble of carefully selecting a test group of utilities, separately
9 for both natural gas and electric operations, is to weed out firms with characteristics,
10 including degree of regulated activity and credit rating, that are dissimilar to LG&E. The
11 grouping of all firms with a Value Line Safety Factor of 2 is too broad and disparate to
12 be considered similar to LG&E for purposes of computing a ROE.

13
14 I used long-term Treasury bond returns as a basis for computing the industry RP test
15 because the risk premium is normally defined as the difference between the equity return
16 and the return of a riskless asset. (See the discussion in *SBB* *Valuation Yearbook 2003*,
17 by Ibbotson Associates, Chapter 5.) Utility bonds are not riskless and there is no reason
18 to expect a uniform average difference over time between returns from utility bonds and
19 utility stocks.

20
21 I rejected use of Mr. Rosenberg’s RP regression equation which relates authorized
22 returns, yields on utility bonds and yields on Treasury bonds (Direct Testimony, p. 41)
23 primarily because authorized returns are not based only on market required returns.
24 Commissions take in account many other considerations when setting an authorized
25 return, such as health of the company, the need for a better credit rating, the ability of the

1 ratepayers to cope with the attendant increase in rates, etc. I do believe this Commission
2 should be familiar with what other Commissions are granting similar companies by way
3 of authorized returns. However, a simpler and more reliable method is to directly peruse
4 the November 15, 2003 edition of the *Public Utilities Fortnightly*, which lists all recent
5 ROE authorizations by utility commissions, or the *Regulatory Focus*, published by
6 Regulatory Research Associates, which aggregates all authorized returns by calendar
7 quarter. I believe it is my job to inform the Commission as what the market is requiring
8 for an ROE for LG&E. The Commission can then decide to adjust the market-based ROE
9 upward or downward taking into account other factors.

10
11 **Q. HOW WAS THE DCF ANALYSIS PERFORMED FOR ELECTRIC**
12 **OPERATIONS?**

13 A. As I mentioned above, I applied the constant growth DCF model to perform my analysis.
14 All DCF models assume that the price of a share of common stock is equal to the present
15 value of the expected cash flows derived from future dividends and changes in stock
16 price. The constant growth model further adds the constraining assumption that growth in
17 dividends, earnings and book value per share are all approximately the same. The
18 constant growth model simply states that the cost of common equity is the sum of : (1)
19 the dividend in the next period, divided by the current price per share, plus (2) the growth
20 rate in dividends. Because this model rests on the assumption that earnings and book
21 value per share both grow at nearly the same rate as dividends per share, the trends and
22 expectations of growth in these two other financial variables can also be examined to
23 estimate the constant growth rate that is needed for the model.

1 Exhibit KKK-6 presents average closing prices of the last 90 days and the sum of the last
2 4 dividends paid over the most recent 12 months for each of the comparable electric
3 utilities. As shown in the table, the average yield of the comparable electric utility group
4 is 4.29%.

5
6 More difficult is to determine the average growth rate for this group. Exhibit KKK-7
7 shows the historical and projected growth rates in dividends, earnings and book value for
8 each of the comparable electric utilities, as reported by *Value Line Investment Survey*. I
9 used the annual data to determine the precise growth rates, rather than the smoothed
10 averages provided by *Value Line* in order to get more precise growth rates. The
11 discontinuity in growth rates expected from the historical period to the near term is
12 evident from Exhibit KKK-7. Dividend growth has been only 1.8% for the past 5 years,
13 but is expected by security analysts to increase to 3.3% over approximately the same
14 period in the future. This is probably due to the change in tax policy for dividends, which
15 was enacted in May 2003. Earnings for the group are expected to be growing at 5.3%
16 over the next several years, which represents an increase from the dismal 2.2% growth
17 rate experienced over the past 5 years. Growth in book value was 2.8% over the past five
18 years, and is expected to grow to 4.9%.

19
20 I normally average the recent historical results with the near-term projected estimates to
21 calculate a growth rate for the utility group. This is because I believe that a rational
22 investor bases his purchases not only on the projections of industry analysts, but on
23 actual recent experience. However, based on Exhibit KKK-7, I don't think a rational
24 investor would purchase the stock of this group unless he heavily discounted recent past
25 results. Thus, I used only the projected estimates of growth to perform my DCF analysis.

1 The model itself assumes constant growth in earnings, dividends and book value. So, as a
2 low estimate for growth, I used the average of the three projections, or 4.49%. As an
3 upper bound on the growth estimate, I used the projection for earnings alone, 5.26%.
4 This is based on the knowledge that earnings provide the cash that can be used
5 discriminately by each of the utilities to retain some portion, and thereby increase book
6 value, or distribute some portion as dividends.

7
8 On the bottom of Exhibit KKK-6, I grow the average dividend yield actually realized by
9 the comparable distribution company group over the past year by each of these growth
10 rates to arrive at a corresponding average expected dividend yield over the next twelve
11 months. When this is added to the growth rate, as required by the DCF constant growth
12 model, a range for the calculated ROE for the comparable company group is found, 9%
13 to 10%, when rounded. The average of the upper and lower estimate is 9.5%, as shown
14 in Exhibit KKK-5

15
16 **Q. HOW DID YOU APPLY THE RISK PREMIUM TEST TO DETERMINE ROE**
17 **FOR THE ELECTRIC UTILITY OPERATIONS OF LG&E?**

18 A. I applied a historical risk premium analysis for Moody's (now Mergent's) electric utility
19 group. The results of this test is an estimated ROE of 9.2% for LG&E, as shown on
20 Exhibit KKK-5.

21
22 The expected equity risk premium is the additional return an investor expects to receive
23 to compensate for the additional risk associated with investing in equities as opposed to
24 investing in riskless assets. For the comparable group, I chose Moody's electric utility
25 group because data for this group are published annually, and these companies compare

1 quite reasonably closely to LG&E in the nature of their business activities, the markets
2 they serve and the risks they undertake. The average risk premium over the long term
3 Government bond total return is calculated at 3.97% within Exhibit KLK-8.

4
5 Some financial analysts, in particular those performing research at Ibbotson Associates,
6 argue that when historic risk premia are calculated, the income return on the long term
7 Government bond should be used instead of the total return because “it represents the
8 truly riskless portion of the return.” (See *Stocks, Bonds, Bills and Inflation, Valuation*
9 *Edition, 2003 Yearbook*, p. 70.). To entertain this notion, I also calculated the risk
10 premium using the income return of the long term Government bond, as shown on
11 Exhibit KLK-9, The result was higher at 4.27%. Regardless of which basis is used, the
12 appropriate forward-looking measure of the riskless rate is the yield to maturity of the
13 long-term Government bond. I used the average yield to maturity of 20-year bonds
14 reported for the last 12 Friday closings (week ending 12/26/2003 through 3/12/2004) by
15 the *Federal Reserve Statistical Release*, or 4.95%. Adding the historic risk premium,
16 using the income return series, to the current long term Government bond yield results in
17 an expected ROE required by investors of 9.2%, as shown in Exhibit KLK-5.

18
19 **Q. HOW DID YOU APPLY THE CAPM TEST FOR ROE FOR ELECTRIC**
20 **OPERATIONS OF LG&E?**

21 A. I relied on Ibbotson Associates for the methodology used to apply the capital asset
22 pricing model (CAPM). The principle feature of the CAPM model is that the expected
23 return is related to the risks taken by the investor, as measured by beta, a statistical
24 measure of the relative movement of the price for an equity to the overall market. The
25 simple formula is $k = r + b \times (R_m - R_f)$, where k is the cost of equity, r is the expected

1 return of the riskless asset, b is the beta of the stock, R_m is the total return of the market
2 and R_f is the riskless rate of return.

3
4 As a proxy for the market, I used the historical returns of the S&P 500 group of equities.
5 Ibbotson Associates provides an average historical market risk premium, $(R_m - R_f)$, of
6 7.0% for the S&P 500 over the very long period of 1926-2002, using the income return
7 of 20-year Treasury bonds as the riskless asset. I used betas for each firm within the
8 comparable group of electric utilities, as published by *Value Line Investment Survey*, as
9 shown in Exhibit KKK-10.

10
11 By multiplying the beta for these companies times the historical market risk premium,
12 the long term average equity risk premium for the distribution company group is
13 determined. However, this result must be adjusted because several of the members of the
14 comparable group of utilities fall within the small or mid-cap market capitalization
15 category. The size adjustment simply means that small companies require a larger ROE
16 because they are inherently more risky than accounted for by the statistical beta. As
17 shown on Exhibit KKK-10, the average ROE for the group, based on historical returns,
18 and when properly adjusted for firm size, is 10.2%.

19
20 **Q. DID YOU PERFORM A CAPM ANALYSIS BASED ON PROJECTED RETURNS**
21 **FOR THE ELECTRIC OPERATIONS OF LG&E?**

22 A. Yes I did, but I have less faith in the results. When the most recent estimate of projected
23 earnings growth of the S&P 500 over the next five years from First Call (11.4%) and
24 Standard and Poor's (13.4%) is added to the current dividend rate (1.68%), total returns
25 are estimated at 13.08% and 15.08%, respectively. By subtracting the recent average

1 yield on long term bonds (4.95%), a market risk premium can be derived, as shown on
2 Exhibit KLK-10. The result is a market risk premium by First Call of 8.13%; 10.13% for
3 Standard and Poors. Applying then the same methodology as used for the historical
4 CAPM analysis, an estimated ROE of 11.7% is obtained, as shown in Exhibit KLK-10.

5
6 The reason that I have less faith in this test result is that I believe the stock market
7 industry tends to be biased on the high side when projecting earnings results, primarily
8 because the analysts are generally housed in the same firms that are selling the stocks.
9 My understanding is that the industry is now working to increase the independence of
10 stock analysts, thereby reducing or eliminating the upward bias in market forecasts. I
11 used to not include this CAPM test at all, but have reluctantly added this test result in
12 order to be able to report it and discuss it during cross-examination.

13
14 **Q. HOW DID YOU ARRIVE AT YOUR RECOMMENDED ROE FOR THE**
15 **ELECTRIC OPERATIONS OF LG&E?**

16 A. As shown in Exhibit KLK-5, the average provided by all three types of tests (CAPM, risk
17 premium and DCF analysis) in my analysis is 9.9%. Ignoring the CAPM test result based
18 on projected returns for the market as a whole, for the reasons stated earlier, I estimate
19 the reasonable range provided by all three tests to be from 9.2% (the historical industry
20 RP test result) to 10.2% (the historical CAPM result). Thus, I do not recommend that the
21 Commission consider an ROE for LG&E electric operations more than 10.2%. However,
22 within this reasonable range, in the interests of gradualism (the firm is now authorized a
23 higher ROE), I propose that LG&E be granted an ROE of 10.0%.

1 **Q. HOW WAS THE DCF ANALYSIS PERFORMED FOR NATURAL GAS**
2 **OPERATIONS OF LG&E?**

3 A. I again utilized the constant growth DCF model to perform my analysis, as applied to the
4 natural gas comparable utility group, using the same methodology that I applied for the
5 electric utility group.

6
7 Exhibit KLK-12 presents average closing prices of the last 90 days and the sum of the
8 last 4 dividends paid over the most recent 12 months for each of the comparable natural
9 gas utilities. As shown in the table, the average yield of the comparable natural gas group
10 is 4.41%.

11
12 Exhibit KLK-13 shows the historical and projected growth rates in dividends, earnings
13 and book value for each of the comparable natural gas utilities, as reported by *Value*
14 *Line Investment Survey*. Again, I used the annual data to determine the precise growth
15 rates, rather than the smoothed averages provided by *Value Line* in order to get more
16 precise growth rates. The discontinuity in growth rates expected from the historical
17 period to the near term is evident again for natural gas utilities on Exhibit KLK-13, but
18 not to the same extent as for the electric utilities. I suspect that the problems with the
19 Enron bankruptcy and the California deregulation debacle over the recent historical
20 period can explain a lot of the difference.

21
22 Dividend growth for the natural gas comparable group has been 2.2% for the past 5
23 years, but is expected by security analysts to decrease to 1.7% over the next several
24 years. Earnings for the group are expected to be growing at 5.8% over the next several
25 years, which represents an increase from the 3.4% growth rate experienced over the past

1 5 years. Growth in book value was 3.3% over the past five years, and is expected to grow
2 to 4.7% over the near-term.

3
4 Again, as a low estimate for growth, I used the average of the three projections for
5 dividends, book value and earnings, or 4.05%. As an upper bound on the growth
6 estimate, I used the projection for earnings alone, 5.76%. This is based on the knowledge
7 that earnings provide the cash that can be used discriminately by each of the utilities to
8 retain some portion, and thereby increase book value, or distribute some portion as
9 dividends.

