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John J. Finnigan, Jr.
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VIA OVERNIGHT DELIVERY

July 19, 2005

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: In the Matter of an Adjustment of the Gas Rates of The Union Light, Heat and Power Company
Case No. 2005-00042

Dear Ms. O'Donnell:

I have enclosed an original and ten copies of The Union Light, Heat and Power Company's Rebuttal Testimony in the above-referenced case.

In addition, I have enclosed and original and ten copies of the updated responses to data request KyPSC-R-02-002-Supplemental and AG-DR-01-159 Supplemental, in the same case.

Please date stamp and return the two extra copies of my cover letter in the enclosed, self-addressed envelope.

If you have any questions, please do not hesitate to contact me at (513) 287-3601.

Sincerely,

John Finnigan

John J. Finnigan, Jr.
Senior Counsel

JJF/sew

cc: Hon. Elizabeth Blackford (w/encl.)

KyPSC Staff Second Set Data Requests
ULH&P Case No. 2005-00042
Date Received: April 5, 2005
Response Due Date: April 19, 2005
Response Date: April 28, 2005
Supplemental Response: July 19, 2005

KyPSC-DR-02-002 Supplemental

REQUEST:

2. Refer to the response to the Staff's First Request, Item 7. ULH&P was requested to provide the same information sought in the Staff's First Request, Item 6, for 2005 as it became available. ULH&P's response was the same as provided for Item 6. ULH&P shall provide the originally requested information. If ULH&P cannot provide the requested information or if the information is not available, submit a detailed explanation discussing why the information cannot be provided.

RESPONSE:

Please see KyPSC-DR-02-002 Supplemental Attachment.

WITNESS RESPONSIBLE: Steven E. Schrader

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
May 2005
Dollars In Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Description
Revenues		5,667	1,191	4,476	376%	
Cost of Gas		3,157	(690)	3,847	-558%	
Margin		2,510	1,881	629	33%	See attached schedule.
O&M						
	416	21	2	19	950%	Joint Trench expenses budgeted to
	426.52	-	14	(14)	-100%	Sale of A/R fees not allocated to gas line
	711	-	-	-	0%	
	712	-	-	-	0%	
	735	-	-	-	0%	
	742	1	-	1	0%	Non-budgeted maintenance work at Erlanger gas plant
	807	34	27	7	26%	Purchased gas expenses greater than
	859	-	-	-	0%	
	870	16	17	(1)	-6%	
	871	6	6	-	0%	
	874	95	90	5	6%	Leak surveys and corrosion monitoring.
	875	3	4	(1)	-25%	Engineering support activity less than
	876	5	3	2	67%	commercial customers more than planned; Timing difference, prior months were under plan.
	878	(141)	43	(184)	-428%	operations entered into this account. Meter handling work was budgeted to 878, actuals charged to 893. Moved meter installation costs to capital account.
	879	69	65	4	6%	than plan, partially offset by lower than plan inspection activity. Customer investigative order requests for gas meters charged to 879, budgeted to 902.
	880	52	83	(31)	-37%	charged to 908. Maintenance of gas meter actuals charged to 893, budgeted to 880. Also, spending for DOT Public Safety Program is delayed.
	881	32	-	32	0%	Intercompany rents not budgeted.
	885	6	3	3	100%	Exempt labor was budgeted to 597000; this area supports both gas & electric. Charges under this account are correct
	887	66	122	(56)	-46%	Delayed start on Integrity Management
	889	4	3	1	33%	Corrective maintenance activity slightly higher than plan
	892	34	33	1	3%	

						878, actuals charged to 893.
	893	21	-	21	0%	Maintenancing of gas meter actuals charged to 893, budgeted to 880.
	894	(1)	(3)	2	-67%	Less third-party damages reimbursements than budgeted.
	901	2	2	-	0%	
	902	38	47	(9)	-19%	gas meters charged to 879, budgeted to 902.
	903	104	153	(49)	-32%	labor, as well as timing difference for certain invoices.
	904	-	121	(121)	-100%	GT4 (ULHP Gas), charged to LOB RB3 (ULHP - General)
	905	1	-	1	0%	Exempt labor addition not budgeted for
	908	14	12	2	17%	Customer inquiry budgeted to 880,
	909	1	4	(3)	-75%	Advertising expense less than plan.
	910	21	19	2	11%	plan due to timing difference. More costs incurred in early part of year, this variance should reverse by year's end.
	911	1	10	(9)	-90%	Administrative, load forecasting, and market research actvities less than plan.
	913	6	1	5	500%	Timing difference for advertising expense, actuals lower in previous months.
	916	-	104	(104)	-100%	DSM amortization entry. Will correct in June.
	920	240	185	55	30%	Administrative labor over plan. Annual incentive plan greater than plan for May.
	921	69	104	(35)	-34%	Risk management activity charged to 925, budgeted to 921. Employee expenses and training costs under budget.
	922	-	-	-	0%	
	923	91	63	28	44%	Variance due to higher Outside Service expenses than budgeted in the Legal & Investor Relations departments
	924	-	-	-	0%	
	925	42	4	38	950%	Risk management activity charged to 925, budgeted to 921.
	926	232	252	(20)	-8%	Fringe benefit costs are less than
	928	19	20	(1)	-5%	
	929	-	-	-	0%	
	930	10	11	(1)	-9%	compensation expense less than budgeted.
	931	77	52	25	48%	budgeted, and intercompany rent was charged but not budgeted due to net impact of $0 to company.
	935	12	10	2	20%	Hardware maintenance expense greater than estimated
Total O&M		1,303	1,686	(383)	-23%	
Depreciation		811	784	27	3%	More plant was put in service than
Amortization	404-405	-	-	-	0%	

Taxes Other Than Income Taxes	408.1	237	250	(13)	-5%	Payroll taxes under budget.
Operating Income		159	(839)	998	-119%	

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
April 2005
Dollars in Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Description
Revenues		9,282	4,556	4,726	104%	
Cost of Gas		5,816	1,451	4,365	301%	
Margin		3,466	3,105	361	12%	See attached schedule.
O&M						
	416	(6)	2	(8)	-400%	Revenues collected for relocation of propane lines not anticipated in budget.
	426.52	-	14	(14)	-100%	Sale of A/R fees not allocated to gas. Will be corrected next month.
	506	-	-	-	0%	
	586	1	-	1	0%	
	587	-	-	-	0%	
	588	-	-	-	0%	
	597	-	-	-	0%	
	711	-	-	-	0%	
	712	-	-	-	0%	
	717	6	9	(3)	-33%	Credit for CG&E ownership of Erlanger plant was greater than budgeted.
	735	-	-	-	0%	
	742	1	-	1	0%	
	807	30	27	3	11%	Corrective maintenance work was greater than budgeted.
	859	-	-	-	0%	
	870	2	17	(15)	-88%	Certain labor was budgeted in account 870 but charged to 885. The payroll accrual reversal was greater than
	871	6	6	-	0%	
	874	135	96	39	41%	Leak Surveys and Corrosion Monitoring activities were greater than budgeted.
	875	7	4	3	75%	Engineering support was greater than
	876	5	3	2	67%	Calibration & testing were greater than
	878	46	37	9	24%	Meter handling work was budgeted to 878, actuals charged to 893. There is also a timing difference due to budget dollars being spread equally throughout the year.
	879	105	77	28	36%	Curb to meter replacement and customer premise work higher than budgeted.
	880	27	82	(55)	-67%	Rebuilds activity and the payroll accrual reversal were less than budgeted.
	881	32	-	32	0%	Intercompany rents were not budgeted.
	885	6	3	3	100%	Dollars budgeted to 870 & 878, actuals charged to 885.

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
April 2005
Dollars in Thousands

			Variance		
Account	Actual	Plan	Amount	Percent	Description
887	76	91	(15)	-16%	Code compliance activities were less than
889	4	3	1	33%	
892	54	33	21	64%	Maintenace dispatching related to inspections was less than budgeted.
893	26	-	26	0%	Meter handling work was budgeted to 878, actuals charged to 893.
894	1	(1)	2	-200%	Miscellaneous revenues were less than
901	2	2	-	0%	
902	44	48	(4)	-8%	Meter reading expenses were less than
903	126	166	(40)	-24%	Hardware, processing and postage expenses for customer billings and contract labor costs related to credit and
904	(2)	121	(123)	-102%	Provision for uncollectable receivables was less than budgeted.
905	1	-	1	0%	
908	14	12	2	17%	Customer inquiry and customer support were greater than budgeted.
909	-	4	(4)	-100%	Advertising expense less than budgeted.
910	22	15	7	47%	Customer relations expenses greater than
911	1	10	(9)	-90%	Administrative, load forecasting, and market research actvities less than
913	2	1	1	100%	
916	209	216	(7)	-3%	Actual amortization of DSM dollars slightly less than budgeted.
920	250	204	46	23%	Administrative labor and annual incentive plan were greater than budgeted.
921	55	99	(44)	-44%	Risk management activity charged to 924 and 925, budgeted to 921. Employee expenses and training costs were less
922	-	-	-	0%	
923	51	69	(18)	-26%	Outside services/contract labor expenses were less than budgeted.
924	14	-	14	0%	Risk management activity charged to 924 and 925, budgeted to 921.
925	13	4	9	225%	The risk management activity was charged to accounts 924 and 925 but budgeted in
926	279	246	33	13%	Fringe benefit and indirect labor costs greater than budget partially due to loading rate difference between budget and actual.
928	22	20	2	10%	Regulatory affair expenses were greather than budgeted.
930	22	13	9	69%	Association dues greater than budgeted.
931	75	53	22	42%	Hardware related expenses greater than

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
April 2005
Dollars in Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Variance Description
	935	12	10	2	20%	Hardware maintenance expense greater than budgeted.
Total O&M		1,776	1,816	(40)	-2%	
Depreciation		808	787	21	3%	More plant was put in service than
Amortization	404-405	-	-	-	0%	
Taxes Other Than Income Taxes	408.1	251	250	1	0%	
Operating Income		631	252	379	150%	

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
March 2005
Dollars in Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Description
Revenues		17,988	13,779	4,209	31%	
Cost of Gas		12,256	8,747	3,509	40%	
Margin		5,732	5,032	700	14%	See attached schedule.
O&M						
	711	1	-	1	0%	Propane not budgeted
	712	1	-	1	0%	Propane not budgeted
	728	13	-	13	0%	Propane vaporized was not budgeted
	735	1	0	1	270%	Propane operation expenses not budgeted to this account
	742	1	-	1	0%	performing non-budgeted maintenance work at Erlanger gas plant
	807	26	27	(1)	-3%	Calibration & testing for industrial/ commercial customers less than plan.
	859	-	-	-	0%	
	870	22	17	5	27%	Administrative union labor budgeted to 880 & 878, actuals went to 870 & 885.
	871	6	6	(1)	-13%	Administrative expense slightly less than
	874	85	98	(13)	-13%	Leak surveys. No corrosion monitoring-mains and services in 1st quarter; will pick up in summer. Delayed start on Integrity Management Program.
	875	5	4	1	15%	Engineering support activity slightly above
	876	2	3	(1)	-31%	Calibration & testing for industrial/ commercial customers less than plan.
	878	(76)	31	(107)	-348%	account. Meter handling work was budgeted to 878, actuals charged to 893. And timing difference dut to equal spread of budget dollars for the year.
	879	41	55	(15)	-26%	higher than normal precipitation crews utilized weather training instead of O&M functions.
	880	94	91	3	3%	Administrative union actuals charged to 870 & 885. Maintenancing (rebuilding) of gas meters budgeted to 880, actuals charged to 893.
	881	32	-	32	0%	Unbudgeted Gas Distribution rent
	885	5	3	2	86%	Dollars budgeted to 870 & 878, actuals charged to 885.

