COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY UTILITIES COMPANY FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO CONSTRUCT FLUE GAS DESULPHURIZATION SYSTEMS AND APPROVAL OF ITS 2004 COMPLIANCE PLAN FOR RECOVERY BY ENVIRONMENTAL SURCHARGE	)	Case No. 2004-00426

and

THE APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR APPROVAL OF ITS 2004 COMPLIANCE PLAN FOR RECOVERY BY ENVIRONMENTAL SURCHARGE	)	Case No. 2004-00421

POST HEARING BRIEF OF THE ATTORNEY GENERAL

In December of 2004 Kentucky Utilities ("KU") and Louisville Gas and Electric Company ("LG&E") filed applications[1] seeking a Certificate of Convenience and Necessity for the construction of four new Flue Gas Desulphurization sulfur dioxide control technologies pursuant to KRS 278.020 and for new Compliance Plans allowing for the recovery of the costs of new and additional pollution control facilities pursuant to KRS 278.183. For KU, the capital costs of the new pollution control facilities is estimated to be $708 million and for LG&E the capital costs of the new pollution control facilities is estimated to be $40.2 million.

The Attorney General ("AG") and the Kentucky Industrial Utility Customers, Inc. ("KIUC") were granted full intervention. The procedural schedules allowed for the filing of testimony, discovery, and public hearings. The two cases have not been officially consolidated,

[1] *In the Matter of: The Application of Kentucky Utilities Company for a Certificate of Convenience and Necessity to Construct Flue Gas Desulphurization Systems and Approval of its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00426 and *The Application of Louisville Gas and Electric Company for Approval of its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00421. The applications have been handled as companion cases but have not been formally consolidated.

but they have tracked one another and present similar issues. Therefore, this single brief will address the issues in both cases.

COST OF EQUITY

1. The cost of equity for KU and LG&E has declined since the June 20, 2004, decision in the Companies base rate cases and is in a rage between 9.75% and 10.25%.

Both Companies request use of an overall rate of return which would include an 11% return on equity consistent with Article III, Section 3.1 of the Partial Settlement Agreement, Stipulation and Recommendation[2] entered into on May 12, 2004, and subsequently approved by the Commission by Order dated June 30, 2004.[3] The settlement term specifically provides that the 11.0% rate agreed to was to be utilized "until the Commission orders otherwise." The rate of return has declined between 19 and 28 basis points since June 2004.[4] The appropriate rate of return now lies between 9.75% and 10.25%. This is the return on equity that should be used.

Both Dr. Weaver and Richard Baudino agreed that the cost of equity has decreased since the cost of equity analysis was performed in conjunction with the base rate cases. Though Robert Rosenberg indicated on behalf of the Companies that he did not know of any changes since the base rate cases, not having done a differential study, he did agree that the interest rate on 20-year constant maturity government bonds has gone from an average of 5.5% in June 2004 to about 4.8% in April 2005, a decrease of about 70 basis points. He also agreed that the interest rate on

[2] That provision states: The signatories hereto, including the AG, agree that, after the date hereof, orders approving cost recovery of LG&E's and KU's environmental projects pursuant to KRS 278.183 shall be based upon an 11.0% return on common equity until directed by order of the Commission that a different rate of return shall be utilized.

[3] *In the Matter of: An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities*, Case No. 2003-00434 and *An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company*, Case No. 2003-00433.

[4] See Schedule 1 accompanying the Direct Testimony of Dr. Carl G. C. Weaver which indicates that utilizing the same companies and same methodology from Cases 2003-00433 and 2003-00434 with updated data the unadjusted cost of equity had fallen 19 basis points from 9.49% to 9.30%. The Schedule also indicates that the unadjusted cost of equity found using the same methodology but a list of companies revised to account for risk changes is 9.21%, 28 basis points below the 9.49% of Cases 2003-00433 and 2003-00434.

