SINCE 1895
OGDEN NEWELL & WELCH PLLC
ATTORNEYS FOR BUSINESS

1700 PNC PLAZA
500 WEST JEFFERSON STREET
LOUISVILLE, KENTUCKY 40202-2874
(502) 582-1601
FAX (502) 581-9564
www.ogdenlaw.com

KENDRICK R. RIGGS

DIRECT DIAL 502-560-4222
DIRECT FAX 502-627-8722

kriggs@ogdenlaw.com

April 26, 2004

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APR 26 2004
PUBLIC SERVICE COMMISSION

**VIA HAND DELIVERY**
Thomas M. Dorman
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

**RE:** ***Application of Louisville Gas and Electric Company for an Adjustment of its Gas and Electric Rates, Terms and Conditions***
**Case No. 2003-00433**

Dear Mr. Dorman:

Enclosed please find for filing the original and eleven (11) copies each of the following testimonies in the above-referenced matter:

1. Rebuttal Testimony of S. Bradford Rives;
2. Rebuttal Testimony of Valerie L. Scott;
3. Rebuttal Testimony of Earl M. Robinson;
4. Rebuttal Testimony of Robert G. Rosenberg;
5. Rebuttal Testimony of Michael S. Beer;
6. Rebuttal Testimony of William Steven Seelye; and
7. Rebuttal Testimony of Clay Murphy*.

*A portion of the Rebuttal Testimony of Clay Murphy, specifically language highlighted on page 18 of the original only, has been redacted on all copies pursuant to 807 KAR 5:001(7). Confidential protection was afforded by the Commission pursuant to a letter from the Executive Director dated March 28, 2000 in Case No. 2000-00071.

Please confirm your receipt of these filings by placing the stamp of your Office with the date received on the enclosed additional copies and return them to me in the enclosed self-addressed stamped envelope or via our courier.

Should you have any questions or need any additional information, please contact me at your convenience.

Very truly yours,

Kendrick R. Riggs

Kendrick R. Riggs

KRR/ec
Enclosures
cc: Parties of Record
Dorothy E. O'Brien
Robert M. Watt, III

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APR 2 6 2004
PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|---|---|---|
| APPLICATION OF LOUISVILLE GAS AND | ) | |
| ELECTRIC COMPANY FOR AN ADJUSTMENT | ) | CASE NO. 2003-00433 |
| OF THE GAS AND ELECTRIC RATES, | ) | |
| TERMS AND CONDITIONS | ) | |

In the Matter of:

| | | |
|---|---|---|
| APPLICATION OF KENTUCKY UTILITIES | ) | |
| COMPANY FOR AN ADJUSTMENT | ) | CASE NO. 2003-00434 |
| OF THE ELECTRIC RATES, TERMS AND | ) | |
| CONDITIONS | ) | |

# REBUTTAL TESTIMONY

OF

S. BRADFORD RIVES

CHIEF FINANCIAL OFFICER
LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY

Filed: April 26, 2004

**Q. Please state your name, position and business address.**

A. My name is S. Bradford Rives. I am the Chief Financial Officer for Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU"). My business address is 220 West Main Street, Louisville, Kentucky.

**Q. Have you previously testified in these proceeding?**

A. Yes. I filed direct testimony on December 29, 2003 on behalf of LG&E and KU (collectively "the Companies"). A statement of my qualifications is attached as Appendix A to that testimony.

**Q. What is the purpose of your rebuttal testimony?**

A. The purpose of my testimony is to rebut certain contentions concerning the calculation of LG&E's and KU's revenue requirements raised by: (1) Robert Henkes, Michael Majoros and Carl Weaver for the Office of the Attorney General ("AG"); (2) Lane Kollen for the Kentucky Industrial Utility Customers, Inc. ("KIUC"); and (3) Kevin Higgins on behalf of The Kroger Co. ("Kroger"). (The AG, KIUC and Kroger are hereafter collectively referred to as "Intervenors.")

## Initial Comments

**Q. In their fourth set of data requests in these proceedings, Commission Staff inquired about E.ON's intentions for its investment in LG&E and KU, and about a Dow Jones report that E.ON was considering possible withdrawal from the U.S. market in connection with investment in Russia. Please comment on that inquiry.**

A. In responding to those requests, the Companies have provided information about E.ON's intentions for its investment in the Companies, and have disputed the accuracy of the Dow Jones report. Beyond that, however, I think it is important to recognize that the issue in these proceedings is not the identity of the Companies' shareholder. Instead, the issue here is whether the Companies are earning a reasonable return on their investments to serve their ratepayers. As discussed in detail in my direct testimony, the Companies are not presently earning a reasonable return, and should be allowed the rate increases being sought so that they can continue to effectively meet their service obligations both now and in the future. It is not in the interests of the Companies, their ratepayers, or this Commission for KU and LG&E to remain in the financially-weakened conditions which presently exist. Kentucky benefits, the ratepayers benefit, and the Companies benefit if rates are set at a level which is fair, just and reasonable, regardless of the identity or intentions of the Companies' owner.

**Q. Do you have any overall comments regarding the positions taken by the Intervenors?**

A. Yes. I find the attacks on existing settlement agreements which we have seen in these proceedings to be very troubling. The evidence is clear that the Companies have achieved significant savings over the years, which savings have been shared with customers through mechanisms such as the merger and VDT surcredit mechanisms. The handling of those surcredits were resolved by settlements through cooperation with ratepayers and ratepayer advocacy groups such as Lexington-Fayette Urban County Government, the AG (the representative designated to represent the interests of all ratepayers), and Kentucky Industrial Utility Customers, Inc. However, now that the Companies are seeking base rate increases, claims are being made that those settlements, which were negotiated to benefit both the Companies and their ratepayers and were unanimously entered into and approved by the Commission, should simply be disregarded. Such claims threaten the sound, consistent regulatory environment in Kentucky. The Commission has long recognized that settlement of matters pending before it can serve the public interest and conserve resources. Additionally, both the KIUC and the AG have asserted in their data responses continued support for adherence to all of the provisions contained in the settlement agreements. If settlement agreements, entered into unanimously and approved by the Commission, may simply be set aside before the end of their term, there will be no regulatory certainty derived from settlement and thus no rational reason for any party to enter into such agreements in the future.

**Q. Have the Companies complied with the terms of the merger surcredit and VDT settlements?**

A. Yes. The Companies have complied with the terms of those settlement agreements, and no party to those agreements has claimed otherwise.

**Q. How should the Commission resolve the issues regarding the merger surcredit and VDT settlements?**

A. The Commission should leave the settlement agreements in place as entered into by the parties and approved by the Commission.

**Q. Do you have any other concerns regarding the positions taken by some of the Intervenors?**

A. Yes, I do. Many of the Intervenors, unfortunately, have taken a results-oriented approach motivated by their objective to reduce the Companies revenue requirements to suit their own interests or the interests of their constituents. And, as discussed more fully in the Rebuttal Testimony of W. Steven Seelye, the Intervenors have in many instances disregarded prior Commission precedent and practice in their quest to achieve that result.

Such an approach lacks credibility and is also disturbing because it threatens the sound, consistent regulatory environment which has been in place in this Commonwealth for many years and which has operated to the benefit of ratepayers and utilities alike.

**Q. How do you recommend the Commission deal with this situation?**

A. In calculating their revenue requirement in these proceedings, the Companies have sought to follow established Commission precedent or, where the Commission has not previously considered a specific issue, guidance from the Federal Energy Regulatory Commission ("FERC"). The Commission should follow its precedent and the guidance from the FERC. There is no appropriate reason for the Commission to adopt Intervenor positions which are contrary to established precedent.

## Rate Base and Capitalization

**Q. In their direct testimony on behalf of the Attorney General, Carl Weaver and Robert Henkes state that the Commission should use the lower of rate base or capitalization in order to determine the Companies' revenue requirements. Please comment on that testimony.**

A. The Companies certainly do not agree with the opinions of Dr. Weaver and Mr. Henkes that the determination should hinge on the result which produces the lowest number. Rather, it is the Companies' position that their returns in these proceedings should be set based on capitalization because capitalization reasonably represents the amount of investment supporting the Companies' utility operations. The Commission has consistently set the Companies' returns based on capitalization, and the Companies have followed that precedent. There is no reason to deviate from the established Commission precedent here.

**Q. Mr. Henkes' testimony also states that the Companies have not presented an adjusted original cost rate base for the purpose of determining the appropriate return on rate base as compared to the appropriate return on capitalization. Is that accurate?**

A. No. In their Application, the Companies presented a reconciliation of their respective rate bases and capitalization, as required by 807 KAR 5:001, Section 10(6)(i). There is no requirement that a utility seeking an adjustment to rates based on capitalization present an adjusted original cost rate base. Nonetheless, when the information was sought in discovery, KU presented its adjusted original cost rate base in response to PSC 3-38, and LG&E presented its adjusted original cost rate base in response to PSC 3-39.

**Q. Is such a detailed inquiry into rate base even necessary in this case?**

A. No. The Companies are seeking a return on capitalization, not on rate base, which is in keeping with legal precedent in the Commonwealth. In the words of the Kentucky Supreme Court, a calculation based on rate base, therefore, is simply "an after the fact unnecessary exercise in arithmetic." Public Service Commission v. Continental Telephone Co., Ky., 692 S.W.2d 794, 798 (1985).

## Capital Cost Rates and Capital Structure Ratios

**Q. Dr. Weaver stated in his testimony that the Companies' capital cost rates should be updated beyond the test year and before a final decision in these cases, and that capital structure ratios should also be updated but only if the changes are minor. Do you agree?**

A. I agree that the Companies' cost rates and capital structure ratios should be updated beyond the test year and before a final decision in these proceedings, consistent with past

Commission practice. However, I do not agree that capital structure ratios should be updated only if the changes are minor. If cost rates are updated, as the Companies and Dr. Weaver agree should be done, then it is only reasonable to also update capital structure ratios, regardless of whether the changes are minor in nature or not.

**Q. Mr. Kollen has stated in response to Commission Staff's First Data Request to KIUC, in Case Nos. 2003-00433 and 2003-00434, Item Nos. 3(a) and 5(a), respectively, that the Companies' capital cost rates should not be updated unless they can justify the increased costs resulting from the replacement of accounts receivable securitization program with higher rate long-term debt costs. Please comment on that position.**

A. The capital provided by the accounts receivable securitization program was used to fund the cash needs of the Companies, and cannot be ignored in ratemaking. The program was terminated consistent with the January 16, 2001 Order in Case No. 2000-00490. The Companies' debt refinancing secured the debt at low-cost long-term rates, thereby gaining protection against interest rate fluctuations. Accordingly, there is no basis for the Commission to disallow a post-test year update for the change in capital cost rates.

## Minimum Pension Liability

**Q. Mr. Henkes and Michael Majoros both argue that the Companies' adjustments for minimum pension liability ("MPL") should be rejected. Do you agree?**

A. No. As explained in detail in my direct testimony, the Companies' MPL adjustment is necessary to avoid unfair regulatory policy by reducing equity today for a loss not yet recorded on the income statement. Such treatment of MPL has been expressly recognized by the FERC. Specifically, on March 29, 2004, the FERC issued an opinion letter in Docket No. AI04-2-000 providing that jurisdictional public utilities shall recognize a regulatory asset for their minimum pension liability otherwise chargeable to accumulated other comprehensive income related to its costs-based rate regulated business segments. A copy of that opinion letter was filed in these proceedings on April 15, 2004 in the Companies' Supplemental Response to data request PSC 3-9(b), and is also attached as SBR Rebuttal Exhibit 1. The Companies have made an adjustment in their accounting records consistent with the FERC mandate effective March 2004, and will reflect that adjustment in their next quarterly filings with the Commission and FERC.

**Q. Mr. Majoros contends that the MPL adjustment should be rejected because the Companies have already made write-downs to their common equity balance, and proposed reversals of equity write-downs were rejected in Case Nos. 98-426 and 98-474. Do you agree?**

A. No. In the test periods in Case Nos. 98-426 and 98-474, LG&E and KU wrote-off the shareholder portion of costs associated with the merger of KU Energy Corporation and LG&E Energy Corp. As a result, LG&E's and KU's retained earnings were correspondingly reduced, which in turn lowered LG&E's and KU's common equity component of their capitalizations. LG&E and KU proposed to reverse this write-off by adjustments to their common equity components of their capitalizations on the grounds that it was a non-recurring item and for reasons related to the regulatory recognition of the merger. The Commission's rejection of the proposed write-down reversals was based on its determination that write-offs were permanent and continuous in nature and thus would have a recurring impact on LG&E's and KU's equity components in the future, and for other ratemaking reasons related to the ratemaking recognition of the shareholders' portion of the merger savings. The Commission's concerns with, and analysis of, the adjustments to capital structure in Case Nos. 98-426 and 98-474 thus have no bearing on the need for and analysis of the MPL adjustments in these proceedings. For all of the reasons explained in my direct testimony, the write-downs need to be reversed so that there is equitable treatment under SFAS No. 130.

**Q. Mr. Majoros also argues that the Companies' proposed MPL adjustment is inconsistent with SFAS No. 71. Is there an inconsistency?**

A. No. Indeed, as noted earlier, the FERC has resolved this issue in its March 29, 2004 opinion letter. Specifically, at page 3 of that letter, the FERC stated: "Further, the minimum pension liability, as well as, [sic] any related regulatory asset is not amortized over future periods. At each measurement date, the entry recorded for the previous measurement date is reversed and the computation redone. A new minimum pension liability and related regulatory asset would be recognized, if required, at the new measurement date."

**Q. Finally, Mr. Majoros contends that "it is possible the establishment of a regulatory asset pursuant to SFAS No. 71 may give rise to a presumption that the underlying costs are recoverable from ratepayers without a prudence [sic] review of these costs in the future." Please comment on that argument.**

A. That contention has no merit. The Companies have made no claim for such treatment, and Mr. Majoros is merely speculating. And, as noted above, the FERC opinion letter of March 29, 2004, which the Companies seek to have implemented here, expressly provides that minimum pension liability and the related regulatory asset are not amortized over future periods, but are adjusted at each subsequent measurement date.

**Q. In response to Commission Staff's First Data Request to KIUC, in Case Nos. 2003-00433 and 2003-00434, Item Nos. 3(b) and 5(b), respectively, Mr. Kollen states that he does not agree with the Company's MPL adjustment. Please comment on that response.**

A. Mr. Kollen states that he does not agree with the adjustment because it creates a mismatch between common equity and capitalization. However, Mr. Kollen then acknowledges that the mismatch would be corrected if the Companies were allowed to create a regulatory asset and thereby increase their per books common equity. Such a correction of the mismatch is exactly what the FERC has stated should be done, and exactly what the Companies are proposing in this proceeding. Mr. Kollen goes on to state that if a regulatory asset is created, it should not be amortized. The Companies agree, consistent with the FERC opinion letter of March 29, 2004, that the asset would not be amortized but would be adjusted at each subsequent measurement date.

## Income Tax Rate

**Q. Mr. Henkes and Mr. Majoros have recommended that the Companies' proposed state income tax rate of 8.25% be replaced with the effective state income tax rate from the Companies' most recent 2002 consolidated Kentucky corporation income tax return. Please comment on that recommendation.**

A. The recommendation should be rejected. The Commission has used the state statutory tax rate in the Companies' past rate cases, and it is important that consistent treatment be afforded. Furthermore, the Companies' respective effective state income tax rates in 2002 were less than the statutory rate because of credits and apportionment adjustments from out-of-state activities, which may not be present at all or to the same extent in the future. The Kentucky statutory income tax rate of 8.25% is objective, known and measurable, easily understood and verified, and not distorted by non-recurring items or apportionment adjustments from out-of-state activities.

In the event the PSC nonetheless determines to use an effective income tax rate for the Companies, it is critical that an all-inclusive effective rate be used. LG&E is required to pay Indiana tax on a portion of its off-system sales, all of which benefit Kentucky customers. At a minimum, the Commission should allow the recovery of these Indiana taxes which result in an effective tax rate of 8.07% for LG&E. Similarly, KU presently pays tax in Virginia and Tennessee in addition to Kentucky. KU's total taxable income is apportioned for Kentucky and non-Kentucky payroll, property and receipts factors. The Company believes that the effective state income tax rate referenced in PSC 2-15(e)(3) is distorted because it compares the total Kentucky taxes to all of KU's taxable income. In fact, the 2002 effective state income tax rate computed by excluding the Virginia property, payroll, and receipts is 7.98%.

**Q. Please comment on Mr. Henkes' position concerning the use of the calculation of the income tax liability based on the adjusted operating statement, before consideration of taxes, and reflecting the effective tax rate.**

A. For all of the reasons discussed above, the statutory tax rate should be used.

**Revenue Conversion Factor**

**Q. Please comment on Mr. Henkes' calculation of the revenue conversion factor.**

A. The difference between the Companies' proposed revenue conversion factor and the AG's recommended revenue conversion factor is that the Companies' proposed factor incorporates the Kentucky state income tax rate of 8.25%, while the AG's recommended factor incorporates the Companies' effective tax rates. For the reasons discussed above, LG&E and KU believe that the Kentucky state income tax rate of 8.25% should be used and that the AG's recommendation to use the effective Kentucky state income tax rate should be rejected.

## Interest Synchronization

**Q. Mr. Henkes criticizes LG&E's interest synchronization adjustment as having been calculated improperly. Was there an error in the calculation?**

A. Yes. As LG&E stated in its response to data request AG 2-42, the Company inadvertently failed to include interest expense on debt to associated companies and interest costs related to the accounts receivable securitization when calculating its electric and gas operating tax provision for the rate case test year. The Company also overstated interest expense charged to electric and gas operations for the test year as a result of an incorrect interest expense allocation between electric and gas. Corrected information was provided in response to AG 2-42. As a result, the interest synchronization adjustment should be an expense of $406,954 for LG&E's electric operations, and an expense of $1,027,535 for LG&E's gas operations, as shown on SBR Rebuttal Exhibit 2.

## VDT Surcredit and Shareholders' Savings

**Q. Please describe the Value Delivery Team ("VDT") initiative.**

A. Following the acquisition by Powergen, LG&E and KU undertook a Best Practices review of their entire operations to determine whether further efficiencies or cost savings could be achieved. On June 1, 2001, LG&E and KU filed a joint application requesting an order approving certain proposed deferred debits and declaring the amortization of the deferred debits to be included in the ESM calculations.

After extensive negotiations, which included the participation of the Commission Staff, on August 31, 2001, LG&E, KU, the AG, and KIUC filed a written unanimous Settlement Agreement along with a motion requesting the approval of the same with the Commission in Case No. 2001-169 and in four other proceedings.[1]

On December 3, 2001, the Commission issued an order approving the Settlement Agreement in its entirety. Pursuant to the Commission's approval of the Settlement Agreement, LG&E and KU were allowed to defer their costs to achieve the savings and amortize them over a five-year period ending March 31, 2006. LG&E and KU also provided to their customers forty percent of the projected savings through a VDT surcredit rate mechanism. The VDT surcredit mechanism will continue through March 31, 2006, and then will be withdrawn from service. Sixty percent of the net savings were allocated to LG&E's and KU's shareholders through an adjustment in the calculation of their annual ESM filings. SBR Rebuttal Exhibit 3 is an accurate and complete copy of the Settlement Agreement.