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
March 2005
Dollars in Thousands

Account	Actual	Plan	Variance Amount	Variance Percent	Description
887	53	106	(53)	-50%	dispatching expense. Due to higher than normal precipitation, crews utilized weather training (Cost Pool) instead of O&M functions.
889	7	3	5	162%	Low station maintenance in Feb. made up
890	-	-	-	0%	
892	16	15	0	2%	Unbudgeted construction & maintenace dispatching expense.
893	20	-	20	0%	878, actuals charged to 893. Customer orders not budgeted by center MOE due to past history of low dollar impact.
894	(3)	(32)	29	-89%	Less third-party damages reimbursements than budgeted.
901	9	2	8	404%	Timing difference due to direct labor hours being spread equally throughout the year.
902	43	44	(1)	-3%	
903	117	156	(40)	-25%	Timing difference due to direct labor hours being spread equally throughout the year.
904	137	121	16	13%	Provision for uncollectable receivables greater than plan.
905	0	0	0	747%	Exempt labor addition not budgeted for
907	-	-	-	0%	
908	15	12	3	28%	Customer inquiry and customer support activity is slightly greater than budgeted.
909	-	4	(4)	-100%	Advertising expense less than plan.
910	16	16	1	4%	Dollars budgeted to 920, actuals charged
911	5	10	(5)	-53%	Administrative, load forecasting, and market research actvities less than plan.
912	4	-	4	0%	Unbudgeted cellphone and pagers actvity.
913	-	1	(1)	-100%	Advertising expense less than plan.
916	381	340	41	12%	DSM recoveries granted by the Kentucky Commission is greater than the budgeted amortization.
920	304	186	119	64%	annual incentive plan is charged to account 920 but was budgeted in account 921.
921	51	110	(59)	-54%	budgeted to 921. The annual incentive plan was charged to account 920 but budgeted to account 921.
923	53	69	(16)	-23%	activities less than plan, partially offset by higher administrative and contract labor expense.
924	-	-	-	0%	

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
March 2005
Dollars in Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Description
						to account 925 bud budgeted in account 920. This was partially offset by favorable
	925	(58)	4	(62)	-1501%	claims experience.
	926	229	243	(14)	-6%	Fringe benefit costs are less than
	928	18	20	(2)	-8%	Regulatory affairs activity less than plan.
	929	(18)	-	(18)	0%	Gas company use not budgeted.
						compensation expense greater than
	930	26	11	15	131%	budgeted.
	931	102	52	50	96%	Software related expenses greater than
						Hardware maintenance expense greater
	935	28	10	18	188%	than estimated
Total O&M		1,814	1,837	(23)	-1%	
						construction expenditures being under
Depreciation		734	786	(52)	-7%	budget.
Amortization	404-405	-	-	-	0%	
Taxes Other Than Income Taxes	408.1	245	248	(3)	-1%	
Operating Income		2,939	2,161	778	36%	

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
February 2005
Dollars in Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Description
Revenues		18,233	20,555	(2,322)	-11%	
Cost of Gas		12,610	14,047	(1,437)	-10%	
Margin		5,623	6,508	(885)	-14%	See Attached Schedule
O&M						
	711	1	-	1	0%	Propane not budgeted
	712	1	-	1	0%	Propane not budgeted
	728	-	-	-	0%	
	735	0	0	(0)	-85%	
	742	1	-	1	0%	performing non-budgeted maintenance work at Erlanger gas plant
	807	26	38	(11)	-30%	Calibration & testing for industrial/ commercial customers less than plan.
	859	-	-	-	0%	
	870	15	17	(2)	-11%	Administrative union labor budgeted to 880 & 878, actuals went to 870 & 885.
	871	5	6	(1)	-15%	Administrative expense slightly less than
	874	82	167	(85)	-51%	Leak surveys. Postponed odorant shipment from Feb. to April due to mild weather. No corrosion monitoring-mains and services in 1st quarter; will pick up in summer. Delayed start on Integrity Management Program.
	875	4	4	(0)	-5%	
	876	3	3	1	20%	Calibration & testing for industrial/ commercial customers greater than plan.
	878	(13)	46	(58)	-128%	account. Meter handling work was budgeted to 878, actuals charged to 893. And timing difference dut to equal spread of budget dollars for the year.
	879	43	68	(25)	-37%	higher than normal precipitation crews utilized weather training instead of O&M functions.
	880	67	86	(19)	-22%	870 & 885. Maintenancing (rebuilding) of gas meters budgeted to 880, actuals charged to 893.
	881	32	-	32	0%	Unbudgeted Gas Distribution rent
	885	7	3	4	145%	Dollars budgeted to 870 & 878, actuals charged to 885.

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
February 2005
Dollars in Thousands

Account	Actual	Plan	Variance Amount	Variance Percent	Description
887	51	91	(39)	-43%	dispatching expense. Due to higher than normal precipitation, crews utilized weather training (Cost Pool) instead of O&M functions.
889	1	3	(2)	-68%	Low station maintenance in Feb. made up in March.
890	-	-	-	0%	
892	8	13	(5)	-39%	crews utilized weather training (Cost Pool) instead of O&M functions.
893	18	-	18	0%	878, actuals charged to 893. Customer orders not budgeted by center MOE due to past history of low dollar impact.
894	7	(6)	13	-229%	Higher than expected third-party damages
901	9	2	7	382%	Timing difference due to direct labor hours being spread equally throughout the year.
902	44	49	(5)	-10%	Administrative expense less than plan.
903	114	160	(46)	-29%	Timing difference due to direct labor hours being spread equally throughout the year.
904	138	121	17	14%	Provision for uncollectable receivables greater than plan.
905	1	0	1	1991%	Exempt labor addition not budgeted for
907	-	-	-	0%	
908	15	11	3	28%	Customer inquiry and customer support activity is slightly greater than budgeted.
909	-	4	(4)	-100%	Advertising expense less than plan.
910	12	15	(3)	-22%	in account 910 but charged to account 903.
911	3	10	(7)	-69%	Administrative, load forecasting, and market research actvities less than plan.
912	-	-	-	0%	
913	-	1	(1)	-100%	Advertising expense less than plan.
916	296	430	(134)	-31%	DSM recoveries granted by the Kentucky Commission is greater than the budgeted amortization.
920	227	178	49	27%	Administrative labor greater than
921	54	102	(48)	-47%	Risk management activity charged to 925, budgeted to 921.
923	67	67	(0)	0%	Outside services & market research activities less than plan, offset by higher administrative contract labor expense.
924	-	-	-	0%	
925	44	4	40	969%	to account 925 bud budgeted in account 920. This was partially offset by favorable claims experience.
926	233	268	(35)	-13%	Fringe benefit costs are less than

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
February 2005
Dollars In Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Variance Description
	928	18	20	(2)	-8%	Regulatory affairs activity less than plan.
	929	(20)	-	(20)	0%	Gas company use not budgeted.
	930	6	14	(8)	-58%	Director compensation and association dues expense less than plan.
	931	105	50	55	110%	Software related expenses greater than
	935	17	9	7	80%	Hardware maintenance expense greater than estimated
Total O&M		1,747	2,055	(308)	-15%	
Depreciation		730	778	(48)	-6%	construction expenditures being under budget.
Amortization	404-405	-		-	0%	
Taxes Other Than Income Taxes	408.1	245	253	(8)	-3%	
Operating Income		2,901	3,422	(521)	-15%	

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
January 2005
Dollars in Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Description
Revenues		21,554	30,562	(9,008)	-29%	
Cost of Gas		15,338	22,638	(7,300)	-32%	
Margin		6,216	7,924	(1,708)	-22%	See attached schedule.
O&M						
	711	1	-	1	0%	Propane not budgeted
	712	1	-	1	0%	Propane not budgeted
	728	41	-	41	0%	Propane vaporized was not budgeted
	735	3	0	3	929%	Propane operation expenses not budgeted to this account
	742	1	-	1	0%	performing non-budgeted maintenance work at Erlanger gas plant
	807	26	28	(2)	-8%	Administrative and maintenance corrective expense less than plan.
	859	-	-	-	0%	
	870	11	19	(8)	-41%	Administrative union labor budgeted to 880 & 878, actuals went to 870 & 885.
	871	6	6	(0)	-5%	
	874	97	148	(51)	-35%	Leak surveys. Due to unseasonable weather, actual expense was less than plan. No corrosion monitoring-mains and services in 1st quarter; will pick up in summer. Delayed start on Integrity Management Program.
	875	5	4	0	10%	Engineering support activity slightly above
	876	2	3	(0)	-8%	Calibration & testing for industrial/ commercial customers less than plan.
	878	28	43	(14)	-34%	account. Meter handling work was budgeted to 878, actuals charged to 893. And timing difference dut to equal spread of budget dollars for the year. Bad weather reduced amount of new service tie
	879	41	56	(15)	-26%	higher than normal precipitation crews utilized weather training instead of O&M functions.
	880	66	92	(26)	-28%	870 & 885. Maintenancing (rebuilding) of gas meters budgeted to 880, actuals charged to 893.
	881	32	-	32	0%	Unbudgeted Gas Distribution rent
	885	6	4	3	72%	Dollars budgeted to 870 & 878, actuals charged to 885.

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
January 2005
Dollars in Thousands

Account	Actual	Plan	Variance Amount	Variance Percent	Description
887	79	118	(39)	-33%	dispatching expense. Due to higher than normal precipitation, crews utilized weather training (Cost Pool) instead of O&M functions.
889	3	3	(0)	-13%	Station maintenance expense under
890	-	-	-	0%	
892	9	13	(4)	-27%	crews utilized weather training (Cost Pool) instead of O&M functions.
893	21	-	21	0%	878, actuals charged to 893. Customer orders not budgeted by center MOE due to past history of low dollar impact.
894	(11)	24	(36)	-146%	Lower than expected third party damage reimbursements in Covington District
901	8	4	4	90%	Timing difference due to direct labor hours being spread equally throughout the year.
902	47	47	(1)	-2%	
903	105	173	(68)	-39%	Timing difference due to direct labor hours being spread equally throughout the year.
904	165	121	44	37%	Provision for uncollectable receivables greater than plan.
905	1	0	1	1904%	Exempt labor addition not budgeted for
907	5	-	5	0%	907 & 908, budgeted to 908 only for January.
908	10	11	(2)	-14%	Customer support expense charged to 907 & 908 for January.
910	17	16	1	9%	Dollars budgeted to 920, actuals charged
909	-	4	(4)	-100%	Advertising expense less than plan.
911	7	10	(3)	-31%	Administrative, load forecasting, and market research actvities less than plan.
912	-	-	-	0%	
913	-	1	(1)	-100%	Advertising expense less than plan.
916	324	452	(128)	-28%	DSM recoveries granted by the Kentucky Commission is greater than the budgeted amortization.
920	191	222	(31)	-14%	Administrative labor less than budgeted.
921	114	128	(14)	-11%	Risk management activity charged to 925, budgeted to 921.
923	32	72	(39)	-55%	activities less than plan, partially offset by higher administrative and contract labor expense.
924	-	-	-	0%	
925	97	4	93	2268%	to account 925 bud budgeted in account 920. This was partially offset by favorable claims experience.

The Union Light, Heat and Power Company
Comparative Gas Financial Statements
January 2005
Dollars in Thousands

	Account	Actual	Plan	Variance Amount	Variance Percent	Variance Description
	926	246	264	(19)	-7%	Fringe benefit costs are less than
	928	26	32	(7)	-20%	Regulatory affairs activity less than plan.
	929	(13)	-	(13)	0%	Gas company use not budgeted.
	930	16	13	3	24%	Safety advertising and regulatory affairs expense is greater than budgeted.
	931	107	57	49	86%	Software related expenses greater than
	935	13	10	3	32%	Hardware maintenance expense greater than estimated
Total O&M		1,987	2,203	(216)	-10%	
Depreciation		728	777	(49)	-6%	construction expenditures being under budget.
Amortization	404-405	-	-	-	0%	
Taxes Other Than Income Taxes	408.1	250	256	(6)	-2%	
Operating Income		3,251	4,688	(1,437)	-31%	

The Union Light, Heat and Power Company
Monthly Gas Margins Compared to Plan Analysis
2005
(Dollars in Thousands)

2005	Variance												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Weather	(519)	(511)	855	(279)	275	-	-	-	-	-	-	-	(179)
Riders	(114)	(177)	11	(33)	(3)	-	-	-	-	-	-	-	(316)
Realization	17	64	(9)	(17)	(69)	-	-	-	-	-	-	-	(14)
Volume	(683)	(293)	(286)	501	547	-	-	-	-	-	-	-	(214)
Other	(409)	32	129	189	(121)	-	-	-	-	-	-	-	(180)
	(1,708)	(885)	700	361	629	-	-	-	-	-	-	-	(903)

Attorney General First Set Data Requests
ULH&P Case No. 2005-00042
Date Received: April 6, 2005
Response Due Date: April 19, 2005
Supplemental Response: July 19, 2005

AG-DR-01-159 Supplemental

REQUEST:

159. In the same format and detail as per Schedule B-8, pages 1 and 2, please provide the Total Company actual balance sheet account balances as of March 31, 2005.

RESPONSE:

See AG-DR-01-159 Supplemental Attachment.

WITNESS RESPONSIBLE: William Don Wathen, Jr.