10-year constant maturity bonds has declined about 30 basis points (from 4.7% to 4.4%)[5] during that same time and that the average allowed returns for the first quarter of 2005 are about 47 basis points lower than the average allowed returns in the fourth quarter of 2004 (10.91% in the fourth quarter of 2004 and 10.44% in the first quarter of 2005).[6]

In reaching the determination that the cost of equity is a range of 9.75% to 10.25%, Dr. Weaver used four methods; the Constant Growth Discounted Cash Flow ("DCF"), the Multi-stage DCF, the Capital Asset Pricing Model ("CAPM"), and the Bond-Yield plus Risk-Premium methods. These same four methods were used in determining the return on equity in the base rate cases decided in 2004, but risk changes occurring since the base rate case among the companies used in the analysis resulted in removing three of the companies that were utilized in the base rate cases and the addition of two companies now having similar risk to that of LG&E and KU. Here, there a total of eight companies were used.

Using data from the eight companies, Dr. Weaver found that the average of the four methods to be 9.21%. He adjusted the two DCF methods upwards by 100 basis points to account for the difference between the forecasted interest rates and the interest rates in effect when his data was obtained and added an additional 25 basis points to account for the agreed elimination in the base rate cases of the Earnings Sharing Mechanism ("ESM") under which the Companies had been operating. These adjustments resulted in an average coast of equity for the four methods of 9.96% that Dr. Weaver set at 10.0%.[7] 10.0% became the midpoint of the range of cost of equity he was estimating.

Because Dr. Weaver places greater weight on his DCF constant-growth method for determining his final recommendation, that method became the primary source for selecting the

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[5] Transcript of Evidence ("TE"), pp. 88-91.
[6] Rebuttal testimony of Robert C. Rosenberg, p. 6, lies 10-12.
[7] Direct Testimony of Carl Weaver, pp. 41-42.

range for the cost of equity. The lower end of the range was established by adding 50 basis points for the interest differential and 25 basis points for the elimination of the ESM to his constant growth DCF results and the upper end of the range was established by adding 100 basis points for the interest differential and 25 basis points for the elimination of the ESM to his constant growth DCF results. This range encompasses the results of the four models used by Weaver.

The Multi-stage DCF model indicates that the adjusted cost of equity is 9.90%. This represents the addition of 100 basis points for the interest differential and 25 basis points for the discontinuation of the ESM to the unadjusted cost of equity in the Multi-stage model of 8.65%.[8] At 9.90% the adjusted cost of equity lies slightly below the 10.00 mid-point that Weaver found for the 9.75% to 10.75% range for cost of equity.

The Multi-stage DCF model used an internal rate of return to determine the cost of equity.[9] The cash outflow for computing the internal rate of return is the cash outflow at the beginning of the period of the analysis.[10] Weaver used a February 14, 2005, stock price in his analysis. This was done instead of using an average price because use of an average price diminishes the accuracy of the results by using cash outflows prior to the beginning of the period of the analysis.

2. The Companies Critique of Dr. Weaver's Range of Equity Does Not Provide Grounds to Ignore Weaver's Recommendation.

a. Rosenberg's Rebuttal concerning Dr. Weaver's use the Multi-stage DCF models is flawed.

The Multi-stage DCF models used by Rosenberg in his rebuttal are different than the one used by Dr. Weaver. In his rebuttal Schedule 1, Rosenberg changed Dr. Weaver's methodology

[8] Direct Testimony of Carl Weaver, p 36.
[9] Direct Testimony of Carl Weaver, p. 37.
[10] Recording of Hearing (RH), Time 1:13:35-1:14:45.

by adding an additional "long-term growth rate" after the analysts forecasts were achieved and by using 200 years rather than perpetuity for the duration of his model.[11]

Rosenberg used a "sustainable growth rate" for the additional "long-term growth rate" in his second multi-stage DCF model.[12] He subtracted the dividend yield from his "long-term growth rates" to determine the rate of dividend growth.[13]

Rosenberg's Multi-stage DCF model is flawed because it utilizes circular reasoning in which a value is compounded forward for 195 of the 200 years into the future at a particular compounded rate and then an internal rate of return is taken of that data series. This produces a result in which the internal rate of return is always very close to the rate at which the data was compounded.

Rosenberg's implementation of the Multi-stage DCF model using the Ibbotson's average growth rate for all companies is erroneous in its assumption that electric utility companies have risk equal to all other companies in the equity market despite the fact that he agreed that all companies have a beta of 1.0 and electric companies had a beta of 0.73, indicating a substantially lower risk for electric companies.[14] Lower risk companies have a lower required return. The electric companies would have a required return lower than the 10.0% return associated with companies with a beta of 1.0. Therefore, the cost of equity for electric companies would be lower.

b. Rosenberg's Rebuttal of Dr. Weaver's use of the CAPM Model is flawed.