**Q. How have LG&E and KU reflected the ratemaking treatment in their filings in this proceeding?**

A. The following shows the test year VDT savings and costs:

[1] *In the Matter of: The Annual Earnings Sharing Mechanism Filing of Louisville Gas and Electric Company*, Case No. 2001-054; *In the Matter of: The Annual Earnings Sharing Mechanism Filing of Kentucky Utilities Company*, Case No. 2001-055; *In the Matter of: Application of Kentucky Utilities Company for an Order Approving Revised Depreciation Rates*, Case No. 2001-140; *In the Matter of: Application of Louisville Gas and Electric Company for an Order Approving Revised Depreciation Rates*, Case No. 2001-141; and *In the Matter of: Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be Included in Earnings Sharing Mechanism Calculations*, Case No. 2001-169.

| | KU | LG&E | | |
|---|---|---|---|---|
| | | Electric | Gas | Total |
| Estimated Gross Savings | 16,325 | 33,300 | 8,625 | 41,925 |
| Cost (Exhibit 1, Reference Schedule 1.21, Line 5) | 11,500 | 23,900 | 6,100 | 30,000 |
| Estimated Net Savings | 4,825 | 9,400 | 2,525 | 11,925 |
| Customer Share 40% (Exhibit 1, Reference Schedule 1.21, Line 2) | 1,930 | 3,760 | 1,010 | 4,770 |
| Company Share 60%(Exhibit 1, Reference Schedule 1.20, Line 1) | 2,895 | 5,640 | 1,515 | 7,155 |

LG&E and KU have included the amortized costs to achieve as part of their respective cost of service, and have proposed pro forma adjustments to increase expense to reflect the shareholders' sixty percent portion of the savings. In my direct testimony, I testified that this type of an adjustment is consistent with the treatment of the shareholders' portion of the net merger savings approved in Case Nos. 98-426 and 98-474.

**Q. In his testimony on behalf of The Kroger Company, Mr. Higgins argues that the Commission should deny the Companies' proposed adjustment for VDT net savings to shareholders. Do you agree?**

A. I certainly do not. As an initial matter, the recommendation is procedurally out of order. These proceedings are not a reopening of the VDT matter, which was the subject of an earlier proceeding resulting in a unanimous settlement approved by the Commission. Kroger chose not to intervene in the VDT proceeding and should not now be permitted to renegotiate the settlement.

The Companies' proposed adjustment (Reference Schedule 1.20 to Rives Exhibit 1) is necessary for the shareholders to retain its 60% share of the net savings from the VDT initiative, and is entirely consistent with the ratemaking treatment of the shareholders' portion of the merger surcredit savings in Case No. 98-426 and 98-474. And, as discussed earlier and referenced in the data responses of the KIUC and the AG, there are severe regulatory implications in setting aside settlement agreements unanimously entered into by the parties and approved by the Commission.

**Q. Please discuss Mr. Higgins' proposal to discontinue the VDT surcredit.**

A. Mr. Higgins asserts that discontinuation of the surcredit would be "revenue neutral" to both the Companies and their ratepayers, as long as a corresponding adjustment is made to the Companies' revenues. While it is true that discontinuation of the surcredit with a corresponding pro-forma increase to test year revenues would generally have no impact on the revenues of the Company, removal of this line item credit from customer bills will confuse customers who will likely believe that value has been taken from them.

It is important to distinguish this recommendation to discontinue the VDT surcredit from Mr. Higgins' recommendation that the Companies' pro-forma adjustments for the shareholders' portion of the VDT savings be denied. The latter recommendation is in direct conflict with the unanimous settlement agreement on this matter that provided for a 60/40 sharing between shareholders and customers of the net VDT savings. Rather, it would provide customers with 100 percent of the VDT savings after the Companies had made a $196 million investment to reduce costs, reached a written unanimous settlement agreement with the principal consumer groups, including the AG and, applied for and obtained the approval of the Settlement Agreement from the Commission through a written order for a term of 60 months. Mr. Higgins' proposal is a punitive form of regulation. The Commission should reject Mr. Higgins' recommendation.

**Q. Please comment on KIUC's recommendation for an adjustment to reflect the "failure to achieve labor savings from VDT."**

A. KIUC's witness, Mr. Kollen, has recommended the Commission disallow at least fifty percent of what he calls the "net harm" to ratepayers based on his contention that LG&E and KU failed to achieve the labor savings from the VDT management initiative. The Companies dispute his assertion that the VDT initiative has failed to achieve the estimated savings and ask the Commission to reject his recommendation.

**Q. Please comment on Mr. Kollen's analysis of the labor savings reflected in the Companies' filings compared to costs incurred in 2000, the year prior to the implementation of the VDT.**

A. First, the Companies stated in discovery requests that they were not specifically tracking savings. See LG&E and KU Response to KIUC's First Data Request dated August 31, 2001, Case No. 2001-169, Question No. 11. Second, Mr. Kollen's analysis is restricted only to labor expenses. The VDT initiative, however, was not so limited and also included other operation and maintenance savings and fixed charge savings. This is documented in the discovery responses in Case No. 2001-169. By limiting his analysis to include only labor savings, Mr. Kollen has biased the result he intended to achieve. Third, Mr. Kollen's analysis gives no consideration to increases in labor and benefit rates and other costs since 2000. Such increases have partially masked the VDT savings when reviewing total expenses but do not mean that the anticipated savings were not achieved.

**Q. Have the Companies prepared an analysis which adjusts for these noted limitations in Mr. Kollen's analysis?**

**Q. Have the Companies prepared an analysis which adjusts for these noted limitations in Mr. Kollen's analysis?**

A. Yes. SBR Rebuttal Exhibit 4 contains such an analysis. This analysis begins with operations and maintenance expenses of the Companies in 2000, the year prior to implementation of the VDT initiative. The use of total operations and maintenance expenses, rather than simply using labor, is not only consistent with the intended VDT savings, it also removes the shortcoming in Mr. Kollen's analysis because it considers all related employee costs as well as other operating costs including the use of contractors.

Operations and maintenance expenses for 2000 were then escalated by the appropriate escalation factors to derive projected operations and maintenance expenses as if the VDT initiative had not been undertaken – see line item "Projected O&M Without VDT Initiative". This amount was reduced by the estimated VDT savings. The amortization of the costs to achieve these savings was added back to derive the "Target O&M" result for the test year. In addition, the components of VDT savings which are reflected in line items other than operation and maintenance expenses in the Companies' income statements were added back to derive a true Target O&M.

Other significant incremental expenses that occurred subsequent to the VDT initiative and which have served to offset some of the VDT savings in the Companies' net operating income results were then added in order to reconcile Target O&M to "Actual O&M" as recorded by the Companies. There are many other such items that could have been considered here; however, I wanted to keep the analysis as simple as possible to illustrate the point that the VDT savings have been achieved.

**Q. What did the results of your analysis indicate?**

A. The fact that "Other (net incremental savings)" is a negative number for both of the Companies for the test year demonstrates that, absent these incremental expenses, the targeted VDT savings were achieved. As a result, Mr. Kollen's claims are not accurate and his recommended adjustment in this proceeding should be denied.

**Q. Does this conclude your testimony?**

A. Yes.

**VERIFICATION**

**COMMONWEALTH OF KENTUCKY )**
**) SS:**
**COUNTY OF JEFFERSON )**

The undersigned, **S. Bradford Rives**, being duly sworn, deposes and says he is the Chief Financial Officer for Louisville Gas and Electric Company, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

S. Bradford Rives

**S. BRADFORD RIVES**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 23 day of April 2004.

Nancy L. Retchen (SEAL)
Notary Public

My Commission Expires:

**Notary Public, State at Large, KY**
**My commission expires Nov. 5, 2006**

106 FERC ¶ 62,230

In Reply Refer To:
OED-DRAP
Docket No. AI04-2-000

March 29, 2004

Recognition of a Regulatory Asset for Minimum Pension Liability

TO ALL JURISDICTIONAL PUBLIC UTILITIES AND LICENSEES, NATURAL GAS COMPANIES, AND OIL PIPELINE COMPANIES

The generally lower interest rate environment of recent years and decline in value of assets set aside to meet pension obligations has resulted in many FERC jurisdictional entities recognizing a minimum liability for employee pension obligations. The Commission has received a number of requests for guidance on whether a regulatory asset should be recognized for some or all of the charge to other comprehensive income that is made at the time the minimum pension obligation is recognized. The following discussion responds to these requests.

**Facts:** An entity provides pension benefits to its employees under a defined pension benefit plan and recognizes pension expense (i.e. net periodic pension cost) for financial accounting and reporting purposes in accordance with Statement of Financial Accounting Standards No 87. (SFAS No. 87).[1] The rates the entity charges for services provided by a segment of its business are regulated by a third party regulator and are determined on the basis of the entity's costs. Development of the rates to be charged for services provided by this business segment include an allowance for employee pension benefits and the amount of that allowance is based on net periodic pension cost determined in accordance with SFAS No. 87. As a result of a decline in the value of its pension fund assets and an increase in the accumulated pension benefit obligation due to lower interest rates used to estimate that obligation on a present value basis, the entity determines that its accumulated pension benefit obligation exceeds the fair value of the assets set aside to meet that obligation. Consistent with the requirements of SFAS No. 87, the entity records a minimum pension liability for the amount of such excess.

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[1] Financial Accounting Standards Board Statement of Financial Accounting Standards No 87, Employer's Accounting for Pensions

**Question:** At the time the entity recognizes its minimum pension liability in accordance with SFAS No. 87, should it recognize a regulatory asset for the amount of the liability otherwise chargeable to accumulated other comprehensive income that relates to its cost based rate-regulated business segment?

**Response:** The cost of pension benefits provided to employees under a defined pension benefit plan are recognized as an expense at the time the employee provides related employment services. SFAS No. 87 contains a delayed recognition feature. This means that changes in the pension obligation and the value of assets set aside to meet these obligations are not recognized when they occur but are recognized systematically and gradually over subsequent periods. [2] An entity that determines its pension allowance included in its costs based regulated rates on the basis of SFAS No. 87 adopts that same delayed recognition feature for ratemaking purposes. That is, changes in the pension obligation and assets set aside to meet those obligations are not included in rates when they occur but rather are included in rates systematically and gradually in subsequent periods. The recognition of a minimum pension liability which would otherwise be charged to accumulate other comprehensive income therefore constitutes a measurement of the changes in pension obligations and the value of plan assets that are to be included in the determination of rates in subsequent periods in so far as they relate to the cost based rate regulated segment of the entity.

Under the Commission's accounting requirements regulatory assets are to be established for those charges that would have been included in net income or accumulated other comprehensive income determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.

Therefore, in the circumstances described above and provided that it is probable that the pension allowance to be included in rates in future periods will continue to be calculated on the basis of SFAS No. 87, entities shall recognize a regulatory asset for the minimum pension liability otherwise chargeable to accumulated other comprehensive income related to its cost based rate regulated business segments.

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[2] Ibid. (See: Summary - Fundamentals of Pension Accounting)

Further, the minimum pension liability, as well as, any related regulatory asset is not amortized over future periods. At each measurement date, the entry recorded for the previous measurement date is reversed and the computation redone. A new minimum liability and related regulatory asset would be recognized, if required, at the new measurement date.

This guidance is for accounting purposes only and does not limit the Commission from reviewing the reasonableness of the elements of pension expense included in future rate proceedings before the Commission.

John M. Delaware
Deputy Executive Director
And Chief Accountant

**Rives Exhibit 1**
**Reference Schedule 1.37**
**Sponsoring Witness: Brad Rives**

## LOUISVILLE GAS AND ELECTRIC COMPANY

### Calculation of Current Tax Adjustment Resulting From "Interest Synchronization"

| | Revised Electric | Revised Gas |
|---|---|---|
| 1. Adjusted Capitalization - Exhibit 2 | $ 1,485,701,357 | $ 312,142,752 |
| 2. Weighted Cost of Debt | 1.63% | 1.63% |
| 3. "Interest Synchronization" | 24,216,932 | 5,087,927 |
| 4. Interest per books (excluding other interest) | 23,208,685 | 2,542,160 |
| 5. "Interest Synchronization" adjustment | (1,008,247) | (2,545,767) |
| 6. Composite Federal and State tax rate | 40.3625% | 40.3625% |
| 7. Current tax adjustment from "Interest Synchronization" | $ (406,954) | $ (1,027,535) |

## Louisville Gas & Electric Company
## VDT Savings Analysis
***$ Millions***

| | 2000 Actual (per PSC1-23 (b) and (c)) | Test Year Ended 9/30/03 Escalated |
|---|---|---|
| **O&M Expense Analysis:** | | |
| Power Production - Labor | 36.3 | 40.5 |
| Power Production - Non Labor | 45.0 | 48.5 |
| **Power Production** [1] | **81.3** | **88.9** |
| Distribution - Labor | 13.4 | 14.9 |
| Distribution - Non Labor | 10.5 | 11.3 |
| **Distribution** | **23.9** | **26.3** |
| Transmission - Labor | 1.8 | 2.0 |
| Transmission - Non Labor | 6.5 | 7.0 |
| **Transmission** | **8.3** | **9.1** |
| Customer Accounts and Sales - Labor | 9.0 | 10.0 |
| Customer Accounts and Sales - Non Labor | 5.5 | 5.9 |
| **Customer Accounts and Sales** | **14.5** | **15.9** |
| Gas Business - Labor | 10.7 | 11.9 |
| Gas Business - Non Labor | 13.5 | 14.6 |
| **Gas Operations** [2] | **24.2** | **26.5** |
| Admin and General - Labor | 15.1 | 16.8 |
| Admin and General - Non Labor (excludes Labor and Benefits) | 25.3 | 27.3 |
| **Adminstrative and General** [3] (excludes Benefits) | **40.4** | **44.1** |
| **Benefits** (FERC account 926 - see attached page 5 of Rives Exhibit 4 for calculation of test year) | **7.3** | **36.6** |
| **Projected O&M Without VDT Initiative** | **199.8** | **247.4** |
| Less Gross VDT Savings (per Settlement Agreement) | | (41.9) |
| Add Payroll Tax Component of VDT Savings [4] | | 1.6 |
| Add Fixed Charge Component of VDT Savings (per Joint Application) [5] | | 2.4 |
| Add VDT Cost Amortization (per Settlement Agreement) | | 30.0 |
| ***Target O&M*** | | ***239.5*** |
| Significant Expense Additions Post-VDT: | | |
| MISO Expenses (attached page 3 of Rives Exhibit 4) | | 18.6 |
| Expanded DSM Program (attached page 3 of Rives Exhibit 4) | | 3.3 |
| Incremental (> CPI) Property Insurance Increase (attached page 3 of Rives Exhibit 4) | | 3.4 |
| E.W. Brown Legal Expenses (per direct testimony Rives Exhibit 1 Reference Schedule 1.27) | | 2.2 |
| Increase in Uncollectible Accounts (attached page 3 of Rives Exhibit 4) | | 1.3 |
| Incremental (> CPI) Lime Cost Increase (attached page 3 of Rives Exhibit 4) | | 1.3 |
| Other (Net Incremental Savings) | | (0.9) |
| ***Actual O&M*** | **199.8** | **268.7** |

**Escalation Notes:**

Labor expenses were escalated by the average salary increases shown in PSC1-23d as follows:

| | 12/31/03 Employees Per 2000 Form 10-K | 2001 | 2002 | Test Year |
|---|---|---|---|---|
| Union (60%) | 1,192 | 4.7% | 4.7% | 3.0% |
| Non-Union (40%) | 811 | 3.5% | 4.1% | 3.6% |
| Weighted Average Salary Increase | 2,003 | 4.2% | 4.5% | 3.2% |

Non-Labor expenses were escalated at the CPI-All Urban Consumers Index (see direct testimony Rives Exhibit 1 Reference Schedule 1.14 for CPI factor).

Benefit Expenses were escalated based on the product of straight time labor (escalated from 2000) and the annual benefit rate shown below:

| | 2000 | Test Year |
|---|---|---|
| Actual Benefits (FERC Account 926 - per PSC1-23b) | 7.3 | 21.9 |
| / Actual Straight Time Labor (see attached page 4 of Rives Exhibit 4) | 68.2 | 45.8 |
| Benefit Rate | 10.65% | 47.76% |

[1] Excludes Fuel and Purchased Power.
[2] Excludes Gas Supply Expenses.
[3] Reflects Administrative and General expenses for both electric and gas operations.
[4] Must add back to derive targed O&M as payroll taxes are included in Property and Other Taxes on the income statement. Amount computed as 7.65% x (escalated test year labor above - actual test year labor per PSC1-23c).
[5] A small portion of the projected savings were to be achieved through fixed charge savings rather than O&M.

| | | | |
|---|---|---|---|
| Fixed Charge Savings per Joint Application - 2003 | 4.0 | x 9/12 | 3.0 |
| Fixed Charge Savings per Joint Application - 2002 | 1.7 | x 3/12 | 0.4 |
| Test Year | | | 3.4 |
| LG&E Percentage Per Joint Application | | x | 68.87% |
| | | | 2.4 |

# Kentucky Utilities
## Jurisdictional VDT Savings Analysis
*$ Millions*

| | 2000 Actual (per PSC1-23 (b) and (c)) | Test Year Ended 9/30/03 Escalated |
|---|---|---|
| **O&M Expense Analysis:** | | |
| Power Production - Labor | 26.2 | 29.1 |
| Power Production - Non Labor | 25.4 | 27.3 |
| **Power Production**[1] | **51.5** | **56.4** |
| Distribution - Labor | 14.8 | 16.5 |
| Distribution - Non Labor | 11.3 | 12.2 |
| **Distribution** | **26.1** | **28.7** |
| Transmission - Labor | 2.3 | 2.5 |
| Transmission - Non Labor | 5.4 | 5.8 |
| **Transmission** | **7.7** | **8.4** |
| Customer Accounts and Sales - Labor | 11.3 | 12.6 |
| Customer Accounts and Sales - Non Labor | 9.9 | 10.7 |
| **Customer Accounts and Sales** | **21.2** | **23.3** |
| Admin and General - Labor | 11.3 | 12.6 |
| Admin and General - Non Labor | 23.2 | 25.0 |
| **Adminstrative and General** | **34.5** | **37.6** |
| **Benefits** (FERC account 926 - see attached page 5 of Rives Exhibit 4 for calculation of test year) | **8.0** | **22.6** |
| **Projected O&M Without VDT Initiative** | **149.0** | **176.9** |
| Less Gross VDT Savings (per Settlement Agreement) | | (16.3) |
| Add Payroll Tax Component of VDT Savings [2] | | 0.8 |
| Add Fixed Charge Component of VDT Savings (per Joint Application)[3] | | 0.9 |
| Add VDT Cost Amortization (per Settlement Agreement) | | 11.5 |
| ***Target O&M*** | | ***173.8*** |
| Significant Expense Additions Post-VDT: | | |
| MISO Expenses (attached page 3 of Rives Exhibit 4) | | 6.5 |
| Expanded DSM Program (attached page 3 of Rives Exhibit 4) | | 2.9 |
| Incremental (> CPI) Property Insurance Increase (attached page 3 of Rives Exhibit 4) | | 4.2 |
| E.W. Brown Legal Expenses (per direct testimony Rives Exhibit 1 Reference Schedule 1.27) | | 3.1 |
| Increase in Uncollectible Accounts (attached page 3 of Rives Exhibit 4) | | 0.7 |
| Ice Storm Expenses ( per direct testimony Rives Exhibit 1 Reference Schedule 1.31) | | 6.6 |
| Other (Net Incremental Savings) | | (1.2) |
| ***Actual O&M*** | | ***196.6*** |

**Escalation Notes:**

Labor expenses were escalated by the average salary increases shown in PSC1-23d as follows:

| | 12/31/03 Employees Per 2000 Form 10-K | 2001 | 2002 | Test Year |
|---|---|---|---|---|
| Union (15%) | 221 | 3.5% | 3.5% | 3.0% |
| Non-Union (85%) | 1,254 | 3.0% | 4.0% | 4.0% |
| Weighted Average Salary Increase | 1,475 | 3.1% | 3.9% | 3.9% |

Non-Labor expenses were escalated at the CPI-All Urban Consumers Index (see direct testimony Rives Exhibit 1 Reference Schedule 1.14 for CPI factor).