The Union Light, Heat and Power Company

Quarterly Supplemental Financial Statements
Income Statement
For the 12 Months Ended March 31, 2005
(Unaudited)

	Electric Jurisdictional	Gas Jurisdictional	Non-Jurisdictional	Total Company
Revenues				
Residential Sales	91,054,766	77,726,523	0	168,781,289
Commercial Sales	77,635,419	30,796,787	0	108,432,206
Industrial Sales	38,720,164	4,742,467	0	43,462,631
Sales to Public Authorities	16,638,949	5,089,267	0	21,728,216
Public Street & Highway Lighting	1,503,673	975	0	1,504,648
Inter-Departmental Sales	84,447	51,270	0	135,718
Forfeited Discounts	0	0	0	0
Misc. Service Revenues	207,028	23,177	659,864	890,068
Revenues from Transportation	0	4,514,703	0	4,514,703
Rents from Property	187,899	34,176	1,781,490	2,003,565
Interdepartmental Rents	0	0	0	0
Other Revenues	268,968	8,911	0	277,879
Less Provision for Rate Refunds	0	0	0	0
Total Revenues	226,301,313	122,988,255	2,441,354	351,730,923
Operating Expenses				
Operation Expense	197,650,720	94,535,164	59,209	292,245,094
Maintenance Expense	4,915,495	1,702,062	(100,870)	6,516,686
Depreciation Expense	8,985,508	7,468,113	1,596,084	18,049,705
Amortization and Depletion	1,336,168	832,601	0	2,168,769
Taxes Other than Income Taxes	1,750,260	1,492,602	347,593	3,590,454
Income Taxes - Federal & Other	(4,580,108)	3,736,266	(124,775)	(968,617)
Provision of Deferred Income Taxes - Net	4,121,175	3,824,709	7,303	7,953,187
Investment Tax Credit Adjustment	(163,467)	(64,357)	(3,480)	(231,304)
Total Operating Expenses	214,015,750	113,527,160	1,781,065	329,323,976
NET OPERATING INCOME	12,285,563	9,461,095	660,289	22,406,947
Other Income & Deductions				
Revenues from Merchandising, Jobbing and Contract Work	0	0	817,321	817,321
Less Expense of Merchandising, Jobbing and Contract Work	0	0	(260,130)	(260,130)
Revenues from Nonutility Operations	0	0	(44,590)	(44,590)
Less Expenses from Nonutility Operations	0	0	(460,168)	(460,168)
Interest & Dividend Income	0	0	1,777,869	1,777,869
AFUDC	63,218	48,549		111,767
Gain on Disposition of Property	0	0		0
Loss on Disposition of Property	0	0		0
Misc. Income Deductions	0	0	(219,051)	(219,051)
Taxes Other than Income Taxes	0	0		0
Income Taxes - Federal & Other	0	0	(1,825,469)	(1,825,469)
Provision for Deferred Income Taxes - Net	0	0	295,561	295,561
Total Other Income & Deductions	63,218	48,549	81,343	193,110
Interest Charges				
Interest on Long Term Debt	(2,419,870)	(1,858,392)	(392,942)	(4,671,204)
Amortization of Debt Disc. And Expense	(42,585)	(32,705)	(6,915)	(82,205)
Amortizaton of Loss on Reacquired Debt	(93,987)	(72,179)	(15,262)	(181,428)
Interest on Debt to Assoc Co	(112,051)	(86,053)	(18,195)	(216,299)
Other Interest Expense	(315,981)	(242,664)	(51,309)	(609,954)
Less Allowance for Borrowed Fund Used During Construction - Credit	39,978	24,240	0	64,219
Net Interest Charges	(2,944,496)	(2,267,753)	(484,623)	(5,696,872)
Extraordinary Items after Taxes	0	0	0	0
NET INCOME	9,404,285	7,241,891	257,009	16,903,184

The Union Light, Heat and Power Company

Quarterly Supplemental Financial Statements
Balance Sheet - Page 1
As of March 31, 2005
(Unaudited)

	Electric Jurisdictional	Gas Jurisdictional	Non-Jurisdictional	Total Company
Assets				
Utility Plant in Service	301,236,456	258,086,257	10,923,298	570,246,011
Construction Work in Progress	6,378,342	4,474,673		10,853,016
Less Accum. Depreciation	(117,863,924)	(80,448,860)	(6,726,190)	(205,038,973)
Net Utility Plant	189,750,875	182,112,070	4,197,108	376,060,053
Nonutility Property	0	0	13,248,316	13,248,316
Other Investments	0	0	3,068	3,068
Special Funds	0	0	0	0
Total Other Property & Investments	0	0	13,251,384	13,251,384
Cash	4,820,078	3,701,683	782,691	9,304,452
Special Deposits	0	0	0	
Working Funds	1,295	995	210	2,500
Temporary Cash Investments	0	0	0	
Notes Receiveable	0	0	0	
Customer Accounts Receiveable	568,872	308,394	0	877,266
Other Accounts Receiveable	(3,784)	28,682	52,557	77,455
Less Provision for Uncollectibles	(4,323)	(1,619)	0	(5,942)
Notes Receivable from Assoc. Co.	7,915,595	6,078,952	1,285,344	15,279,891
Accounts Receivable from Assoc. Co.	317,313	243,687	51,526	612,526
Fuel Stock	0	648,736	1,204,795	1,853,531
Plant Materials & Operating Supplies	160,186	158,016	0	318,202
Other Materials & Supplies	44,040	43,444	0	87,484
Stores Expense Undistributed	(4,267)	(4,209)	0	(8,476)
Gas Stored Underground - Current	0	1,800,563	0	1,800,563
Prepayments	96,637	45,748	0	142,385
Interest & Dividends Receivable	0	0	0	
Misc. Current & Accrued Assets	601	0	0	601
Total Current & Accrued Assets	13,912,243	13,053,072	3,377,123	30,342,438
Unamortized Debt Expense	529,912	406,957	86,048	1,022,917
Extraordinary Property Losses	0	0	0	
Other Regulatory Assets	24,760,761	13,068,845	0	37,829,606
Preliminary Survey & Investigation	0	0	0	
Clearing Accounts	147,718	106,859	5,047	259,624
Temporary Facilities	(128,997)	0	0	(128,997)
Miscellaneous Deferred Debits	802,965	589,577	124,661	1,517,203
Unamortized Loss on Reacquired Debt	1,177,715	904,452	191,239	2,273,406
Accumulated Deferred Income Taxes	1,919,088	2,032,402	3,346,417	7,297,907
Unrecovered Purchased Gas Costs	0	(1,791,176)	0	(1,791,176)
Total Deferred Debits	29,209,161	15,317,916	3,753,412	48,280,490
TOTAL ASSETS AND OTHER DEBITS	232,872,279	210,483,058	24,579,027	467,934,365

The Union Light, Heat and Power Company

Quarterly Supplemental Financial Statements
Balance Sheet - Page 2
As of March 31, 2005
(Unaudited)

	Electric Jurisdictional	Gas Jurisdictional	Non-Jurisdictional	Total Company
Proprietary Capital				
Common Stock Issued	4,548,389	3,493,033	738,573	8,779,995
Premium on Capital Stock	9,759,328	7,494,886	1,584,732	18,838,946
Other Paid-in Capital Stock	2,391,488	1,836,594	388,333	4,616,415
Less Capital Stock Expense	0	0	0	0
Retained Earnings	80,092,482	78,168,864	9,454,352	167,715,698
Accumulated Other Comprehensive Income	(666,103)	(511,548)	(108,163)	(1,285,814)
Total Proprietary Capital	96,125,584	90,481,829	12,057,827	198,665,240
Liabilities				
Bonds	49,213,800	37,794,800	7,991,400	95,000,000
Less Reacquired Bonds	0	0	0	0
Other Long-Term Debt	0	0	0	0
Unamortized Premium on Long-Term Debt	0	0	0	0
Less Unamortized Discount on Long-Term Debt	(333,037)	(255,762)	(54,079)	(642,878)
Less Current Portion of Long-Term Debt	0	0	0	0
Total Long-Term Debt	48,880,763	37,539,038	7,937,321	94,357,122
Obligations Under Capital Leases - Noncurrent	4,510,289	3,463,773	0	7,974,062
Accum. Provision for Injuries & Damages	346,874	2,166,133	0	2,513,007
Accum. Misc. Operating Provisions	3,748,225	2,711,448	128,066	6,587,739
Total Other Noncurrent Liabilities	8,605,388	8,341,354	128,066	17,074,809
Current Portion of Long-Term Debt	0	0	0	0
Notes Payable	0	0	0	0
Accounts Payable	6,514,459	5,002,920	1,057,826	12,575,205
Notes Payable to Assoc. Co.	0	0	0	0
Accounts Payable to Assoc. Co.	10,207,848	7,839,338	1,657,564	19,704,750
Customer Deposits	2,189,265	1,472,325	0	3,661,590
Taxes Accrued	(2,134,999)	3,944,939	1,545,343	3,355,283
Interest Accrued	818,493	628,580	132,908	1,579,981
Tax Collections Payable	252,788	215,566	50,196	518,549
Misc. Current & Accrued Liabilities	871,852	630,694	29,789	1,532,335
Obligations Under Capital Leases - Current	525,921	403,893	0	929,814
Total Current & Accrued Liabilities	19,245,627	20,138,255	4,473,626	43,857,508
Customer Advances for Construction	0	2,637,947	0	2,637,947
Accum. Deferred Investment Tax Credits	1,083,661	1,499,048	907	2,583,616
Other Deferred Credits	6,208,833	6,000,067	0	12,208,900
Other Regulatory Liabilities	20,874,299	11,808,179	0	32,682,478
Accumulated Deferred Income Taxes	31,848,124	32,037,341	(18,720)	63,866,745
Total Deferred Credits	60,014,917	53,982,582	(17,813)	113,979,687
TOTAL PROPRIETARY CAPITAL, LIABILITIES, AND OTHER DEFERRED CREDITS	232,872,279	210,483,058	24,579,027	467,934,365

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

JUL 20 2005

PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN ADJUSTMENT OF GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	)))	CASE NO. 2005-00042

THE UNION LIGHT, HEAT AND POWER COMPANY

REBUTTAL TESTIMONY OF

- WILLIAM DON WATHEN, JR.
- JEFFREY R. BAILEY
- GARY J. HEBBELER
- ROBERT C. LESUER
- ROGER A. MORIN
- PAUL F. OCHSNER
- JAMES A. RIDDLE
- JOHN J. SPANOS
- JOHN P. STEFFEN
- ALEXANDER J. TOROK
- TIMOTHY J. VERHAGEN

July 20, 2005

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN ADJUSTMENT OF GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	) CASE NO. 2005-00042

REBUTTAL TESTIMONY OF

WILLIAM DON WATHEN, JR.

ON BEHALF OF

THE UNION LIGHT, HEAT AND POWER COMPANY

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APPENDIX

I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is William Don Wathen, Jr.

Q. ARE YOU THE SAME WILLIAM DON WATHEN, JR. WHO PREVIOUSLY TESTIFIED IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I am responding to several issues raised by the Attorney General's witnesses in this proceeding. Specifically, I will address a number of issues raised in the Direct Testimony of Mr. Robert J. Henkes. I will also address the proposed adjustments made by Dr. J. Randall Woolridge, Mr. Michael J. Majoros, Jr., and Mr. David H. Brown Kinloch.

Q. PLEASE SUMMARIZE THE ISSUES YOU WILL DISCUSS IN YOUR REBUTTAL TESTIMONY.

A. Mr. Henkes makes a number of adjustments to the revenue requirements projected by ULH&P. He also summarizes the proposed adjustments made by the Attorney General's other witnesses. Schedule RJH-8 incorporates his and the other witnesses' proposed adjustments. In my rebuttal testimony, I will specifically address several issues raised by the Attorney General's witnesses. I will also summarize all the contested issues which I and other ULH&P witnesses will address in rebuttal testimony.

II. SUMMARY OF ADJUSTMENTS TO FORECASTED TEST YEAR

Q. PLEASE SUMMARIZE THE ADJUSTMENTS PROPOSED BY THE ATTORNEY GENERAL TO ULH&P'S FORECASTED TEST PERIOD.

A. Through its witnesses the Attorney General makes a number of adjustments which affect ULH&P's forecasted test year revenue requirement. The following table includes each issue raised by the Attorney General that results in a change in the forecasted test year revenue requirement, with the Company's rebuttal position and the identity of the Company's witness who will offer rebuttal testimony.