Rosenberg critiques Dr. Weaver's use of an interest rate that is not longer-termed than ten years. This is incorrect. The CAPM model's derivation assumes that the risk-free rate should be

[11] Rebuttal Testimony of Robert C. Rosenberg, Schedule 1.
[12] Rebuttal Testimony of Robert C. Rosenberg, pp. 14, lines 19-20; 15, line 1.
[13] Rebuttal testimony of Robert C. Rosenberg, p. 14, lines 14-15.
[14] RH Time 11:11:41.

short-termed. Further, twenty year interest rate information relied on by Rosenberg is not readily available to the investing public. Therefore, it should not be considered in a model designed to demonstrate investor thinking. Finally, if the 20-year rate is useful, it should be noted that this rate too has declined some 48 basis points, from 5.4% to 4.8%, since the base rate case decisions.

Rosenberg's claim that *Value Line* considers its stock price appreciation estimate to be 3 ½ years is also erroneous. Rosenberg provided a description published by *Value Line* of its projection of its price appreciation index on June 13, 2003.[15] There *Value Line* provides a comparison of the actual results of stock price appreciation with *Value Line's* estimates in a bar chart at the bottom of the publication. It used four years for the comparison and the midpoint of the fourth year is 3 ½ years out. The 3 ½ years reference is strictly to explain how *Value Line* constructed the bar chart it used to show its results. All other references in its explanation are for "our 3-to-5 year price appreciation potential."

By contrast, *Value Line's* Appreciation Potential is dated April 15, 2005, (some two years after the publication Rosenberg refers to for his 3 ½ year claim) and is labeled "The Estimated Median Price **Appreciation Potential** of all 1,700 stocks in the hypothesized economic environment 3 to 5 years hence." [Emphasis added.] The *Value Line* Appreciation Potential used in the Cross Examination of Dr. Weaver, dated May 6, 2005, is also labeled "The estimated Median Price **Appreciation Potential** of all 1,700 stocks in the hypothesized economic environment 3 to 5 year hence."[16] [Emphasis added.] The *Value Line* page dated February 11, 2005, furnished by Dr. Weaver in response to the Companies' data request, question 6, also has the same 3 to 5 years hence reference.

[15] Rosenberg Rebuttal workpaper, page 43 of 67.
[16] LG&E and KU Exhibit 2.

c. Rosenberg's Rebuttal of Dr. Weaver's Risk Premium Analysis is flawed.

Rosenberg criticizes Weavers risk premium analysis saying that the "return achieved over the 1993-1994 period is given many times the weight compared to the return achieved in the 2003-2004 period."[17] This is incorrect. Both the 1993-1994 period and the 2003-2004 period are weighted 12 times in the calculation. This is shown in the Response to Company Request for Information, Question 9, where the cells, with formulae intact, were provided. The formulae in the cells show the number of times each return is weighted in the calculation.

In critiquing Dr. Weaver's analysis, Rosenberg provides an example to demonstrate his point.[18] The example ignores compound interest, as basic fact of finance, by treating both the one-year holding period and the two-year holding period of his example as if both were a one-year holding period.[19] An investment made at the end of 2002 and held to the end of 2004 is a two year holding period. To state a rate of return for a two-year holding period as a one-year rate, a compound interest methodology must be used. Likewise, to determine a risk premium for two-year holding period using a one-year Treasury bond rate, a compound interest methodology must be used. Rosenberg's critique of Dr. Weaver's use of a compound interest methodology is erroneous and his example misleading.

Rosenberg's alternative approach[20] of calculating the average return of 1992 to 2004 and then averaging the return of 1993 to 1994 also ignores the fact that an interest rate return over a number of years should be stated as compound interest. The arithmetic mean utilized by Rosenberg represents the midpoint of a distribution set, not the compound rate achieved.