Benefit Expenses were escalated based on the product of straight time labor (escalated from 2000) and the annual benefit rate shown below:

| | 2000 | Test Year |
|---|---|---|
| Actual Benefits (FERC Account 926 - per PSC1-23b) | 8.0 | 17.5 |
| / Actual Straight Time Labor (see attached page 4 of Rives Exhibit 4) | 43.2 | 37.3 |
| Benefit Rate | 18.49% | 46.97% |

[1] Excludes Fuel and Purchased Power.

[2] Must add back to derive targed O&M as payroll taxes are included in Property and Other Taxes on the income statement.
Amount computed as 7.65% x (escalated test year labor above - actual test year labor per PSC1-23c).

[3] A small portion of the projected savings were to be achieved through fixed charge savings rather than O&M.

| | | | | |
|---|---|---|---|---|
| Fixed Charge Savings per Joint Application - 2003 | 4.0 | x 9/12 | | 3.0 |
| Fixed Charge Savings per Joint Application - 2002 | 1.7 | x 3/12 | | 0.4 |
| Test Year | | | | 3.4 |
| KU Percentage Per Joint Application | | | x | 30.43% |
| Jurisdictional Percentage Per Joint Application | | | x | 88.21% |
| | | | | 0.9 |

**VDT Savings Analysis**
**Supporting Calculations**
**Significant Expense Additions Post-VDT**
***$ Millions***

| MISO EXPENSES | KU | LG&E |
|---|---|---|
| MISO Expenses per PSC2-16(j)(1) | 7.3 | 19.7 |
| Reconcile Payments to Booked Expense (see footnote to PSC2-16(j)(1)) | | |
| Less Amount Paid under Schedules 1, 2, 7, 8 and 11 | (3.7) | (17.0) |
| Add Amount Booked in FERC Account No. 565 | 4.6 | 15.9 |
| Total Company | 8.2 | 18.6 |
| x Jurisdictional Percentage | 79.47% | N/A |
| Jurisdictional MISO Expenses | 6.5 | 18.6 |

| EXPANDED DSM PROGRAM | KU | LG&E |
|---|---|---|
| DSM Expenses Per Rives Exhibit 1 Reference Schedule 1.09 | 2.9 | 4.8 |
| DSM Expenses in 2000: | | |
| Account No. 908002 | 0.0 | 0.6 |
| Account No. 908005 | 0.0 | 0.8 |
| Total | 0.0 | 1.4 |
| x CPI Escalation Factor | 1.078 | 1.078 |
| DSM Expenses 2000 Escalated | 0.0 | 1.5 |
| Test Year vs. 2000 Escalated | 2.9 | 3.3 |

| INCREMENTAL PROPERTY INSURANCE INCREASE | KU | LG&E |
|---|---|---|
| Test Year Property Insurance Per PSC1-23(b): | | |
| Electric (page 3 of 6) | 5.2 | 4.4 |
| Gas (page 6 of 6) | N/A | 0.1 |
| Total Test Year | 5.2 | 4.5 |
| Year 2000 Property Insurance Per PSC1-23(b): | | |
| Electric (page 3 of 6) | 1.0 | 1.0 |
| Gas (page 6 of 6) | N/A | 0.1 |
| Total Test Year | 1.0 | 1.0 |
| x CPI Escalation Factor | 1.078 | 1.078 |
| Year 2000 Escalated | 1.1 | 1.1 |
| Test Year vs. 2000 Escalated | 4.2 | 3.4 |

| INCREASE IN UNCOLLECTIBLE ACCOUNTS | KU | LG&E |
|---|---|---|
| Test Year Actuals (per PSC1-23b): | | |
| Electric (FERC Account 904, per PSC1-23b p. 3 of 6) | 1.8 | 3.1 |
| Gas (FERC Account 904, per PSC1-23b, p. 5 of 6) | N/A | 1.2 |
| Total | 1.8 | 4.3 |
| Year 2000 Actuals (per PSC1-23(b)): | | |
| Electric (FERC Account 904, per PSC1-23b p. 3 of 6) | 1.0 | 2.2 |
| Gas (FERC Account 904, per PSC1-23b, p. 5 of 6) | | 0.6 |
| Total | 1.0 | 2.8 |
| x CPI Escalation Factor | 1.078 | 1.078 |
| Year 2000 Escalated | 1.1 | 3.0 |
| Test Year vs. 2000 Escalated | 0.7 | 1.3 |

| INCREMENTAL LIME COSTS | LG&E |
|---|---|
| Test Year Actuals | 8.4 |
| 2000 Actuals | 6.6 |
| x CPI Escalation Factor | 1.078 |
| 2000 Escalated | 7.1 |
| Incremental Lime Costs | 1.3 |

## VDT Savings Analysis
## Breakdown of Labor Per PSC1-23(c)
***$ Millions***

| ACCOUNT TYPE | EXPENDITURE TYPE | KU 2000 | KU TEST YEAR | LG&E 2000 | LG&E TEST YEAR |
|---|---|---|---|---|---|
| Power Production | Straight Time | 20.0 | 18.4 | 25.7 | 19.5 |
| Power Production | Over Time | 3.2 | 3.0 | 5.9 | 3.7 |
| Power Production | Overheads | 7.5 | 5.7 | 4.8 | 5.2 |
| Distribution | Straight Time | 10.1 | 7.3 | 9.5 | 6.3 |
| Distribution | Over Time | 2.4 | 4.7 | 2.3 | 1.5 |
| Distribution | Overheads | 3.4 | 2.6 | 1.6 | 1.7 |
| Transmission | Straight Time | 1.9 | 2.4 | 1.9 | 1.1 |
| Transmission | Over Time | 0.1 | 0.1 | 0.1 | 0.1 |
| Transmission | Overheads | 0.8 | 0.7 | -0.1 | 0.3 |
| Gas Operations | Straight Time | N/A | N/A | 8.2 | 6.5 |
| Gas Operations | Over Time | N/A | N/A | 0.8 | 0.9 |
| Gas Operations | Overheads | N/A | N/A | 1.7 | 1.7 |
| Customer Accounts and Sales | Straight Time | 9.0 | 6.5 | 6.7 | 4.3 |
| Customer Accounts and Sales | Over Time | 0.3 | 0.2 | 0.3 | 0.2 |
| Customer Accounts and Sales | Overheads | 2.8 | 1.9 | 1.9 | 1.2 |
| Admin and General | Straight Time | 8.1 | 7.1 | 16.2 | 8.1 |
| Admin and General | Over Time | 0.2 | 0.1 | 0.3 | 0.1 |
| Admin and General | Overheads | 4.8 | 10.7 | -1.4 | 12.3 |
| **Total Company Labor Expense Per PSC1-23(c)** | | 74.6 | 71.4 | 86.2 | 74.7 |
| Straight Time Component | | 49.1 | 41.7 | 68.2 | 45.8 |
| Jurisdictional % | | 88.06% | 89.51% | 100.00% | 100.00% |
| Jurisdictional Straight Time | | 43.2 | 37.3 | 68.2 | 45.8 |

## VDT Savings Analysis
## Escalation of Benefits
***$ Millions***

| | | | KU | LG&E |
|---|---|---|---|---|
| Straight Time Labor in 2000 | | | 43.2 | 68.2 |
| Escalation Factors: | | | | |
| | 2001 | x | 1.031 | 1.042 |
| | 2002 | x | 1.039 | 1.045 |
| | Test Year | x | 1.039 | 1.032 |
| Escalated Straight Time Labor | | | 48.1 | 76.6 |
| Actual Benefit Rate | | | 46.97% | 47.76% |
| Escalated Benefits | | | 22.6 | 36.6 |

COMMONWEALTH OF KENTUCKY

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PUBLIC SERVICE COMMISSION

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|---|---|---|
| APPLICATION OF LOUISVILLE GAS AND | ) | |
| ELECTRIC COMPANY FOR AN ADJUSTMENT | ) | CASE NO. 2003-00433 |
| OF THE GAS AND ELECTRIC RATES, | ) | |
| TERMS AND CONDITIONS | ) | |

In the Matter of:

| | | |
|---|---|---|
| APPLICATION OF KENTUCKY UTILITIES | ) | |
| COMPANY FOR AN ADJUSTMENT | ) | CASE NO. 2003-00434 |
| OF THE ELECTRIC RATES, TERMS AND | ) | |
| CONDITIONS | ) | |

# REBUTTAL TESTIMONY

OF

VALERIE L. SCOTT

DIRECTOR, FINANCIAL PLANNING AND ACCOUNTING – UTILITY OPERATIONS
LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY

Filed: April 26, 2004

**Q. Please state your name, position and business address.**

A. My name is Valerie L. Scott. I am the Director, Financial Planning and Accounting - Utility Operations for Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky.

**Q. Have you previously testified in this proceeding?**

A. Yes. I filed direct testimony in this case on December 29, 2003 on behalf of LG&E and KU. A statement of my professional history and education was attached as Appendix A to that testimony, as well as to KU's response to PSC 2-16(m) and LG&E's response to PSC 2-16(o).

**Q. What is the purpose of your testimony?**

A. The purpose of my testimony is to rebut certain contentions concerning the calculation of LG&E's and KU's revenue requirements raised by: (1) Robert Henkes and Michael Majoros for the Office of the Attorney General ("AG"); (2) Lane Kollen for the Kentucky Industrial Utility Customers, Inc. ("KIUC"); (3) Thomas Prisco for the United States Department of Defense ("DOD"); and (4) Kevin Higgins on behalf of The Kroger Co. ("Kroger").

## Annualized Depreciation Expense

**Q. Does LG&E object to the annualized depreciation expense proposed by Mr. Henkes as shown on Schedule RJH-8 for LG&E's electric operations, and Schedule RJH-8 for LG&E's gas operations?**

A. Yes. Both schedules, according to Mr. Henkes, reflect the difference between the new depreciation rates proposed in this case by LG&E and those recommended by Mr. Majoros, as applied to the depreciable plant in-service balances at the end of the test year.

For the reasons stated in Mr. Robinson's Rebuttal Testimony, the depreciation rates recommended by Mr. Majoros are not reasonable and should be rejected.

**Q. Does KU object to the annualized depreciation expense proposed by Mr. Majoros as shown on Exhibit ___ (MJM-7) for KU's electric operation?**

A. Yes. The schedule, like the schedule presented by Mr. Henkes, reflects the difference between the new depreciation rates proposed in this case by KU and those recommended by Mr. Majoros, as applied to the depreciable plant in-service balances at the end of the test year. For the reasons stated in Mr. Robinson's Rebuttal Testimony, the depreciation rates recommended by Mr. Majoros are not reasonable and should be rejected.

**Q. Do you agree with Mr. Prisco's recommendation that the Commission reject LG&E's current depreciation study on the grounds that it is premature under the terms of the Value Delivery Team ("VDT") Settlement Agreement approved in Case No. 2001-00141 ("VDT Settlement Agreement")?**

A. No. The Department of Defense elected not to intervene in, and therefore was not a party to the VDT Settlement Agreement, and thus should not now be allowed to renegotiate that settlement. Importantly, no party to the VDT Settlement Agreement has argued that LG&E's current depreciation study is inconsistent with that agreement. Indeed, the AG has offered a new depreciation study in this proceeding as well.

In any event, LG&E's submission of a depreciation study in this proceeding is consistent with the terms of the VDT Settlement Agreement, which provided for a new study of its depreciation rates to be completed no later than calendar year 2004 based on its plant-in-service as of December 31, 2003. The defining limit on the commitment in the VDT Settlement Agreement was the timing of another study (e.g., "no later than calendar year 2004"), and not the timing of the plant-in-service date. Thus, the depreciation studies offered by the Companies in these proceedings are timely and comport with the requirements contained in the VDT Settlement Agreement.

**Q. Mr. Prisco has also testified that depreciation issues should generally be excluded from base rate proceedings. Please comment on that position.**

A. A rate proceeding is certainly the appropriate forum for the Commission to consider a change in depreciation rates, because the proceeding involves the review of all significant components of net operating income. Indeed, the Commission has considered depreciation issues in the context of base rate proceedings in the past. <u>See e.g.</u>, *In the Matter of: Adjustment of Gas Rates of The Union Light, Heat and Power Company*, Case No. 2001-00092, Order of January 31, 2002. And, as a matter of economy for the Commission, its Staff, the Companies' ratepayers, and the Intervenors, the Companies' depreciation rates should be considered in these proceedings rather than being deferred for consideration in later, separate proceedings.

## Promotional Expenses

**Q. Please comment on the promotional expense adjustments proposed by Mr. Henkes for LG&E's electric and gas operations.**

A. LG&E does not object to Mr. Henkes' recommendation that $22,699.00 in Account #909001 and $3,119.00 in Account #909002 be disallowed from LG&E's calculation of the revenue requirement for its electric operations or $9,272.00 in Account No. 909001 and $1,274.00 in Account No. 909002 be disallowed from the calculation of LG&E's revenue requirement for its gas operations. However, LG&E does object to Mr. Henkes' recommendation to disallow the following expenses from the calculation of its electric and gas revenue requirements:

| | Electric | Gas |
|---|---|---|
| Account #912001 | $13,177.00 | $5,382.00 |
| Account #912005 | $51,455.00 | $21,017.00 |

The expenses in account 912001 are related to economic development and produce a "material benefit" as envisioned under 807 KAR 5:016. These expenses are incurred in assisting and attracting employers to the Commonwealth who are "selecting" the location of their facility, not their electric supplier. The Companies work closely with state and local governments to encourage the relocation of businesses and expansion of existing businesses.

These expenses should not be at issue as they are reasonable and typical of the type of expenses incurred for economic development activities and produce a material benefit to the Commonwealth and its citizens. Expansion of existing manufacturing facilities and the attraction of new businesses increase the number of jobs and the amount of potential taxes available for state government. Furthermore, in approving the Powergen and E.ON transactions, the Commission required the following commitment:

> E.ON and Powergen commit to maintaining LG&E's and KU's proactive stance on developing economic opportunities in Kentucky and supporting economic development ... throughout LG&E's and KU's service territories.

*In the Matter of: Joint Application for Transfer of Louisville Gas and Electric Company and Kentucky Utilities Company in Accordance with E.ON AG's Planned Acquisition of Powergen plc*, Case No. 2001-104 (Order of August 6, 2001); *In the Matter of: Joint Application of Powergen plc, LG&E Energy Corp., Louisville Gas and Electric Company, and Kentucky Utilities Company for Approval of a Merger*, Case No. 2000-095 (Order of May 15, 2000). Economic development expenses are an appropriate part of the Companies' cost of providing service to their customers, and inclusion of their expenses as part of their cost of service for ratemaking purposes is consistent with the fulfillment of this commitment.

Economic development expenses were not removed in LG&E's Case No. 98-426 or KU's Case No. 98-474, and although such expenses were disallowed in LG&E's last gas base rate case, Case No. 2000-080, the Companies recommend the Commission include the economic development expenses here as a matter of sound regulatory policy consistent with 807 KAR 5:016 and its requirement for the Companies to support economic development.

The expenses charged to account 912005 are for customer satisfaction surveys and utility industry research which help the Companies provide better service to their customers. These expenses should be allowable in determining base rates since they benefit the Companies' ratepayers as evidenced by the Companies' multiple J. D. Power awards.

## Rate Case Expenses

**Q. Please comment on Mr. Henkes' contention that the Commission should not rely on the rate case expense estimates that have been presented by LG&E in its electric and gas rate cases.**

A. First of all, Mr. Henkes concurs that there should be an adjustment to recognize rate case expenses in the Companies' revenue requirements. Contrary to Mr. Henkes' contention, LG&E and KU are not requesting the recovery of the estimated cost of the rate case expenses. As explained in my direct testimony, LG&E and KU used the estimate only for the purpose of calculating the revenue requirement at the time of filing their applications. Pursuant to established Commission policy, LG&E and KU are requesting recovery of their actual rate case expenses in these cases. Therefore, Mr. Henkes' concern is misplaced. Since filing their applications, LG&E and KU have provided the Commission, in response to PSC 1-57 and the monthly updates thereto, their actual rate case expenses. It is well established under Commission policy[1] that rate case expenses are to be included as part of a utility's cost of service. VLS Rebuttal Exhibit 1 shows the actual rate case expenses incurred by LG&E and KU to date.

**<u>Normalization of Expenses</u>**

**Q. Please comment on the recommendations of Mr. Henkes and Mr. Prisco concerning normalization of injuries and damages expense.**

A. Mr. Henkes agrees with LG&E's proposed injuries and damages expense normalization adjustments for electric and gas revenue requirements with one exception. Mr. Henkes recommends that the five-year CPI-adjusted average should be moved forward by approximately one year, so that the five-year period begins with 1999 and ends with the test year. Mr. Prisco, for the DOD, appears to concur with Mr. Henkes and further recommends that the inflation adjustment not be used.

The methodology used by the Companies to compute the average injuries and damages expenses is similar to the AG's approach in LG&E's last gas rate case. The Companies excluded the test year expense in order to avoid over-weighting the three-month period ending December 31, 2002. By including the test year in the five-year average, this three-month period would have been included in both the 2002 and the test year results. While the Commission has approved the inclusion of the test year amounts

[1] *In the Matter of: An Adjustment of the Rates of Delta Natural Gas Company, Inc.*, Case No. 99-176, <u>Order</u>, pp. 18-21 (December 27, 1999).

as part of the calculation of the normalization of the storm damage expense in Case No. 98-426, that calculation uses a ten-year average, adjusted for inflation.

LG&E and KU believe that the use of a multi-year normalization of expenses is appropriate. The use of a longer historical period in the normalization of expenses such as injuries and damages, as adjusted for inflation, results in a better representation of normal expenses. To resolve this dispute, the Companies recommend the pro forma adjustment for Account No. 925, Injuries and Damages, be calculated consistently with the methodology used to calculate their storm damages adjustment. VLS Rebuttal Exhibit 2 shows the injuries and damages expense normalization adjustment calculated using a ten-year average, including the test period, adjusted for inflation. These amounts are taken from KU's and LG&E's Data Responses to PSC 2-16(g)(4). The methodology used for calculating the normalization adjustment for injuries and damages expense should be consistent with the calculation of storm damages. Thus, LG&E and KU recommend the normalization of injuries and damages be based on a ten-year average, adjusted for inflation.

**Q. Do you agree with Mr. Prisco's recommendation concerning the pro forma adjustment for storm damage?**

**A.** No. The Commission has authorized the normalization of a ten-year period in the past. Commission's Order of December 21, 1990, Case No. 90-158, p. 30. Mr. Prisco has not presented any justification for departing from this established policy of the Commission and has not shown how technology and enhanced productivity eliminate the need to adjust for inflation.