TABLE 1 – ULH&P'S REBUTTAL POSITION

AG Issue	ULH&P Position	Rebuttal Witness
Change in State Corporate Income Tax Rate	Accepted	Wathen
Weather Normalization Adjustment	Rejected	Riddle
Firm Transportation Sales Adjustment	Rejected	Riddle
Injuries & Damages Expenses	Accepted	Wathen
Base Payroll Adjustment	Accepted	Wathen
Incentive Compensation Adjustment	Rejected in part	Verhagen
Miscellaneous Expense Adjustment	Accepts adjustments for lobbying expenses and corporate sponsorship but rejects the adjustment for governmental affairs	Wathen
Depreciation Expenses	Rejected	Spanos
Slippage Factor	Rejected but does make a change to reflect the elimination of its proposed Automated Meter Reading project.	Hebbeler
Prepayments	Rejected	Wathen
Property Tax Adjustment	Rejected	Torok
Interest Synchronization Adjustment	Accepted	Wathen
ITC Amortization	Accepted	Wathen
Unbilled Revenue-Fuel ADIT	Accepted	Torok
Unprotected ADIT	Rejected	Torok
Long-Term Debt Rate	Accepted	Wathen
Return on Equity	Rejected	Morin

The Rebuttal Schedules for the forecasted test period affected by these changes are attached to my testimony as Attachment-WDW-R1.

III. STATE CORPORATE INCOME TAX RATE CHANGE

Q. DESCRIBE THE ADJUSTMENT FOR THE CHANGE IN STATE CORPORATE INCOME TAX RATE.

A. On March 18, 2005, Governor Fletcher signed legislation which, among other things, lowered the top state income tax rate on corporations from 8.25% to 7.0% beginning in 2005, and to 6.0% beginning in 2007. This change in income taxes occurred after ULH&P filed its application for a rate increase in this instant proceeding.

In data request KyPSC-DR-02-021, the Staff requested that the Company update its forecasted test period to reflect the impact of the change in state income taxes. As described in Mr. Henkes' Direct Testimony, the resulting increase in the Company's operating income was $24,363.

Q. DO YOU AGREE WITH THIS RECOMMENDED ADJUSTMENT TO THE COMPANY'S REVENUE REQUIREMENT CALCULATION?

A. Yes. The Company agrees to make this change. The impact of the change on the Company's requested revenue increase is reflected in Rebuttal Schedule D-1 on Attachment-WDW-R1.

IV. INJURIES & DAMAGE EXPENSE ADJUSTMENT

Q. MR. HENKES OBJECTS TO YOUR PROPOSED NORMALIZATION ADJUSTMENT FOR INJURIES AND DAMAGES EXPENSE. DO YOU AGREE WITH HIS PROPOSAL TO ELIMINATE THE ADJUSTMENT AND INSTEAD USE THE FORECASTED AMOUNT?

A. Yes. In my direct testimony, I attempted to obviate the need for any debate on this issue by using a methodology used by the Commission in the last rate case for normalizing injuries and damages expense. As Mr. Henkes points out, the forecasted test period does include the Company's estimate of the magnitude of injuries and damages expense expected to be incurred during that time. ULH&P

agrees to this adjustment and it is reflected on Attachment-WDW-R1, Rebuttal Schedule D-1.

V. MISCELLANEOUS EXPENSE ADJUSTMENT

Q. MR. HENKES RECOMMENDS TO ELIMINATE CERTAIN EXPENSES IDENTIFIED AS GOVERNMENTAL AFFAIRS EXPENSES, LOBBYING EXPENSES, AND CORPORATE SPONSORSHIP. DO YOU AGREE?

A. As Mr. Henkes observed in his direct testimony, the Company agrees that lobbying expenses and corporate sponsorship expenses should not be included in the Company's revenue requirement calculation. Consequently, we accept Mr. Henkes' proposal to eliminate these items from our rate request.

We object, however, to Mr. Henkes's proposal to eliminate expenses related to government affairs. Mr. Henkes incorrectly reasons that these costs "have nothing to do with the provision of safe, adequate and reliable gas service." (Henkes, page 40, lines 1-2). Yet no utility could safely operate and maintain its infrastructure without interacting with local and state governmental agencies. Consequently, we believe that the expenses related to governmental affairs are legitimate and recoverable costs of operating and maintaining a gas distribution system and should be included in ULH&P's revenue requirement.

VI. BASE PAYROLL EXPENSE ADJUSTMENT

Q. MR. HENKES PROPOSED AN ADJUSTMENT FOR BASE PAYROLL EXPENSES REFLECTED IN THE TEST YEAR. DO YOU AGREE WITH HIS ADJUSTMENT?

A. Yes. The Company accepts this adjustment and it is reflected in our updated revenue requirement calculation as shown on Attachment-WDW-R1, Rebuttal Schedule D1.

VII. RATE BASE ADJUSTMENTS

Q. PLEASE DESCRIBE THE RATE BASE AND CAPITALIZATION ADJUSTMENTS PROPOSED BY THE COMPANY IN REBUTTAL?

A. As explained in the rebuttal testimony of the Company's witness Gary J. Hebbeler, Mr. Henkes' proposal to apply a slippage factor to projected capital expenditures is not appropriate. However, as Mr. Hebbeler explains, the Company has modified its capital expenditures proposed for the forecast period to reflect a change in implementing its Automated Meter Reading ("AMR") program. The AMR program (identified as the "AMRGAS" project in Schedule B-4.1 from the original filing) will not begin until at least after the forecast test period. Therefore, it is appropriate to remove this item from rate base.

None of the dollars for this project will be included in plant-in-service before the end of the forecasted test period and, consequently, this change will only affect construction work in progress ("CWIP"). The project was expected to begin January 2006 and end in June 2009. Capital expenditures for 2006 would have been $158,490 per month for 2006 beginning in January. The resulting thirteen-month average of CWIP associated with this project for the forecasted test period is $548,619 (See Rebuttal Schedule WPB-4.1a).

Removing the thirteen-month average CWIP balance from the rate base affects the rate base directly. This impacts: (1) the rate base ratio and, consequently, the capitalization allocated to gas; and (2) the AFUDC offset amount which is a function of CWIP. These impacts are included in Attachment-WDW-R1, Rebuttal Schedules B-4.1, WPB-4.1a, WPA-1d, and D-1.

VIII. CASH WORKING CAPITAL

Q. DOES MR. HENKES PROPOSE ANY CHANGES TO THE COMPANY'S CASH WORKING CAPITAL?

A. Only to the extent that he proposes changes to the Company's forecasted test year operating and maintenance expenses ("O&M"). The Commission has historically accepted the 1/8th of O&M method for calculating cash working capital and this method is accepted by Mr. Henkes. Since the formula method of calculating cash working capital is a function of O&M expenses, any change in O&M expenses will produce a change in the resulting cash working capital. Mr. Henkes' proposed adjustments to the Company's forecasted test year O&M expenses result in a concomitant change in the cash working capital requirement.

Similarly, my proposed changes to the forecasted test year O&M expenses will also result in a slightly different calculated cash working capital requirement. This calculation is shown in Attachement-WDW-R1, Rebuttal Schedules B-5.1 and WPB-5.1a.

IX. PREPAYMENTS

Q. MR. HENKES REMOVES FROM RATE BASE $105,675 RELATED TO THE PSC ASSESSMENT, WHICH THE COMPANY IS ASSESSED ANNUALLY. WHAT IS THE BASIS FOR HIS PROPOSAL TO EXCLUDE THIS AMOUNT?

A. Without addressing the merits of the Company's argument for including the assessment in rate base, Mr. Henkes states that per Commission policy PSC assessment balances are not considered to be prepayments.

Q. HOW DO YOU RESPOND?

A. I still believe that the prepayment of PSC assessments should be included in rate base. In ULH&P's last gas rate case, the Commission directed the Company to "include in its next rate case a narrative explanation of why the PSC Assessment should not be recorded as an accrued liability rather than a prepayment." (See page 9 of Commission's Order in Case No. 2001-00092). Clearly, the Commission left the issue open for debate in this case and Mr. Henkes offered no independent testimony as to why it should be excluded.

In my Direct Testimony and in response to various data requests, the Company stated that this annual July expenditure is a prepayment of costs it will incur in the subsequent year. The payment provides for the service the Company receives from the Commission for the twelve months following payment of the invoice. In order for the Company to "match" the expense of those services with the receipt of the services, it must account for that payment as a prepayment and apportion it over the periods during which it receives the services

X. ACCUMULATED DEFERRED INCOME TAXES

Q. PLEASE SUMMARIZE THE ADJUSTMENTS MR. HENKES MAKES TO ULH&P'S RATE BASE FOR ACCUMULATED DEFERRED INCOME TAXES.

A. Mr. Henkes makes adjustments to accumulated deferred income taxes ("ADIT") for the impact of the change in state corporate income tax rates and for the impact of

ADIT on unbilled gas revenue. Because of the change in state corporate income tax rates, the Company's existing and ongoing ADIT will change as well. Based on information provided by the Company, Mr. Henkes modified the Company's rate base to reflect the change in ADIT.

Mr. Henkes' other ADIT adjustment to rate base imputed a level of ADIT associated with unbilled gas revenue and to amortize unprotected excess ADIT over a five-year period.

Q. DOES ULH&P AGREE WITH MR. HENKES' ADJUSTMENTS?

A. As discussed in my rebuttal testimony, we accept Mr. Henkes' adjustments for the state income tax rate change. ULH&P witness Alexander J. Torok explains in his rebuttal testimony that we also accept Mr. Henkes' adjustment related to ADIT for unbilled revenue; however, Mr. Torok rejects the adjustment for unprotected ADIT.

Q. HAVE YOU INCLUDED THESE ADJUSTMENTS IN THE REBUTTAL SCHEDULES?

A. Yes. Attachment-WDW-R1 reflects the changes to ADIT for the state tax rate change and for the elimination of ADIT for unbilled revenue. Mr. Henkes' proposal to accelerate the amortization of unprotected ADIT was not included and, as Mr. Torok points out in his testimony, to do so would actually be an increase in revenue requirements rather than a decrease as suggested by Mr. Henkes.

Q. ARE THERE ANY OTHER ISSUES THAT CAME TO LIGHT AFTER REVIEWING MR. HENKES' TESTIMONY ON ADIT?

A. Yes. It was discovered that, in the original filing in this case, we neglected to eliminate from rate base ADIT associated with purchased gas costs. Per the Commission's Order in the last case, Case No. 2001-00092, ULH&P should have eliminated ADIT associated with purchased gas costs from rate base. The Order also provided that this adjustment was not to be made for the purpose of calculating the rate base ratio. Because rates have typically been set based on allocated capitalization rather than rate base, and because the elimination of these ADIT does not affect the basis for the allocation of capitalization, the impact of making this change is nil. Nevertheless, the change is shown on Schedule B-6.

XI. <u>INTEREST SYNCHRONIZATION</u>

Q. HOW DO YOU RESPOND TO MR. HENKES' PROPOSAL TO ADJUST INTEREST SYNCHRONIZATION?

A. As Mr. Henkes explains in his Direct Testimony, interest synchronization is a "flow-through" calculation. Changes in the debt rate used or the capitalization (or rate base in some jurisdictions) to which it is applied will change the interest synchronization adjustment.

Mr. Henkes adjusts the Company's interest synchronization calculation due to an error that ULH&P made in its initial filing. As described in the Company's response to AG-DR-01-183, there was an error in the forecasted "book" interest that was included in Schedule E-1. In addition, as discussed below, the Company accepts the change in long-term debt rate proposed by Dr. Woolridge. The combined impact of all adjustments to the Company's capitalization, correcting the amount of book interest included in the forecasted test year as a result of the error described above, and reflecting the lower cost of long-term debt as described by Dr. Woolridge results in a decrease in income taxes of $199,192 and reduction of $334,035 in forecasted test period revenue requirements, as shown on Rebuttal Schedules D-1 and D-21.8 of Attachment-WDW-R1.

XII. INCENTIVE COMPENSATION

Q. DO YOU HAVE ANY COMMENTS REGARDING MR. HENKES' PROPOSAL TO REMOVE 100% OF INCENTIVE COMPENSATION?

A. Yes. Mr. Henkes proposed to eliminate all incentive compensation expenses. As ULH&P witness Timothy J. Verhagen discusses in his rebuttal testimony, ULH&P now proposes to modify its revenue requirement to address Mr. Henkes proposal. The sharing mechanism proposed by Mr. Verhagen will result in a level of expense for incentive compensation that is lower than originally proposed in the Company's forecasted test period. For all the reasons outlined in Mr. Verhagen's rebuttal testimony, the Company believes that Mr. Henkes' adjustment to incentive compensation expenses is too large. Consequently, consistent with Mr. Verhagen's rebuttal testimony, ULH&P proposes to reduce its forecasted test period revenue requirement by $175,339. Attachment-WDW-R1, Rebuttal Schedules D-2.26 and WPD-2.26a, show the calculation of the incentive compensation expense based on the sharing percentages proposed by Mr. Verhagen for each of the Company's incentive plans.