[17] Rebuttal Testimony of Robert C. Rosenberg, p. 18.
[18] *Id*, p. 18
[19] Rosenberg's example of a 10.0% and a 2.0% risk premium in 2003 and 2004, respectively, compares a one-year and a two-year holding period and treats each as if they were a one-year holding period. *Id*, p. 18.
[20] *Id*, p. 20

Furthermore, this approach makes the unfounded assumption that an investor who purchases the eight company portfolio in 1992 will hold those same companies until 2004. Because it is not valid to assume that that portfolio will be held for the entire period, Dr. Weaver's analysis examines all possible risk premiums that occur in the 1992-2004 period, whether they be for a one-year holding period, a two-year holding period, or any other holding period up to the full twelve-year holding period. This recognizes that the holding period of that portfolio could begin or end at any year within the 1992-2004 window.

4. The lower part of Dr. Weaver's range of equity and the pollution control debt rate should be utilized for environmental cost recovery under KRS 278.183.

KRS 278.183 is a cost recovery statute. This differs from establishing fair, just, and reasonable rates pursuant to KRS 278.030, KRS 278.180, and KRS 278.190 that allows the utility a reasonable opportunity to earn a return. It is a guarantee of recovery rather an opportunity for recovery that includes a recovery of a guaranteed profit margin in the amount to be recovered. Because KRS 278.183 defines the return on equity as a cost whose return is among those for which recovery is guaranteed, the element of LG&E and KU's operations whose costs are recovered under KRS 278.183 represent the lowest risk possible for companies providing service to a guaranteed rate base. Both the return of the investment and the return on the investment are guaranteed under KRS 287.183. The profit inclusive guaranteed cost recovery of KRS 278.183 is less risky than the general operation of the utility and opportunity to earn afforded the utilities under Chapter 278. In addition, costs that qualify for recovery under KRS 278.183 represent the lowest risk possible for the Companies because cost recovery can occur under the environmental surcharge without reference to whether that cost recovery is necessary

to allow the utility fair, just, and reasonable rates. Cost recovery, given the true up mechanisms, is absolute.

Dependent upon the length of time between rate cases, entire cadres of costs may come and go without ever being specifically recognized for recovery in base rates. With the environmental cost recovery statute, even if a cost is disallowed for expedited recovery under the statute, it assumes the posture of any other normal expense that might still be specifically recognized for recovery in general rates if occurring within the test year for a general rate case. The utility has the right to bring a general rate case if that cost creates an overall financial situation for the utility that warrants an increase in general rates. The primary risk attendant on environmental compliance assets identified by the utilities is the possibility that a cost might be disallowed. The possibility of disallowance for expedited guaranteed recovery under KRS 278.183 does no more than render that excluded item subject to the level of risk attendant on the general operations of the utility subject to the opportunity to earn present in base rates. The risk/return trade-of indicates that there is a lower required rate of return where there is lower risk.[21] Therefore, the lower end of the range of should be utilized for the return to investors for this set of investment.

By like token, the tax exempt pollution control debt rate indicates the cost of debt associated with assets that bear the minimum risk possible for the companies. Therefore, that is the debt rate that should be used for assets whose cost is recovered via a cost recovery mechanism whose only risk lies in the time it takes for full recovery to occur under a true up mechanism. This seems to have been recognized by the companies in earlier filings in which they sought nothing more than the pollution control rate.

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[21] Direct Testimony of Carl Weaver, pp. 44-45.

SURCHARGE ALLOCATION

1. The surcharge allocation based on total revenues currently in use for KU and LG&E should and must be continued.

KIUC argues that the environmental costs should be allocated among jurisdictional rate payers on a net revenue basis rather than on the total revenue basis now in use by Kentucky Utilities in order to mitigate subsidies either arising from or shown to exist in the Companies' most recent base rate cases in which rates were established on June 30, 2004. KIUC's requested relief must be denied as it seeks relief irrelevant to the environmental surcharge as delineated in KRS 278.183. The relief should be denied as KIUC has shown no change from the situation present June 30, 2004, when the Commission found the rates to which KIUC agreed in the underlying settlement executed May 12, 2004 to be fair, just and reasonable. Further, the relief should be denied as it is inconsistent with the allocation of environmental costs utilized for other Kentucky electric utilities and with the allocation of environmental costs as between jurisdictional and non-jurisdictional rate payers.