10
11 On the bottom of Exhibit KKK-12, I grow the average dividend yield actually realized by
12 the comparable distribution company group over the past year by each of these growth
13 rates to arrive at a corresponding average expected dividend yield over the next twelve
14 months. When this is added to the growth rate, as required by the DCF constant growth
15 model, a range for the calculated ROE for the comparable company group is found, 8.6%
16 to 10.5%, when rounded. The average of the upper and lower estimate is 9.6%, as shown
17 in Exhibit KKK-11.

18
19 **Q. HOW DID YOU APPLY THE RISK PREMIUM TEST TO DETERMINE ROE**
20 **FOR THE NATURAL GAS UTILITY OPERATIONS OF LG&E?**

21 A. I applied a historical risk premium analysis for Moody's (now Mergent's) natural gas
22 distribution utility group. The results of this test is an estimated ROE of 10.4% for the
23 natural gas operations of LG&E, as shown on Exhibit KKK-11.
24
25

1 The expected equity risk premium is the additional return an investor expects to receive
2 to compensate for the additional risk associated with investing in equities as opposed to
3 investing in riskless assets. For the comparable group, I chose Moody's natural gas
4 distribution utility group because data for this group are available for a historical period,
5 and these companies compare quite reasonably closely to LG&E's gas operations in the
6 nature of their business activities, the markets they serve and the risks they undertake.
7 The average risk premium over the long term Government bond total return is calculated
8 at 5.36% within Exhibit KLK-14.

9
10 I also calculated the risk premium using the income return of the long term Government
11 bond, as shown on Exhibit KLK-15. The result was 5.45%, slightly higher. Regardless
12 of which basis is used, the appropriate forward-looking measure of the riskless rate is the
13 yield to maturity of the long-term Government bond. I again used the average yield to
14 maturity of 20-year bonds reported for the last 12 Friday closings (week ending
15 12/26/2003 through 3/12/2004) by the *Federal Reserve Statistical Release*, or 4.95%.
16 Adding the historic risk premium, using the income return series, to the current long term
17 Government bond yield results in an expected ROE required by investors of 10.4%, as
18 shown in Exhibit KLK-11.

19
20 **Q. HOW DID YOU APPLY THE CAPM TEST FOR ROE FOR NATURAL GAS**
21 **OPERATIONS OF LG&E?**

22 A. I again relied on Ibbotson Associates for the methodology used to apply the capital asset
23 pricing model (CAPM). As a proxy for the market, I used the historical returns of the
24 S&P 500 group of equities. Ibbotson Associates provides an average historical market
25 risk premium, ($R_m - R_f$), of 7.0% for the S&P 500 over the very long period of 1926-

1 2002, using the income return of 20-year Treasury bonds as the riskless asset. I used
2 betas for each firm within the comparable group of natural gas utilities, as published by
3 *Value Line Investment Survey*, as shown in Exhibit KLK-16.

4
5 By multiplying the beta for these companies times the historical market risk premium,
6 the long term average equity risk premium for the distribution company group is
7 determined. However, this result must again be adjusted because several of the members
8 of the comparable group of utilities fall within the small or mid-cap market capitalization
9 category. The size adjustment simply means that small companies require a larger ROE
10 because they are inherently more risky than accounted for by the statistical beta. As
11 shown on Exhibit KLK-16, the average ROE for the group, based on historical returns,
12 and when properly adjusted for firm size, is 10.75%.

13
14 **Q. DID YOU PERFORM A CAPM ANALYSIS BASED ON PROJECTED RETURNS**
15 **FOR THE NATURAL GAS OPERATIONS OF LG&E?**

16 A. Yes I did, but for the same reasons as I reported for the electric utility group, I have less
17 faith in the results. When the most recent estimate of projected earnings growth of the
18 S&P 500 over the next five years from First Call (11.4%) and Standard and Poor's
19 (13.4%) is added to the current dividend rate (1.68%), total returns are estimated at
20 13.08% and 15.08%, respectively. By subtracting the recent average yield on long term
21 bonds (4.95%), a market risk premium can be derived, as shown on Exhibit KLK-16.
22 The result is a market risk premium by First Call of 8.13%; 10.13% for Standard and
23 Poors. Applying then the same methodology as used for the historical CAPM analysis, an
24 estimated ROE of 12.24% is obtained, as shown in Exhibit KLK-16.
25

1 **Q. HOW DID YOU ARRIVE AT YOUR RECOMMENDED ROE FOR THE**
2 **NATURAL GAS OPERATIONS OF LG&E?**

3 A. As shown in Exhibit KLK-11, the average provided by all three types of tests (CAPM,
4 risk premium and DCF analysis) in my analysis is 10.5%. Ignoring the CAPM test result
5 based on projected returns for the market as a whole, for the reasons stated earlier, I
6 estimate the reasonable range provided by all three tests to be from 9.6% (the average of
7 the DCF test results) to 10.75% (the historical CAPM result). Thus, I do not recommend
8 that the Commission consider an ROE for LG&E natural gas operations more than
9 10.75%. However, within this reasonable range, in the interests of gradualism (the firm is
10 now authorized a higher ROE), I propose that LG&E be granted an ROE of 10.5%,
11 which is also coincidentally the average of my three model test results.

12
13 **Q. WHAT CHANGES IN THE ALLOCATION OF INCREASED REVENUE**
14 **REQUIREMENTS BY RATE CLASS ARE YOU RECOMMENDING?**

15 A. I generally support the Company's proposed criteria for allocating increased revenue
16 requirements that are ultimately found by the Commission in this proceeding, for both
17 natural gas and electric utility operations of LG&E. However, there is one exception. The
18 Company treats all of its electric special contract customers as a single customer class for
19 the purposes of performing the cost of service analysis, but thereafter decides to impose
20 separate individual treatment for each customer in this class when allocating increases in
21 revenue requirements. (See Direct Testimony of Company Witness W. S. Seelye, p. 57,
22 line 22.) Specifically, the Company is proposing to impose a rate increase of 12.3% on
23 Fort Knox, but only 10.6% on other special contract electric customers (Seelye Exhibit
24 29, p. 14-18). Mr. Seelye states in his testimony that the higher increase is imposed on
25 special contract customers with rates of return below the overall rate of return. However,

1 the Company provided no data to support that conclusion. As shown in Exhibit KLK-3,
2 Fort Knox is a reasonably high load factor electric customer, with a load factor in excess
3 of 54% during the test year. From the data provided by Mr. Seelye cited above, it doesn't
4 appear that the other special contract customers granted the proposed lower 10.6% rate
5 increase by the Company have load factors significantly different from Fort Knox. Thus,
6 in absence of any reasonable justification by the Company for the higher increase to Fort
7 Knox, I recommend to the Commission that all special contract electric customers be
8 granted the same percentage increase in revenue requirements.
9

10 **Q. WHICH CHANGES IN TERMS AND CONDITIONS FOR FIRM**
11 **TRANSPORTATION SERVICE OF NATURAL GAS DO YOU OPPOSE?**

12 A. LG&E is proposing to shorten the OFO notice period from 24 to 18 hours, and change its
13 methodology for determining the cash-out price. (See Direct Testimony of Clay Murphy,
14 p. 20 to 26.) The shortened OFO notice period means that the Company could notify Fort
15 Knox or its gas supplier at 3:00 PM in the afternoon requiring a change in deliveries by
16 the next morning at 9:00 AM. It is just too easy to miss a key employee this late in the
17 afternoon. As a result, balancing penalties to Fort Knox will likely increase. The
18 Company provides no proof that the current OFO notice period is causing any costs to
19 the Company that could be avoided by the shorter notice period. Thus, I recommend that
20 this change in procedure should be rejected by the Commission.
21

22 The Company is also proposing to price imbalances at the monthly cash-out time at the
23 highest daily mid-point price posted in *Gas Daily* for under-deliveries, and the lowest
24 daily mid-point for over-deliveries. This is a change from the current procedure which
25 calculates the cash-out at the monthly average of the daily mid-point prices posted in the

1 **Gas Daily.** The Company argues that this change is needed to further encourage FT
2 customers to minimize imbalances and to prevent “gaming” of the system. However, the
3 Company has presented no evidence that “gaming” exists or has ever been attempted.
4 Also, the existing sliding scale that successively increases the penalties for large
5 imbalances is a sufficient incentive for customers to manage their gas nominations with
6 gas takes. Further increases to the cost of imbalances are unnecessary and unjustifiably
7 onerous.

8
9 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

10 **A. Yes it does.**

1 Commonwealth of Virginia

2

3 County of Fairfax


4

5 Before me, the undersigned Notary Public, personally appeared Kenneth L. Kincel, who being
6 duly sworn on oath deposes and says that the foregoing prepared direct testimony and statement
7 of facts contained therein are true and correct to the best of his knowledge, information and
8 belief.

9

10

11



12

Kenneth L. Kincel

13

President , Decision Analysis Corporation of Virginia

14

15 Subscribed to and sworn before me on this 19th day of March, 2004.

16

17

18



19

20

Notary Public

21

My Commission Expires: 01/31/08

22

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25



1
2 **Exhibit KLK-1**

3 **Education and Qualifications of Kenneth L. Kincel**
4

5 PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

6 My name is Kenneth L. Kincel. My business mailing address is Decision Analysis
7 Corporation of Virginia, 8009 Snowpine Way, Suite 100, McLean, Virginia 22102.
8

9 WHAT IS YOUR OCCUPATION?

10 I am an energy consultant in the field of energy modeling, forecasting and economic
11 analysis, and I perform these services as President and Chief Executive Officer of Decision
12 Analysis Corporation of Virginia, an energy and environmental analysis consulting firm.
13

14 PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

15 I was awarded a Bachelor of Science Degree in Engineering by Rensselaer Polytechnic
16 Institute (RPI) in 1967, and a Master of Science in Business Management in 1968, also from
17 RPI. Subsequently, I served as Project Manager at Computer Sciences Corporation where I
18 performed management consulting services until the summer of 1972. From July 1972 through
19 June 1974, I served in several capacities performing industry economic analysis for the Cost of
20 Living Council of the Federal Government during the period of wage and price controls.
21 Following the oil embargo of 1973 -1974, I joined the Federal Energy Administration in the
22 capacity of Director, Office of Energy Demand Policy and Special Projects, and was later
23 promoted to Director, Office of Conservation and Resource Development Policy.
24
25

1 During this period, I testified in several natural gas import cases before the Federal
2 Energy Regulatory Commission as to the economic benefits to the nation of limiting liquefied
3 natural gas imports. I also appeared before several committees of the U.S. Senate and the U.S.
4 House of Representatives on issues such as the availability of winter fuels, the domestic supply
5 and price of natural gas and horizontal oil company divestiture. I headed the Interagency Natural
6 Gas Emergency Task Force, the Synthetic Natural Gas Task Force and the Interagency Liquefied
7 Natural Gas Task Force for FEA. When the Department of Energy (DOE) was formed in 1977, I
8 joined the Energy Information Administration of DOE, and ultimately became the Deputy
9 Assistant Administrator for Energy Applied Analysis (Modeling and Forecasting). In this
10 capacity, I managed over 200 professional economists, energy analysts and computer scientists
11 in the conduct of energy modeling and forecasting services to produce both the *Short Term*
12 *Energy Outlook*, the *Annual Energy Outlook* and the *International Energy Outlook*, the major
13 energy forecasting publications of the Federal Government.

14
15 In August 1980 I left the Federal Government and founded Decision Analysis
16 Corporation of Virginia (DAC). DAC performs energy and environmental modeling, forecasting
17 and analysis services for utilities, industry associations, utility commissions, private firms and
18 several agencies of the Federal Government, including DOD, Commerce and Energy. Since
19 1980, DAC has performed over 600 projects involving analysis of energy issues, and I have
20 served as Project Manager for most of these projects.

21
22 Since 1994 and to the present, DAC has assisted DOE in the development of the National
23 Energy Modeling System. Since the mid-1980's and to the present, DAC has also provided
24 energy analysis and expert witness services to DOD on utility rate cases and cases involving the
25 restructuring of the natural gas or electric utility industry for competition. I, myself, have

1 testified on cost of capital, revenue requirements, deregulation/industry restructuring policy
2 and/or rate design issues before the Georgia Public Service Commission (natural gas and
3 electricity), the New York State Public Service Commission (electricity), the Federal Energy
4 Regulatory Commission (natural gas), the Kentucky Public Service Commission (electricity), the
5 Public Utility Commission of Texas (electricity), the North Carolina Utilities Commission
6 (natural gas), the New Jersey Office of Administrative Law (electricity) and the Public Service
7 Commission of Maryland (gas and electricity), as listed in Exhibit KKK-2.