XIII. LONG-TERM DEBT RATE

Q. PLEASE DISCUSS THE CHANGES TO THE COMPANY'S LONG-TERM DEBT RATE PROPOSED BY DR. WOOLRIDGE.

A. Dr. Woolridge and Mr. Henkes note that, in response to KyPSC-DR-03-009 and KyPSC-03-016, the Company modified its estimated cost of long-term debt associated with the asset transfer from CG&E. Substituting the updated cost of long-term debt into Schedule J-3, from the original filing's forecast test period, the resulting overall cost of long-term debt becomes 5.926%, as demonstrated by Dr. Woolridge in his response to ULH&P-DR-01-057.

The schedules included in Attachment-WDW-R1 reflect this change. Specifically, the overall weighted-average cost of capital, shown on Rebuttal Schedule A-1 and J-1, reflects this change. Additionally, as noted above, the interest synchronization calculation is impacted and included in the Attachment-WDW-R1, Rebuttal Schedule D-2.18.

XIV. ITC AMORTIZATION

Q. MR. HENKES ALSO STATES THAT ULH&P FAILED TO INCLUDE ITC AMORTIZATION IN ITS FORECASTED TEST PERIOD REVENUE REQUIREMENTS.

A. I agree. This error is remedied in the rebuttal schedules attached. See Attachment-WDW-R1, Rebuttal Schedule D-1.

XV. CONCLUSION

Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?

A. Yes.

VERIFICATION

State of Ohio)
) **SS:**
County of Hamilton)

The undersigned, William Don Wathen, Jr., being duly sworn, deposes and says that he is the Manager, Revenue Requirements for Cinergy Services, Inc. ("Cinergy Services") that he has personal knowledge of the matters set forth in the foregoing testimony, and that the answers contained therein are true and correct to the best of his information, knowledge and belief.

William Don Wathen, Jr., Affiant

Subscribed and sworn to before me by William Don Wathen, Jr., on this 13TH day of July, 2005.

NOTARY PUBLIC

My Commission Expires:

JOHN J. FINNIGAN, JR. Attorney at Law
NOTARY PUBLIC, STATE OF OHIO
My commission has no expiration date. Section 147.03 O.R.C.

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
OVERALL FINANCIAL SUMMARY
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: "X" BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: SEE BELOW

REBUTTAL SCHEDULE A
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	DESCRIPTION	SUPPORTING SCHEDULE REFERENCE	JURISDICTIONAL REVENUE REQUIREMENTS FORECAST PERIOD *AS FILED*	FORECAST PERIOD *REBUTTAL*
1	Capitalization Allocated to Gas Operations	WPA-1a, 1c	165,719,193	161,960,977
2	Operating Income	C-2	6,312,696	6,748,367
3	Earned Rate of Return (Line 2 / Line 1)		3.81%	4.17%
4	Rate of Return	J-1	8.787%	8.647%
5	Required Operating Income (Line 1 x Line 4)		14,561,745	14,004,766
6	Operating Income Deficiency (Line 5 - Line 2)		8,249,049	7,256,399
7	Gross Revenue Conversion Factor	H	1.6997957	1.6769492
8	Revenue Deficiency (Line 6 x Line 7)		14,021,698	12,168,612

THE UNION LIGHT, HEAT AND POWER COMPANY
GAS DEPARTMENT
CASE NO. 2005-00042
DATA: BASE PERIOD "X" FORECASTED PERIOD
CALCULATION OF JURISDICTIONAL CAPITALIZATION

REBUTTAL WPA-1c
WITNESS RESPONSIBLE:
W. D. WATHEN

Line No.	Description		(KyPSC-DR-02-021) Total	(KyPSC-DR-02-021) Gas	Rebuttal Position Total	Rebuttal Position Gas
1	Total Forecast Period Capitalization	(1)	648,387,631		648,387,631	
2						
3	Less: Non-jusrisdictional gas plant		4,769,872		8,223,936	
4	Non-jusrisdictional electric plant		0		0	
5	Non-jusrisdictional - Other		8,536,837		8,536,837	
6						
7	Jurisdictional Capitalization		635,080,922		631,626,858	
8						
9	Gas Jurisdictional Rate Base Allocation %	(2)	25.889%	164,416,100	25.423%	160,578,496
10						
11	Plus: Jurisdictional Gas ITC	(3)		1,382,481		1,382,481
12						
13	Total Allocated Capitalization			165,798,581		161,960,977
14						
15						To Sch. A
16						

Notes:
(1) Schedule J-1, page 2.
(2) Allocation percentage from WPA-1d.
(3) Schedule B-6, page 2.

THE UNION LIGHT, HEAT AND POWER COMPANY
GAS DEPARTMENT
CASE NO. 2005-00042
TO DETERMINE THE FORECAST PERIOD RATIO OF KENTUCKY JURISDICTIONAL GAS OPERATIONS
TO JURISDICTIONAL TOTAL COMPANY OPERATIONS
DATA: BASE PERIOD "X" FORECASTED PERIOD

REBUTTAL WPA-1d
WITNESS RESPONSIBLE:
W. D. WATHEN

Line No.	Description	Schedule Reference	Total Company	Gas Excl. of Facil Dev. to Other Than ULH&P Custs.	Gas Non-Juris.	Elec Excl. of Facil Dev. to Other Than ULH&P Custs.	Electric Non-Juris.	Non-Jurisdictional
1	Total Utility Plant in Service (Accts 101 & 106)	Sch B-2	1,385,081,000	277,747,000	11,103,000	1,077,104,000	0	19,127,000
2								
3	Additions:							
4	Construction Work in Progress (Account 107)	Sch B-4	26,143,000	3,571,000	0	22,572,000	0	0
5								
6	Fuel Inventory		5,710,000	0	0	5,710,000	0	0
7								
8	Materials & Supplies -							
9	Propane Inventory (Account 151) (A)	Sch B-5	1,934,987	677,245	1,257,742	0	0	0
10	Other Material and Supplies (Accts. 154 & 163) (A)	Sch B-5	9,844,000	232,273	0	9,611,727	0	0
11	Total Materials & Supplies		11,778,987	909,518	1,257,742	9,611,727	0	0
12								
13	Gas Stored Underground (Account 164) (A)	Sch B-5	5,462,513	5,462,513	0	0	0	0
14								
15	Prepayments (Account 165) (A)	Sch B-5.1	317,628	105,675	0	211,953	0	0
16								
17	Cash Working Capital Allowance	Sch B-5.1	12,219,879	2,336,716	0	9,883,163	0	0
18								
19	Other Rate Base Items	Sch B-6	0	0	0	0	0	0
20	Total Additions		61,632,007	12,385,422	1,257,742	47,988,843	0	0
21								
22	Deductions:							
23	Reserve for Accumulated Depreciation (Acct 108)	Sch B-3	627,304,000	87,230,000	6,987,000	526,365,000	0	6,722,000
24								
25	Accum. Deferred Income Taxes (Accts 190, 282, & 283)	Sch B-6	150,220,000	36,359,585	(2,850,922)	118,258,991	0	(1,547,654)
26								
27	Customer Advances for Construction (Account 252)	Sch B-6	2,721,042	2,721,042	0	0	0	0
28								
29	Investment Tax Credits	Sch B-6	5,450,327	33,782	728	0	0	5,415,817
30	Total Deductions		785,695,369	126,344,409	4,136,806	644,623,991	0	10,590,163
31								
32	Net Original Cost Rate Base		661,017,638	163,788,013	8,223,936	480,468,852	0	8,536,837
33								
34	Jurisdictional Rate Base Ratio		100.000%	24.778%	1.244%	72.686%	0.000%	1.291%
35								
36	Jurisdictional Rate Base Ratio - Excl. Non-Jurisdictional		100.000%	25.423%		74.577%		

↑ To WPA-1c

Notes:
(A) Based on thirteen month average.

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
JURISDICTIONAL RATE BASE SUMMARY
AS OF SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: SEE BELOW

REBUTTAL SCHEDULE B-1
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	RATE BASE COMPONENT	SUPPORTING SCHEDULE REFERENCE	13 MONTH AVG. FORECAST PERIOD *AS FILED*	REBUTTAL ADJUSTMENTS		13 MONTH AVG. FORECAST PERIOD *REBUTTAL*
1	Adjusted Jurisdictional Plant in Service	B-2	$277,747,000			$277,747,000
2	Accumulated Depreciation and Amortization	B-3	(87,230,000)			(87,230,000)
3	Net Plant in Service (Line 1 + Line 2)		190,517,000			$190,517,000
4	Construction Work in Progress	B-4	4,120,000	(549,000)	(1)	3,571,000
5	Cash Working Capital Allowance	B-5	2,384,337	(47,621)	(2)	2,336,716
6	Other Working Capital Allowances	B-5	6,477,706			6,477,706
7	Other Items:					
8	Customers' Advances for Construction	B-6	(2,721,042)			(2,721,042)
9	Investment Tax Credits	B-6	(33,782)			(33,782)
10	Deferred Income Taxes	B-6	(32,905,521)	2,865,755	(3)	(30,039,766)
11	Other Rate Base Adjustments	B-6	0			0
12	Jurisdictional Rate Base (Line 3 through Line 11)		$167,838,698	$2,269,134		$170,107,832

(1) Adjustment to CWIP related AMR projects. See Rebuttal WPB-4.1a
(2) Adjustment resulting from changes in O&M expense. See Rebuttal WPB-5.1a.
(3) Reflects acceptance of Unbilled Revenue elimination proposed by Mr. Henkes in addition to elimination of Unrecovered Purchased Gas Cost. See rebuttal testimony of Mr. Alex J. Torok.

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
CONSTRUCTION WORK IN PROGRESS
THIRTEEN MONTH AVERAGE AS OF SEPTEMBER 30, 2006
($000 Omitted)

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).:

REBUTTAL SCHEDULE B-4
PAGE 1 OF 1
WITNESS RESPONSIBLE:
G. J. HEBBELER

Line No.	Major Property Groupings	Jurisdic-tional %	Amount Subject to AFUDC		Amount Not Subject to AFUDC		Total	
			Gross	Jurisdictional	Gross	Jurisdictional	Gross	Jurisdictional
		%	$	$	$	$	$	$
1	Manufactured Gas Production	100.00%	0	0	0	0	0	0
2	Less: Gas Facilities Devoted to Other Than Kentucky Customers	100.00%	0	0	0	0	0	0
3	Net Manufactured Gas Production	100.00%	0	0	0	0	0	0
4	Distribution	100.00%	3,571	3,571	0	0	3,571	3,571
5	Less: Gas Facilities Devoted to Other Than Kentucky Customers	100.00%	0	0	0	0	0	0
6	Net Distribution	100.00%	3,571	3,571	0	0	3,571	3,571
7	General	100.00%	0	0	0	0	0	0
8	Total Common	100.00%	0	0	0	0	0	0
9	38.13% Common Allocated to Gas	100.00%	0	0	0	0	0	0
10	TOTAL GAS INCLUDING COMMON ALLOCATED		3,571	3,571	0	0	3,571	3,571

↑ From WPB-4.1a

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
CONSTRUCTION WORK IN PROGRESS - PERCENT COMPLETE (a)
AS OF SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).:

REBUTTAL SCHEDULE B-4.1
PAGE 1 OF 1
WITNESS RESPONSIBLE:
G. J. HEBBELER

Line No. (A)	Project No. (B)	Date Construction Work Began (C)	Estimated Project Completion Date (D)	Percent of Elapsed Time (E)	Original Budget Estimate (F)	Most Recent Budget Estimate (G)	Total Project Expenditures (H)	Percent of Total Expenditures (I)= (H) / (G)
					$	$	$	
1	G7RISR06 (b)	May-06	December-06	63%	1,124,851	1,124,851	1,012,364	90%
2	KYCIBS06 (b)	Jan-06	December-06	75%	10,942,173	10,942,173	5,908,624	54%
3	ELIJAHCR	May-06	December-06	63%	421,239	421,239	375,405	89%
4	~~AMRGAS~~	~~Jan-06~~	~~June-09~~	~~21%~~	~~9,397,500~~	~~9,397,500~~	~~1,426,407~~	~~15%~~

(a) Based on expenditures including AFUDC.
(b) 2006 activity for a multi-year program.

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
CONSTRUCTION WORK IN PROGRESS - AMR
AMOUNT SUBJECT TO AFUDC
THIRTEEN MONTH AVERAGE AS OF SEPTEMBER 30, 2006

REBUTTAL WPB-4.1a
WITNESS RESPONSIBLE:
G. J. HEBBELER

Line No.	Month	Amount $
1	September 2005	0
2	October	0
3	November	0
4	December	0
5	January 2006	158,490
6	February	316,980
7	March	475,470
8	April	633,960
9	May	792,450
10	June	950,940
11	July	1,109,430
12	August	1,267,920
13	September	1,426,410
14	Total	7,132,050
15		
16	13 Month Average	548,619
17		
18		
19	CWIP Subject to AFUDC - As Filed	4,120,000
20	CWIP - AMR Projects	548,619
21	CWIP Subject to AFUDC - Rebuttal	3,571,381

↑ To SCH B-4

Source: Schedule B-4, Project No. AMRGAS.