The merger of LG&E Energy Corp. and KU Energy Corporation did not diminish the geographical service territories of LG&E and KU. In fact, the service territories remain essentially the same after the merger, but contain a greater number of customers. Although the merger allowed either utility to draw more readily on assistance from the other in terms of access to a trained workforce to respond to storms, the merger did not diminish the frequency of storms or the nature, type and volume of resources which must be devoted to restoration efforts following a storm. Specifically, the merger had no impact on the number of line crews it takes to restore power lines after a storm. The cost of repairing the damage from storms is still incurred, just as it was before the merger.

**<u>Miscellaneous Expenses Adjustments</u>**

**Q. Please comment on the recommendation of Mr. Henkes concerning LG&E's adjustments to miscellaneous expenses.**

A. Mr. Henkes has recommended several minor adjustments to test year expense in his Miscellaneous Expenses Adjustment to the calculation of the revenue requirement for LG&E's electric and gas operations. LG&E objects only to Mr. Henkes' adjustment relating to expenses associated with employee gifts, award banquets and social expenses. These expenses should be charged to ratepayers because they are prudent and reasonable expenses associated with rewarding employees in connection with the Companies' safety programs and professional achievements or accomplishments. They contribute to the morale of employees and provide incentives for high levels of performance. Customers benefit from an efficient, motivated workforce. Such expenses are typically incurred by other companies and are not unusual or unreasonable in any way.

**Pension and Post-retirement Benefit Expenses**

**Q. Please comment on the recommendations concerning the Companies' pension and post-retirement benefit expenses adjustments.**

A. Mr. Kollen, Mr. Prisco and Mr. Majoros have each recommended the Companies' adjustments be rejected. As explained in my direct testimony, the adjustment for pension and post-retirement expenses is necessary to annualize the test period ended September 30, 2003 to reflect the 2003 known and measurable pension and post-retirement expenses calculated by Mercer. The adjustment is no different in concept or purpose than the labor adjustment proposed by LG&E and KU in these cases.

**Q. Do LG&E and KU agree with the recommendation of Mr. Kollen regarding the annualization adjustment to pension and post-retirement benefit expenses?**

A. No. Mr. Kollen recommends the Commission not allow the annualization adjustment to increase pension and post-retirement benefit expenses on the grounds that it is a selective post-test year adjustment, that the actuarial calculations relied upon by the Companies are not known and measurable, and that the actuarial calculations cannot be verified based on the schedules provided in response to discovery. His contentions are without merit.

Mr. Kollen misinterprets the Companies' pension and post-retirement benefit expense adjustment. His contention that "[t]he Company proposes a selective post test year adjustment to increase its pension and post-retirement benefit expense to projected 2004 levels" at page 16, line 1-2 of his testimony is simply wrong. This adjustment is not an out of period adjustment. Specifically, LG&E and KU are not proposing an adjustment of their pension and post-retirement benefit expense to projected 2004 levels. The adjustment merely annualizes pension expense based on 2003 levels for the test period.

In other words, the adjustment is annualizing the test year amounts to reflect the 2003 actuarial calculations of pension expense. Therefore, the adjustment is not, as KIUC contends, a selective post-test year adjustment.

Furthermore, the actuarial calculations relied upon by the Companies are known and measurable because they reflect the recorded pension and post-retirement benefit expenses for the nine months of 2003 that is in the test period. Mercer, a firm of long-standing, professional competence and reputation in the field of actuarial analysis and evaluation, prepared the actuarial calculations. Mercer's actuarial calculations have been used by LG&E and KU and many other utilities for years in booking pension and post-retirement benefit expenses. The Commission has approved LG&E's pension and post-retirement benefit expenses in the last three rate cases based upon the actuarial calculations provided by Mercer.

Because the actuarial calculations are shown in the schedules provided in response to discovery, in both in the disclosure statements and the actuarial studies, the adjustment can be verified to the actuarial calculations. The Companies have filed the 2003 and 2002 studies prepared by Mercer in their responses to PSC 2-16, KIUC 2-6 (LG&E), and KIUC 2-18 (KU).

Finally, Mr. Kollen, at page 17, lines 10-14, asserts that the Companies were incorrect in stating, in response to PSC 2-16(e), that "actuarial reports from Mercer for the fiscal year ending December 31, 2003 are not yet available." Again, Mr. Kollen is incorrect. The Companies' statement in the data response is accurate. The reports presented in response to PSC 2-16(e) are the reports for the 2003 expense, calculated as of a valuation date of January 1, 2003, in accordance with standard actuarial practice.

These reports were issued in 2003 and were provided in response to PSC 2-16(e). The actuarial valuation reports calculated as of a valuation date of December 31, 2003/January 1, 2004, will not be issued by Mercer until later this year and are not currently available.

**Q. Please comment on the recommendation by Mr. Prisco concerning this adjustment.**

A. Mr. Prisco has recommended that the Commission reject LG&E's pro forma adjustment for pension and post-retirement expenses and establish a "regulatory asset and/or credit as balancing accounts for pensions and other post-retirement expenses." The mechanism he recommends is vague in concept. The details of its operation and implementation are not discussed in his testimony. Mr. Prisco further contends, with no analytical support, a fifteen percent band should be established that would require a refund or recovery if or when the account reaches the specific threshold of fifteen percent of the plan assets. This recommendation is not adequately supported by his testimony, is not supported by prior Commission decisions, and should be rejected.

**Q. Do you agree with the recommendation of Mr. Majoros that the Commission should allow only the test year expense?**

A. No. Mr. Majoros has made three assumptions in his testimony that are incorrect and has not presented any support for his speculative contentions about the Companies' pension and post-retirement benefit costs in the future.

First, with respect to his erroneous assumptions, at page 11, lines 14-16 of his testimony, Mr. Majoros states:

> Amortization of actuarial (gain) or loss, which I assume to be changes in the ABO due to revisions in predicted retirement periods of the Companies' employees.

His reference to "the ABO" appears to be a typographical error that should be "PBO". An "Accumulated Benefit Obligation" ("ABO") represents the present value of the benefit to date. In contrast, a Projected Benefit Obligation ("PBO") is the benefit of future salaries based on the participants' years of service to date. Actuarial gains or losses are changes either in the PBO due to changes in assumptions (i.e., discount rates, retirement rates, turnover rates, mortality rates, salary increase rates) or in the plan assets due to changes in actual gains or losses experienced. This definitional error impacts Mr. Majoros' assumptions about the ABO discussed below.

Secondly, Mr. Majoros, at page 12, lines 19- 22, in support of his argument that the interest rate chosen for the actuarial calculation "creates volatility in pension costs" makes the following contention:

> [A] lower interest rate has the counter-intuitive effect of increasing the interest costs on the ABO. That is because as the present value of the ABO increases, the annual accretion in that value is correspondingly larger, even at the lower interest rate.

However, depending on the plan demographics, a lower interest rate may not always increase the interest cost on the PBO.

Third, Mr. Majoros asserts at page 14 that the value of KU's pension and post-retirement benefit fund assets "will probably increase" because:

> [M]ost companies do not fully revalue their pension assets each year. Rather, they use a "smoothing" technique in which only a one-third of each year's gain or loss is recognized in calculating the capital gains or losses in the funds' asset values. The remaining two-thirds are amortized into the re-evaluation over the next two years.

Mr. Majoros' assumption that the Companies use such a "smoothing" technique in the calculation of the value of the pension and post-retirement benefit fund assets is incorrect. LG&E Energy LLC's external auditor, PricewaterhouseCoopers LLP, does not allow

LG&E or KU to use the smoothing technique and instead requires the use of the fair market value methodology. The Companies do not use the smoothing technique to value assets for SFAS No. 87 purposes.

In addition to these erroneous assumptions, Mr. Majoros' testimony makes a number of unsupported and speculative assertions about the possible changes in the Companies' pension and post-retirement benefit costs in the future. For example, at page 14, lines 16-18, of his testimony, he contends that because interest rates are likely to increase through the next several years, during that same time, the value of KU's pension and post-retirement benefit fund assets "will probably increase." However, Mr. Majoros does not provide any quantitative analysis that supports his speculation that the value of KU's pension and post-retirement benefit fund assets is likely to increase as a consequence of a possible increase in interest rates. Further, he has offered no quantitative support for his speculative conclusion at page 15, lines 9-12, that "the present value of KU's Projected Benefit Obligation and Accumulated Benefit Obligation will decline" if interest rates rise. He also has offered no independent analysis to support his conjecture at page 15, lines 15 -17, that the pension and post-retirement benefit costs computed for 2003 "may be the peak costs that KU has experienced and that it will experience in the immediate future." These unsupported assertions fail to meet the known and measurable standard.

Notwithstanding the lack of support for his speculative assertions, the AG's contention that the Companies' pension and post-retirement benefit expense "will very probably decline in the immediately following years" completely overlooks the fundamental reason for the adjustment. The pension and post-retirement benefit adjustment, as previously discussed, is an annualization adjustment based on the known and measurable change in pension and post-retirement benefit expense occurring in the test year. The unsupported speculation about possible changes in the future is well beyond the test year, has absolutely no bearing on the need to annualize the pension and post-retirement benefit expense for the full 12-month period ending September 30, 2003 and does satisfy the known and measurable standard. The only known and measurable adjustments before the Commission are the Companies' proposed adjustments based on Mercer's actuarial study. The Commission should adopt the Companies' adjustments.

**SFAS No. 143 (Asset Retirement Obligation Adjustment)**

**Q. Please comment on the findings and conclusions of the witnesses for some of the Intervenors concerning the Companies' adjustments to reflect SFAS No. 143.**

A. The Attorney General's witnesses, Mr. Majoros and Mr. Henkes, recommend that the adjustments be rejected. KIUC's witness, Mr. Kollen, however, believes the Companies properly reflected the impact of SFAS No. 143 in its filings consistent with the December 19, 2003 stipulation KIUC and the Companies signed in Case Nos. 2003-00426 and 2003-00427. Mr. Kollen participated in the accounting discussions with others and me in the course of those proceedings, which ultimately produced the Stipulation on the accounting treatment for SFAS No. 143. The Commission approved the Stipulation and resulting accounting treatment in its Order of December 23, 2003. A complete and accurate copy of the December 23, 2003 Order and Stipulation attached thereto is attached as VLS Rebuttal Exhibit 3. Simply stated, the pro forma adjustments remove non-recurring regulatory credits recorded above the net operating income line in account 407. The Companies recorded these regulatory credits to offset the non-recurring cumulative effect of adopting SFAS No. 143 during the test year. The cumulative effect of adoption was recorded in account 435, an account reported below the net operating income line in conformity with the FERC USofA.

**Q. Do you agree with Mr. Majoros' criticism of the adjustment?**

A. No. Mr. Majoros contends that the Companies' accounting adjustments were contrived to create incremental revenue requirements because the credit booked to account 407 was a result of "an unnecessary charge to below-the line net income" (pages 12-13).

The Companies were required to record a cumulative effect adjustment when adopting SFAS No. 143 and FERC Order No. 631. As prescribed by the FERC USofA, this cumulative effect was recorded in account 435, Extraordinary Deductions, which is to "be debited with losses of unusual nature and infrequent occurrence". The one-time occurrence of adopting this pronouncement met the definition of this account, a below-the-line account.

**Q. Do you agree with Mr. Majoros' interpretation of FERC Order No. 631?**

A. No. FERC Order No. 631 generally adopts the requirements of SFAS No. 143. Unfortunately, it did not recognize the ratemaking implications of recording a cumulative effect adjustment in the FERC-prescribed account 435, which is below-the-line, versus the FERC-prescribed regulatory credit account 407, which is above-the-line. VLS Rebuttal Exhibit 4 shows an example of the mismatch between LG&E's and KU's net operating income that was created by the implementation of SFAS No. 143. The Commission recognized the implications of recording a cumulative effect adjustment in the FERC-prescribed account created by FERC Order No. 631 when it stated "[t]he cumulative effect impact reflects the restatement of account balances in accordance with the requirements of SFAS No. 143." Order, p. 4.

Reference Schedule 1.25 of Rives Exhibit 1 as referenced in my direct testimony shows the adjustment necessary to net the cumulative affect of this accounting change against the corresponding regulatory credit in the test year. The adjustment proposed by the Companies simply reverses the non-recurring "above-the-line" regulatory credit recorded during the test year to achieve the "revenue neutral" result desired by both the Companies and Mr. Majoros.

**Q. What is the position of the Companies with respect to Mr. Majoros' contention that the accounting entries are incomplete?**

A. The entries presented by the Companies represent the impact of adopting SFAS No. 143 for Asset Retirement Obligations. Mr. Majoros refers to paragraph B73 of SFAS No. 143 which indicates that costs of removal related to assets without a legal liability should be recognized as regulatory liabilities if the requirements of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, are met. However, FERC Order 631 indicated that these same amounts, currently recorded in account 108, should merely be maintained in separate subsidiary records supporting account 108 (paragraph 38). The Companies have separated these costs of removal for assets with no legal liability through reclassification of the amounts to account 108 sub-accounts. In its order, FERC recognized that the calculation of these amounts would be difficult, or perhaps impossible for some companies and that if the amounts previously recorded could not be identified that this provision of the order could be prospectively adopted (paragraph 39). The Companies calculated these amounts between the date the FERC order was issued in April 2003 and its calendar year end and made the reclassifications required by FERC Order 631 in December 2003. Since the reclassifications were merely among accounts within the 108 series of accounts there was no net impact of adopting this portion of FERC Order 631 and these entries had no bearing on the adoption of SFAS No. 143.

Q. **What is the position of the Companies with respect to Mr. Majoros' contention concerning excessive accumulated depreciation?**

A. Mr. Majoros states that, if the Companies have no legal obligations, then no future cost of removal is capitalized. While no accrual is established for the cost of removal for assets without a legal obligation similar to the accrual established under SFAS No. 143, long-standing utility practice has been to recognize the cost of removing all assets through depreciation expense and accumulated depreciation. The Companies continue to support this practice since it charges the costs of ultimately replacing or removing assets to the ratepayers benefiting from their use.

The Stipulation approved by the Commission on December 19, 2003 clearly indicates that the Companies will remove all effects of adopting SFAS No. 143 for ratemaking purposes. As recognized in the Stipulation, the Companies have recorded all expense impacts of SFAS No. 143 as either regulatory assets or regulatory liabilities and continued depreciating all assets using the depreciation rates approved by the Commission. Continued use of the approved depreciation rates, which include a cost of removal component, while removing the effects of SFAS No. 143, ensures that the Companies do not charge excessive depreciation.

The Stipulation was made recognizing that the accounting under SFAS No. 143 did not dictate the regulatory treatment of depreciation. In fact, SFAS No. 143 recognized that regulated entities use depreciation rates that include a cost of removal component and might be subject to different depreciation accounting for financial and regulatory accounting purposes. Paragraph 20 of SFAS No. 143 states:

> Many rate-regulated entities currently provide for the costs related to the retirement of certain long-lived assets in their financial statements and recover those amounts in rates charged to their customers. Some of those costs result from asset retirement obligations within the scope of this Statement; others result from costs that are not within the scope of this Statement. The amounts charged to customers for the costs related to the retirement of long-lived assets may differ from the period costs recognized in accordance with the Statement and, therefore, may result in a difference in the timing of recognition of period costs for financial reporting and rate-making purposes. An additional recognition timing difference may exist when the costs related to the retirement of long-lived assets are included in amounts charged to customers but liabilities are not recognized in the financial statements. If the requirements of Statement 71 are met, a regulated entity also shall recognize a regulatory asset or liability for differences in the timing of recognition of the period costs associated with asset retirement obligations for financial reporting pursuant to this Statement and rate-making purposes.

The FERC, in Order 631, similarly recognized the differences in financial and regulatory accounting practices for assets without a legal liability in paragraph 38 of the order, as follows:

> Instead we will require jurisdictional entities to maintain separate subsidiary records for cost of removal for non-legal retirement obligations that are included as specific identifiable allowances recorded in accumulated depreciation in order to separately identify such information to facilitate external reporting and for regulatory analysis, and rate setting purposes.

Paragraph 38 specifically addresses the FERC's requirements related to the $456 million Mr. Majoros refers to on lines 17 to 22 and lines 1 to 7 of pages 22 and 23, respectively, of his testimony. This amount is the accumulated normal cost of removal embedded in account 108, accumulated depreciation, and now separately tracked in account 108 sub-accounts. This amount has accumulated over time through the application of depreciation rates approved by the Commission and was calculated with the assistance of Earl Robinson to allow the Companies to comply with the provisions of FERC Order 631. The Companies' continuing depreciation practice of including a cost of removal component in its depreciation rates ensures that customers benefiting from the use of the assets are also paying a portion of their ultimate replacement or removal costs. Mr. Majoros' contention of a $456 million over-collection from ratepayers is without merit, and costs of removal is further addressed in the rebuttal testimony of Mr. Robinson.

**<u>Obsolete Inventory and Carbide Lime Adjustments</u>**

**Q. Please describe the positions of the witnesses for the AG and KIUC concerning LG&E's adjustment for obsolete inventory write-off.**

A. Mr. Henkes recommends that the Commission reject the adjustment on the grounds that it is a non-recurring event. For the same reason, Mr. Kollen also contends that the adjustment should be denied. He further asserts that, because the obsolete inventory is recoverable through the 2003 ESM, it should not be recovered through base rates.

**Q. Does LG&E agree with these recommendations?**

A. No. For reasons I will discuss, the Commission should reject the contentions of these witnesses and accept the pro forma adjustment for obsolete inventory.

The objective of the test period is to set a representative ongoing level of costs going forward to be recovered through base rates. The obsolete inventory adjustment of LG&E meets that objective. Rejecting the adjustment, as recommended by Mr. Henkes, simply disallows a frequently-incurred, reasonable cost of providing service. Including the adjustment, based upon a three-year amortization, more fully reflects a representative level of annual expenses for ratemaking purposes. This is especially so for the write-off of obsolete inventory because it is an investment in utility property. In LG&E's 1988 rate case, Case No. 10064, the Commission, in reviewing the early retirement of certain scrubbers and the abandonment of underground gas storage fields, treated these items as extraordinary property losses. The Commission did not completely disallow cost of this property, but instructed LG&E to establish deferred asset accounts and begin an amortization of those assets. This ratemaking treatment allowed LG&E to recover the total cost of the utility plant no longer in service, but did not allow an earned return on the plant retirements or abandonments. The same ratemaking treatment should be afforded LG&E in this case.

**Q. Please describe the positions of the witnesses for the AG, KIUC and DOD concerning LG&E's adjustment for the carbide lime adjustment.**

A. Mr. Henkes recommends that the Commission reject the adjustment on the grounds that it is a non-recurring event. For the same reason, Mr. Kollen also contends that the adjustment should be denied. He further asserts that, because the carbide lime is recoverable through the 2003 ESM, it should not be recovered through base rates. Mr. Prisco also recommends the Commission reject LG&E's pro forma adjustment for the carbide lime write-off because the payments occurred before the test year.