8

9 I previously filed testimony at this Commission concerning electric performance base
10 rates and an earnings sharing mechanism for Kentucky Utilities (Docket No. 98-474) and LG&E
11 (Docket No. 98-426).

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Recent Testimony and Regulatory Submissions of Kenneth L. Kinzel

Regulatory Commission	Date	On Behalf Of	Submission Type	Docket No.	Utility	Issues	Topics Covered
Georgia Public Service Commission	October 18, 1996	US Dept. of Defense/FEA	Direct Testimony	6691-U	United Cities Gas Company	Natural gas rate increase	Revenue requirements, ROE
Federal Energy Regulatory Commission	December 13, 1996	US Dept. of Defense/FEA	Direct Testimony	RP96-190-00	Colorado Interstate Gas Co.	Interstate gas transportation rates	Cost allocation, rate design
New York Public Service Commission	January 7, 1997	US Dept. of Defense/FEA	Direct Testimony	96-E-0134	Niagara Mohawk Power Co.	Electric rate increase	Revenue requirements
Georgia Public Service Commission	October 23, 1997	US Dept. of Defense/FEA	Direct Testimony	8044-U	GPSC NOPR	Implementation of gas retail dereg.	Comments on marketers' certification
Georgia Public Service Commission	October 23, 1997	US Dept. of Defense/FEA	Direct Testimony	8053-U	GPSC NOPR	Implementation of gas retail dereg.	Comments on random assignment of customers
Georgia Public Service Commission	January 23, 1998	US Dept. of Defense/FEA	Formal Comments	8346-U	GPSC NOPR	Implementation of gas retail dereg.	Formal recommendations on unbundling methods
Maryland Public Service Commission	February 12, 1998	US Dept. of Defense/FEA	Direct Testimony	8780	Baltimore Gas & Electric Co.	Gas base rate increase	ROE, rate design
Georgia Public Service Commission	March 31, 1998	US Dept. of Defense/FEA	Direct Testimony	8390-U	Alliant Gas Light Co.	Unbundling, Restructuring	ROE, rate design, performance rates
Georgia Public Service Commission	October 1, 1998	US Dept. of Defense/FEA	Direct Testimony	9355-U	Georgia Power Company	Base rate increase, earnings sharing	ROE, earnings sharing mechanism
Kentucky Public Service Commission	March 18, 1999	US Army	Direct Testimony	98-474	Kentucky Utilities	Electric performance based rates	Performance based rates, earnings sharing mechanism
Kentucky Public Service Commission	March 18, 1999	US Army	Direct Testimony	98-426	Louisville Gas & Electric Co.	Electric performance based rates	Performance based rates, earnings sharing mechanism
Maryland Public Service Commission	December 18, 1998	US Dept. of Defense/FEA	Direct Testimony	8794	Baltimore Gas & Electric Co.	Electric restructuring	Stranded costs, cost unbundling, rate design
Maryland Public Service Commission	February 3, 1999	US Dept. of Defense/FEA	Direct Testimony	8804	Baltimore Gas & Electric Co.	Base rates	ROE, rate design
Texas Public Utility Commission	September 15, 2000	US Army	Affidavit	23040	TXU Electric Company	Wholesale electric purchaser status	Information in support of petition for Fort Hood
Texas Public Utility Commission	February 2, 2001	US Army	Direct Testimony	22350	TXU Electric Company	Unbundling, Restructuring	Rate design
Georgia Public Service Commission	October 12, 2001	US Dept. of Defense/FEA	Direct Testimony	14000-U	Georgia Power Company	Base rate increase, earnings sharing	ROE, earnings sharing mechanism
North Carolina Utilities Commission	August 23, 2002	US Dept. of Defense/FEA	Direct Testimony	G21 Sub 431	North Carolina Natural Gas Corp.	Base rate rebalancing and increase	Rate design
New Jersey Office of Administrative Law	December 20, 2002	US Dept. of Defense/FEA	Direct Testimony	ER02080506-7 PUC7983,4-02	Jersey Central Power & Light Co.	Base rate increase, surcharges	ROE, ROI, rate design
Kansas State Corporation Commission	July 10, 2003	US Dept. of Defense/FEA	Direct Testimony	03-KGSG-602-RTS	Kansas Gas Division, ONEOK, Inc.	NG base rate increase, rate design	ROE, rate design
North Carolina Utilities Commission	August 12, 2003	US Dept. of Defense/FEA	Direct Testimony	G21 Sub 442	North Carolina Natural Gas Corp.	NG base rate increase, rate design, terms and conditions.	ROE, revenue requirements, rate design, terms and conditions for sales and transportation service.

Exhibit KLK-5
Louisville Gas & Electric Company
Docket No. 2003-00433
Testimony of K. L. Kincel for DOD
March 19, 2004

**Summary of Tests Results to Determine the Appropriate Regulatory Return on Common Equity
For Louisville Gas & Electric Company (Electric Service)**

<u>DCF Test Result</u>		
Range of DCF Test Results	9.0% to 10.0%	
Average DCF Test Result	9.50%	Exhibit KLK-6
<u>Historical Industry Equity Risk Premium Analysis</u>		
Equity Risk Premium for the Electric Utility Industry	4.27%	Exhibit KLK-9
Yield on 20-Year Treasury Bonds	4.95%	Average of last 12 Friday closings, as reported by Federal Reserve Statistical Release*
ROE	9.22%	
<u>CAPM</u>		
Historical CAPM Estimated ROE	10.21%	Exhibit KLK-10
Projected CAPM Estimated ROE	11.70%	Exhibit KLK-10
Average CAPM Test Result	10.96%	
Average of CAPM, Risk Premium and DCF Test Results	9.89%	
Reasonable Range provided by all three tests	9.2% - 10.2%	
KLK RECOMMENDED ROE	10.0%	

**ROE Based on Discounted Cash Flow Model
For Comparable Electric Utilities**

<u>Firm Name</u>	Average Closing Price	Latest 12 Months	Historic
	December 17, 2003 through March 16, 2004	Dividend	Yield
	(\$)	(\$)	
Alliant Energy Corporation	25.51	1.00	3.92%
Ameren Corporation	46.48	2.54	5.46%
Consolidated Edison	43.45	2.24	5.16%
DTE Energy Company	39.55	2.06	5.21%
Exelon Corporation	66.11	2.01	3.04%
MGE Energy	31.47	1.35	4.29%
NSTAR	49.43	2.18	4.40%
Pinnacle West Capital Corporation	38.78	1.73	4.46%
SCANA Corporation	34.71	1.40	4.03%
Southern Company	29.95	1.39	4.65%
Vectren Corporation	24.73	1.11	4.49%
Wisconsin Energy Corporation	33.06	0.80	2.42%
Average of Comparable Companies			4.29%
KLK Low Growth Rate Estimate for Comparable Companies from Exhibit KLK-7			4.49%
Expected Dividend Yield Next 12 Months Over Average Price at Growth Rate for Comparable Companies			4.49%
ROE for Comparable Companies			8.98%
KLK High Growth Rate Estimate for Comparable Companies from Exhibit KLK-7			5.26%
Expected Dividend Yield Next 12 Months Over Average Price at Growth Rate for Comparable Companies			4.70%
ROE for Comparable Companies			9.96%

Source: Dividend values from Value Line Investment Survey, January 2, February 13 and March 5, 2004 (most recent on March 15, 2004).
Source: For Average Closing Prices, Yahoo Finance, Historical Quotes Database.

Historic and Projected Growth in Dividends, Earnings and Book Value For Comparable Electric Utility Companies

Firm Name	Past 5 Years Growth Rates			Past 10 Years Growth Rates			Projected 2003 out 4 or 5 Years*		
	Earnings	Dividends	Book Value	Earnings	Dividends	Book Value	Earnings	Dividends	Book Value
Alliant Energy Corporation	4.89%	Neg.	-0.73%	-2.73%	Neg.	0.41%	3.59%	4.66%	3.28%
Ameren Corporation	0.91%	0.00%	3.50%	0.63%	0.82%	2.05%	2.84%	0.78%	2.77%
Consolidated Edison	-1.42%	1.11%	2.16%	0.62%	1.45%	2.90%	1.51%	0.88%	2.48%
DTE Energy Company	-2.77%	0.00%	3.82%	-2.29%	0.00%	3.21%	12.53%	0.48%	5.78%
Exelon Corporation	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.27%	6.25%	10.26%
MGE Energy	5.46%	0.76%	6.03%	1.77%	1.27%	2.82%	5.74%	0.55%	2.83%
NSTAR	4.26%	2.79%	2.87%	4.08%	2.40%	2.82%	3.30%	2.78%	4.03%
Pinnacle West Capital Corporation**	-1.59%	7.06%	3.51%	3.04%	nmf	4.85%	6.63%	5.34%	3.89%
SCANA Corporation	3.35%	Neg.	4.24%	3.00%	0.07%	3.79%	5.39%	5.22%	5.79%
Southern Company***	2.63%	0.74%	-1.50%	2.92%	1.84%	0.47%	4.46%	3.36%	5.94%
Vectren Corporation	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.74%	3.42%	3.93%
Wisconsin Energy Corporation	6.40%	Neg.	4.13%	2.20%	Neg.	2.55%	5.14%	5.74%	8.08%
Mean of Comparable Companies	2.21%	1.78%	2.80%	1.32%	1.12%	2.59%	5.26%	3.29%	4.92%
Average Mean Earnings, Dividends, Book Value Growth		2.26%			1.68%			4.49%	
Median of Comparable Companies	2.99%	0.76%	3.50%	1.99%	1.27%	2.82%	5.27%	3.39%	3.98%
Average Median Earnings, Dividends, Book Value Growth		2.42%			2.03%			4.21%	

KLLK Growth Rate for Comparable Companies

Low Estimate - Projected Average Mean Earnings, Dividends and Book Value Growth

High Estimate - Average Mean Projected Earnings Growth

Source for values used in computing growth rates: Value Line Investment Survey, Annual Data, January 2, February 13 and March 5, 2004 (most recent on March 15, 2004).

Notes:

* Value Line provides forecasts out 4 years from 2003 when the last quarter is estimated, and five years when 2003 is complete.

** Pinnacle West Capital Corporation stopped dividends in 1990 and did not return to full quarterly dividends until 1994.

*** Value Line dropped reporting 1993 historical values for Southern Company; thus the long term historical growth rates are for the period 1994-2003, 9 years instead of 10.