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
WORKING CAPITAL COMPONENTS
AS OF SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: WPB-5.1a

REBUTTAL SCHEDULE B-5.1
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	DESCRIPTION	13 MONTH AVERAGE FOR PERIOD TOTAL COMPANY	JURISDIC-TIONAL %	JURISDIC-TIONAL AMOUNT
		(1)	(2)	(3)
1	Cash Working Capital:			
2	1/8 Oper. and Maint. Expense	N.C.	Computed	2,336,716
3				
4	Materials and Supplies:			
5	Gas Enricher Liquids	1,934,987	35.000	677,245
6	Other	455,911	Computed	232,273
7	Total	2,390,898		909,518
8				
9	Gas Stored Underground - Current	5,462,513	100.000	5,462,513
10				
11	Prepayments:			
12	KPSC Maintenance Tax	317,629	Computed	105,675
13	Total	317,629		105,675
14				
15	Total Other Working Capital			6,477,706
16				
17	Total Working Capital			8,814,422

N.C. - Not Calculated

THE UNION LIGHT, HEAT AND POWER COMPANY
GAS DEPARTMENT
CASE NO. 2005-00042
CASH WORKING CAPITAL

REBUTTAL WPB-5.1a
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	DESCRIPTION	WORK PAPER REFERENCE	JURISDICTIONAL FORECAST PERIOD AS FILED	JURISDICTIONAL REBUTTAL ADJUSTMENTS	JURISDICTIONAL FORECAST PERIOD REBUTTAL
1	Total Jurisdictional O & M Expense	Sch C-2	110,924,695	(380,966)	110,543,729
2					
3	Less: Annualized Purchased Gas Expense	Sch C-2	91,850,000	0	91,850,000
4					
5	Net Operation & Maintenance Expense		19,074,695	(380,966)	18,693,729
6					
7					
8	Cash Working Capital				
9					
10	1/8 of Net Operation & Maintenance Expense	To Sch B-5.1 <---	2,384,337	(47,621)	2,336,716

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
CERTAIN DEFERRED CREDITS AND ACCUMULATED DEFERRED INCOME TAXES
AS OF SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).:

SCHEDULE B-6
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	ACCOUNT NUMBER	DESCRIPTION	ADJUSTED JURIS. AMOUNT *AS FILED*	ELIMINATE UNBILLED REVENUE FUEL	JURIS. AMOUNT FOR RATE BASE RATIO	ELIMINATE UNRECOVERED PURCHASED GAS COST	ADJUSTED JURIS. AMOUNT *REBUTTAL*
1							
2	252	Customers' Advances for Construction	(2,721,042)				
3							
4	255	Investment Tax Credits: (B)					
5		3% Credit	(33,782)				
6		4% Credit	0				
7		10% Credit	0				
8		Total Investment Tax Credits	(33,782)				
9							
10	190,	Deferred Income Taxes:					
11	282,283	Total Deferred Income Taxes	(32,905,521)	(3,454,064)	(36,359,585)	6,319,819	(30,039,766)
					↑ TO WPA-1d		↑ TO SCH-B1

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
SUMMARY OF UTILITY JURISDICTIONAL ADJUSTMENTS TO
OPERATING INCOME BY MAJOR ACCOUNTS

FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: SEE BELOW

REBUTTAL SCHEDULE C-2
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	MAJOR ACCOUNT OR GROUP CLASSIFICATION	FORECAST PERIOD *AS FILED*	SUM OF ADJUSTMENTS IN REBUTTAL	FORECAST PERIOD *REBUTTAL*
1	**Operating Revenue**			
2	Base	37,673,000	-	37,673,000
3	Gas Cost	91,850,000	-	91,850,000
4	Other Revenue	706,785	-	706,785
5	Total Revenue	130,229,785		130,229,785
6				
7	**Operating Expenses**			
8	Operation and Maint. Expenses			
9	Production Expenses			
10	Liquefied Petroleum Gas	-	-	-
11	Other	53,346	-	53,346
12	Total Production Expense	53,346		53,346
13				
14	Other Gas Supply Expenses			
15	Purchased Gas	91,850,000	-	91,850,000
16	Other	359,575	-	359,575
17	Total Other Gas Supply Expenses	92,209,575		92,209,575
18	Transmission Expense	-	-	-
19	Distribution Expense	5,529,076	-	5,529,076
20	Customer Accounts Expense	3,919,934	-	3,919,934
21	Customer Serv & Info Expense	323,671	-	323,671
22	Sales Expense	79,202	(2,747)	76,455
23	Admin. & General Expense	8,809,891	(378,219)	8,431,672
24	Other	-	-	-
25	Total Oper and Maint Expenses	110,924,695	(380,966)	110,543,729
26				
27	Depreciation Expense	8,840,365	-	8,840,365
28				
29	Taxes Other Than Income Taxes			
30	Other Federal Taxes	604,878	-	604,878
31	State and Other Taxes	2,503,615	(509)	2,503,106
32	Total Taxes Other Than Income Tax	3,108,493	(509)	3,107,984
33				
34	State Income Taxes			
35	Normal and Surtax	(156,410)	20,984	(135,426)
36	Deferred Inc Tax - Net	437,000	(66,477)	370,523
37	Total State Income Tax Expense	280,590	(45,493)	235,097
38				
39	Federal Income Taxes			
40	Normal and Surtax	(610,030)	(17,945)	(627,975)
41	Deferred Inc Tax - Net	1,735,000	25,132	1,760,132
42	Amortization of Investment Tax Credit	-	(69,130)	(69,130)
43	Total Federal Income Tax Expense	1,124,970	(61,943)	1,063,027
44				
45	Total Oper. Expenses and Tax	124,279,113	(488,911)	123,790,202
46				
47	AFUDC Offset	362,024	(53,240)	308,784
48				
49	Net Operating Income	6,312,696	435,671	6,748,367

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
SUMMARY OF UTILITY JURISDICTIONAL ADJUSTMENTS TO
OPERATING INCOME BY MAJOR ACCOUNTS
ADJUSTMENTS TO REFLECT REBUTTAL POSITION
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: SEE BELOW

REBUTTAL SCHEDULE D-1
PAGE 1 OF 2
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	ELEMENT of OPERATING INCOME	SUM OF ALL REBUTTAL ADJUSTMENTS	CHANGE IN STATE INCOME TAX RATE	ELIMINATE INJURIES & DAMAGES ADJ	ELIMINATE LOBBYING EXPENSES	ELIMINATE CORP. SPONS. EXPENSES	CORRECT INTEREST SYNCH ADJ.
	REFERENCE		KyPSC-02-021	D-2.15	KyPSC-03-057	KyPSC-03-057	D-2.18
1	**Operating Revenue**						
2	Base	-					
3	Gas Cost	-					
4	Other Revenue	-					
5	Total Revenue	-	-	-	-	-	-
6							
7	**Operating Expenses**						
8	Operation and Maint. Expenses						
9	Production Expenses						
10	Liquefied Petroleum Gas	-					
11	Other	-					
12	Total Production Expense	-	-	-	-	-	-
13							
14	Other Gas Supply Expenses						
15	Purchased Gas	-					
16	Other	-					
17	Total Other Gas Supply Expenses	-	-	-	-	-	-
18	Transmission Expense	-					
19	Distribution Expense	-					
20	Customer Accounts Expense	-					
21	Customer Serv & Info Expense	-					
22	Sales Expense	(2,747)			(2,747)		
	Admin. & General Expense	(378,219)		(143,957)	(8,903)	(40,120)	
	Other	-					
	Total Oper and Maint Expenses	(380,966)	-	(143,957)	(11,650)	(40,120)	-
26							
27	Depreciation Expense	-		-	-	-	-
28							
29	Taxes Other Than Income Taxes						
30	Other Federal Taxes	-					
31	State and Other Taxes	(509)			(509)		
32	Total Taxes Other Than Income Tax	(509)	-	-	(509)	-	-
33							
34	State Income Taxes						
35	Normal and Surtax	20,984	23,474	10,077	851	2,808	(29,193)
36	Deferred Inc Tax - Net	(66,477)	(66,477)				
37	Total State Income Tax Expense	(45,493)	(43,003)	10,077	851	2,808	(29,193)
38							
39	Federal Income Taxes						
40	Normal and Surtax	(17,945)	(6,368)	46,858	3,958	13,059	(135,747)
41	Deferred Inc Tax - Net	25,132	25,132				
42	Amortization of Investment Tax Credit	(69,130)					
43	Total Federal Income Tax Expense	(61,943)	18,764	46,858	3,958	13,059	(135,747)
44							
45	Total Oper. Expenses and Tax	(488,911)	(24,239)	(87,022)	(7,350)	(24,253)	(164,940)
46							
47	AFUDC Offset	(53,240)	124	-	-	-	-
48							
49	Net Operating Income	435,671	24,363	87,022	7,350	24,253	164,940

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
SUMMARY OF UTILITY JURISDICTIONAL ADJUSTMENTS TO
OPERATING INCOME BY MAJOR ACCOUNTS
ADJUSTMENTS TO REFLECT REBUTTAL POSITION
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: SEE BELOW

REBUTTAL SCHEDULE D-1
PAGE 2 OF 2
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	ELEMENT of OPERATING INCOME	CORRECT ITC AMORTIZATION IN TAX CALC	BASE PAYROLL ADJUSTMENT	INCENTIVE COMPENSATION ADJUSTMENT	CHANGE IN AFUDC OFFSET		
	REFERENCE	D-2.27	AG-02-022	D-2.26	D-2.20		
1	**Operating Revenue**						
2	Base						
3	Gas Cost						
4	Other Revenue						
5	Total Revenue	-		-	-	-	-
6							
7	**Operating Expenses**						
8	Operation and Maint. Expenses						
9	Production Expenses						
10	Liquefied Petroleum Gas						
11	Other						
12	Total Production Expense	-		-	-	-	-
13							
14	Other Gas Supply Expenses						
15	Purchased Gas						
16	Other						
17	Total Other Gas Supply Expenses	-		-	-	-	-
18	Transmission Expense						
19	Distribution Expense						
20	Customer Accounts Expense						
21	Customer Serv & Info Expense						
22	Sales Expense						
	Admin. & General Expense		(9,900)	(175,339)			
	Other						
	Total Oper and Maint Expenses	-	(9,900)	(175,339)	-	-	-
26							
27	Depreciation Expense						
28							
29	Taxes Other Than Income Taxes						
30	Other Federal Taxes						
31	State and Other Taxes						
32	Total Taxes Other Than Income Tax	-	-	-	-	-	-
33							
34	State Income Taxes						
35	Normal and Surtax		693	12,274			
36	Deferred Inc Tax - Net						
37	Total State Income Tax Expense	-	693	12,274	-	-	-
38							
39	Federal Income Taxes						
40	Normal and Surtax		3,222	57,073			
41	Deferred Inc Tax - Net						
42	Amortization of Investment Tax Credit	(69,130)					
43	Total Federal Income Tax Expense	(69,130)	3,222	57,073	-	-	-
44							
45	Total Oper. Expenses and Tax	(69,130)	(5,985)	(105,992)	-	-	-
46							
47	AFUDC Offset	-			(53,364)		
48							
49	Net Operating Income	69,130	5,985	105,992	(53,364)	-	-

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
INTEREST EXPENSE DEDUCTIBLE
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: WPD-2.18a, WPD-2.18b

REBUTTAL SCHEDULE D-2.18
PAGE 1 OF 2
WITNESS RESPONSIBLE:
W. D. WATHEN

PURPOSE AND DESCRIPTION	KyPSC-DR-2-021 AMOUNT	REBUTTAL AMOUNT	VARIANCE
PURPOSE AND DESCRIPTION: To reflect federal income taxes at 35% due to interest deductible for tax purposes being based on allocated interest costs based on Proforma interest charges as contained on Schedule J-1.			
Total	$ 67,645	$ (68,102)	$ (135,747)
Jurisdictional allocation percentage (A)	100.000%	100.000%	100.000%
Jurisdictional amount	$ 67,645	$ (68,102)	$ (135,747)
			To Sch D-1

(A) Allocation Code - DALL

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
INTEREST EXPENSE DEDUCTIBLE
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: "X" BASE PERIOD FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: WPD-2.18a, WPD-2.18b