**Q. Does LG&E agree with these recommendations?**

A. No. The Commission should reject the contentions of these witnesses and accept the pro forma adjustment for carbide lime. The witnesses for the Intervenors are asserting a standard that fails to recognize that LG&E should be able to recover its prudently incurred costs. LG&E made an investment in the carbide lime now being written off. The Company should, as a matter of principle, be provided an opportunity to recover its investment, irrespective of whether a write-off occurs every year or only once in 30 years. None of the Intervenor witnesses claim, or otherwise demonstrate, that any of these investments were improperly incurred or otherwise imprudent. The Intervenor witnesses, however, have put forward an unsuitable standard for evaluating whether a utility should be allowed to recover an investment made to provide service to customers. By their very nature, investments in utility property are nonrecurring until they are replaced years later.

**Q. Do you agree with Mr. Kollen's recommendation that the Commission should not allow LG&E to defer and amortize the amounts associated with the write-offs of carbide lime and obsolete inventory?**

A. No. Mr. Kollen contends that these are non-recurring amounts that were subject to the ESM for the 2003 operating period and, for that reason, it is appropriate to remove what he asserts to be non-recurring amounts set in base rates prospectively. The write off of carbide lime occurred in 2002; accordingly, it was not included in the ESM for 2003. As previously discussed, these costs should be included to better reflect the representative level of annual expenses for ratemaking purposes going forward or to recover prudently incurred costs. The fact that these costs are included in the ESM is not a reason to exclude them as and at a representative level of these types of costs going forward for purposes of establishing base rates. Indeed, it is disingenuous on the part of KIUC to claim that the non-recurring write-offs of carbide lime and obsolete inventory should be disallowed from base rates because they will be recovered through the 2003 ESM and then in a different part of its testimony recommend to the Commission that the Company should not be permitted to complete the billing of the 2003 ESM. Mr. Kollen wants to be selective with regard to certain expenses and disregard the expressed operation of the

ESM Tariffs. The ESM was designed to be simple and easily calculated in order to share risks and rewards outside the deadband on a timely basis. The deadband lodges the entire risk and reward for operational variations first with the Companies and only shares a portion with customers outside the deadband for each annual period under the ESM. Therefore, it is inappropriate as Mr. Kollen suggests denying recovery of a representative amount of these costs going forward in base rates because of his so-called recovery through the ESM.

**KU Ice Storm**

**Q. Does Mr. Kollen make a similar recommendation concerning adjustments KU proposes to defer and amortize the costs associated with the ice storm during the test year?**

A. Yes. KU has reduced expense by $5.277 million to reflect a five-year amortization of its costs net of insurance recovery to reflect an ongoing representative level of extraordinary storm damage. The amortization period is consistent with the ratemaking treatment for LG&E of the 1974 tornado costs (Case No. 6220). Like the other adjustments, it is appropriate to include a representative level of this type of storm expense on a going forward basis in base rates. It does not represent, as Mr. Kollen contends, 140% recovery of the same cost.

KIUC's witness, however, contends this expense is a non-recurring amount and should be denied in its entirety to set base rates prospectively because the amount is included in the 2003 operating period for the ESM. As discussed above, KIUC's position that this specific cost will be recovered through the ESM is inconsistent with its objection to the Companies' billing of the 2003 ESM. When confronted with this inconsistency in the Commission's data request PSC KIUC No. 2, Mr. Kollen admitted to the punitive impact of his recommendation when he confessed that KU would only collect 40 percent of its ice storm expenses for approximately four months and "under the assumption that such ice storm costs are on the margin."

The cumulative effect of KIUC's recommendation is almost a complete disallowance of a prudent and reasonable level of costs associated with extraordinary storm damage expense. Challenged with this inconsistency, Mr. Kollen then acknowledged in the same data response that the Company "was not entitled to any more than the 40% recovery of the ESM rate plan that was in effect for the calendar year 2003."

**<u>LG&E Cane Run Insurance Proceeds and Corporate Office Lease</u>**

Q. **Does Mr. Kollen make a recommendation concerning adjustments LG&E proposes to remove from test year costs associated with Cane Run insurance proceeds and the corporate office lease?**

A. Mr. Kollen does not object to LG&E's pro forma adjustments to remove non-recurring credits recorded in the test year related to pre-test year expenses for the Cane Run insurance proceeds and the corporate office lease. However, he indicates that if the pro formas to recover a portion of the ice storm costs, obsolete inventory write-off, and carbide lime write-off, all expenses within the test year, are allowed that the Cane Run inventory proceeds and corporate office lease credits should be deferred and amortized, as well. Mr. Kollen bases his conclusion on the fact that all these costs and credits were included in the calculation of the 2003 ESM. Like the other adjustments, the Company-proposed adjustments to remove credits related to the Cane Run insurance proceeds and the corporate office lease expense are made to adjust to a representative level of expenses on a going forward basis in base rates. Their treatment in the 2003 ESM calculation, or relative to expenses incurred during the test year given that they are credits for costs incurred prior to the test year, should not be considered in setting base rates. The Commission should reject KIUC's recommendation that LG&E defer and amortize these two amounts over a three-year period and reduce the revenue requirement accordingly. To do so would include these credits into base rates going forward as if these non-recurring amounts would continue in the future. For the same reason, Mr. Prisco's recommendation to normalize LG&E's corporate lease expense and Cane Run repair fund over a three-year period should be rejected.

## KU OMU $NO_x$ Expense

**Q. Does KU agree with the recommendation of Mr. Kollen that the Commission should not allow the adjustment to operating expenses to reflect an increase in purchase power demand cost?**

A. No. As explained in my direct testimony, under the current power contract between KU and Owensboro Municipal Utilities ("OMU"), KU has a contractual obligation to pay OMU an increase in demand charges for KU's portion of the costs associated with OMU's compliance with $NO_x$ regulations proposed during the test period. The adjustment reflects KU's estimate of increases in demand charges that will begin July 1, 2004. The contractual responsibility for these demand charges is known. The estimate of the increases in demand charges is reasonable. It is therefore not only appropriate to recover these costs through base rates, but it is also appropriate to pro form the test period to reflect the ongoing level of these costs going forward. The suggestion by KIUC that the Company could seek to have the Commission include such costs in its environmental compliance plan and recover them through the ECR once they are known and measurable is appropriate only if the Commission makes a determination in this proceeding that KU can include the costs in its environmental compliance plan and recover them through the ECR beginning with the expense month July 2004 for billing in September 2004. KIUC's suggestion otherwise delays the recovery of KU's costs due to regulatory lag.

**ESM Audit Expenses**

Q. **Do you agree with Mr. Prisco's recommendation that the ESM audit expenses should be shared 50/50 between customers and shareholders?**

A. No. Mr. Prisco's testimony does not identify how any of the recommendations from the ESM audit benefit shareholders. This expense is no different than the cost of management audits. Pursuant to KRS 278.255(3), the cost of such an audit is borne by the utility, but the Commission is required to include such costs in the utility's cost of service for ratemaking purposes. An update of the actual costs associated with the ESM audit is attached hereto as VLS Rebuttal Exhibit 5.

**Merger Surcredit Agreement**

Q. **Do LG&E and KU agree with the recommendation of Mr. Higgins to reject selective provisions of the 2003 Settlement Agreement and LG&E's and KU's adjustment for shareholder merger savings?**

A. Absolutely not. Notwithstanding the very serious regulatory policy issues raised by Mr. Higgins' recommendation, as addressed by Mr. Beer in his rebuttal testimony, the Companies categorically reject his objections as I describe hereafter.

**Q. Do you agree with Mr. Higgins' first objection that the merger savings are not known and measurable amounts?**

A. No. The professional consulting firm, Deloitte & Touche, which has experience in identifying and evaluating the potential savings that could be created from synergistic mergers, independently developed the estimated savings. These estimates were then subject to full review, discovery and comment by the parties and Commission scrutiny during Case No. 97-300. There was no objection to their estimated nature by any party then or by any customer since then who has received the benefits from the operation of the merger surcredit mechanism. Since July 1998, the merger surcredit mechanism has successfully operated to provide customers with their fifty percent share of the non-fuel savings. Indeed, it is unlikely, in the absence of these rate cases, that Kroger would object to the use of these estimated savings for purposes of calculating the merger surcredit mechanism.

**Q. Do you agree with Mr. Higgins' second objection that the inability of the Companies to track the actual savings realized as a result of the merger shifts the risk associated with any achievement of the projected savings to customers?**

A. No. Mr. Higgins has created an argument without support. His testimony fails to demonstrate that the Companies have not achieved the estimated savings from the LG&E /KU merger. Indeed, his contention ignores the fact that the savings identified by Deloitte & Touche were undertaken during the first three to five years following the merger. Instead, he simply assumes the various savings initiatives are not complete or are yet to be undertaken. His contention further disregards the fact that, after the first three years, the increase in the estimated savings used for purposes of the merger surcredit is largely due to the function of cost-escalation factors. Thus, his objection concerning the risk of achievement of the merger savings under current conditions is diminished because the cost-saving initiatives identified by Deloitte & Touche were undertaken many years ago, and the estimated savings associated with the initiatives are escalated over time. His second objection therefore should be rejected.

**Q. Do you agree with Mr. Higgins' contention that the merger surcredit benefit to customers is purely illusory?**

A. No. Under the ratemaking approved by the Commission's Order of October 16, 2003, customers and shareholders will continue to share in the benefits of the savings on a 50/50 basis. This ratemaking is completely consistent with the Commission's determinations in Case Nos. 98-426 and 98-474 "that an adjustment should be made to secure the shareholder portion of the merger savings." Order, p. 82; Order, p. 80. In both cases, the Commission found it reasonable to use the gross level of merger savings as the amount to adjust expenses and specifically included eight months of the gross savings as the level of merger savings during the test period by an adjustment to increase operating expenses. This adjustment was necessary then, just as it is now, to eliminate the shareholders' merger savings from the return calculations.

Kroger's argument is illusory because, in effect, it would grant one hundred percent of the savings to customers and cause LG&E's and KU's returns to be overstated. This ratemaking treatment is necessary to provide the shareholders the benefit of their fifty percent share of the synergies created by the merger. If this ratemaking treatment is not awarded, the shareholders will be penalized twice for the merger costs: once by the write-off below-the-line of the one-time merger cost recorded as an expense to Other Income and Deductions and again by an overstated rate of return.

The following illustrates the 50/50 balance between customers and shareholders struck by the Commission in its Order in Case No. 97-300:

| | **Pre-Merger** | **Customer Savings** | **Shareholder Savings** | **Pro forma Adjustment for Shareholder Savings** | **Post-Merger Surcredit** |
|---|---|---|---|---|---|
| Revenues | $1,000 | $(50) | | | $950 |
| Expenses | $500 | $(50) | $(50) | $50 | $450 |
| Pre-tax net operating income | $500 | $0 | $50 | $(50) | $500 |

This table assumes an overall $100 savings, which is shared 50% by the customers and 50% by the shareholders. The customers' 50% share of the $100 savings is paid to the customers through the surcredit that reduces revenues by $50. The shareholders' 50% share of the $100 savings without the pro forma adjustment would increase pre-tax net operating profit by $50. The pro forma adjustment for the shareholder savings brings pre-tax net operating profit back to the pre-merger amount and provides the shareholders for recovery of their 50% share of the savings. Without the pro forma adjustment the customers would receive 100% of the savings, 50% as a surcredit and 50% as an increase in pre-tax net operating profit.

**Q. Do you agree with Mr. Higgins' opinion that the impact of the shareholder savings adjustment cancelled any future benefits to customers from the 2003 settlement?**

A. No. As previously stated, the adjustment increased operating expenses to reflect the shareholders' portion of the merger savings and was necessary to eliminate the shareholders' portion of the merger savings from return calculations. Clearly, if this was an appropriate adjustment in the calculation of the revenue sufficiency in Case Nos. 98-426 and 98-474, it is even more appropriate to make the same adjustment in the calculation of the present revenue deficiency. The impact of Mr. Higgins' recommendation is to provide customers with one hundred percent of the savings from the merger and would be a punitive result.

**Q. Do you agree with Mr. Higgins' assertion that the shareholders of the merged utilities have already experienced enough of the benefits from 1999 through 2003 and are no longer entitled to receive further benefits?**

A. No. Mr. Higgins' argument is contrary to the well-established determination by the Commission, made nearly seven years ago, that customers and shareholders should share the merger savings on a 50/50 basis. That fundamental determination, which was crucial to the decision to consummate the LG&E/KU merger, was established in the Commission's September 1997 Order in Case No. 97-300. It was then affirmed in the ratemaking treatment determination contained in the Commission's orders in Case Nos. 98-426 and 98-474; and again in the six orders approving LG&E's and KU's annual ESM filings from 2000 to 2002. Most recently, this determination was reaffirmed in the Commission's October 2003 orders in Case Nos. 2003-0043 and 2003-0044. In those orders, the Commission approved the continuation of the 50/50 sharing of the merger savings for another five-year period through the existing merger surcredit mechanisms and the long-standing ratemaking treatment of the shareholders' portion of the merger savings in the calculation of the annual ESM filings and base rate revenue requirements in these proceedings. Mr. Higgins' results-oriented contention should be rejected because is not consistent with the long-standing determination by, and numerous orders of, the Commission. The shareholders' 50 percent portion of the merger savings should not be confiscated for the benefit of ratepayers simply because it provides a convenient result in these rate proceedings.

**Q. What is your recommendation to the Commission concerning the proposal by Kroger?**

A. The Commission should reject the recommendation of Mr. Higgins concerning the merger surcredit, and continue to follow its established ratemaking determinations and prior orders concerning the regulatory treatment of the shareholder savings.

**Q. Do you agree with Mr. Prisco's recommendation to eliminate the pro forma operating revenue adjustment for merger savings?**

A. No. Mr. Prisco bases his contention apparently on the misunderstanding that the merger surcredit should have been accrued in account 449, Provision for Rate Refunds. This is not correct.

The merger surcredit is recorded as it is provided to customers as credits against billings. This treatment follows the matching principle of accounting whereby revenues and related expenses are recorded in the same period. Merger savings occur each month as costs are saved by the synergies created by the merger; accordingly, the allocation of the customers' portion of those costs not incurred are credited to the customers' billings each month and recorded when credited. No accrual for refund is required.

The adjustments proposed by the Companies are to recognize the higher level of savings due to the customers under the settlement agreement approved by the Commission in October 2003. In that settlement the accounting for the refunds was clearly established and the settlement clearly indicates the amount of the adjustment for the shareholders' savings in any base rate case and indicates that the customers' portion of the savings will be adjusted to an equal amount (paragraphs 3.1.2 for LG&E and 3.2.2 for KU). The adjustments proposed at Reference Schedule 1.22 reflect these amounts per the settlement agreement.

For these reasons, Mr. Prisco's recommendation should be rejected.

**Q. Does this conclude your testimony?**

A. Yes.

**VERIFICATION**

**COMMONWEALTH OF KENTUCKY )**
**) SS:**
**COUNTY OF JEFFERSON )**

The undersigned, **Valerie L. Scott**, being duly sworn, deposes and says she is the Director of Financial Planning and Accounting-Utility Operations for Louisville Gas and Electric Company, that she has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

Valerie L. Scott
**VALERIE L. SCOTT**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 23rd day of April 2004.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2003-00433