4.49%

5.26%

Annual Long Term Risk Premium Analysis
For Electric Utility Common Stocks
Using Government Bond Total Returns

Year	Long Term Government	Electric Utility Common Stock Data					Equity Risk
	Bond Total Return*	Year End Stock Price	Capital Gain/Loss	Year End Dividend	Yield	Total Return	Premium
1954		47.56					
1955	-0.0129	49.35	0.0376	2.27	0.0477	0.0854	0.0983
1956	-0.0559	48.96	-0.0079	2.37	0.0480	0.0401	0.0960
1957	0.0746	50.30	0.0274	2.46	0.0502	0.0776	0.0030
1958	-0.1609	66.37	0.3195	2.57	0.0511	0.3706	0.4315
1959	-0.0226	65.77	-0.0090	2.64	0.0398	0.0307	0.0533
1960	0.1378	76.82	0.1680	2.74	0.0417	0.2097	0.0719
1961	0.0097	99.32	0.2929	2.86	0.0372	0.3301	0.3204
1962	0.0689	96.49	-0.0285	3.07	0.0309	0.0024	-0.0665
1963	0.0121	102.31	0.0603	3.33	0.0345	0.0948	0.0827
1964	0.0351	115.54	0.1293	3.68	0.0360	0.1653	0.1302
1965	0.0071	114.86	-0.0059	4.02	0.0348	0.0289	0.0218
1966	0.0365	105.99	-0.0772	4.18	0.0364	-0.0408	-0.0773
1967	-0.0918	98.19	-0.0736	4.44	0.0419	-0.0317	0.0601
1968	-0.0026	104.04	0.0596	4.58	0.0466	0.1062	0.1088
1969	-0.0507	84.62	-0.1867	4.63	0.0445	-0.1422	-0.0915
1970	0.1211	88.59	0.0469	4.73	0.0559	0.1028	-0.0183
1971	0.1323	85.56	-0.0342	4.81	0.0543	0.0201	-0.1122
1972	0.0569	83.61	-0.0228	4.92	0.0575	0.0347	-0.0222
1973	-0.0111	60.87	-0.2720	5.04	0.0603	-0.2117	-0.2006
1974	0.0435	41.17	-0.3236	4.83	0.0793	-0.2443	-0.2878
1975	0.0920	55.66	0.3520	4.99	0.1212	0.4732	0.3812
1976	0.1675	66.29	0.1910	5.25	0.0943	0.2853	0.1178
1977	-0.0069	68.19	0.0287	5.68	0.0857	0.1143	0.1212
1978	-0.0118	59.75	-0.1238	5.98	0.0877	-0.0361	-0.0243
1979	-0.0123	56.41	-0.0559	6.34	0.1061	0.0502	0.0625
1980	-0.0395	54.42	-0.0353	6.67	0.1182	0.0830	0.1225
1981	0.0186	57.20	0.0511	7.16	0.1316	0.1827	0.1641
1982	0.4036	70.26	0.2283	7.64	0.1336	0.3619	-0.0417
1983	0.0065	72.03	0.0252	8.00	0.1139	0.1391	0.1326
1984	0.1548	80.16	0.1129	8.37	0.1162	0.2291	0.0743
1985	0.3097	94.98	0.1849	8.71	0.1087	0.2835	-0.0162
1986	0.2453	113.66	0.1967	8.97	0.0944	0.2911	0.0458
1987	-0.0271	94.24	-0.1709	9.12	0.0802	-0.0906	-0.0635
1988	0.0967	100.94	0.0711	8.71	0.0924	0.1635	0.0668
1989	0.1811	122.52	0.2138	8.85	0.0877	0.3015	0.1204
1990	0.0618	117.77	-0.0388	8.76	0.0715	0.0327	-0.0291
1991	0.1930	144.02	0.2229	9.02	0.0766	0.2995	0.1065
1992	0.0805	141.06	-0.0206	8.82	0.0612	0.0407	-0.0398
1993	0.1824	146.70	0.0400	9.04	0.0641	0.1041	-0.0783
1994	-0.0777	115.50	-0.2127	9.01	0.0614	-0.1513	-0.0736
1995	0.3167	142.90	0.2372	9.06	0.0784	0.3157	-0.0010
1996	-0.0093	136.00	-0.0483	9.06	0.0634	0.0151	0.0244
1997	0.1585	155.73	0.1451	9.06	0.0666	0.2117	0.0532
1998	0.1306	181.84	0.1677	8.01	0.0514	0.2191	0.0885
1999	-0.0896	137.30	-0.2449	8.06	0.0443	-0.2006	-0.1110
2000	0.2148	227.09	0.6540	8.71	0.0634	0.7174	0.5026
2001	0.0370	200.50	-0.1171	8.95	0.0394	-0.0777	-0.1147
2002	0.1784	169.50	-0.1546	8.83	0.0440	-0.1106	-0.2890
Average	0.0705					0.1101	0.0397

* Ibbotson Associates utilizes Treasury bonds with 20 years to maturity.

Sources: For Bond Data: Ibbotson Associates, Stocks, Bonds, Bills, and Inflation, Valuation Edition 2003 Yearbook, Table B6
For Electric Utility Common Stock Company Data: Mergent Public Utility Manual, 2003, pages a15, a16.

Annual Long Term Risk Premium Analysis
For Electric Utility Common Stocks
Using Government Bond Income Returns

Year	Long Term Government	Electric Utility Common Stock Data					Equity Risk
	Bond Income Return*	Year End Stock Price	Capital Gain/Loss	Year End Dividend	Yield	Total Return	Premium
1954		47.56					
1955	0.0275	49.35	0.0376	2.27	0.0477	0.0854	0.0579
1956	0.0299	48.96	-0.0079	2.37	0.0480	0.0401	0.0102
1957	0.0344	50.30	0.0274	2.46	0.0502	0.0776	0.0432
1958	0.0327	66.37	0.3195	2.57	0.0511	0.3706	0.3379
1959	0.0401	65.77	-0.0090	2.64	0.0398	0.0307	-0.0094
1960	0.0426	76.82	0.1680	2.74	0.0417	0.2097	0.1671
1961	0.0383	99.32	0.2929	2.86	0.0372	0.3301	0.2918
1962	0.0400	96.49	-0.0285	3.07	0.0309	0.0024	-0.0376
1963	0.0389	102.31	0.0603	3.33	0.0345	0.0948	0.0559
1964	0.0415	115.54	0.1293	3.68	0.0360	0.1653	0.1238
1965	0.0419	114.86	-0.0059	4.02	0.0348	0.0289	-0.0130
1966	0.0449	105.99	-0.0772	4.18	0.0364	-0.0408	-0.0857
1967	0.0459	98.19	-0.0736	4.44	0.0419	-0.0317	-0.0776
1968	0.0550	104.04	0.0596	4.58	0.0466	0.1062	0.0512
1969	0.0595	84.62	-0.1867	4.63	0.0445	-0.1422	-0.2017
1970	0.0674	88.59	0.0469	4.73	0.0559	0.1028	0.0354
1971	0.0632	85.56	-0.0342	4.81	0.0543	0.0201	-0.0431
1972	0.0587	83.61	-0.0228	4.92	0.0575	0.0347	-0.0240
1973	0.0651	60.87	-0.2720	5.04	0.0603	-0.2117	-0.2768
1974	0.0727	41.17	-0.3236	4.83	0.0793	-0.2443	-0.3170
1975	0.0799	55.66	0.3520	4.99	0.1212	0.4732	0.3933
1976	0.0789	66.29	0.1910	5.25	0.0943	0.2853	0.2064
1977	0.0714	68.19	0.0287	5.68	0.0857	0.1143	0.0429
1978	0.0790	59.75	-0.1238	5.98	0.0877	-0.0361	-0.1151
1979	0.0886	56.41	-0.0559	6.34	0.1061	0.0502	-0.0384
1980	0.0997	54.42	-0.0353	6.67	0.1182	0.0830	-0.0167
1981	0.1155	57.20	0.0511	7.16	0.1316	0.1827	0.0672
1982	0.1350	70.26	0.2283	7.64	0.1336	0.3619	0.2269
1983	0.1038	72.03	0.0252	8.00	0.1139	0.1391	0.0353
1984	0.1174	80.16	0.1129	8.37	0.1162	0.2291	0.1117
1985	0.1125	94.98	0.1849	8.71	0.1087	0.2935	0.1810
1986	0.0898	113.66	0.1967	8.97	0.0944	0.2911	0.2013
1987	0.0792	94.24	-0.1709	9.12	0.0802	-0.0906	-0.1698
1988	0.0897	100.94	0.0711	8.71	0.0924	0.1635	0.0738
1989	0.0881	122.52	0.2138	8.85	0.0877	0.3015	0.2134
1990	0.0819	117.77	-0.0388	8.76	0.0715	0.0327	-0.0492
1991	0.0822	144.02	0.2229	9.02	0.0766	0.2995	0.2173
1992	0.0726	141.06	-0.0206	8.82	0.0612	0.0407	-0.0319
1993	0.0717	146.70	0.0400	9.04	0.0641	0.1041	0.0324
1994	0.0659	115.50	-0.2127	9.01	0.0614	-0.1513	-0.2172
1995	0.0760	142.90	0.2372	9.06	0.0784	0.3157	0.2397
1996	0.0618	136.00	-0.0483	9.06	0.0634	0.0151	-0.0467
1997	0.0664	155.73	0.1451	9.06	0.0666	0.2117	0.1453
1998	0.0583	181.84	0.1677	8.01	0.0514	0.2191	0.1608
1999	0.0557	137.30	-0.2449	8.06	0.0443	-0.2006	-0.2563
2000	0.0650	227.09	0.6540	8.71	0.0634	0.7174	0.6524
2001	0.0553	200.50	-0.1171	8.95	0.0394	-0.0777	-0.1330
2002	0.0559	169.50	-0.1546	8.83	0.0440	-0.1106	-0.1665
Average	0.0674					0.1101	0.0427

* Ibbotson Associates utilizes Treasury bonds with 20 years to maturity.

Sources: For Bond Data: Ibbotson Associates, Stocks, Bonds, Bills, and Inflation, Valuation Edition 2003 Yearbook, Table B7.
For Electric Utility Common Stock Company Data: Mergent Public Utility Manual, 2003, pages a15, a16.

**CAPM Estimate of ROE
For Comparable Electric Utilities
of Louisville Gas & Electric Company**

CAPM Analysis Based on Historical Returns

<u>Firm Name</u>	<u>Market Risk Premium*</u>	<u>Value Line Beta</u>	<u>Company Risk Premium</u>	<u>Yield on 20-Yr. Treasury Bonds</u>	<u>Company ROE Before Adjustment</u>	<u>Size Premium**</u>	<u>ROE</u>
Alliant Energy Corporation	7.00%	0.75	5.25%	4.95%	10.20%	0.82%	11.02%
Ameren Corporation	7.00%	0.70	4.90%	4.95%	9.85%	0.00%	9.85%
Consolidated Edison	7.00%	0.60	4.20%	4.95%	9.15%	0.00%	9.15%
DTE Energy Company	7.00%	0.65	4.55%	4.95%	9.50%	0.00%	9.50%
Exelon Corporation	7.00%	0.70	4.90%	4.95%	9.85%	0.00%	9.85%
MGE Energy	7.00%	0.55	3.85%	4.95%	8.80%	1.52%	10.32%
NSTAR	7.00%	0.70	4.90%	4.95%	9.85%	0.82%	10.67%
Pinnacle West Capital Corporation	7.00%	0.80	5.60%	4.95%	10.55%	0.82%	11.37%
SCANA Corporation	7.00%	0.65	4.55%	4.95%	9.50%	0.82%	10.32%
Southern Company	7.00%	0.60	4.20%	4.95%	9.15%	0.00%	9.15%
Vectren Corporation	7.00%	0.75	5.25%	4.95%	10.20%	0.82%	11.02%
Wisconsin Energy Corporation	7.00%	0.65	4.55%	4.95%	9.50%	0.82%	10.32%
Average of Comparable Companies	7.00%	0.68	4.73%	4.95%	9.68%	0.54%	10.21%

* Ibbotson Associates, Valuation Yearbook, 2003, Table A-1, p.174, Long-Horizon Equity Risk Premium from 1926-2002, S&P 500 basis.

** Ibbotson Associates, Valuation Yearbook, 2003, Last Page.

CAPM Analysis Based on Projected S&P 500 Returns

First Call*	8.13%	0.68	5.53%	4.95%	10.48%	0.54%	11.02%
Standard & Pooors**	10.13%	0.68	6.89%	4.95%	11.84%	0.54%	12.38%
Average							11.70%

* Based on projected earnings growth of 11.4%, plus current dividends of 1.68% (Barons Market Week, March 15, 2004, p. MW38) minus yield on 20-year bond of 4.95%.

** Based on projected earnings growth of 13.4%, plus current dividends of 1.68%, minus yield on 20-year Treasury bond of 4.95%.

**Summary of Tests Results to Determine the Appropriate Regulatory Return on Common Equity
For Louisville Gas & Electric Company (Natural Gas Service)**

<u>DCF Test Result</u>		
Range of DCF Test Results	8.6% to 10.5%	
Average DCF Test Result	9.60%	Exhibit KLK-12
<u>Historical Industry Equity Risk Premium Analysis</u>		
Equity Risk Premium for the Natural Gas Distribution Industry	5.45%	Exhibit KLK-15
Yield on 20-Year Treasury Bonds	4.95%	Average of last 12 Friday closings, as reported by Federal Reserve Statistical Release*
ROE	10.40%	
<u>CAPM</u>		
Historical CAPM Estimated ROE	10.75%	Exhibit KLK-16
Projected CAPM Estimated ROE	12.24%	Exhibit KLK-16
Average CAPM Test Result	11.50%	
Average of CAPM, Risk Premium and DCF Test Results	10.50%	
Reasonable Range provided by all three tests	9.6% to 10.75%	
KLK RECOMMENDED ROE	10.5%	

* Average of 12 Friday closing yields for Treasury fixed-income bonds with 20 years remaining to maturity, starting with week ending December 26, 2003 and continuing through March 12, 2004.