REBUTTAL SCHEDULE D-2.18
PAGE 2 OF 2
WITNESS RESPONSIBLE:
W. D. WATHEN

PURPOSE AND DESCRIPTION	KyPSC-DR-2-021 AMOUNT	REBUTTAL AMOUNT	VARIANCE
PURPOSE AND DESCRIPTION: To reflect state income taxes at 7.00% due to interest deductible for tax purposes being based on allocated interest costs based on Proforma interest charges as contained on Schedule J-1.			
Total	$ 14,547	$ (14,646)	$ (29,193)
Jurisdictional allocation percentage (A)	100.000%	100.000%	100.000%
Jurisdictional amount	$ 14,547	$ (14,646)	$ (29,193)
			↑ To Sch D-1

(A) Allocation Code - DALL

THE UNION LIGHT, HEAT AND POWER COMPANY
GAS DEPARTMENT
CASE NO. 2005-00042
DATA: BASE PERIOD "X" FORECASTED PERIOD
FEDERAL & STATE INCOME TAX ON INTEREST DEDUCTION

REBUTTAL WPD-2.18a
WITNESS RESPONSIBLE:
W. D. WATHEN

Line No	Description		Schedule Reference	Long-Term Debt	Short-Term Debt
1	Capital Structure		J-1, page 2	38.164%	7.382%
2					
3	Debt Portion of $161,960,977 Gas Capitalization		WPA-1c	61,810,787	11,955,959
4					
5	Less: Debt Portion of $3,571,000 CWIP Subject to AFUDC		B-4	1,362,836	263,611
6					
7	Debt Component less Applicable Portion				
8	of Gas CWIP Subject to AFUDC			60,447,951	11,692,348
9					
10	Annual Cost Rate		J-1, page 2	5.9260%	3.8750%
11					
12	Annualized Gas Interest Expense				
13	for each Debt Component			3,582,146	453,078
14					
15	Total Annualized Gas Interest Expense				4,035,224
16					
17	Test Period Gas Interest Deduction		WPD-2.18b		3,826,000
18					
19	Increase in Gas Interest Expense				209,224
20					
21	State Income Tax Effect @ 7.00% (A)	(Line 19 * 7.00%)	To Sch D-2.18, Pg. 2 <--		(14,646)
22					
23	Federal Income Tax Effect @ 35.00% (A)	((Line 19 - Line 21) * 35%)	To Sch D-2.18, Pg. 1 <--		(68,102)

(A) Source: Schedule H

THE UNION LIGHT, HEAT AND POWER COMPANY
GAS DEPARTMENT
CASE NO. 2005-00042
DATA: BASE PERIOD "X" FORECASTED PERIOD
GAS BOOK INTEREST EXPENSE

REBUTTAL WPD-2.18b
WITNESS RESPONSIBLE:
W. D. WATHEN

Line No.	Description	Total	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06
1	Interest on Long-Term Debt	3,424,000	285,333	285,333	285,337	285,333	285,333	285,333	285,333	285,333	285,333	285,333	285,333	285,333
2	Short-Term Interest	144,000	9,000	11,000	13,000	16,000	10,000	5,000	11,000	17,000	14,000	14,000	13,000	11,000
3	Other Interest	162,000	14,000	14,000	14,000	14,000	14,000	14,000	13,000	13,000	13,000	13,000	13,000	13,000
4	Amortization of Debt Items	96,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000
5	Total Interest Expense	3,826,000	316,333	318,333	320,337	323,333	317,333	312,333	317,333	323,333	320,333	320,333	319,333	317,333

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
ANNUALIZATION OF AFUDC ASSOCIATED WITH CWIP - AMR
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: WPD-2.20a

REBUTTAL SCHEDULE D-2.20
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

PURPOSE AND DESCRIPTION				AMOUNT
PURPOSE AND DESCRIPTION: To reflect the change in annualization of AFUDC related to AMR CWIP subject to AFUDC for the 13-month average as of September 30, 2006. Per Commission precedent this adjustment is made to after tax operating income.				
Total			$	(53,364)
Jurisdictional allocation percentage (A)				100.000%
Jurisdictional amount	To Sch D-1 Summary	←	$	(53,364)

(A) Allocation Code - DALL

THE UNION LIGHT, HEAT AND POWER COMPANY
GAS DEPARTMENT
CASE NO. 2005-00042
ANNUALIZATION OF AFUDC FOR AMR PROJECTS
CONSTRUCTION WORK IN PROGRESS

REBUTTAL WPD-2.20a
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	DESCRIPTION	SCHEDULE/ WORK PAPER REFERENCE	KyPSC-DR-2-021 AMOUNT ($)	REBUTTAL AMOUNT ($)	VARIANCE ($)
1	Jurisdictional CWIP subject to AFUDC	Sch B-4	4,120,000	3,571,000	
2					
3	Rate of return at September 30, 2006	Sch J-1	8.790%	8.647%	
4					
5	Annualized AFUDC	To Sch D-2.20 <--	362,148	308,784	(53,364)

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
INCENTIVE COMPENSATION
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: WPD-2.26

REBUTTAL SCHEDULE D-2.26
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

PURPOSE AND DESCRIPTION				AMOUNT
PURPOSE AND DESCRIPTION: To adjust incentive compensation to reflect a sharing of costs between ratepayers and shareholders.				
Total			$	(175,339)
Jurisdictional allocation percentage (A)				100.000%
Jurisdictional amount	To Sch D-1 Summary	←	$	(175,339)

(A) Allocation Code - DALL

THE UNION LIGHT, HEAT AND POWER COMPANY
GAS DEPARTMENT
CASE NO. 2005-00042
INCENTIVE COMPENSATION

REBUTTAL WPD-2.26a
WITNESS RESPONSIBLE:
W. D. WATHEN

Line No.	Plan Description	Forecasted Period Expense [1]	Percent of Plan Dollars [2]		Amount of Plan Dollars		Proposed Adjustment
			Ratepayer	Shareholder	Ratepayer	Shareholder	
1	AIP	451,116	75%	25%	338,337	112,779	(112,779)
2							
3	UEIP	80,460	100%	0%	80,460	0	0
4							
5	LTIP	125,121	50%	50%	62,561	62,560	(62,560)
6							
7	Total	656,697			481,358	175,339	(175,339)

[1] Source: AG-DR-01-204.
[2] See Rebuttal Testimony of Mr. Timothy J. Verhagen, page 3.

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
ITC AMORTIZATION
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).: AG-02-011

REBUTTAL SCHEDULE D-2.27
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

PURPOSE AND DESCRIPTION				AMOUNT
PURPOSE AND DESCRIPTION: To reflect the inclusion of ITC amortization that was inadvertently left out of the forecasted period.				
Total			$	(69,130)
Jurisdictional allocation percentage (A)				100.000%
Jurisdictional amount	To Sch D-1 Summary	←	$	(69,130)

(A) Allocation Code - DALL

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
COMPUTATION OF GROSS REVENUE CONVERSION FACTOR
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2006

DATA: "X" BASE PERIOD "X" FORECASTED PERIOD
TYPE OF FILING: ORIGINAL "X" UPDATED REVISED
WORK PAPER REFERENCE NO(S).:

REBUTTAL SCHEDULE H
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. D. WATHEN

LINE NO.	DESCRIPTION	PERCENT OF INCREMENTAL GROSS REVENUE *AS FILED*	PERCENT OF INCREMENTAL GROSS REVENUE *REBUTTAL*
1	Operating Revenues	100.0000%	100.0000%
2			
3			
4	Less: Uncollectible Accounts Expenses		
5	KPSC Maintenance Tax		
6	Subtotal	1.3530%	1.3530%
7			
8	Income before Income Tax (Line 1 - Line 7)	98.6470%	98.6470%
9			
10	Income Taxes - State of Kentucky		
11	(Tax Rate * 98.647%)	8.1384%	6.9053%
12			
13	Income before Federal Income Tax (Line 9 - Line 12)	90.5086%	91.7417%
14			
15	Federal Income Tax (35% x Line 13)	31.6780%	32.1096%
16			
17	Operating Income Percentage (Line 14 - Line 16)	58.8306%	59.6321%
18			
19	Gross Revenue Conversion Factor (100% / Line 17)	1.6997957	1.6769492

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
COST OF CAPITAL SUMMARY
THIRTEEN MONTH AVERAGE BALANCE

DATA: BASE PERIOD "X" FORECASTED PERIOD
DATE OF CAPITAL STRUCTURE: END OF FORECAST PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).:

REBUTTAL SCHEDULE J-1
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. L. AUMILLER

LINE NO.	CLASS OF CAPITAL	REFERENCE	13 MONTH AVG BALANCE ($)	% OF TOTAL	% COST	WEIGHTED COST %
1	Common Equity		353,072,000	54.454%	11.200%	6.099%
2	Long-Term Debt	J-3	247,448,802	38.164%	5.926%	2.262%
3	Short-Term Debt	J-2	47,866,829	7.382%	3.875%	0.286%
4						
5	Total Capital		648,387,631	100.000%		8.647%
6						
7						
8	Accumulated Deferred Investment Tax Credit					
9	Account 255		7,722,452			
10						
11						
12	Investment Tax Credit Included in Total Capital					
13						
14	Common Equity		357,277,184	54.454%	11.200%	6.099%
15	Long-Term Debt		250,395,999	38.164%	5.926%	2.262%
16	Short-Term Debt		48,436,900	7.382%	3.875%	0.286%
17						
18	Total Capital Including Investment Tax Credit		656,110,083	100.000%		8.647%

THE UNION LIGHT, HEAT AND POWER COMPANY
CASE NO. 2005-00042
EMBEDDED COST OF LONG-TERM DEBT
THIRTEEN MONTH AVERAGE BALANCE
(CORPORATE)

DATA: BASE PERIOD "X" FORECASTED PERIOD
DATE OF CAPITAL STRUCTURE: END OF FORECAST PERIOD
TYPE OF FILING: "X" REBUTTAL
WORK PAPER REFERENCE NO(S).:

SCHEDULE J-3
PAGE 1 OF 1
WITNESS RESPONSIBLE:
W. L. AUMILLER

LINE NO.	DEBT ISSUE TYPE, COUPON RATE		DATE ISSUED (DAY/MO/YR) (A)	MATURITY DATE (DAY/MO/YR) (B)	PRINCIPAL AMOUNT (C)	FACE AMOUNT OUTSTANDING (D)	UNAMORT. (DISCOUNT) OR PREMIUM (E)	UNAMORT. DEBT EXPENSE (F)	UNAMORT. LOSS ON REACQUIRED DEBT (G)	CARRYING VALUE (H=D+E-F-G)	ANNUAL INTEREST COST(*) (I)
1	A/C 227: Capital Lease - Non Current										
2											
3	Capital Lease - Meters (1999 Acquisitions)	6.708%	20-Dec-99	20-Sep-08	909,680	346,492	-	-	-	346,492	23,243
4	Capital Lease - Meters (2000 Acquisitions)	6.089%	25-Dec-00	25-Sep-09	3,832,158	1,859,106	-	-	-	1,859,106	113,201
5	Capital Lease - Meters (2001 Acquisitions)	5.997%	20-Dec-01	20-Sep-10	1,411,952	812,282	-	-	-	812,282	48,713
6	Capital Lease - Meters (2002 Acquisitions)	4.481%	20-Dec-02	20-Sep-11	1,074,181	696,726	-	-	-	696,726	31,220
7	Capital Lease - Meters (2003 Acquisitions)	4.740%	20-Dec-03	20-Sep-12	2,068,445	1,532,230	-	-	-	1,532,230	72,628
8	Capital Lease - Meters (2004 Acquisitions)	5.010%	20-Dec-04	20-Sep-13	2,017,084	1,667,420	-	-	-	1,667,420	83,538
9											
10	A/C 221: Bonds										
11											
12	A/C 189: Unamortized Loss on R/A Debt										
13											
14	10.25% due 6/1/2020								556,410	(556,410)	39,276
15	9.7% due 7/1/2019								887,697	(887,697)	66,996
16	9.5% due 12/1/2008								100,512	(100,512)	37,692
17	10.25% due 11/15/2020								547,911	(547,911)	37,464
18											
19	A/C 223: Advance from Associated Companies										
20											
21	Inter-Company Long Term Notes 5.50% Series		01-Apr-05	01-Jan-24	48,000,000	48,000,000	(272,925)	409,826	-	47,317,249	2,678,464
22	Inter-Company Long Term Notes 6.50% Series		01-Apr-05	15-Nov-22	12,720,663	12,720,663	(72,167)	-	-	12,648,496	831,184
23	Inter-Company Long Term Notes 2.46% Series		01-Apr-05	01-Aug-13	16,000,000	16,000,000	(39,916)	84,327	-	15,875,757	409,541
24	Inter-Company Long Term Notes 5.50% Series		01-Apr-05	01-Apr-40	73,300,000	73,300,000			-	73,300,000	4,031,500
25											
26	A/C 224: Other Long Term Debt										
27											
28	Debentures 7.65% Series		15-Jul-95	15-Jul-25	15,000,000	15,000,000	(190,388)	585,454	-	14,224,158	1,187,695
29	Debentures 6.50% Series		30-Apr-98	30-Apr-08	20,000,000	20,000,000	(35,286)	(45,956)	-	20,010,670	1,294,878
30	Debentures 7.88% Series		15-Sep-99	15-Sep-09	20,000,000	20,000,000	(17,838)	60,399	-	19,921,763	1,597,623
31	Debentures 5.00% Series		09-Dec-04	15-Dec-14	40,000,000	40,000,000	(322,415)	348,602	-	39,328,983	2,078,789
32											
33	Totals				256,334,163	251,934,919	(950,935)	1,442,652	2,092,530	247,448,802	14,663,644
34											
35											
36	Embedded Cost of Long-Term Debt (I / H)										5.926%

(*) Annualized interest cost plus (or minus) amortization of discount or premium plus amortization of issue costs minus (or plus) amortization of gain (or loss) on reacquired debt.