In the days of the initial utilization and implementation of KRS 278.183,[22] the AG both proposed allocation methodologies distinct from those contained in base rates for the allocation of environmental surcharge rates and supported KIUC in its proposal for an allocation methodology other than total revenues. This issue of the allocation of the environmental surcharge other than by total revenues has been an intervenor issue exclusively in the Kentucky Utilities environmental cases. KU proposed a total revenues allocation for its first environmental

[22] *In the Matter of: The Application of Kentucky Utilities Company to Assess a Surcharge Under KRS 278.183 to Recover the Costs of Compliance with Environmental Requirements for Coal Combustion Wastes and By-Products*, PSC Case No. 93-465 and *In the Matter of: Application of Big Rivers Electric Corporation to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance With Environmental Requirements of the Clean Air Act*, Case No. 94-032.

surcharge recovery action[23] and has continued to do so since. In responding to those proposals, in 1994 the Commission refused to utilize a rate allocation other than total revenues on the ground that there would have to be compelling reasons, as supported by cost of service studies, to warrant a change in the allocation of the surcharge. [24] Both the proposals and the decision occurred before the scope of the statute was defined by judicial review.

a. KRS 278.183 is a single-issue self-contained statute operating independently of the rest of KRS Chapter 278 that does not allow consideration of issues other than those specifically defined.

Since those proposals and the consequent Commissions rulings two important decisions have occurred. First was the decision issued by the Supreme Court in *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company*, 983 S.W.2d 493 (Ky.1998) clearly setting out the fact that the statute is self-contained and intended to operate independently of the rest of the statutory scheme pertaining to rate setting. There, the Court declared that with KRS 278.183, the environmental surcharge, "the traditional rules about rate making have been completely changed."[25] It further stated that the opening language of the statue, which reads "Notwithstanding any other provisions of this chapter," clearly indicates that "the General Assembly intended to consider the surcharge separately without regard to any other rate-making statutes."

There is no question that establishing the allocation of rate increases among classes based on cost of service is an appropriate consideration when establishing fair, just, and reasonable rates under KRS 278.030. Cost of service studies **prepared and presented by the companies** are required by 807 KAR 5:001 Section 10 in connection with applications for a change in rates.

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[23] *Id.*, p. 20.
[24] *Id.*, p. 21.
[25] *Id.*, p. 501.

Likewise, there is no question that the overall financial condition of the utility is an issue in establishing fair, just, and reasonable rates under KRS 278.030 and that the other filing requirements of 807 KAR 5:001 Section 10 allow and require the consideration of the full financial condition of the utility. But these are both considerations attendant to general rate cases, not to the self-contained single-issue surcharge. The sole function of KRS 278.183 is to incent Kentucky utilities to utilize Kentucky coal by leveling the cost recovery playing field between capital intensive scrubbers and the use of low sulfur coal.[26]

In KRS 278.183, the single-issue statute designed to garner between base rate case cost recovery for the utility, the extent of the Commission's consideration is dictated by Section 2 (a) through (c). Nowhere in that consideration is rectification of purported subsidies in base rates established as an issue to be considered by the Commission. The issue of subsidies purportedly contained in base rates is as irrelevant to and beyond the scope of the matters the Commission is authorized to consider in KRS 278.183 proceedings as the overall financial picture of the utility. KIUC, not the utilities, seeks to use KRS 278.183 as a tool to accomplish purposes for which it is not designed; between general rate case adjustments to the level of class contributions to cost of service. The relief sought is not authorized by the statute and must be denied.

Despite its proposal, KIUC too recognizes that the relief sought is not allowed by KRS 278.183. Speaking for KIUC, Baron testified that,

> "Ideally, rate schedule cost of service analysis and rate design should incorporate all elements of cost of service, especially ECR revenue requirements as large as being requested in this case. **However, the statutory requirements do not permit such base rate treatment for ECR costs.**[27]

[26] Preamble to Senate Bill 342, now codified as KRS 278.183, 1992 Acts of the General Assembly, Chapter 102, pp. 521-522.
[27] Direct Testimony of Stephen Baron, pp. 20-21.

Under KRS 278.183 the Company is not required to present a cost of service study. KRS 278.183 does not allow for base rate case cost of service analysis and rate design. The correction of purported class subsidies has nothing to do with the leveling of the cost recovery playing field for the utility and KRS 278.183 is deliberately drawn to divorce rate recovery under it from those statutes and regulations under which both concerns of reasonableness of rates as they relate to the overall financial needs of the utility and class contributions to cost of service are at issue. KRS 278.183 should not be used to implement policies it does not address or to affect results with which it is not concerned.