**ROE Based on Discounted Cash Flow Model
For Comparable Natural Gas Utilities**

Firm Name	Average Closing Price	Latest 12 Months	Historic
	December 17, 2003 through March 16, 2004	Dividend	Yield
	(\$)	(\$)	
AGL Resources	28.91	1.120	3.87%
Atmos Energy	25.51	1.210	4.74%
KeySpan	36.88	1.780	4.83%
Laclede Group	29.93	1.345	4.49%
Northwest Natural Gas	31.23	1.280	4.10%
Peoples Energy	43.10	2.120	4.92%
Piedmont Natural Gas	42.18	1.660	3.94%
Average of Comparable Companies			4.41%
KLK Low Growth Rate Estimate for Comparable Companies from Exhibit KLK-13			4.05%
Expected Dividend Yield Next 12 Months Over Average Price at Growth Rate for Comparable Companies			4.59%
ROE for Comparable Companies			8.64%
KLK High Growth Rate Estimate for Comparable Companies from Exhibit KLK-13			5.76%
Expected Dividend Yield Next 12 Months Over Average Price at Growth Rate for Comparable Companies			4.76%
ROE for Comparable Companies			10.53%

Source: For both last 4 dividends and average closing prices, Yahoo Finance, Historical Quotes Database.

Historic and Projected Growth in Dividends, Earnings and Book Value For Comparable Natural Gas Utility Companies

Firm Name	Past 5 Years Growth Rates			Past 10 Years Growth Rates			Projected 2003 Out 4 Years		
	Earnings	Dividends	Book Value	Earnings	Dividends	Book Value	Earnings	Dividends	Book Value
AGL Resources	7.24%	0.55%	4.67%	6.36%	0.65%	3.78%	2.99%	0.22%	7.97%
Atmos Energy	-1.45%	2.51%	6.46%	3.69%	3.39%	5.65%	3.99%	2.41%	-1.30%
KeySpan*	5.12%	3.48%	-0.77%	3.33%	3.03%	3.68%	8.29%	1.64%	5.86%
Laclede Group	2.87%	0.30%	1.44%	1.23%	0.94%	2.53%	1.74%	0.56%	4.55%
Northwest Natural Gas*	3.22%	0.81%	3.18%	0.06%	0.82%	4.02%	7.65%	1.91%	4.57%
Peoples Energy	4.99%	2.11%	1.85%	3.12%	1.76%	2.49%	6.56%	1.39%	8.46%
Piedmont Natural Gas	1.87%	5.34%	5.89%	4.02%	5.74%	6.18%	9.14%	3.43%	3.07%
Mean of Comparable Companies	3.41%	2.16%	3.25%	3.12%	2.34%	4.05%	5.76%	1.65%	4.74%
Average Mean Earnings, Dividends, Book Value Growth		2.94%			3.17%			4.05%	
Median of Comparable Companies	3.22%	2.11%	3.18%	3.33%	1.76%	3.78%	6.56%	1.64%	4.57%
Average Median Earnings, Dividends, Book Value Growth		2.84%			2.96%			4.26%	

KLK Growth Rate for Comparable Companies
Low Estimate - Projected Average Mean Earnings, Dividends and Book Value Growth
High Estimate - Average Mean Projected Earnings Growth

4.05%
5.76%

Source for values used in computing growth rates: Value Line Investment Survey, Annual Data, December 19, 2003 (most recent on March 15, 2004).
* Keyspan and Northwest Natural experienced large earnings disruptions in 1998, therefore earnings smoothed during the 1997-1999 period are used to compute the past 5- year earnings growth rates.

**Annual Long Term Risk Premium Analysis
 For Natural Gas Distribution Company Common Stocks
 Using Government Bond Total Returns**

Year	Long Term Government	Natural Gas Distribution Company Data						Equity Risk Premium
	Bond Total Return	Year End Stock Price	Capital Gain/Loss	Year End Dividend	Yield	Total Return		
1954		26.47						
1955	-0.0129	28.10	0.0616	1.38	0.0521	0.1137	0.1266	
1956	-0.0559	28.23	0.0046	1.48	0.0527	0.0573	0.1132	
1957	0.0746	25.78	-0.0868	1.49	0.0528	-0.0340	-0.1086	
1958	-0.0609	38.71	0.5015	1.57	0.0609	0.5825	0.6234	
1959	-0.0226	39.59	0.0227	1.66	0.0429	0.0656	0.0882	
1960	0.1378	48.21	0.2177	1.84	0.0465	0.2642	0.1264	
1961	0.0097	64.96	0.3474	1.94	0.0402	0.3877	0.3780	
1962	0.0689	59.73	-0.0805	2.02	0.0311	-0.0494	-0.1183	
1963	0.0121	64.62	0.0819	2.18	0.0365	0.1184	0.1063	
1964	0.0351	68.24	0.0560	2.30	0.0356	0.0916	0.0565	
1965	0.0071	64.31	-0.0576	2.48	0.0363	-0.0212	-0.0283	
1966	0.0365	53.50	-0.1681	2.61	0.0406	-0.1275	-0.1640	
1967	-0.0918	50.49	-0.0563	2.74	0.0512	-0.0050	0.0868	
1968	-0.0026	53.80	0.0656	2.81	0.0557	0.1212	0.1238	
1969	-0.0507	43.88	-0.1844	2.93	0.0545	-0.1299	-0.0792	
1970	0.1211	52.33	0.1926	3.01	0.0686	0.2612	0.1401	
1971	0.1323	47.86	-0.0854	3.07	0.0587	-0.0268	-0.1591	
1972	0.0569	53.54	0.1187	3.12	0.0652	0.1839	0.1270	
1973	-0.0111	43.43	-0.1888	3.28	0.0613	-0.1276	-0.1165	
1974	0.0435	29.71	-0.3159	3.34	0.0769	-0.2390	-0.2825	
1975	0.0920	38.29	0.2888	3.48	0.1171	0.4059	0.3139	
1976	0.1675	51.80	0.3528	3.70	0.0966	0.4495	0.2820	
1977	-0.0069	50.88	-0.0178	3.93	0.0759	0.0581	0.0650	
1978	-0.0118	45.97	-0.0965	4.18	0.0822	-0.0143	-0.0025	
1979	-0.0123	53.50	0.1638	4.44	0.0966	0.2604	0.2727	
1980	-0.0395	56.61	0.0581	4.68	0.0875	0.1456	0.1851	
1981	0.0186	53.50	-0.0549	5.12	0.0904	0.0355	0.0169	
1982	0.4036	50.62	-0.0538	5.39	0.1007	0.0469	-0.3567	
1983	0.0065	55.79	0.1021	5.55	0.1096	0.2118	0.2053	
1984	0.1548	69.70	0.2493	5.88	0.1054	0.3547	0.1999	
1985	0.3097	76.58	0.0987	6.22	0.0892	0.1879	-0.1218	
1986	0.2453	90.89	0.1869	5.71	0.0746	0.2614	0.0161	
1987	-0.0271	77.25	-0.1501	6.02	0.0662	-0.0838	-0.0567	
1988	0.0967	86.76	0.1231	6.30	0.0816	0.2047	0.1080	
1989	0.1811	117.05	0.3491	6.58	0.0758	0.4250	0.2439	
1990	0.0618	108.86	-0.0700	6.84	0.0584	-0.0115	-0.0733	
1991	0.1930	124.32	0.1420	6.99	0.0642	0.2062	0.0132	
1992	0.0805	138.79	0.1164	7.14	0.0574	0.1738	0.0933	
1993	0.1824	154.06	0.1100	7.30	0.0526	0.1626	-0.0198	
1994	-0.0777	126.96	-0.1759	7.44	0.0483	-0.1276	-0.0499	
1995	0.3167	155.94	0.2283	7.56	0.0595	0.2878	-0.0289	
1996	-0.0093	166.64	0.0686	7.91	0.0507	0.1193	0.1286	
1997	0.1585	191.04	0.1464	8.02	0.0481	0.1946	0.0361	
1998	0.1306	177.24	-0.0722	8.13	0.0426	-0.0297	-0.1603	
1999	-0.0896	166.84	-0.0587	8.22	0.0464	-0.0123	0.0773	
2000	0.2148	200.68	0.2028	8.22	0.0493	0.2521	0.0373	
Average	0.0688					0.1224	0.0536	

Sources: For Bond Data: Ibbotson Associates, Stocks, Bonds, Bills, and Inflation, Valuation Edition 2003 Yearbook, Table B6
 For Natural Gas Distribution Company Data: Mergent Public Utility Manual, 2003, pages a20, a21.

**Annual Long Term Risk Premium Analysis
For Natural Gas Distribution Company Common Stocks
Using Government Bond Income Returns**

Year	Long Term Government	Natural Gas Distribution Company Data					
	Bond Income Return	Average Stock Price	Capital Gain/Loss	Dividend	Yield	Total Return	Equity Risk Premium
1954		26.47		1.25			
1955	0.0275	28.10	0.0818	1.38	0.0521	0.1137	0.0862
1956	0.0299	28.23	0.0046	1.48	0.0527	0.0573	0.0274
1957	0.0344	25.78	-0.0868	1.49	0.0528	-0.0340	-0.0684
1958	0.0327	38.71	0.5016	1.57	0.0609	0.5625	0.5298
1959	0.0401	39.59	0.0227	1.66	0.0429	0.0656	0.0255
1960	0.0426	48.21	0.2177	1.84	0.0465	0.2642	0.2216
1961	0.0383	64.96	0.3474	1.94	0.0402	0.3877	0.3494
1962	0.0400	59.73	-0.0805	2.02	0.0311	-0.0494	-0.0894
1963	0.0389	64.62	0.0819	2.18	0.0365	0.1184	0.0795
1964	0.0415	68.24	0.0560	2.30	0.0356	0.0916	0.0501
1965	0.0419	64.31	-0.0576	2.48	0.0363	-0.0212	-0.0631
1966	0.0449	53.50	-0.1681	2.61	0.0406	-0.1275	-0.1724
1967	0.0459	50.49	-0.0563	2.74	0.0512	-0.0050	-0.0509
1968	0.0550	53.80	0.0656	2.81	0.0557	0.1212	0.0662
1969	0.0595	43.88	-0.1844	2.93	0.0545	-0.1299	-0.1894
1970	0.0674	52.33	0.1926	3.01	0.0686	0.2612	0.1938
1971	0.0632	47.86	-0.0854	3.07	0.0587	-0.0268	-0.0900
1972	0.0587	53.54	0.1167	3.12	0.0652	0.1839	0.1207
1973	0.0651	43.43	-0.1888	3.28	0.0613	-0.1276	-0.1863
1974	0.0727	29.71	-0.3159	3.34	0.0769	-0.2390	-0.3041
1975	0.0799	38.29	0.2688	3.48	0.1171	0.4059	0.3332
1976	0.0789	51.80	0.3528	3.70	0.0966	0.4495	0.3696
1977	0.0714	50.88	-0.0178	3.93	0.0759	0.0581	-0.0208
1978	0.0790	45.97	-0.0965	4.18	0.0822	-0.0143	-0.0857
1979	0.0886	53.50	0.1638	4.44	0.0966	0.2604	0.1814
1980	0.0997	56.61	0.0581	4.68	0.0875	0.1456	0.0570
1981	0.1155	53.50	-0.0549	5.12	0.0904	0.0355	-0.0800
1982	0.1350	50.62	-0.0538	5.39	0.1007	0.0469	-0.0881
1983	0.1038	55.79	0.1021	5.55	0.1096	0.2118	0.1080
1984	0.1174	69.70	0.2493	5.88	0.1054	0.3547	0.2373
1985	0.1125	76.58	0.0967	6.22	0.0892	0.1879	0.0754
1986	0.0898	90.89	0.1869	5.71	0.0746	0.2614	0.1716
1987	0.0792	77.25	-0.1501	6.02	0.0662	-0.0838	-0.1630
1988	0.0897	86.76	0.1231	6.30	0.0816	0.2047	0.1150
1989	0.0881	117.05	0.3491	6.58	0.0758	0.4250	0.3369
1990	0.0819	108.86	-0.0700	6.84	0.0584	-0.0115	-0.0934
1991	0.0822	124.32	0.1420	6.99	0.0642	0.2062	0.1240
1992	0.0726	138.79	0.1164	7.14	0.0574	0.1738	0.1012
1993	0.0717	154.06	0.1100	7.30	0.0526	0.1626	0.0909
1994	0.0659	128.96	-0.1759	7.44	0.0483	-0.1276	-0.1935
1995	0.0760	155.94	0.2283	7.56	0.0595	0.2878	0.2118
1996	0.0618	166.64	0.0686	7.91	0.0507	0.1193	0.0575
1997	0.0664	191.04	0.1464	8.02	0.0481	0.1946	0.1282
1998	0.0583	177.24	-0.0722	8.13	0.0426	-0.0297	-0.0880
1999	0.0557	166.84	-0.0587	8.22	0.0464	-0.0123	-0.0680
2000	0.0650	200.68	0.2026	8.22	0.0493	0.2521	0.1871
Average	0.0680					0.1224	0.0545

Sources: For Bond Data: Ibbotson Associates, Stocks, Bonds, Bills, and Inflation, Valuation Edition 2003 Yearbook, Table B7
For Natural Gas Distribution Company Data: Mergent Public Utility Manual, 2003, pages a20, a21.