Schedule of Rate Case Preparation Costs

Response to Commission's Order
Dated December 19, 2003

Question No. 57c

Responding Witness: Valerie L. Scott

| Account | Date | Wire # / Journal # / Check # | Vendor # | Vendor Name | Amount | Description | Hours | Rate/Hr |
|---|---|---|---|---|---|---|---|---|
| 0100.111.008570.026900.186021.0321.0000 | 16-Jul-03 | 46268 | 16680 | OGDEN NEWELL AND WELCH | 12,493.50 | LGE Electric rate case preparation | 54.32 | 230.00 |
| 0100.111.008570.026900.186021.0321.0000 | 15-Sep-03 | 48681 | 16680 | OGDEN NEWELL AND WELCH | 5,124.45 | LGE Electric rate case preparation | 22.28 | 230.00 |
| 0100.111.008570.026900.186021.0321.0000 | 23-Sep-03 | 48681 | 16680 | OGDEN NEWELL AND WELCH | 1,410.75 | LGE Electric rate case preparation | 6.13 | 230.00 |
| 0100.111.008570.026900.186021.0321.0000 | 19-Nov-03 | 50331 | 16680 | OGDEN NEWELL AND WELCH | 2,515.75 | LGE Electric rate case preparation | 10.94 | 230.00 |
| 0100.111.008570.026900.186021.0321.0000 | 2-Dec-03 | 50407 | 16680 | OGDEN NEWELL AND WELCH | 10,148.50 | LGE Electric rate case preparation | 43.19 | 235.00 |
| 0100.111.008570.026900.186021.0321.0000 | 8-Dec-03 | 50407 | 16680 | OGDEN NEWELL AND WELCH | 34,864.10 | LGE Electric rate case preparation | 148.36 | 235.00 |
| | | | | **TOTAL LEGAL OUTSIDE COUNSEL LG&E ELECTRIC** | **66,557.05** | | | |
| | | | | | | | | |
| 0100.111.008570.021440.186021.0305.0000 | 7-Nov-03 | 48964 | 53957 | EDGEWOOD CONSULTING INC | 10,659.59 | Rate-of-return studies for LGE Electric rate case | 47.38 | 225.00 |
| 0100.111.008570.021440.186021.0305.0000 | 5-Dec-03 | 49783 | 53957 | EDGEWOOD CONSULTING INC | 4,785.49 | Rate-of-return studies for LGE Electric rate case | 21.27 | 225.00 |
| 0100.111.008570.021440.186021.0305.0000 | 2-Feb-04 | 51403 | 53957 | EDGEWOOD CONSULTING INC | 2,019.60 | Rate-of-return studies for LGE Electric rate case | 8.98 | 225.00 |
| 0100.111.008570.021440.186021.0305.0000 | 26-Mar-04 | 1317 | 53957 | EDGEWOOD CONSULTING INC | 2,602.37 | Rate-of-return studies for LGE Electric rate case | 10.50 | 225.00 |
| 0100.111.008570.021440.186021.0305.0000 | 3-Jul-03 | 45428 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 630.00 | Paul Normand - LGE Electric rate case loss studies | 3.94 | 160.00 |
| 0100.111.008570.021440.186021.0305.0000 | 1-Aug-03 | 46916 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 1,092.00 | Paul Normand - LGE Electric rate case loss studies | 6.83 | 160.00 |
| 0100.111.008570.021440.186021.0305.0000 | 3-Oct-03 | 48137 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 1,386.00 | Paul Normand - LGE Electric rate case loss studies | 8.66 | 160.00 |
| 0100.111.008570.021440.186021.0305.0000 | 7-Nov-03 | 48926 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 7,182.00 | Paul Normand - LGE Electric rate case loss studies | 44.89 | 160.00 |
| 0100.111.008570.021440.186021.0305.0000 | 5-Dec-03 | 50533 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 5,502.00 | Paul Normand - LGE Electric rate case loss studies | 34.39 | 160.00 |
| 0100.111.008570.021440.186021.0305.0000 | 29-Mar-04 | 1374 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 668.07 | Paul Normand - LGE Electric rate case loss studies | 4.18 | 160.00 |
| 0100.111.008570.021440.186021.0305.0000 | 9-Jul-03 | 45339 | 40674 | THE PRIME GROUP LLC | 11,258.34 | Various Consultants - LGE Electric rate case cost of service study | 75.06 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 5-Aug-03 | 45687 | 40674 | THE PRIME GROUP LLC | 17,541.67 | Various Consultants - LGE Electric rate case cost of service study | 116.94 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 4-Sep-03 | 46575 | 40674 | THE PRIME GROUP LLC | 15,625.00 | Various Consultants - LGE Electric rate case cost of service study | 104.17 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 6-Oct-03 | 47909 | 40674 | THE PRIME GROUP LLC | 14,300.00 | Various Consultants - LGE Electric rate case cost of service study | 95.33 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 4-Nov-03 | 48940 | 40674 | THE PRIME GROUP LLC | 33,025.00 | Various Consultants - LGE Electric rate case cost of service study | 220.17 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 11-Dec-03 | 50043 | 40674 | THE PRIME GROUP LLC | 27,050.00 | Various Consultants - LGE Electric rate case cost of service study | 180.33 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 8-Jan-04 | 50928 | 40674 | THE PRIME GROUP LLC | 29,650.00 | Various Consultants - LGE Electric rate case cost of service study | 197.67 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 17-Feb-04 | 51828 | 40674 | THE PRIME GROUP LLC | 11,950.00 | Various Consultants - LGE Electric rate case cost of service study | 69.50 | 150.00 |
| 0100.111.008570.021440.186021.0305.0000 | 11-Mar-04 | 52561 | 40674 | THE PRIME GROUP LLC | 17,500.00 | Various Consultants - LGE Electric rate case cost of service study | 111.00 | 157.66 |
| 0100.111.008570.021440.186021.0305.0000 | 13-Apr-04 | 1846 | 40674 | THE PRIME GROUP LLC | 18,300.00 | Various Consultants - LGE Electric rate case cost of service study | 101.50 | 180.30 |
| 0100.111.008570.026120.186021.0314.0000 | 2-Jun-03 | 44543 | 58967 | AUS Consultants | 655.73 | Earl Robinson - LGE Elec rate case depreciation study | 3.45 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 30-Jun-03 | 45262 | 58967 | AUS Consultants | 1,727.50 | Various Consultants - LGE Elec rate case depreciation study | 9.09 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 30-Jun-03 | 45262 | 58967 | AUS Consultants | 337.50 | David Sheffer - LGE Elec rate case depreciation study | 2.25 | 150.00 |
| 0100.111.008570.026120.186021.0314.0000 | 4-Aug-03 | 46637 | 58967 | AUS Consultants | 12,930.25 | Various Consultants - LGE Elec rate case depreciation study | 68.05 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 4-Aug-03 | 46637 | 58967 | AUS Consultants | 2,585.63 | Various Consultants - LGE Elec rate case depreciation study | 17.24 | 150.00 |
| 0100.111.008570.026120.186021.0314.0000 | 1-Sep-03 | 47628 | 58967 | AUS Consultants | 6,007.50 | Various Consultants - LGE Elec rate case depreciation study | 31.62 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 1-Sep-03 | 47420 | 58967 | AUS Consultants | 2,324.22 | Various Consultants - LGE Elec rate case depreciation study | 12.23 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 6-Oct-03 | 48758 | 58967 | AUS Consultants | 3,708.15 | Earl Robinson - LGE Elec rate case depreciation study | 19.52 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 6-Oct-03 | 48758 | 58967 | AUS Consultants | 1,140.00 | Earl Robinson - LGE Elec rate case depreciation study | 6.00 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 3-Nov-03 | 50779 | 58967 | AUS Consultants | 5,364.75 | Earl Robinson - LGE Elec rate case depreciation study | 28.24 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 3-Nov-03 | 50779 | 58967 | AUS Consultants | 1,822.88 | Earl Robinson - LGE Elec rate case depreciation study | 9.59 | 190.00 |
| 0100.111.008570.026120.186021.0314.0000 | 25-Mar-04 | 1397 | 58967 | AUS Consultants | 690.83 | Earl Robinson - LGE Elec rate case depreciation study | 4.61 | 150.00 |
| 0100.111.008570.026120.186021.0314.0000 | 25-Mar-04 | 1397 | 58967 | AUS Consultants | 9,276.79 | Earl Robinson - LGE Elec rate case depreciation study | 54.57 | 170.00 |
| | | | | **TOTAL CONSULTANTS LG&E ELECTRIC** | **281,298.86** | | | |

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2003-00433

Schedule of Rate Case Preparation Costs

Response to Commission's Order
Dated December 19, 2003

Question No. 57c

Responding Witness: Valerie L. Scott

| Account | Date | Wire # / Journal # / Check # | Vendor # | Vendor Name | Amount | Description | Hours | Rate/Hr |
|---|---|---|---|---|---|---|---|---|
| 0100.111.008570.026900.186021.0670.0000 | 22-Dec-03 | 50123 | 59656 | NATIONAL SERVICE INFORMATION INC | 176.00 | Corporate - retrieval - articles of incorporation | | |
| 0100.111.008570.026900.186021.0670.0000 | 23-Dec-03 | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 20.00 | Corporate - retrieval - assumed business name search | | |
| 0100.111.008570.026900.186021.0670.0000 | 23-Dec-03 | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 40.00 | Corporate - retrieval - good standing - short form | | |
| 0100.111.008570.021440.186021.0240.0000 | 8-Dec-03 | 50572 | 57676 | HENDERSON SERVICES LLC | 50.91 | LGE Electric rate case related electrical work in Regulatory dept. | 1.00 | 50.90 |
| 0100.111.008570.021440.186021.0301.0000 | 8-Dec-03 | 50572 | 57676 | HENDERSON SERVICES LLC | 525.96 | LGE Electric rate case related electrical work in Regulatory dept. | 10.33 | 50.90 |
| 0100.111.008570.021440.186021.0604.0000 | 21-Jan-04 | 51357 | 18904 | THE COURIER JOURNAL | 9,301.48 | Newspaper ads | | |
| 0100.111.008570.021440.186021.0604.0000 | 22-Jan-04 | 51184 | 18904 | THE COURIER JOURNAL | 26,660.08 | Newspaper ads | | |
| 0100.111.008570.021440.186021.0301.0000 | 20-Jan-04 | 51137 | 24102 | XEROX CORP | 833.94 | Coping services - data response | | |
| 0100.111.008570.021440.186021.0301.0000 | 21-Jan-04 | 51136 | 24102 | XEROX CORP | 379.83 | Coping services - data response | | |
| 0100.111.008570.021440.186021.0301.0000 | 26-Feb-04 | 52144 | 24102 | XEROX CORP | 1,353.60 | Coping services - data response | | |
| 0100.111.008570.021440.186021.0301.0000 | 26-Feb-04 | 52144 | 24102 | XEROX CORP | 1,710.90 | Coping services - data response | | |
| 0100.111.008570.021440.186021.0301.0000 | 26-Feb-04 | 52144 | 24102 | XEROX CORP | 1,150.25 | Coping services - data response | | |
| 0100.111.008570.021440.186021.0301.0000 | 30-Mar-04 | 1473 | 24102 | XEROX CORP | 8,680.04 | Coping services - data response | | |
| 0100.111.008570.021440.186021.0620.0000 | 31-Jan-04 | 9041100 | 21652 | JONES LANG LASALLE | 1,237.64 | Overtime HVAC | | |
| 0100.111.008570.021440.186021.0620.0000 | 29-Feb-04 | 9041203 | 21652 | JONES LANG LASALLE | 119.25 | Overtime HVAC | | |
| 0100.111.008570.021440.186021.0620.0000 | 31-Mar-04 | 1473 | 21652 | JONES LANG LASALLE | 112.77 | Overtime HVAC | | |
| 0100.111.008570.021440.186021.0670.0000 | 24-Feb-04 | 52038 | 53655 | MERRILL COMMUNICATIONS LLC | 287.50 | File 8K related to rate case | | |
| | | | | TOTAL SUPPLIES / SERVICES - OTHER LG&E ELECTRIC | 52,640.15 | | | |
| | | | | TOTAL ELECTRIC RATECASE EXPENSES @ 4/19/2004 | 400,496.06 | | | |
| 0100.131.008570.026900.186022.0321.0000 | 23-Jul-03 | 46279 | 40033 | STOLL KEENON AND PARK LLP | 12,643.42 | LGE Gas rate case preparation | 48.63 | 260.00 |
| 0100.131.008570.026900.186022.0321.0000 | 16-Oct-03 | 49827 | 40033 | STOLL KEENON AND PARK LLP | 3,776.08 | LGE Gas rate case preparation | 14.52 | 260.00 |
| 0110.105.018570.026900.186023.0321.0000 | 6-Nov-03 | 49745 | 40033 | STOLL KEENON AND PARK LLP | 6,997.50 | LGE Gas rate case preparation | 26.91 | 260.00 |
| 0100.131.008570.026900.186022.0321.0000 | 10-Nov-03 | 48642 | 40033 | STOLL KEENON AND PARK LLP | 10,668.83 | LGE Gas rate case preparation | 41.03 | 260.00 |
| 0100.131.008570.026900.186022.0321.0000 | 23-Feb-04 | 52009 | 40033 | STOLL KEENON AND PARK LLP | 18,987.51 | LGE Gas rate case preparation | 71.50 | 260.00 |
| 0100.131.008570.026900.186022.0321.0000 | 24-Feb-04 | 52048 | 40033 | STOLL KEENON AND PARK LLP | 39,061.16 | LGE Gas rate case preparation | 150.00 | 260.00 |
| | | | | TOTAL LEGAL OUTSIDE COUNSEL LG&E GAS | 92,134.50 | | | |
| 0100.131.008570.021440.186022.0305.0000 | 7-Nov-03 | 48964 | 53957 | EDGEWOOD CONSULTING INC | 5,329.79 | Rate-of-return studies for LGE Gas rate case | 23.69 | 225.00 |
| 0100.131.008570.021440.186022.0305.0000 | 12-Dec-03 | 49783 | 53957 | EDGEWOOD CONSULTING INC | 2,392.75 | Rate-of-return studies for LGE Gas rate case | 10.63 | 225.00 |
| 0100.131.008570.021440.186022.0305.0000 | 2-Feb-04 | 51403 | 53957 | EDGEWOOD CONSULTING INC | 1,009.80 | Rate-of-return studies for LGE Gas rate case | 4.49 | 225.00 |
| 0100.131.008570.021440.186022.0305.0000 | 30-Mar-04 | 1405 | 53957 | EDGEWOOD CONSULTING INC | 1,301.19 | Rate-of-return studies for LGE Gas rate case | 5.25 | 225.00 |
| 0100.131.008570.021440.186022.0305.0000 | 9-Jul-03 | 45339 | 40674 | THE PRIME GROUP LLC | 9,683.33 | Various Consultants - LGE Gas rate case cost of service study | 64.56 | 150.00 |
| 0100.131.008570.021440.186022.0305.0000 | 5-Aug-03 | 45687 | 40674 | THE PRIME GROUP LLC | 7,916.67 | Various Consultants - LGE Gas rate case cost of service study | 52.78 | 150.00 |
| 0100.131.008570.021440.186022.0305.0000 | 4-Sep-03 | 46575 | 40674 | THE PRIME GROUP LLC | 13,275.00 | Randall Walker - LGE Gas rate case cost of service study | 88.50 | 150.00 |
| 0100.131.008570.021440.186022.0305.0000 | 6-Oct-03 | 47909 | 40674 | THE PRIME GROUP LLC | 10,500.00 | Various Consultants - LGE Gas rate case cost of service study | 70.00 | 150.00 |
| 0100.131.008570.021440.186022.0305.0000 | 18-Nov-03 | 48940 | 40674 | THE PRIME GROUP LLC | 15,000.00 | Various Consultants - LGE Gas rate case cost of service study | 100.00 | 150.00 |
| 0100.131.008570.021440.186022.0305.0000 | 11-Dec-03 | 50043 | 40674 | THE PRIME GROUP LLC | 16,950.00 | Various Consultants - LGE Gas rate case cost of service study | 113.00 | 150.00 |
| 0100.131.008570.021440.186022.0305.0000 | 8-Jan-04 | 50928 | 40674 | THE PRIME GROUP LLC | 21,650.00 | Various Consultants - LGE Gas rate case cost of service study | 144.33 | 150.00 |
| 0100.131.008570.021440.186022.0305.0000 | 17-Feb-04 | 51828 | 40674 | THE PRIME GROUP LLC | 6,850.00 | Various Consultants - LGE Gas rate case cost of service study | 42.50 | 161.18 |

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2003-00433

Schedule of Rate Case Preparation Costs

Response to Commission's Order
Dated December 19, 2003

Question No. 57c

Responding Witness: Valerie L. Scott

| Account | Date | Wire # / Journal # / Check # | Vendor # | Vendor Name | Amount | Description | Hours | Rate/Hr |
|---|---|---|---|---|---|---|---|---|
| 0100.131.008570.021440.186022.0305.0000 | 11-Mar-04 | 52561 | 40674 | THE PRIME GROUP LLC | 9,100.00 | Various Consultants - LGE Gas rate case cost of service study | 56.50 | 161.06 |
| 0100.131.008570.021440.186022.0305.0000 | 13-Apr-04 | 1846 | 40674 | THE PRIME GROUP LLC | 8,075.00 | Various Consultants - LGE Gas rate case cost of service study | 44.50 | 181.46 |
| 0100.131.008570.026120.186022.0314.0000 | 2-Jun-03 | 44543 | 58967 | AUS Consultants | 218.58 | Earl Robinson - LGE Gas rate case depreciation study | 1.15 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 30-Jun-03 | 45262 | 58967 | AUS Consultants | 675.00 | David Sheffer - LGE Gas rate case depreciation study | 4.50 | 150.00 |
| 0100.131.008570.026120.186022.0314.0000 | 30-Jun-03 | 45262 | 58967 | AUS Consultants | 112.50 | David Sheffer - LGE Gas rate case depreciation study | 0.75 | 150.00 |
| 0100.131.008570.026120.186022.0314.0000 | 4-Aug-03 | 46637 | 58967 | AUS Consultants | 6,646.05 | Various Consultants - LGE Gas rate case cost of service study | 34.98 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 4-Aug-03 | 46637 | 58967 | AUS Consultants | 861.87 | Various Consultants - LGE Gas rate case cost of service study | 5.75 | 150.00 |
| 0100.131.008570.026120.186022.0314.0000 | 1-Sep-03 | 47420 | 58967 | AUS Consultants | 14,830.00 | Various Consultants - LGE Gas rate case cost of service study | 78.05 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 1-Sep-03 | 47628 | 58967 | AUS Consultants | 2,002.50 | Various Consultants - LGE Gas rate case cost of service study | 10.54 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 6-Oct-03 | 48945 | 58967 | AUS Consultants | 2,565.00 | Earl Robinson - LGE Gas rate case cost of service study | 13.50 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 6-Oct-03 | 47858 | 58967 | AUS Consultants | 380.00 | Earl Robinson - LGE Gas rate case cost of service study | 2.00 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 3-Nov-03 | 50779 | 58967 | AUS Consultants | 1,955.50 | Earl Robinson - LGE Gas rate case cost of service study | 10.29 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 3-Nov-03 | 50779 | 58967 | AUS Consultants | 607.62 | Earl Robinson - LGE Gas rate case cost of service study | 3.20 | 190.00 |
| 0100.131.008570.026120.186022.0314.0000 | 22-Mar-04 | 1397 | 58967 | AUS Consultants | 890.39 | Earl Robinson - LGE Gas rate case cost of service study | 5.94 | 150.00 |
| 0100.131.008570.026120.186022.0314.0000 | 22-Mar-04 | 1397 | 58967 | AUS Consultants | 230.27 | Earl Robinson - LGE Gas rate case cost of service study | 1.54 | 150.00 |
| | | | | **TOTAL CONSULTANTS LG&E GAS** | **161,008.81** | | | |
| 0100.131.008570.021440.186022.0240.0000 | 8-Dec-03 | 50572 | 57676 | HENDERSON SERVICES LLC | 50.91 | LGE Electric rate case related electrical work in Regulatory dept. | 1.00 | 50.90 |
| 0100.131.008570.021440.186022.0301.0000 | 8-Dec-03 | 50572 | 57676 | HENDERSON SERVICES LLC | 525.97 | LGE Electric rate case related electrical work in Regulatory dept. | 10.33 | 50.90 |
| 0100.131.008570.021440.186022.0604.0000 | 21-Jan-04 | 51357 | 18904 | THE COURIER JOURNAL | 9,301.48 | Newspaper ads | | |
| 0100.131.008570.021440.186022.0604.0000 | 22-Jan-04 | 51184 | 18904 | THE COURIER JOURNAL | 26,660.08 | Newspaper ads | | |
| 0100.131.008570.021440.186022.0301.0000 | 20-Jan-04 | 51137 | 24102 | XEROX CORP | 833.94 | Coping services - data response | | |
| 0100.131.008570.021440.186022.0301.0000 | 21-Jan-04 | 51136 | 24102 | XEROX CORP | 379.83 | Coping services - data response | | |
| 0100.131.008570.021440.186022.0301.0000 | 26-Feb-04 | 52144 | 24102 | XEROX CORP | 1,353.60 | Coping services - data response | | |
| 0100.131.008570.021440.186022.0301.0000 | 26-Feb-04 | 52144 | 24102 | XEROX CORP | 1,710.90 | Coping services - data response | | |
| 0100.131.008570.021440.186022.0301.0000 | 26-Feb-04 | 52144 | 24102 | XEROX CORP | 1,150.25 | Coping services - data response | | |
| 0100.131.008570.021440.186022.0301.0000 | 30-Mar-04 | 1473 | 24102 | XEROX CORP | 8,680.04 | Coping services - data response | | |
| 0100.131.008570.021440.186022.0620.0000 | 31-Jan-04 | 9041100 | 21652 | JONES LANG LASALLE | 1,237.64 | Overtime HVAC | | |
| 0100.131.008570.021440.186022.0620.0000 | 29-Feb-04 | 9041203 | 21652 | JONES LANG LASALLE | 119.25 | Overtime HVAC | | |
| 0100.131.008570.021440.186022.0620.0000 | 31-Mar-04 | 1473 | 21652 | JONES LANG LASALLE | 112.77 | Overtime HVAC | | |
| | | | | **TOTAL SUPPLIES / SERVICES - OTHER LG&E GAS** | **52,116.66** | | | |
| | | | | **TOTAL GAS RATECASE EXPENSES @ 4/19/2004** | **305,259.97** | | | |
| | | | | **TOTAL RATE CASE EXPENSES @ 4/19/2004** | **705,756.03** | | | |