Not only is the correction of purported base rate subsidies not established by the statute as an issue that the Commission is to consider under Subsection 2(a) through (c), the statute repeatedly refers to the surcharge in the singular. A single surcharge to be applied to existing rates results from the use of a total revenues allocation. Differing surcharges/surcharge factors result from the use of the net revenues allocation. This is not a result contemplated or allowed by the statute. Therefore the requested relief must be denied.

b. The user is the cost causer. Consistency requires that allocation among jurisdictional customers be done as the allocation between jurisdictional and non-jurisdictional customers is done based on total revenue.

The second decision to occur was the Franklin Circuit Court's ruling on Kentucky Power Company's appeal of the Commission's determination that environmental costs should not be allocated on a demand basis between jurisdictional and non-jurisdictional because it is the user of the system that causes pollution and the use of the system is captured by a total revenues approach. Kentucky Power had argued strenuously that 98% of the environmental costs had to be allocated to the jurisdictional customers on a demand basis because the system was built to serve

jurisdictional customers. The Franklin Circuit Court validated the Commission's decision to use a total revenues approach to the allocation saying,

> Despite huge blocks of power sold off-system, Kentucky Power maintains that Kentucky ratepayers should pay for 98.6% of all its new environmental costs. The Commission disagreed and ruled that costs should be allocated to the cost causer. The Commission held that there is some relationship between the energy consumed and the pollution caused by generating that energy. That decision is reasonable and should be affirmed.[28]

It is no less the use of the system (total revenues) that results in the proper allocation of environmental costs to the cost causer among jurisdictional customers than it is for the allocation of costs between jurisdictional and non-jurisdictional use.[29] For jurisdictional customers, the user of the system is a surely the cost causer of environmental costs as it is for the non-jurisdictional customer. Given that the allocation of environmental costs based on total revenues does recognize cost causation, consistency demands continued use of total revenues for the allocation of environmental costs among jurisdictional customers as well as between jurisdictional and non-jurisdictional customers.

c. Rates found to be reasonable continue to be reasonable.

KIUC's testimony shows that the only change in circumstance since all parties, including KIUC and the Companies, agreed to a rate design that did not align with the cost of service studies presented in the base rate cases is that the updated cost of service studies show less of a departure from the class contribution to cost of service is occurring under the new base rates than was true before the implementation of the new rates.[30] Unlike the time limitation built into the agreement pertaining to the use of an 11% return for the environmental surcharge filings with

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[28] *Kentucky Power Company d/b/a American Electric Power v Kentucky Service Commission*, consolidated actions numbered 97-CI-1144, 97-CI-1138, and 97-CI-1319 appealing PSC Case No. 96-489, Slip Opinion and Order of April 28, 1998, p. 19.

[29] By way of rebuttal the Companies ask that for the sake of consistency, the jurisdictional/non-jurisdictional allocation be based on demand if the jurisdictional allocation is based on demand. Rebuttal Testimony of Kent Blake, p. 13.

[30] Direct Testimony of Stephen J. Baron, p. 9, lines 7-13.

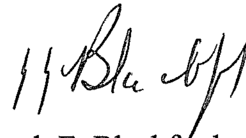
their reference to "until the Commission orders otherwise," no time limitation was placed on the use of the agreed rate design. Less than one year ago, the Commission found that the agreed upon rate design results in fair, just, and reasonable. The base rate design and the rates it produces continue to be as reasonable today as it was when approved in 2004. Because the base rates are reasonable, there is nothing to be rectified by implementing a change in the allocation of environmental costs. Therefore, even if rectifying purported inequities in class contribution to cost of service in base rates were a matter that could be considered in this KRS278.183 action, the allocation proposed by KIUC should be denied.

CONCLUSION

For the reasons set out above, the cost of equity for the environmental surcharges of each of the Companies should be set in a range from 9.75% to 10.25%, the pollution control debt rate should be used as the cost of debt, and total revenues should be used for the surcharge.

Respectfully submitted,

GREGORY D. STUMBO
ATTORNEY GENERAL.



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NOTICE OF FILING AND CERTIFICATION OF SERVICE

I hereby give notice that I have filed the original and ten true copies of the foregoing with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 this the 31st day of May, 2005, and certify that this same day I have served the parties by mailing a true copy, postage prepaid, to the following:

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