**CAPM Estimate of ROE
For Comparable Natural Gas Utilities
of Louisville Gas & Electric Company**

CAPM Analysis Based on Historical Returns

Firm Name	Market Risk Premium*	Value Line Beta	Company Risk Premium	Yield on 20-Yr. Treasury Bonds	Company ROE Before Adjustment	Size Premium**	ROE
AGL Resources	7.00%	0.75	5.25%	4.95%	10.20%	0.82%	11.02%
Amos Energy	7.00%	0.65	4.55%	4.95%	9.50%	0.82%	10.32%
KeySpan*	7.00%	0.75	5.25%	4.95%	10.20%	0.00%	10.20%
Laclede Group	7.00%	0.70	4.90%	4.95%	9.85%	1.52%	11.37%
Northwest Natural Gas*	7.00%	0.60	4.20%	4.95%	9.15%	1.52%	10.67%
Peoples Energy	7.00%	0.75	5.25%	4.95%	10.20%	0.82%	11.02%
Piedmont Natural Gas	7.00%	0.70	4.90%	4.95%	9.85%	0.82%	10.67%
Average of Comparable Companies	7.00%	0.70	4.90%	4.95%	9.85%	0.90%	10.75%

* Ibbotson Associates, Valuation Yearbook, 2003, Table A-1, p.174, Long-Horizon Equity Risk Premium from 1926-2002, S&P 500 basis.

** Ibbotson Associates, Valuation Yearbook, 2003, Last Page.

CAPM Analysis Based on Projected S&P 500 Returns

First Call* Standard & Poores** Average	8.13% 10.13%	0.70 0.70	5.69% 7.09%	4.95% 4.95%	10.64% 12.04%	0.90% 0.90%	11.54% 12.94% 12.24%
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* Based on projected earnings growth of 11.4%, plus current dividends of 1.68% (Barrons Market Week, March 15, 2004, p. MW38) minus yield on 20-year bond of 4.95%.

** Based on projected earnings growth of 13.4%, plus current dividends of 1.68%, minus yield on 20-year Treasury bond of 4.95%.

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U4117

SUBJECT: In the Matter of Adjustment of Gas and Electric Rates of Louisville Gas
and Electric Company, KY PSC Case No. 2003-00433

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MAR 23 2004

PUBLIC SERVICE
COMMISSION

Hon. Thomas M. Dorman
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

Dear Mr. Dorman:

In accord with the Commission's Order dated 14 January 2004, enclosed for filing find the original and eleven copies of the each of the prepared direct testimony and exhibits of Kenneth L. Kincel and Thomas J. Prisco, expert witnesses on behalf of the consumer interest of the United States Department of Defense and other affected Federal Executive Agencies (hereinafter "DOD") and intervenor in the above styled proceeding. Enclosed is a computer diskette with an electronic copy of the text documents in MicroSoft Word and spreadsheet exhibits in Excel (XLS).

Copies of this pleading are being sent in accord with the Certificate of Service. Inquiries regarding this proceeding should be directed to the undersigned at the address above or at telephone number (703) 696-1646.

Sincerely yours

David A. McCormick
General Attorney

CF: Certificate of Service
Hon. Daniel M. Kininmonth, Fort Knox, KY

COMMONWEALTH OF KENTUCKY
BEFORE THE
PUBLIC SERVICE COMMISSION

RECEIVED

MAR 23 2004

PUBLIC SERVICE
COMMISSION

In the Matter of:)

An Adjustment of the Gas and)
Electric Rates, Terms and Conditions)
of Louisville Gas and Electric)
Company)

Docket No. 2003-00433

**Direct Testimony
of Thomas J. Prisco**

David A. McCormick, Attorney
Regulatory Law Office
U.S. Army Legal Services Agency
JALS-RL
901 N. Stuart Street, Room 713
Office of Judge Advocate General
Arlington, VA 22203-1837

FOR

**THE UNITED STATES DEPARTMENT OF DEFENSE
AND OTHER ALL FEDERAL EXECUTIVE AGENCIES**

Dated: March 22, 2004
Filing Due: March 23, 2004

1 **Q. WOULD YOU PLEASE STATE YOUR FULL NAME AND BUSINESS**
2 **ADDRESS?**

3 A. My name is Thomas J. Prisco and my business address is United States Army
4 Litigation Center, JALS-RL, Suite 713, 901 North Stuart Street, Arlington,
5 Virginia 22203-1837.

6

7 **Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?**

8 A. I am employed by the Regulatory Law Office, United States Army Office of The
9 Judge Advocate General, Department of the Army, as a Staff Accountant and
10 Financial Advisor.

11

12 **Q. PLEASE SUMMARIZE YOUR PAST WORK EXPERIENCE.**

13 A. Prior to assuming my present position in October 1987, I had been employed by the
14 United States Army Information Systems Command as a Systems Accountant,
15 responsible for the development and fielding of a cost chargeback system for the
16 VIABLE Project Management Office. From 1978 to 1983, I held various positions
17 with the United States Computer Systems Command, including Staff Accountant,
18 Chief Accounting Operations, and Contracting Officer. Prior to accepting civilian
19 employment with the Department of the Army, I held a variety of positions with RCA.
20 I also served a tour with the United States Air Force in Vietnam.

21

22 **Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND.**

1 A. I received a Bachelor of Science degree with a major in accounting from the
2 University of Scranton. I have taken numerous professional development courses that
3 include Price and Cost Analysis, U.S. Army Financial Management, and Computer
4 Performance and Capacity Management. I have also attended numerous Regulatory
5 Studies Programs and seminars.

6

7 **Q. WHAT ARE THE RESPONSIBILITIES AND DUTIES ASSOCIATED WITH**
8 **YOUR PRESENT POSITION?**

9 A. As Staff Accountant and Financial Advisor with the Regulatory Law Office, I analyze
10 testimony, exhibits, and supporting data submitted by utilities to regulatory bodies in
11 justification of rate increases/decreases; advise office attorneys in accounting matters;
12 draft proposed cross-examination of company witnesses; prepare statements and
13 exhibits for use in regulatory proceedings; and present testimony before utility
14 commissions to protect the consumer interests of the Federal Government.

15

16 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN RATE PROCEEDINGS BEFORE**
17 **REGULATORY COMMISSIONS?**

18 A. Yes. I have participated in numerous regulatory proceedings in the states of Arizona,
19 Florida, Georgia, Indiana, Kansas, Kentucky, Maryland, Missouri, New Jersey, New
20 York, North Carolina, Pennsylvania, South Carolina, Texas plus the District of
21 Columbia. I have also filed participated in proceedings before the FERC and ICC.
22 These proceedings involved gas, electric, water, wastewater, and telephone. A list of

1 the various proceedings in which I have filed testimony is outlined on DOD/FEA
2 Schedule TJP-1.

3

4 **Q. WOULD YOU OUTLINE THE SUBJECT MATTER OF THE EXPERT**
5 **TESTIMONY YOU HAVE PRESENTED BEFORE REGULATORY**
6 **COMMISSIONS?**

7 A. My testimony has addressed the overall revenue requirements, depreciation, capital
8 structure, cost of capital, valuation, integrated resource planning, rate design,
9 incentive rates, rate base and appropriate tariffs of communications, electric, gas, and
10 water utilities.

11

12 **Q. WHO ARE YOU REPRESENTING IN THIS PROCEEDING?**

13 A. I am presenting testimony on behalf of the consumer interest of the Department of
14 Defense and all Other Federal Executive Agencies (hereinafter called "DOD"). The
15 Secretary of Defense has been delegated authority by the General Services
16 Administration to provide representation of the consumer interest of federal civilian
17 agencies in this proceeding.

18

19 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS**
20 **PROCEEDING?**

21 A. The magnitude of Louisville Gas & Electric Company proposed rates warrants
22 intervention to protect the consumer interests of the Federal government. My purpose
23 is to review LG&E's rate base filing for its electric and gas operations and provide

1 recommendations to the Kentucky Public Service Commission (KPSC or
2 Commission) that may help mitigate the impact on the DOD. In order to develop my
3 recommendations, I reviewed the prefiled testimony and exhibits of the Company; the
4 responses to data request submitted by the Commission Staff, AG, and other parties.
5 I believe my testimony identifies a number of legitimate base rate adjustments that
6 the Commission may wish to consider.

7

8 **Q. PLEASE SUMMARIZE YOUR TESTIMONY IN THIS PROCEEDING.**

9 A. My testimony demonstrates that the base rate increase of \$82,870,472 (\$63,764,203
10 electric and \$19,106,269 gas) is overstated and should be significantly reduced. My
11 review of the Company's filing indicates that a revenue increase in the neighborhood
12 of \$30.1 million may be justified. My revenue requirement recommendation is
13 supported by a number of net operating income adjustments. In quantifying my
14 revenue requirement recommendation I used the return on equity (ROE) for LG&E's
15 electric and gas operations found reasonable by DOD witness Mr. Kenneth L. Kincel.
16 Mr. Kincel's recommendations result in an ROE of 10.0% for electric and 10.5% for
17 gas. It should be noted that because of limited time and resources a comprehensive
18 analysis of all phases of the Company's operation could not be accomplished at this
19 time. Therefore, items which are not been addressed in this filing does not constitute
20 an endorsement of LG&E's position.

21

22 **Q. DO YOU HAVE ANY OBJECTION TO THE TEST PERIOD PROPOSED BY**
23 **THE COMPANY WITNESS?**

1 A. The twelve month period ending September 30, 2003 is an appropriate test year in
2 this proceeding.

3

4 **Q. MR. PRISCO, PLEASE LIST THE BASE RATE ADJUSTMENTS YOU ARE**
5 **RECOMMENDING IN YOUR DIRECT TESTIMONY.**

6 A. Recommended adjustments to LG&E's filing are listed below:

7 **Operating Income Adjustments**

- 8 • Adjustment to LG&E's pro forma unbilled revenues.
- 9 • Adjustment to pro-forma depreciation expense.
- 10 • Adjustment to pro-forma pension and post retirement.
- 11 • Adjustment to normalized storm damage.
- 12 • Adjustment to pro-forma ESM audit expenses.
- 13 • Adjustment to pro-forma injuries & damages.
- 14 • Adjustment to pro-forma revenues for merger savings.
- 15 • Adjustment to pro-forma effect of accounting change.
- 16 • Adjustment to pro-forma office lease expense.
- 17 • Adjustment to Cane Run repair refund.
- 18 • Adjustment to LG&E's pro-forma carbide lime write-off.
- 19 • Eliminate LG&E's field losses & purification pro-forma adjustment

20

21 **Q. WHAT IS THE OVERALL COST OF CAPITAL AND THE**
22 **CAPITALIZATION YOU ARE UTILIZING IN THIS PROCEEDURE?**

1 A. I have made no adjustment to the capitalization proposed by Company witness Mr. S.
2 Bradford Rives. However, in determining the overall cost of capital, as previously
3 stated, I used the return on equity (ROE) recommended in the testimony of DOD
4 witness Mr. Kenneth Kincel. The utilization of LG&E's capitalization and DOD's
5 ROE results in an overall cost of capital for electricity of 6.52% and for natural gas of
6 6.75%. The calculation of the overall cost of capital is provided on DOD/FEA
7 Exhibit 2. This exhibit also provides the calculation of net operating revenues
8 required by LG&E of \$96,868,620 electric (line 7) and \$21,083,489 gas (line 14),
9 presented on line 1 of DOD Exhibit TJP-1.

10
11 **Q. PLEASE PROVIDE A BRIEF EXPLANATION OF UNBILLED REVENUES.**

12 A. The following explanation was provided by Company witness Mr. Butch Cockerill in
13 response to the supplemental data request of MHNA and Power, dated March 1,
14 2003.