KENTUCKY UTILITIES COMPANY
CASE NO. 2003-00434
Schedule of Rate Case Preparation Costs
Response to Commission's Order
Dated December 19, 2003
Question No. 57c
Responding Witness: Valerie L. Scott

| Account | Date | Invoice # | Wire # / Journal # / Check # | Vendor # | Vendor Name | Amount | Description | Hours | Rate/Hr |
|---|---|---|---|---|---|---|---|---|---|
| 0110.105.018570.026900.186023.0321.000 | 16-Jul-03 | 109389 | 46268 | 16680 | OGDEN NEWELL AND WELCH | 12,493.50 | KU Electric rate case preparation | 54.32 | 230.00 |
| 0110.105.018570.026900.186023.0321.000 | 15-Sep-03 | 110781 | 48681 | 16680 | OGDEN NEWELL AND WELCH | 5,124.46 | KU Electric rate case preparation | 22.28 | 230.00 |
| 0110.105.018570.026900.186023.0321.000 | 23-Sep-03 | 111024 | 48681 | 16680 | OGDEN NEWELL AND WELCH | 1,410.75 | KU Electric rate case preparation | 6.13 | 230.00 |
| 0110.105.018570.026900.186023.0321.000 | 19-Nov-03 | 112322 | 50331 | 16680 | OGDEN NEWELL AND WELCH | 2,515.75 | KU Electric rate case preparation | 10.94 | 230.00 |
| 0110.105.018570.026900.186023.0321.000 | 2-Dec-03 | 113192 | 50407 | 16680 | OGDEN NEWELL AND WELCH | 10,148.50 | KU Electric rate case preparation | 43.19 | 235.00 |
| 0110.105.018570.026900.186023.0321.000 | 8-Dec-03 | 113330 | 50407 | 16680 | OGDEN NEWELL AND WELCH | 34,864.10 | KU Electric rate case preparation | 148.36 | 235.00 |
| | | | | | **TOTAL LEGAL OUTSIDE COUNSEL KU ELECTRI(** | **66,557.06** | | | |
| | | | | | | | | | |
| 0110.105.018570.021440.186023.0305.000 | 4-Nov-03 | 33401 | 48964 | 53957 | EDGEWOOD CONSULTING INC | 10,659.59 | Rate-of-return studies for KU Electric rate case | 47.38 | 225.00 |
| 0110.105.018570.021440.186023.0305.000 | 5-Dec-03 | 33402 | 49783 | 53957 | EDGEWOOD CONSULTING INC | 4,785.49 | Rate-of-return studies for KU Electric rate case | 21.27 | 225.00 |
| 0110.105.018570.021440.186023.0305.000 | 3-Feb-04 | | 51403 | 53957 | EDGEWOOD CONSULTING INC | 2,019.60 | Rate-of-return studies for KU Electric rate case | 8.50 | 225.00 |
| 0110.105.018570.021440.186023.0305.000 | 3-Feb-04 | | 1317 | 53957 | EDGEWOOD CONSULTING INC | 2,602.37 | Rate-of-return studies for KU Electric rate case | 10.50 | 225.00 |
| 0110.105.018570.021440.186023.0305.000 | 3-Jul-03 | 20030714 | 45428 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 630.00 | Paul Normand - KU Electric rate case loss studies | 3.94 | 160.00 |
| 0110.105.018570.021440.186023.0305.000 | 1-Aug-03 | 20030809 | 46916 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 1,092.00 | Paul Normand - KU Electric rate case loss studies | 6.83 | 160.00 |
| 0110.105.018570.021440.186023.0305.000 | 3-Oct-03 | 20031007 | 48137 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 1,386.00 | Paul Normand - KU Electric rate case loss studies | 8.66 | 160.00 |
| 0110.105.018570.021440.186023.0305.000 | 7-Nov-03 | 20031109 | 48926 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 7,182.00 | Paul Normand - KU Electric rate case loss studies | 44.89 | 160.00 |
| 0110.105.018570.021440.186023.0305.000 | 5-Dec-03 | 20031208 | 50533 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 5,502.00 | Paul Normand - KU Electric rate case loss studies | 34.39 | 160.00 |
| 0110.105.018570.021440.186023.0305.000 | 29-Mar-04 | 20031208 | 1374 | 36895 | MANAGEMENT APPLICATIONS CONSULTING INC | 668.06 | Paul Normand - KU Electric rate case loss studies | 4.18 | 160.00 |
| 0110.105.018570.021440.186023.0305.000 | 9-Jul-03 | | 45339 | 40674 | THE PRIME GROUP LLC | 4,633.33 | Steve Seelye - KU Electric rate case cost of service study | 23.17 | 200.00 |
| 0110.105.018570.021440.186023.0305.000 | 5-Aug-03 | | 45687 | 40674 | THE PRIME GROUP LLC | 14,516.66 | Randall Walker - KU Electric rate case cost of service study | 96.78 | 150.00 |
| 0110.105.018570.021440.186023.0305.000 | 4-Sep-03 | | 46575 | 40674 | THE PRIME GROUP LLC | 6,600.00 | Various Consultants - KU Electric rate case strategic analysis support | 44.00 | 150.00 |
| 0110.105.018570.021440.186023.0305.000 | 6-Oct-03 | | 47909 | 40674 | THE PRIME GROUP LLC | 2,600.00 | Steve Seelye - KU Electric rate case cost of service study | 13.00 | 200.00 |
| 0110.105.018570.021440.186023.0305.000 | 4-Nov-03 | | 48940 | 40674 | THE PRIME GROUP LLC | 14,750.00 | Various Consultants - KU Electric rate case cost of service study | 98.33 | 150.00 |
| 0110.105.018570.021440.186023.0305.000 | 11-Dec-03 | | 50043 | 40674 | THE PRIME GROUP LLC | 30,800.00 | Various Consultants - KU Electric rate case cost of service study | 205.33 | 150.00 |
| 0110.105.018570.021440.186023.0305.000 | 8-Jan-04 | | 50928 | 40674 | THE PRIME GROUP LLC | 30,762.50 | Various Consultants - KU Electric rate case cost of service study | 205.08 | 150.00 |
| 0110.105.018570.021440.186023.0305.000 | 17-Feb-04 | | 51828 | 40674 | THE PRIME GROUP LLC | 12,075.00 | Various Consultants - KU Electric rate case cost of service study | 70.00 | 163.93 |
| 0110.105.018570.021440.186023.0305.000 | 11-Mar-04 | | 52561 | 40674 | THE PRIME GROUP LLC | 17,300.00 | Various Consultants - KU Electric rate case cost of service study | 110.00 | 157.27 |
| 0110.105.018570.021440.186023.0305.000 | 13-Apr-04 | | 1846 | 40674 | THE PRIME GROUP LLC | 16,950.00 | Various Consultants - KU Electric rate case cost of service study | 93.00 | 182.26 |
| 0110.105.018570.026120.186023.0314.000 | 30-Jun-03 | 88884 | 45262 | 58967 | AUS Consultants | 1,825.04 | Earl Robinson - KU Elec rate case depreciation study | 12.17 | 150.00 |
| 0110.105.018570.026120.186023.0314.000 | 2-Jun-03 | 88668 | 44543 | 58967 | AUS Consultants | 874.32 | Earl Robinson - KU Elec rate case depreciation study | 4.60 | 190.00 |
| 0110.105.018570.026120.186023.0314.000 | 4-Aug-03 | 89069 | 46637 | 58967 | AUS Consultants | 6,240.25 | Various Consultants - KU Elec rate case depreciation study | 32.84 | 190.00 |
| 0110.105.018570.026120.186023.0314.000 | 1-Sep-03 | 89308 | 47420 | 58967 | AUS Consultants | 6,271.25 | Various Consultants - KU Elec rate case depreciation study | 33.01 | 190.00 |
| 0110.105.018570.026120.186023.0314.000 | 6-Oct-03 | 89508 | 48856 | 58967 | AUS Consultants | 10,284.55 | Earl Robinson - KU Elec rate case depreciation study | 54.13 | 190.00 |
| 0110.105.018570.026120.186023.0314.000 | 3-Nov-03 | 89754 | 50779 | 58967 | AUS Consultants | 4,395.00 | Earl Robinson - KU Elec rate case depreciation study | 23.13 | 190.00 |
| 0110.105.018570.026120.186023.0314.000 | 19-Mar-04 | 89754 | 1138 | 58967 | AUS Consultants | 2,500.00 | Earl Robinson - KU Elec rate case depreciation study | 13.16 | 190.00 |
| 0110.105.018570.026120.186023.0314.000 | 25-Mar-04 | 89754 | 1397 | 58967 | AUS Consultants | 8,511.53 | Earl Robinson - KU Elec rate case depreciation study | 50.07 | 170.00 |

KENTUCKY UTILITIES COMPANY
CASE NO. 2003-00434
Schedule of Rate Case Preparation Costs
Response to Commission's Order
Dated December 19, 2003
Question No. 57c
Responding Witness: Valerie L. Scott

| Account | Date | Invoice # | Wire # / Journal # / Check # | Vendor # | Vendor Name | Amount | Description | Hours | Rate/Hr |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | **TOTAL CONSULTANTS KU ELECTRIC** | **228,416.54** | | | |
| 0110.105.018570.026900.186023.0670.000 | 23-Dec-03 | | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 56.00 | Corporate - retrieval - assumed business name search | | |
| 0110.105.018570.026900.186023.0670.000 | 23-Dec-03 | | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 41.00 | Corporate - retrieval - good standing - short form | | |
| 0110.105.018570.026900.186023.0670.000 | 23-Dec-03 | | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 71.00 | Corporate - retrieval - articles of incorporation | | |
| 0110.105.018570.026900.186023.0670.000 | 23-Dec-03 | | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 45.50 | Corporate - retrieval - articles of incorporation | | |
| 0110.105.018570.026900.186023.0670.000 | 23-Dec-03 | | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 20.00 | Corporate - retrieval - assumed business name search | | |
| 0110.105.018570.026900.186023.0670.000 | 23-Dec-03 | | 50174 | 59656 | NATIONAL SERVICE INFORMATION INC | 30.00 | Corporate - retrieval - good standing - short form | | |
| 0110.105.018570.021440.186023.0210.000 | 27-Dec-03 | 21630 | 50572 | 57676 | HENDERSON SERVICES LLC | 50.92 | KU Electric rate case related electrical work in Regulatory dept. | 1.00 | 50.90 |
| 0110.105.018570.021440.186023.0210.000 | 27-Dec-03 | 21630 | 50572 | 57676 | HENDERSON SERVICES LLC | 525.97 | KU Electric rate case related electrical work in Regulatory dept. | 10.33 | 50.90 |
| 0110.105.018570.021440.186023.0210.000 | 20-Jan-04 | | 51137 | 24102 | XEROX CORP | 2,501.82 | Coping services - data response | | |
| 0110.105.018570.021440.186023.0210.000 | 21-Jan-04 | | 51136 | 24102 | XEROX CORP | 379.84 | Coping services - data response | | |
| 0110.105.018570.021440.186023.0210.000 | 26-Feb-04 | | 52144 | 24102 | XEROX CORP | 4,060.80 | Coping services - data response | | |
| 0110.105.018570.021440.186023.0210.000 | 26-Feb-04 | | 52144 | 24102 | XEROX CORP | 5,132.69 | Coping services - data response | | |
| 0110.105.018570.021440.186023.0210.000 | 26-Feb-04 | | 52144 | 24102 | XEROX CORP | 3,450.75 | Coping services - data response | | |
| 0110.105.018570.021440.186023.0210.000 | 30-Mar-04 | | 1473 | 24102 | XEROX CORP | 26,040.13 | Coping services - data response | | |
| 0110.105.018570.021440.186023.0210.000 | 31-Jan-04 | | 9041100 | 21652 | JONES LANG LASALLE | 2,475.28 | Overtime HVAC | | |
| 0110.105.018570.021440.186023.0210.000 | 29-Feb-04 | | 9041203 | 21652 | JONES LANG LASALLE | 238.50 | Overtime HVAC | | |
| 0110.105.018570.021440.186023.0210.000 | 31-Mar-04 | | 1473 | 21652 | JONES LANG LASALLE | 225.53 | Overtime HVAC | | |
| 0110.105.018570.026900.186023.0670.000 | 24-Feb-04 | | 52038 | 53655 | MERRILL COMMUNICATIONS LLC | 287.50 | File 8K related to rate case | | |
| 0110.105.018570.026900.186023.0604.000 | 5-Feb-04 | | 51672 | 03125LKO | KENTUCKY PRESS SERVICE INC | 312,078.27 | Newspaper ads | | |
| 0110.105.018570.026900.186023.0604.000 | 5-Feb-04 | | 51672 | 0412LKO | KENTUCKY PRESS SERVICE INC | 223,348.87 | Newspaper ads | | |
| | | | | | **TOTAL SUPPLIES / SERVICES - OTHER KU ELECTRIC** | **581,060.37** | | | |
| | | | | | **TOTAL RATE CASE EXPENSES AT 4/19/2004** | **876,033.97** | | | |

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment for Injuries and Damages FERC Account 925
For the Twelve Months Ended September 30, 2003

| | Electric | Gas |
|---|---|---|
| 1. Injury/Damage provision based upon ten year average | $ 2,714,892 | $ 723,506 |
| 2. Injury/Damage expenses incurred during the 12 months ended September 30, 2003 | 1,504,891 | 411,928 |
| 3. Adjustment | $ 1,210,001 | $ 311,578 |

| Year | Electric | Gas | CPI-All Urban Consumers | Adjusted Electric | Adjusted Gas |
|---|---|---|---|---|---|
| 2003 | * $ 1,504,891 | $ 411,928 | 1.0000 | $ 1,504,891 | $ 411,928 |
| 2002 | 3,369,044 | 354,333 | 1.0160 | 3,422,949 | 360,002 |
| 2001 | 726,180 | 323,911 | 1.0440 | 758,132 | 338,163 |
| 2000 | 1,750,482 | 770,436 | 1.0780 | 1,887,019 | 830,530 |
| 1999 | 1,912,057 | 1,048,283 | 1.1000 | 2,103,262 | 1,153,111 |
| 1998 | 1,666,969 | 757,523 | 1.1160 | 1,860,337 | 845,396 |
| 1997 | 1,286,765 | 607,735 | 1.1380 | 1,464,339 | 691,602 |
| 1996 | (1,006,929) | 764,769 | 1.1680 | (1,176,093) | 893,250 |
| 1995 | (5,085,639) | 725,262 | 1.1960 | (6,082,424) | 867,413 |
| 1994 | 17,517,597 | 690,399 | 1.2220 | 21,406,504 | 843,668 |
| Total | | | | $27,148,915 | $ 7,235,064 |
| Ten Year Average | | | | $ 2,714,892 | $ 723,506 |

*Test year amount
Revised CPI for 1997 from original data response, PSC 2-16(g)(4). Corrected 1997 CPI agrees with amounts provided on PSC 2-16(f) page 1 of 6 and Storm damage pro forma adjustment, Rives Exhibit 1, Reference Schedule 1.14.

KENTUCKY UTILITIES

Adjustment for Injuries and Damages FERC Account 925
For the Twelve Months Ended September 30, 2003

| | |
|---|---|
| 1. Injury/Damage provision based upon ten year average | $ 3,233,546 |
| 2. Injury/Damage expenses incurred during the 12 months ended September 30, 2003 | 1,861,201 |
| 3. Adjustment | 1,372,345 |
| 4. Kentucky Jurisdiction | 88.826% |
| 5. Kentucky Jurisdictional adjustment | $ 1,218,999 |

| Year | | Amount | CPI-All Urban Consumers | Adjusted Amount |
|---|---|---|---|---|
| 2003 | * | $ 1,861,201 | 1.0000 | $ 1,861,201 |
| 2002 | | 2,510,515 | 1.0160 | 2,550,683 |
| 2001 | | 1,609,827 | 1.0440 | 1,680,660 |
| 2000 | | 1,637,520 | 1.0780 | 1,765,246 |
| 1999 | | 2,126,017 | 1.1000 | 2,338,619 |
| 1998 | | 2,187,039 | 1.1160 | 2,440,735 |
| 1997 | | 3,355,659 | 1.1380 | 3,818,740 |
| 1996 | | 4,579,884 | 1.1680 | 5,349,305 |
| 1995 | | 4,496,799 | 1.1960 | 5,378,172 |
| 1994 | | 4,216,123 | 1.2220 | 5,152,102 |
| Total | | | | $ 32,335,463 |
| Ten Year Average | | | | $ 3,233,546 |

*Test year amount
Revised CPI for 1997 and 1998 from original data response, PSC 2-16(g)(4).
Corrected CPI agrees with amounts provided on PSC 2-16(f)(1) page 1 of 6.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|---|---|---|
| APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR AN ORDER APPROVING AN ACCOUNTING ADJUSTMENT TO BE INCLUDED IN EARNINGS SHARING MECHANISM CALCULATIONS FOR 2003 | ) ) ) ) ) | CASE NO. 2003-00426 |

AND

| | | |
|---|---|---|
| APPLICATION OF KENTUCKY UTILITIES COMPANY FOR AN ORDER APPROVING AN ACCOUNTING ADJUSTMENT TO BE INCLUDED IN EARNINGS SHARING MECHANISM CALCULATIONS FOR 2003 | ) ) ) ) ) | CASE NO. 2003-00427 |

<u>O R D E R</u>

On November 14, 2003, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively the "Companies") filed applications seeking approval of an accounting adjustment to their respective Earnings Sharing Mechanism ("ESM") filings for calendar year 2003. The accounting adjustment is related to the Companies' adoption during 2003 of Statement of Financial Accounting Standards ("SFAS") No. 143, *Accounting for Asset Retirement Obligations.*

The Kentucky Industrial Utility Customers, Inc. ("KIUC") sought and was granted intervention in this proceeding.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, with an effective implementation date of January 1, 2003. In October 2002, the Federal Energy Regulatory Commission ("FERC") issued a Notice of Proposed Rulemaking to modify the Uniform System of Accounts and the FERC annual report forms. FERC issued its final rule on April 9, 2003, generally adopting the requirements of SFAS No. 143.[1]

In conjunction with the adoption of SFAS No. 143, the Companies were required to recognize the "cumulative effect impact" on their respective financial statements, which represents the asset retirement obligation ("ARO") asset depreciation and ARO liability accretion that would have been recorded had the asset and liability been recorded by the Companies when the original asset was placed into service.[2] The timing of cost recognition under SFAS No. 143 and differences in rate recovery methods could result in the need for the Companies to record regulatory assets or liabilities. As part of the entries to record the adoption of SFAS No. 143, LG&E and KU have each recorded a regulatory asset and a regulatory liability.[3]

LG&E and KU state that the accounting required in conjunction with the adoption of SFAS No. 143 results in their respective net operating incomes for calendar year 2003 being overstated for ESM calculation purposes. The overstatement occurs because the cumulative effect impact adjustments are recorded "below the line" while

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[1] FERC Docket No. RM02-7-000, Order No. 631, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, Final Rule Issued April 9, 2003.

[2] LG&E has recorded a net cumulative effect impact of $5,281,000 while KU has recorded a net cumulative effect impact of $9,926,000. See Application, Exhibit 1 for LG&E and KU.

[3] LG&E has recorded a regulatory asset of $5,281,000 and a regulatory liability of $59,000 related to the adoption of SFAS No. 143. KU has recorded a regulatory asset of $9,926,000 and a regulatory liability of $910,000. See Response to the Commission Staff's First Data Request dated December 5, 2003, Item 4(b).

the corresponding regulatory credit is recorded "above the line." The Companies request authorization to offset this "above the line" regulatory credit when performing their respective ESM calculations for calendar year 2003. The Companies also request Commission approval to establish the regulatory asset and liability accounts associated with the adoption of SFAS No. 143.[4]

On December 19, 2003, the Companies and KIUC filed a stipulation agreement ("Stipulation") where the parties recommend the Commission issue an Order granting the applications of LG&E and KU subject to the accounting procedures described in the Stipulation. The parties request the Commission issue an Order which:

1) Approves the regulatory assets and liabilities associated with adopting SFAS No. 143 and going forward;

2) Eliminates the impact on net operating income in the 2003 ESM annual filing caused by adopting SFAS No. 143;

3) To the extent accumulated depreciation related to the cost of removal is recorded in regulatory assets or regulatory liabilities, such amounts will be reclassified to accumulated depreciation for rate-making purposes of calculating rate base; and

4) The ARO assets, related ARO asset accumulated depreciation, ARO liabilities, and remaining regulatory assets associated with the adoption of SFAS No. 143 will be excluded from rate base.[5]

A copy of the Stipulation is attached to this Order as Appendix A.