15 The answer for 3a follows:

16 Utility revenues are recorded in the financial statements based on a two step
17 process. First, customer meters are read in 21 billing cycles throughout the
18 month, based on geographic location. Next, the meter reads are loaded in our
19 Customer Information System and bills are rendered based on those reads. As
20 each bill is calculated, the revenue from that customer is recorded in company
21 revenues "as billed". Example: Customer A has the meter read on the 20th of
22 January. All the revenues from that bill are recorded in the January financial
23 statements even though the billing period runs from December 21 –January 20.
24

25 The answer for 3b follows:

26 This brings us to step two, "unbilled revenues". As you can see from the
27 example in the answer to "a" above, all customer meters are not read on the
28 last day of the month. Therefore, there are days where the customer has kwh,
29 or ccf, usage which is not being recorded in the revenue month it was used,
30 i.e., usage from December 21-31 in the above example is recorded in January
31 revenue month, not December. This is corrected by the company making an
32 "unbilled revenue estimate" each month for the amount of consumption that

1 was used by customers from their regular meter read date to the end of the
2 month. That estimate is then recorded as “unbilled revenues”. That estimate
3 will then be reversed in the next revenue month so that revenues are not
4 “double counted” when the customer is billed again.
5

6 **Q. WHY DO YOU BELIEVE AN ADJUSTMENT TO THE COMPANY’S PRO-**
7 **FORMA “UNBILLED REVENUES” IS NECESSARY?**

8 A. An adjustment for unbilled revenues creates a mismatch between revenues and
9 expenses for the accounting period. LG&E recognizes revenues through the end of
10 an accounting period for financial and tax purposes. Unbilled revenues are currently
11 adjusted out for regulatory purposes only. On the regulated records, the Company
12 recognizes revenues that coincide with meter readings while expenses are recorded
13 through the end of the accounting period resulting in a mismatch between revenues
14 and expenses.
15

16 **Q. DO YOU AGREE WITH COMPANY WITNESS MR. WILLIAM STEVEN**
17 **SEELYE WHO POINTS OUT THAT THIS COMMISSION HAS ACCEPTED**
18 **THIS ADJUSTMENT IN LG&E’S LAST TWO BASE RATE CASES, CASE**
19 **NO. 2000-080 AND CASE NO. 90-158?**

20 A. Yes.
21

22 **Q. HAS ANY NEW DEVELOPMENT TAKEN PLACE WHICH MIGHT**
23 **INFLUENCE THE COMMISSION IN RECONSIDERING THIS PAST**
24 **PRACTICE?**

25 A. Yes. LG&E’s electric rates are now subject to an ESM mechanism. This sets an

1 upper and lower point for rate of return on equity which may be influenced by
2 unbilled revenues. Customers, besides being denied a true accounting because of a
3 mismatch in revenues and expenses, may now be subject to a monetary penalty
4 because of the ESM.

5

6 **Q. PLEASE EXPLAINING THE ADJUSTMENT YOU MADE TO THE**
7 **COMPANY'S PRO-FORMA UNBILLED REVENUES ENTRY.**

8 A. DOD Exhibit TJP-4 quantifies my adjustment. The first was to eliminate the
9 Company's adjustment to current year revenues. I then amortized the balance of the
10 unbilled revenues account over a 10 year period. This resulted in an increase to
11 revenues of \$3,969,800 for electric and \$3,134,600. The Commission may not agree
12 with the actual mechanics of my adjustment however, action needs to be taken to
13 mitigate the growth of unbilled revenues, and the monetary impact it can have on
14 customers as a result of the ESM calculation.

15

16 **Q. WOULD IT BE APPROPRIATE TO INCLUDE THE COMPANY'S PRO-**
17 **FORMA DEPRECIATION EXPENSE ADJUSTMENT?**

18 A. No. The Company has included the effects of a depreciation study for the twelve
19 months ending December 2002. It is my understanding that a settlement was reached
20 which would require the depreciation study to be completed for the 12 months ending
21 December 2003. Absent a current agreement by the parties and/or a Commission
22 decision that the study is valid, I recommend disallowing the pro-forma depreciation
23 expense request. I believe a separate proceeding should be established to deal with

1 depreciation and implementation of SFAS No. 143, Accounting for Asset Retirement
2 Obligations (ARO) simultaneously. Depreciation issues, except for normal growth and
3 attrition, should be excluded from a general rate base proceeding. The issues are
4 complicated and require a great deal of time, plus it taxes the available resources of
5 intervening parties limiting the quality of their investigation. Therefore, I have
6 eliminated the Company's pro-forma depreciation expense on DOD/FEA Exhibit
7 TJP-5.

8

9 **Q. MR. PRISCO, YOU MENTIONED IN YOUR DEPRECIATION DISCUSSION**
10 **THAT YOU WOULD CONSIDER THE ARO EFFECTS AND**
11 **DEPRECIATION ISSUES SIMULTANEOUSLY. HAVE YOU MADE AN**
12 **ADJUSTMENT TO THE COMPANY'S FILING TO RECOGNIZE THE ARO**
13 **ISSUE?**

14 A Yes, I eliminated LG&E's pro-forma adjustment on Rives Exhibit 1, Schedule 1.25
15 prepared by Company witness Ms. Valerie Scott. As mentioned earlier the accounting
16 for ARO's should be evaluated along with depreciation in a separate proceeding
17 especially at the onset of implementing the new accounting change. There seems to be
18 an ambiguity with the pro-forma adjustment sponsored by the Company.
19 Rives Exhibit 1, schedule 1.25 identifies a \$5,280,909 pro-forma adjustment
20 to operating expenses. Yet, the Company's response to KIUC first data request,
21 question no. 100, dated February 3, 2004 states:

22 The Companies have not reflected expenses based on SFAS 143 for
23 ratemaking purposes. In calculating the annualized depreciation adjustment in
24 Rives Exhibit 1.11 each company excluded depreciation expense on ARO
25 assets. Additionally, pursuant to SFAS 71 treatment, offsetting regulatory

1 credits related to ARO accretion and depreciation amounts were established
2 on the Companies' income statements. Therefore, no SFAS 143 expenses are
3 included for ratemaking purposes. Consistent with FERC Final Order No.
4 631, ARO assets and related accumulated depreciation are included in FERC
5 accounts 101 and 108. No adjustments were made for ratemaking purposes.
6

7 Also the calculation for the proposed pro-forma adjustment on schedule 1.25 seems to
8 be more complicated than is necessary. The original amount that was initially
9 identified in the Company's calculation should have ultimately been reversed without
10 adjusting for the tax ramifications. At first glance this adjustment seems to be
11 complicated and the Company has not provided a clear explanation as to why it should
12 be allowed. Without a clearer explanation I recommend that the pro-forma adjustment
13 be disallowed. Reference DOD Exhibit TJP-11.
14

15 **Q. WHY HAVE YOU ELIMINATED LG&E'S PRO-FORMA ADJUSTMENT**
16 **FOR PENSION AND POST RETIREMENT?**

17 A. I am recommending establishing a regulatory asset and/or credit as balancing
18 accounts for pensions and other post-retirement expenses. The Commission could
19 require that any actuarial gains or losses above or below the amount established in
20 rates be deferred for later refund or recovery. This mechanism will insure that
21 actuarial gains and/or losses will neither benefit nor harm the Company's bottom line.
22

23 **Q. ARE YOU PROPOSING TO AMORTIZE THE CURRENT DEFICIENCY**
24 **FOR PENSIONS AND RETIREMENT BENEFITS REQUESTED BY THE**
25 **COMPANY IN THE CURRENT PROCEEDING?**

1 A. No. Various investment strategies result in fluctuations in the pension portfolios from
2 year to year. Therefore, I would recommend that a band be established that would
3 require a refund or recovery if or when the account reaches a specific threshold (e.g.
4 15% of plan assets). The amount LG&E is requesting in this proceeding would most
5 likely be below any threshold established by the Commission and should be deferred
6 for future recovery if warranted. (Reference DOD/FEA Exhibit 6)

7

8 **Q. MR. PRISCO, DO YOU KNOW OF ANY UTILITIES THAT HAVE**
9 **INSTITUTED THIS TYPE OF TREATMENT FOR PENSION AND OTHER**
10 **POST RETIREMENT OBLIGATIONS?**

11 A. Yes. The following companies have adopted some type of deferred accounting
12 mechanism for pensions and post retirement benefits: Central Hudson Energy Group,
13 Entergy, and in certain jurisdictions for Washington Gas Light, Entergy.

14

15 **Q. THE COMPANY HAS REQUESTED NORMALIZATION OF STORM**
16 **DAMAGE EXPENSE OVER A TEN YEAR PERIOD. DO YOU AGREE**
17 **WITH THIS PRO-FORMA ADJUSTMENT?**

18 A. No. Although, the Commission has authorized the normalization over a 10 year
19 period in the past, I have deviated from this position for this proceeding.

20

21 **Q. PLEASE EXPLAIN.**

22 A. The Company's merger physically provides a larger geographical area and should
23 reduce the possibility a storm will cover its entire service territory. The additional

1 resources of the combined company should help in quickly resolving any problems and
2 at a lower price than LG&E as a standalone Company. Therefore, I have used a five
3 year post merge period for normalizing storm damage. The Company has also not
4 justified the use of an inflation factor. Both technology and enhanced productivity
5 should eliminate the need to adjust for inflation. (Ref: DOD/FEA
6 Exhibit TJP-7.

7

8 **Q. WHY HAVE YOU REDUCED THE ESM AUDIT EXPENSES?**

9 A. I believe the audit of the ESM expenses benefits not only the ratepayers but
10 stockholders as well and both should share the cost of the audit equally.

11 (DOD/FEA Exhibit TJP-8)

12

13 **Q. DOD/FEA EXHIBIT TJP-9 NORMALIZES INJURIES & DAMAGES OVER A**
14 **FIVE YEAR PERIOD IT IS ALSO ADJUSTED FOR INFLATION. DO YOU**
15 **AGREE WITH THE COMPANY'S ADJUSTMENT?**

16 A. No. I have no objection to the five year normalization however, I substituted the test
17 year for 1998. I also disallowed the inflation adjustment based on the fact that the
18 Company is aggressively trying to reduce injuries and the lower number of injuries
19 should more than offset the increase in inflation.

20

21 **Q. WHY HAVE YOU ELIMINATED THE PRO-FORMA OPERATING**
22 **REVENUE ADJUSTMENT FOR MERGER SAVINGS?**

1 A. I have made this adjustment based on the fact that an accrual for this refund should
2 have already been established in account 449.1 “provision for rate refunds” in the
3 amount of \$2,758,795 thus reducing test year income. The Company is now
4 requesting that revenues be reduced by this amount because the refund had not been
5 made in the test year and it is a known and measurable adjustment. I believe this
6 account must have been treated similar to the Company’s accrual in account 449
7 “Other sales” for ESM revenue, ECR revenue, and FAC revenue for a total of
8 \$7,150,231 which is being removed from revenues in pro-forma adjustment, schedule
9 1.08 because it overstated revenues in the test year. Why would the revenues be
10 accrued without a corresponding entry to the refund account?

11 (DOD/FEA Exhibit TJP-10)

12

13 **Q. MR. PRISCO, PLEASE EXPLAIN YOUR ADJUSTMENT TO LG&E’S PRO-**
14 **FORMA ADJUSTMENT FOR CORPORATE OFFICE LEASE EXPENSE.**

15 A. I am requesting that since this is a one time credit that it should be normalized over a
16 three year period. See DOD/FEA Exhibit 12.

17

18 **Q. PLEASE EXPLAIN DOD/FEA EXHIBIT TJP-13 FOR THE CANE RUN**
19 **REPAIR REFUND?**

20 A. The Company is removing the revenue associated with this entry because it is a one
21 time refund for expenses incurred prior to the test year. I am requesting that the refund
22 be amortized over a three year period since these cost affected the ESM calculation
23 ultimately depriving customers of a larger refund. (DOD/FEA Exhibit 13).

1 **Q. WHY HAVE YOU ELIMINATED THE PRO-FORMA ADJUSTMENT TO**
2 **WRITE-OFF FOR CARBIDE LIME?**

3 A. The company which provided the carbide lime filed for bankruptcy in September of
4 2001. If LG&E made payments to the Company after that period that would
5 constitute a post bankruptcy claim and guarantee payment in which case ratepayers
6 should not be responsible. On the other hand if the payments where made for the
7 carbide lime prior to September 2001 they would be an out of period adjustment and
8 should be denied. Therefore, I have eliminated LG&E's request for amortization of
9 the carbide lime write-off. (DOD/FEA Exhibit TJP-14).

10

11 **Q. WHY HAVE YOU DISALLOWED THE ADJUSTMENT TO STORAGE**
12 **FIELD LOSSES AND PURIFICATION EXPENSE?**

13 A. My review of the Company's response to the first data request of the Attorney
14 General, question no. 71, dated February 3, 2004 reveals that the test year cost where
15 the actual cost incurred for purification and storage losses. The response also shows
16 that the average unit cost has fluctuated over the past several years. Based on this
17 information I believe it would be inappropriate to substitute the current average cost
18 for the actual cost since rates will be in effect for several years and the average cost
19 could change numerous times. I have eliminated \$426,754 from the Company's pro-
20 forma operating expense. (DOD/FEA Exhibit 15).

21

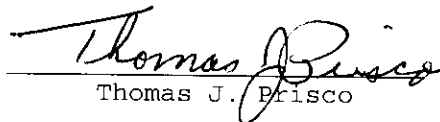
22 **Q. MR. PRISCO DOES THIS CONCLUDE YOUR TESTIMONY?**

23 A. Yes.

AFFIDAVIT OF THOMAS J. PRISCO

COUNTY OF ARLINGTON)
) SS:
COMMONWEALTH OF VIRGINIA)

Before me, the undersigned Notary Public in and for the County of Arlington, Commonwealth of Virginia, this day personally appeared Thomas J. Prisco, Systems Accountant, U.S. Army Legal Services Agency, to me personally known, who stated under oath that the foregoing direct testimony and exhibits were prepared by him or under his direct supervision and control; that he has knowledge of the matters set forth in said testimony and exhibits; and that such matters are true and correct to the best of his knowledge, information, and belief.


Thomas J. Prisco

Subscribed and sworn to before me this 22nd day of March, 2004, in the County of Arlington, Commonwealth of Virginia.


Notary Public

My Commission Expires: *April 30, 2004*

**COMMONWEALTH OF KENTUCKY
BEFORE THE
PUBLIC SERVICE COMMISSION**

In the Matter of:)

**An Adjustment of the Gas and)
Electric Rates, Terms and Conditions)
of Louisville Gas and Electric)
Company)**

Docket No. 2003-00433

**Schedule
of Thomas J. Prisco**

David A. McCormick, Attorney
Regulatory Law Office
U.S. Army Legal Services Agency
JALS-RL
901 N. Stuart Street, Room 713
Office of Judge Advocate General
Arlington, VA 22203-1837

FOR

**THE UNITED STATES DEPARTMENT OF DEFENSE
AND OTHER ALL FEDERAL EXECUTIVE AGENCIES**

Dated: March 22, 2004
Filing Due: March 23, 2004

PROCEEDING APPEARANCES OF THOMAS J. PRISCO
BEFORE REGULATORY TRIBUNALS
1989 to PRESENT

COMPANY	PROCEEDING	JURISDICTION	ACTION	SUBJECT
LOUISVILLE GAS AND ELECTRIC COMPANY	Case No. 10,064	KENTUCKY	TESTIMONY	Revenue Requirements
SOUTHWESTERN BELL TELEPHONE COMPANY	Case No. TC 89-14	MISSOURI	TESTIMONY	Revenue Requirements
MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY	Docket No. E-1051-88-146	ARIZONA	TESTIMONY	Revenue Requirements
BALTIMORE GAS AND ELECTRIC COMPANY	Case No. 8190	MARYLAND	TESTIMONY	Revenue Requirements
JERSEY CENTRAL POWER AND LIGHT COMPANY	BRC Docket No. ER 89110912J	NEW JERSEY	TESTIMONY	Revenue Requirements
BALTIMORE GAS AND ELECTRIC COMPANY	Case No. 8278	MARYLAND	SETTLEMENT NEGOTIATION	Revenue Requirements
EL PASO ELECTRIC COMPANY	Docket No. 12,700	TEXAS	TESTIMONY	Revenue Requirements
POTOMAC ELECTRIC POWER COMPANY	Case No. 8251	MARYLAND	TESTIMONY	Revenue Requirements
UNITED CITIES GAS COMPANY	Docket No. 4188-U	GEORGIA	TESTIMONY	Revenue Requirements
POTOMAC ELECTRIC POWER COMPANY	Case No. 912	DISTRICT OF COLUMBIA	TESTIMONY	Revenue Requirements
TUCSON ELECTRIC POWER COMPANY	Docket No. U1993-90-270	ARIZONA	SETTLEMENT NEGOTIATION	Assist Counsel
DEMAND SIDE OPTIONS AND CONSERVATION RULES	Docket No. 900834-EI	FLORIDA	TECHNICAL ASSISTANCE	Assist Counsel

PROCEEDING APPEARANCES OF THOMAS J. PRISCO
BEFORE REGULATORY TRIBUNALS
1989 to PRESENT

COMPANY	PROCEEDING	JURISDICTION	ACTION	SUBJECT
POTOMAC ELECTRIC POWER COMPANY	Case No. 8466	MARYLAND	SETTLEMENT NEGOTIATION	Assist Counsel
NEW JERSEY AMERICAN WATER COMPANY	BRC Docket No. WR 91081399J	NEW JERSEY	SETTLEMENT NEGOTIATION	Assist Counsel
INTEGRATED RESOURCE PLANNING RULE MAKING FOR GAS UTILITIES	Docket No. 91-677-G	SOUTH CAROLINA	TESTIMONY	Demand Side Management
BALTIMORE GAS AND ELECTRIC COMPANY	Case No. 8487	MARYLAND	TESTIMONY	Revenue Requirements
POTOMAC ELECTRIC POWER COMPANY	Case No. 8466	MARYLAND	SETTLEMENT NEGOTIATION	Assist Counsel
POTOMAC ELECTRIC POWER COMPANY	Case No. 8565	MARYLAND	SETTLEMENT NEGOTIATION	Assist Counsel
POTOMAC ELECTRIC POWER COMPANY	Case No. 929	DISTRICT OF COLUMBIA	TESTIMONY	Revenue Requirements
UNITED GAS PIPELINE COMPANY (KOCH)	Docket No. RS-92-26-000	F.E.R.C.	SETTLEMENT NEGOTIATION	Assist Counsel
NEW JERSEY AMERICAN WATER COMPANY	BRC Docket No. WR92090908J	NEW JERSEY	TESTIMONY	Revenue Requirements
ATLANTA GAS LIGHT COMPANY	Docket No. 4451-U	GEORGIA	TESTIMONY	Revenue Requirements
ENERGY POLICY ACT OF 1992 SECTION 115 CONSERVATION EFFORTS OF GAS UTILITIES	Docket No. 83-730-G	SOUTH CAROLINA	TESTIMONY	Revenue Requirements Demand Side Management

PROCEEDING APPEARANCES OF THOMAS J. PRISCO
BEFORE REGULATORY TRIBUNALS
1989 to PRESENT

COMPANY	PROCEEDING	JURISDICTION	ACTION	SUBJECT
WHEELING & LAKE ERIE RAILROAD COMPANY, LINE ABANDONMENT	Docket No. AB-277 (Sub No. 2X)	I.C.C.	Settled, Prepared Valuation Study	Assist Counsel
INVESTIGATION OF SELF GENERATION AND ECONOMIC INCENTIVE RATES RULE MAKING	Docket No. E-100 (Sub 73)	NORTH CAROLINA	TESTIMONY	Rate Design
INVESTIGATION INTO ELECTRIC POWER COMPETITION	Docket No. I-94-0032	PENNSYLVANIA	TESTIMONY	Electric Deregulation
RECOVERY OF STRANDED COSTS BY PUBLIC AND TRANSMITTING UTILITIES	Docket No. RM 94-007-000	F.E.R.C.	TESTIMONY	Electric Deregulation
INVESTIGATION OF ELECTRIC SERVICE COMPETITION AND REGULATORY POLICIES	Case No. 8678	MARYLAND	TESTIMONY	Electric Deregulation
INVESTIGATION OF ALTERNATIVE POWER POOLING SOLUTIONS	Docket No. RM 94-20-000	F.E.R.C.	TESTIMONY	Wholesale Transmission
ECONOMIC DEVELOPMENT INCENTIVE POLICY (GAS, ELECTRIC, TELECOMMUNICATIONS)	Docket No. 4697-U	GEORGIA	TESTIMONY	Rate Design
NIAGARA MOHAWK POWER CORPORATION	Case Nos. 94-E-0098; 94-E-0099, and 94-E-100	NEW YORK	TESTIMONY	Revenue Requirements and Price Caps
PENNSYLVANIA POWER AND LIGHT COMPANY	Docket No. R-00943271	PENNSYLVANIA	Case is still Pending. TESTIMONY	Revenue Requirements

PROCEEDING APPEARANCES OF THOMAS J. PRISCO
BEFORE REGULATORY TRIBUNALS
1989 to PRESENT

COMPANY	PROCEEDING	JURISDICTION	ACTION	SUBJECT
INDIANAPOLIS POWER AND LIGHT COMPANY	Case no. 39,938	INDIANA	TESTIMONY	Revenue Requirements
BALTIMORE GAS AND ELECTRIC COMPANY	Case No. 8697	MARYLAND	TESTIMONY	Revenue Requirements
NIAGARA MOHAWK POWER CORPORATION	Docket Nos. 96-E-0134 and 135	NEW YORK	TESTIMONY	Revenue Requirements
TUCSON ELECTRIC POWER COMPANY	Docket No. U1933-95-317	ARIZONA	Case Pending SETTLEMENT NEGOTIATION	Assist Counsel
BALTIMORE GAS AND ELECTRIC COMPANY MERGER WITH POTOMAC ELECTRIC POWER CO.	Case No. 8725	MARYLAND	TESTIMONY	Revenues and Rate Design
NOI, PROPOSED RULE MAKING, CAPACITY RESER-VATION, OPEN ACCESS TRANSMISSION TARIFFS	Docket No. RM 96-11-000	F.E.R.C.	TESTIMONY	Comments Rate Design
PENNSYLVANIA POWER AND LIGHT COMPANY, RETAIL ACCESS PILOT PROGRAM	Docket No. P-00971183	PENNSYLVANIA	TESTIMONY	Comments, Assist Counsel
COMMISSION'S INQUIRY INTO PROVISION AND REGULATION OF ELECTRIC SERVICE	Case No. 8738	MARYLAND	TESTIMONY	Comments, Assist Counsel
PENNSYLVANIA POWER AND LIGHT COMPANY, RESTRUCTURING PROCEEDING	Docket No. R-00973954	PENNSYLVANIA	TESTIMONY	Revenue Requirements

PROCEEDING APPEARANCES OF THOMAS J. PRISCO
BEFORE REGULATORY TRIBUNALS
1989 to PRESENT

COMPANY	PROCEEDING	JURISDICTION	ACTION	SUBJECT
NOI, NATURAL GAS COMPETITION AND DEREGULATION ACT OF 1997 FILING REQUIREMENT	Docket No. 7656-U	GEORGIA	TESTIMONY	Comments Rate Design
BALTIMORE GAS AND ELECTRIC COMPANY	Case No. 8780	MARYLAND	TESTIMONY SETTLEMENT	Revenue Requirements
PG ENERGY	Docket No. R 0098-4280	PENNSYLVANIA	TESTIMONY	Revenue Requirements Settlement
BALTIMORE GAS AND ELECTRIC COMPANY	Case No. 8794	MARYLAND	TESTIMONY SETTLEMENT	Revenue Requirements
BALTIMORE GAS AND ELECTRIC COMPANY	Case No. 8829	MARYLAND	TESTIMONY	Revenue Req ROR
LOUISVILLE GAS AND ELECTRIC COMPANY	Case No. 2000-080 & 2000-137	KENTUCKY	TESTIMONY	Rate Design Rate Design
SOUTHERN STAR CENTRAL GAS PIPELINE	Docket No. 99-GIMG-068-GIG	KANSAS	SETTLEMENT	Ad Valorem Tax
WASHINGTON GAS LIGHT COMPANY	Case No. 8920	MARYLAND	TESTIMONY	Revenue Requirements
ONEOK, INC	Docket No. 03-KGSG-602-RTS	KANSAS	TESTIMONY	Revenue Requirements
WASHINGTON GAS LIGHT COMPANY	Case No. 8959	MARYLAND	TESTIMONY	Revenue Requirements

**COMMONWEALTH OF KENTUCKY
BEFORE THE
PUBLIC SERVICE COMMISSION**

In the Matter of:)
)
An Adjustment of the Gas and)
Electric Rates, Terms and Conditions)
of Louisville Gas and Electric)
Company)

Docket No. 2003-00433

**Exhibits
of Thomas J. Prisco**

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FOR

**THE UNITED STATES DEPARTMENT OF DEFENSE
AND OTHER ALL FEDERAL EXECUTIVE AGENCIES**

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