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[4] Response to the Commission Staff's First Data Request dated December 5, 2003, Item 2(c). The Companies did not previously seek approval to establish the regulatory asset and liability accounts based on the assumption that the cost of removal was covered by the Commission's previous approval of the depreciation rates currently in effect. However, the Companies stated that if the Commission did not agree with the assumption, the Companies also request the approval of the regulatory asset and liability accounts in this proceeding.

[5] Stipulation at 5.

The Commission has reviewed the information provided by the Companies and the terms of the Stipulation, and finds that the requested accounting treatments should be approved. The cumulative effect impact reflects the restatement of account balances in accordance with the requirements of SFAS No. 143. The determination of the calendar year 2003 ESM calculations should exclude this change in accounting treatment when determining the Companies' net operating income for ESM purposes.

Concerning the establishment of the regulatory asset and liability accounts, LG&E and KU are reminded that the prior approval of the Commission is required before these accounts are established. However, given the fact the regulatory asset and liability accounts established by the Companies were a direct result of the adoption of SFAS No. 143, in this case the Commission will approve the establishment of these regulatory asset and liability accounts. This approval is for accounting purposes only, and the appropriate rate-making treatment for these regulatory asset and liability accounts will be addressed in the Companies' next general rate case. LG&E and KU are reminded that in the future the Commission's prior approval will be required before regulatory asset or liability accounts are established.

The Commission is not clear as to the exact meaning of Nos. 3 and 4 on page 5 of the Stipulation. When the Stipulation is read as a whole, its appears to address the accounting treatment for the adoption of SFAS No. 143 and how the associated accounting entries will be treated in the calendar year 2003 ESM calculations. However, both discuss rate-making treatments for the calculation of rate base without distinguishing whether the rate base treatments described apply only to the calendar year 2003 ESM calculations or to a general base rate proceeding. Based upon our understanding of the provisions of the Stipulation, the Commission finds that Nos. 3 and 4 should be approved for purposes of the calendar year 2003 ESM calculations only. Consistent with our approval of the regulatory asset and liability accounts, the Commission will address the rate-making treatment for base rates in the next general rate case. The Commission will ask the Companies and KIUC to indicate their acceptance of our approval as described above.

In responses to the Commission Staff's data request, LG&E indicated that no assets associated with AROs are currently included in LG&E's environmental surcharge while KU indicated that three assets associated with AROs are currently included in KU's environmental surcharge.[6] KU estimated the impact of SFAS No. 143 on its environmental surcharge calculations, and expressed the opinion that the asset removal costs impacted by the adoption of SFAS No. 143 should continue to be recovered through the environmental surcharge.[7]

While the Commission believes it was reasonable to determine whether the adoption of SFAS No. 143 could have an impact on the Companies' environmental surcharge, we find it is not reasonable to resolve that issue in this proceeding. The record is not sufficiently developed to support a decision addressing what changes, if any, should be made to KU's environmental surcharge due to the adoption of SFAS No. 143. Therefore, KU should address the affects the adoption of SFAS No. 143 has had on its environmental surcharge as part of its next 6-month environmental surcharge review.

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[6] Id., Item 1(b).

[7] Id., Item 1(c).

IT IS THEREFORE ORDERED that:

1. The accounting treatment for LG&E's and KU's adoption of SFAS No. 143 and the related treatment in the calendar year 2003 ESM calculations as described in the Stipulation are approved as modified in this Order.

2. The regulatory asset and liability accounts established by the adoption of SFAS No. 143 are approved for accounting purposes only.

3. The rate base treatments discussed in Nos. 3 and 4 of page 5 of the Stipulation are adopted for calendar year 2003 ESM calculation purposes only. LG&E, KU, and KIUC shall within 10 days of the date of this Order file written statements agreeing to this interpretation of the Stipulation.

Done at Frankfort, Kentucky, this 23rd day of December, 2003.

By the Commission

ATTEST:

Wm H. Bowker

Deputy Executive Director

# APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NOS. 2003-00426 AND 2003-00427 DATED December 23, 2003.

RECEIVED
DEC 19 2003
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

**In the Matter of:**

| | | |
|---|---|---|
| **APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR AN ORDER APPROVING AN ACCOUNTING ADJUSTMENT TO BE INCLUDED IN EARNINGS SHARING MECHANISM CALCULATIONS FOR 2003** | ) | **CASE NO: 2003-00426** |

**AND**

| | | |
|---|---|---|
| **APPLICATION OF KENTUCKY UTILITIES COMPANY FOR AN ORDER APPROVING AN ACCOUNTING ADJUSTMENT TO BE INCLUDED IN EARNINGS SHARING MECHANISM CALCULATIONS FOR 2003** | ) | **CASE NO: 2003-00427** |

**STIPULATION**

WHEREAS, Louisville Gas and Electric Company ("LG&E") filed an application for an order approving an accounting adjustment with the Kentucky Public Service Commission ("Commission") on November 14, 2003 in Case No. 2003-00426;

WHEREAS, Kentucky Utilities Company ("KU") filed an application for an order approving an accounting adjustment with the Commission on November 14, 2003 in Case No. 2003-00427;

WHEREAS, the Kentucky Industrial Utility Customers, Inc. ("KIUC") was granted intervention by the Commission on December 4, 2003;

WHEREAS, the parties wish to facilitate the disposition of these two proceedings through the submission of a joint stipulation on the accounting issues; and, NOW; THEREFORE, pursuant to 807 KAR 5:001 Section 4(6)the parties stipulate as follows:

1. SFAS No. 143, *Accounting for Asset Retirement Obligations*, and FERC Order 631, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, specify the accounting LG&E and KU must follow relative to legal obligations for the ultimate disposal of assets effective January 1, 2003. The companies have proposed accounting for these asset retirement obligations ("AROs") using a method which both complies with the required accounting literature and is consistent with the current ratemaking treatment.

2. The purpose of this stipulation is to state the accounting treatment which will negate, on a net basis, the income statement effects of implementing SFAS No. 143, so that there is no effect from SFAS No. 143 on LG&E's or KU's operating income for accounting or ratemaking purposes.

3. Effective January 1, 2003, the Companies recorded the entries as summarized on Exhibit 1. Upon implementation of SFAS No. 143 and FERC Order 631, LG&E and KU were required to remove the cost of removal ("COR") component from accumulated depreciation for assets with a legal obligation at retirement (Exhibit 1, Entry 4). The Companies were also required to record the expected future cost of the AROs discounted back to the date the assets were placed in service as ARO liabilities in FERC Account 230 (Exhibit 1, Entry 1). Offsetting ARO assets, equal to the ARO liabilities at the assets' original in-service dates, were recorded in FERC Accounts 317, 347 or 359.1, to represent the additional cost of the assets, due to the ultimate removal cost (Exhibit 1, Entry 1). Each of the ARO assets and ARO liabilities was then incremented to 2003 values by recording depreciation expense and accumulated depreciation from the in-service date of the underlying asset for the ARO asset (Exhibit 1, Entry 2) and by

recording accretion expense incrementing the ARO liability from the in-service date of the underlying asset (Exhibit 1, Entry 3). The net of the previously recorded COR, depreciation on the ARO assets, and the accreted ARO liabilities from the in-service date to January 1, 2003 (the amounts that would have been recorded in prior periods had the standard always been in effect) was recorded as a cumulative effect charge to the income statement using FERC Account 435 (Exhibit 1, Entries 4, 2 and 3, respectively). In order to remove the effect of adopting SFAS No. 143 and retain the ratemaking accounting approved by the Commission, the Companies recorded an offsetting regulatory credit in the income statement in FERC account 407 to counter the impact of the cumulative effect charges (Exhibit 1, Entry 5). The regulatory credit was offset against a regulatory asset in FERC Account 182.3 (Exhibit 1, Entry 5).

4. LG&E and KU made applications to the Commission on November 14, 2003 requesting that they be allowed to offset the amount recorded in the cumulative effect with the amount recorded in the regulatory credit since the cumulative effect was recorded below the line and the regulatory credit was recorded above the line, resulting in inconsistent treatment of these amounts for ratemaking purposes.

5. Exhibit 2 illustrates the entries that will be recorded beginning in 2003. LG&E and KU will continue recording depreciation expense and accumulated depreciation on the ARO asset and will continue incrementing the value of the ARO liability through accretion expense (Exhibit 2, Entries 1 and 3). In order to continue removing the effect of adopting SFAS No. 143 and retain the ratemaking accounting approved by the Commission, the Companies will offset all depreciation expense and accretion expense related to ARO assets and liabilities through a credit to the regulatory credit account (FERC account 407) and a charge to a regulatory asset account (FERC account 182.3) (Entries 2 and 4). LG&E and KU will continue to record the COR

component of depreciation on the underlying assets, by charging depreciation expense (Exhibit 2, Entry 5). The COR depreciation will be offset by a credit to the regulatory liability in FERC Account 254 (Exhibit 2, Entry 5). Non-COR depreciation on the underlying assets will continue to be charged to depreciation expense and credited to accumulated depreciation (Exhibit 2, Entry 5).

6. For ratemaking purposes, the regulatory liability associated with the COR depreciation expense, including the portion netted against regulatory assets in the cumulative effect at adoption of SFAS No. 143, will be included in the calculation of rate base since this amount represents the accumulated depreciation for the COR under Commission approved depreciation rates. The ARO assets, related ARO asset accumulated depreciation, ARO liabilities, and remaining regulatory assets associated with the adoption of SFAS No. 143 will be excluded from rate base.

7. KU and LG&E stipulate to the accounting described above, given that Commission approval is received both for the offset of the cumulative effect against the regulatory credit for the initial adoption of SFAS 143 effective January 1, 2003, and for recording the associated regulatory assets and regulatory liabilities, at initial adoption and on an on-going basis.

8. KIUC's consent and agreement to the terms of this Stipulation is without prejudice to any position KIUC may take on the merits of the issues discussed herein in future ratemaking proceedings before the Commission, except and excluding LG&E's and KU's annual Earning Sharing Mechanism filings for the 2003 operating periods and thereafter.

The parties request the Commission issue an order which:

(1) approves the regulatory assets and liabilities associated with adopting SFAS No. 143 and going forward,

(2) eliminates the impact on net operating income in the 2003 ESM annual filing caused by adopting SFAS No. 143,

(3) to the extent accumulated depreciation related to the cost of removal is recorded in regulatory assets or regulatory liabilities, such amounts will be reclassified to accumulated depreciation for ratemaking purposes of calculating rate base, and

(4) the ARO assets, related ARO asset accumulated depreciation, ARO liabilities, and remaining regulatory assets associated with the adoption of SFAS No. 143 will be excluded from rate base.

The parties recommend the Commission issue an order granting the applications of LG&E and KU subject to the accounting procedures described herein.

Dated: December 19, 2003

Respectfully submitted,

Kendrick R. Riggs
Ogden Newell & Welch PLLC
1700 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202
Telephone: (502) 560-4222

and

Linda S. Portasik
Senior Corporate Attorney
LG&E Energy Corp.
220 West Main Street
Louisville, Kentucky 40202

Counsel for Louisville Gas and

Dated: December 19, 2003

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Kendrick R. Riggs
Ogden Newell & Welch PLLC
1700 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202
Telephone: (502) 560-4222

and

Linda S. Portasik
Senior Corporate Attorney
LG&E Energy Corp.
220 West Main Street
Louisville, Kentucky 40202

Counsel for Louisville Gas and
Electric Company and Kentucky
Utilities Company

Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 2110
Cincinnati, Ohio 45202

Counsel for Kentucky Industrial
Utility Customers, Inc.

293045.03

**Ratemaking Implications of Adopting SFAS No. 143 & FERC Order 631**

**Louisville Gas and Electric Company**

| | Pre-SFAS No. 143 | Impact of SFAS No. 143 | Post SFAS No. 143 * | Pro forma Adjustment ** | Adjusted Net Operating Income |
|---|---|---|---|---|---|
| Operating revenues | 1,079,301,129 | | 1,079,301,129 | | 1,079,301,129 |
| Operating expenses | 900,595,380 | (5,280,909) | 895,314,471 | 5,280,909 | 900,595,380 |
| Income taxes | 56,447,778 | 2,131,507 | 58,579,285 | | 58,579,285 |
| Net operating income | 122,257,971 | 3,149,402 | 125,407,373 | (5,280,909) | 120,126,464 |
| Other and interest expense | 28,832,688 | | 28,832,688 | | |
| Net income before cumulative effect of accounting change | 93,425,283 | 3,149,402 | 96,574,685 | | |
| Cumulative effect of accounting change | - | (5,280,909) | (5,280,909) | | |
| Income tax on cumulative effect | - | 2,131,507 | 2,131,507 | | |
| Net cumulative effect of accounting change | - | (3,149,402) | (3,149,402) | | |
| Net income | 93,425,283 | - | 93,425,283 | | |

* All amounts presented can be found in Section 42 of the filing requirements.

** The pro forma adjustment agrees to Reference Schedule 1.25 of Rives Exhibit 1. Taxes on the pro forma adjustment are calculated on Line 40 of Rives Exhibit 1, Page 3 of 3.

**Kentucky Utilities Company Jurisdictional**

| | Pre-SFAS No. 143 | Impact of SFAS No. 143 | Post SFAS No. 143 * | Pro forma Adjustment ** | Adjusted Net Operating Income |
|---|---|---|---|---|---|
| Operating revenues | 768,801,159 | | 768,801,159 | | 768,801,159 |
| Operating expenses | 648,923,963 | (8,434,618) | 640,489,345 | 8,434,618 | 648,923,963 |
| Income taxes | 38,739,860 | 3,404,423 | 42,144,283 | | 42,144,283 |
| Net operating income | 81,137,336 | 5,030,195 | 86,167,531 | (8,434,618) | 77,732,913 |
| Interest expense | 20,391,767 | | 20,391,767 | | |
| Net income before cumulative effect of accounting change | 60,745,569 | 5,030,195 | 65,775,764 | | |
| Cumulative effect of accounting change | - | (8,434,618) | (8,434,618) | | |
| Income tax on cumulative effect | - | 3,404,423 | 3,404,423 | | |
| Net cumulative effect of accounting change | - | (5,030,195) | (5,030,195) | | |
| Net income | 60,745,569 | - | 60,745,569 | | |

* All amounts presented can be found in Section 42 of the filing requirements.

** The pro forma adjustment agrees to Reference Schedule 1.25 of Rives Exhibit 1. Taxes on the pro forma adjustment are calculated on Line 38 of Rives Exhibit 1, Page 3 of 3.

## Louisville Gas and Electric Company ESM Audit Expenses

| Account | Date | Vendor # | Vendor Name | Amount | Description |
|---|---|---|---|---|---|
| 0100.113.008570.021440.186021.0312.0000 | Jun-03 | 59046 | Barrington Wesley Group | 38,046.94 | Audit |
| 0100.113.008570.021440.186021.0312.0000 | Jul-03 | 59046 | Barrington Wesley Group | 33,548.32 | ESM Audit |
| 0100.113.008570.021440.186021.0312.0000 | Aug-03 | 59046 | Barrington Wesley Group | 24,727.74 | Audit |
| 0100.113.008570.021440.186021.0312.0000 | Nov-03 | 59046 | Barrington Wesley Group | 8,300.44 | Audit |
| 0100.113.008570.021440.186021.0312.0000 | Dec-03 | 59046 | Barrington Wesley Group | 32,725.90 | Audit |
| 0100.113.008570.021440.186021.0312.0000 | Jan-04 | 59046 | Barrington Wesley Group | 4,343.49 | Audit |
| 0100.113.008570.021440.186021.0312.0000 | Feb-04 | 59046 | Barrington Wesley Group | 225.00 | Audit |
| 0100.113.008570.021440.186021.0305.0000 | Sep-03 | 53957 | Edgewood Consulting | 1,984.03 | Consulting - ESM |
| 0100.113.008570.021440.186021.0305.0000 | Feb-04 | 53957 | Edgewood Consulting | 12,145.06 | Analysis - ESM |
| 0100.113.008570.021440.186021.0305.0000 | Nov-03 | 19195 | Towers Perrin | 13,752.00 | Services rendered |
| 0100.113.008570.021440.186021.0305.0000 | Apr-03 | 40674 | The Prime Group | 8,750.00 | ESM Audit |
| 0100.113.008570.021440.186021.0305.0000 | May-03 | 40674 | The Prime Group | 5,050.00 | ESM Audit |
| 0100.113.008570.021440.186021.0305.0000 | Jun-03 | 40674 | The Prime Group | 800.00 | Esm Audit |
| 0100.113.008570.021440.186021.0305.0000 | Nov-03 | 40674 | The Prime Group | 7,400.00 | ESM Audit |
| Total | | | | $ 191,798.92 | |

## Kentucky Utilities Company ESM Audit Expenses

| Account | Date | Vendor # | Vendor Name | Amount | Description |
|---|---|---|---|---|---|
| 0110.105.018570.021440.186023.0312.0000 | Jun-03 | 59046 | Barrington Wesley Group | 38,046.94 | Audit |
| 0110.105.018570.021440.186023.0312.0000 | Jul-03 | 59046 | Barrington Wesley Group | 33,548.32 | ESM Audit |
| 0110.105.018570.021440.186023.0312.0000 | Aug-03 | 59046 | Barrington Wesley Group | 24,727.75 | Audit |
| 0110.105.018570.021440.186023.0312.0000 | Nov-03 | 59046 | Barrington Wesley Group | 8,300.45 | Audit |
| 0110.105.018570.021440.186023.0312.0000 | Dec-03 | 59046 | Barrington Wesley Group | 32,725.89 | Audit |
| 0110.105.018570.021440.186023.0312.0000 | Jan-04 | 59046 | Barrington Wesley Group | 4,343.49 | Audit |
| 0110.105.018570.021440.186023.0312.0000 | Feb-04 | 59046 | Barrington Wesley Group | 225.00 | Audit |
| 0110.105.018570.021440.186023.0305.0000 | Sep-03 | 53957 | Edgewood Consulting | 1,984.03 | Consulting - ESM |
| 0110.105.018570.021440.186023.0305.0000 | Feb-04 | 53957 | Edgewood Consulting | 12,145.06 | Analysis - ESM |
| 0110.105.018570.021440.186023.0305.0000 | Nov-03 | 19195 | Towers Perrin | 13,752.00 | Services rendered |
| 0110.105.018570.021440.186023.0305.0000 | Apr-03 | 40674 | The Prime Group | 8,750.00 | ESM Audit |
| 0110.105.018570.021440.186023.0305.0000 | May-03 | 40674 | The Prime Group | 5,050.00 | ESM Audit |
| 0110.105.018570.021440.186023.0305.0000 | Jun-03 | 40674 | The Prime Group | 800.00 | ESM Audit |
| 0110.105.018570.021440.186023.0305.0000 | Nov-03 | 40674 | The Prime Group | 7,400.00 | ESM Audit |
| Total | | | | $ 191,798.93 | |