RECEIVED
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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN ADJUSTMENT OF GAS RATES OF THE UNION LIGHT, HEAT AND POWER ULH&P	))))	CASE NO. 2005-00042

REBUTTAL TESTIMONY OF

JEFFREY R. BAILEY

ON BEHALF OF

THE UNION LIGHT, HEAT AND POWER COMPANY

TABLE OF CONTENTS

PAGE

I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME.

A. My name is Jeffrey R. Bailey.

Q. ARE YOU THE SAME JEFFREY R. BAILEY WHO PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my testimony is to rebut certain portions of Mr. David H. Brown Kinloch's testimony related to rate design and miscellaneous charges.

II. RATE DESIGN

Q. AT PAGE 17, LINE 17 OF MR. KINLOCH'S TESTIMONY, HE STATES THAT DISTRIBUTION MAINS DOES NOT FIT THE NARUC DESCRIPTION OF APPROPRIATE COSTS TO BE COLLECTED THROUGH THE MONTHLY CUSTOMER CHARGE AND HE STATES IT SHOULD NOT BE INCLUDED IN THE MONTHLY CUSTOMER CHARGE. DO YOU AGREE WITH HIS OPINION?

A. No, I do not. The NARUC Gas Distribution Rate Design Manual is certainly a credible source of information, but it is a guide to the rate design process rather than a treatise with immutable precepts. No one can rationally argue that the cost of ULH&P's distribution mains is a variable cost that varies with consumption from month-to-month or by season. In fact, the cost of distribution mains and the obligations associated with it are reasonably fixed, and have no relationship whatever to the amount of sales. Therefore, it is reasonable to conclude that all or a portion of such costs should be charged to customers on some basis other than consumption.

Q. DO YOU CONSIDER THE MONTHLY CUSTOMER CHARGES AS PROPOSED BY ULH&P TO BE REASONABLE?

A. Yes, I do. For classes that are reasonably similar, as are residential and general service classes, a fixed monthly charge to collect a portion of the cost of mains identified as customer related is fair and reasonable. The Commission clearly accepted this as a reasonable approach by approving ULH&P's treatment of AMRP costs in its last rate case, Case No. 2001-00092.

Q. WHY HAS ULH&P NOT PROPOSED A FIXED MONTHLY FEE FOR ITS LARGER CUSTOMERS?

A. Due to the size disparity of customers within the larger customer classes, it is not practical to have a fixed monthly fee for these groups. Accordingly, we have recovered these costs as part of the commodity charge.

Q. DO YOU SEE ANY OTHER POTENTIAL BENEFITS OF THESE MONTHLY CHARGES TO THE CUSTOMER AND THE COMPANY?

A. Yes. Paying a portion of the cost of mains as a monthly fee does a better job of spreading the costs over an annual period. Usage based fees force most of the costs to be borne in the winter months, just as usage and commodity costs are typically peaking. A fixed monthly charge benefits the customer by reducing the volatility of bills. This likewise benefits the Company by reducing the volatility of cash flows during the year.

Q. MR. KINLOCH COMPARES HIS PROPOSED CUSTOMER CHARGES TO THAT OF OTHER GAS UTILITIES IN THE STATE TO SERVE AS A BASIS FOR REASONABLENESS, AND HE STATES GRADUALISM WOULD BE VIOLATED UNDER THE COMPANY'S PROPOSALS. DO YOU AGREE?

A. I do not agree with his approach or his assessment of gradualism. First, I believe the charges set in any case should be established on the merits of that case. The Company has produced credible studies in support of its charges. Absent any modifications ordered by the Commission, these studies should serve as the basis for those charges. The methods used by other companies, the negotiations of parties within the context of those cases, and the historical timing, are all well outside the scope of this proceeding, and so comparisons to others is of limited value.

As far as gradualism is concerned, the overall impact to customers should be considered rather than narrowly considering individual charges. The overall percentage increase requested results in a significantly smaller percentage increase to customers than suggested by Mr. Kinloch's calculations on the customer charges.

III. <u>BAD CHECK CHARGE</u>

Q. MR. KINLOCH CRITICISES THE COMPANY FOR NOT HAVING COST SUPPORT FOR ITS BAD CHECK CHARGE AND RECOMMENDS THAT THE COMMISSION REJECT THE PROPOSED INCREASE. DO YOU AGREE WITH HIS RECOMMENDATION?

A. No, I do not. The Company has proposed this charge at a level where, as a matter of common knowledge, its level is consistent with that of many retail establishments.

It is commonly argued that regulation serves as a surrogate for competition. Given this charge is so readily observable in a competitive environment, it is *de facto* reasonable. It is the Company's intent to set this charge at a level which the market has determined to be a reasonable deterrent to the passing of bad checks. ULH&P's affiliate company, PSI Energy, Inc., recently had its bad check charge approved by the Indiana Utility Regulatory Commission based on identical logic.

It is important to note that setting the charge at this level does not affect the <u>overall</u> revenue requirement requested or to be granted in this case. To the extent that the charges do exceed costs, the Company is more than willing to have a reduction in cost recovery for other services in preference to a bad check charge set at the proposed level.

IV. <u>RECONNECTION FEE</u>

Q. MR. KINLOCH RECOMMENDS THAT THE RECONNECTION FEE BE INCREASED AT A LEVEL NO HIGHER THAN THE OVERALL PERCENT INCREASE, CITING CONTINUITY AND GRADUALISM. DO YOU AGREE WITH HIS RECOMMENDATION?

A. No, I do not. A simple review of the costs associated with this charge reveals it is predominantly labor-related. Within a short period of time, modest increases in labor costs will exceed the increase in the reconnection charge as proposed by Mr. Kinloch. Thus, the disparity between the charge and its underlying costs will continue to widen. The approach suggested by Mr. Kinloch is therefore not consistent with good ratemaking or gradualism. ULH&P urges the Commission to reject Mr. Kinloch's approach and implement ULH&P's proposed reconnection fees, or in the alternative move the fees 50% of the difference from current levels to proposed levels.

V. <u>CONCLUSION</u>

Q. DOES THIS CONLCUDE YOUR PREFILED REBUTTAL TESTIMONY?

A. Yes, it does.

VERIFICATION

State of Indiana)
) SS:
County of Hendricks)

The undersigned, Jeffrey R. Bailey, being duly sworn, deposes and says that he is the Manager, Pricing for Cinergy Services, Inc., that he has personal knowledge of the matters set forth in the foregoing testimony, and that the answers contained therein are true and correct to the best of his information, knowledge and belief.

Jeffrey R. Bailey
Jeffrey R. Bailey, Affiant

Subscribed and sworn to before me by Jeffrey R. Bailey on this 18TH day of July, 2005.

Kathy L. Cobb
Kathy L. Cobb
NOTARY PUBLIC

My Commission Expires: 05.01.07

COMMONWEALTH OF KENTUCKY

RECEIVED
JUL 2 0 2005
PUBLIC SERVICE COMMISSION

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN ADJUSTMENT OF GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	)))	CASE NO. 2005-00042

REBUTTAL TESTIMONY OF

GARY J. HEBBELER

ON BEHALF OF

THE UNION LIGHT, HEAT AND POWER COMPANY

TABLE OF CONTENTS

I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME.

A. My name is Gary J. Hebbeler.

Q. ARE YOU THE SAME GARY J. HEBBELER WHO PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes.

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

A. I rebut the testimony of Mr. Robert J. Henkes relating the slippage factor adjustment. I also address recovery of costs for installing Automated Meter Reading ("AMR") technology during the forecasted test period. Finally, I address testimony of Mr. Michael J. Majoros, Jr. relating to ULH&P's salvage practices for distribution mains during the past few years.

II. SLIPPAGE FACTOR ADJUSTMENT

Q. WHAT IS MR. HENKES' RECOMMENDATION REGARDING WHETHER THE COMMISSION SHOULD MAKE A SLIPPAGE FACTOR ADJUSTMENT?

A. Mr. Henkes recommends at page 16 of his testimony that ULH&P's 13-month average plant in service balance should be reduced to reflect a slippage factor adjustment of 6.048% to all projected capital expenditures. He explains that this is the slippage factor for non-AMRP plant for the past ten years.

Q. HOW DO YOU RESPOND TO MR. HENKES' TESTIMONY REGARDING THE SLIPPAGE FACTOR ADJUSTMENT?

A. I disagree with Mr. Henkes as to whether a slippage factor adjustment should be applied. If the Commission decides to apply a slippage factor adjustment, I also disagree with Mr. Henkes' methodology for calculating the slippage factor adjustment.

Q. WHY SHOULD THE COMMISSION NOT APPLY A SLIPPAGE FACTOR ADJUSTMENT?

A. I understand that the Commission has applied a slippage factor adjustment in other forecasted test period cases. I do not believe, however, that a slippage factor adjustment is appropriate here because over the past several years, ULH&P has consistently spent what it budgeted for Gas Operations capital expenditures, except in unusual circumstances.

Since 2002, AMRP's first full year, 65% of ULH&P Gas Operations' annual capital expenditures have been spent on AMRP projects which are reflected in the plant in service accounts. The purpose for the AMRP is to allow ULH&P to replace its cast iron and bare steel gas mains on an accelerated basis. This accelerated main replacement produces significant safety and reliability benefits, as discussed in my direct testimony. Rider AMRP allows ULH&P to obtain timely recovery of its costs, thus avoiding possible financial harm.

Since AMRP construction began in 2001, ULH&P has in aggregate spent all of the budgeted amounts for the AMRP. For "All Capital Construction Projects" as indicated in KyPSC-DR-02-105, page 3 of 3, in the years 2003 and 2004 ULH&P did not spend the full budgeted amount for construction projects because the Kentucky Department of Transportation ("KDOT") notified ULH&P

late in the planning/construction cycle that its budget had been cut by the Commonwealth of Kentucky. In my experience, this is an unusual occurrence. I believe that this may have resulted, in large part, from the Commonwealth's failure to pass a budget. As a result, ULH&P was unable to spend a portion of the amount it had allocated for main replacement arising from KDOT-mandated road improvement work.

In March 2005, a new budget was passed. I do not anticipate that there will be the same type of KDOT budget cuts occurring late in our planning/construction cycle which would prevent ULH&P from spending the full amount budgeted for capital construction. As a result, I believe that ULH&P will spend the full amount budgeted for capital construction. As a result, I do not believe the Commission should apply a slippage factor adjustment under these circumstances.

Q. IF THE COMMISSION DECIDES TO APPLY A SLIPPAGE FACTOR ADJUSTMENT, WHAT SLIPPAGE FACTOR SHOULD BE USED?

A. If the Commission decides to apply a slippage factor adjustment, then I recommend a slippage factor adjustment of 1.327%, as calculated on Attachment GLH-Rebuttal-1. I calculated this adjustment using the actual versus budgeted construction expenditures for all projects for the past ten years, which we provided in response to KyPSC-DR-01-012 and KyPSC-DR-02-105. I eliminated the years 2003 and 2004 from this calculation because these years represented extraordinary circumstances where KDOT cut its budget for road improvements late in the planning/construction cycle, as I described earlier in my rebuttal testimony. Based on this methodology and using a mathematic average which Mr. Henkes recommended, I calculated a slippage factor adjustment of 1.327%.

Q. DO YOU HAVE ANY CONCERNS ABOUT MR. HENKES' METHODOLOGY FOR CALCULATING THE SLIPPAGE FACTOR ADJUSTMENT?

A. Yes. I do not agree with Mr. Henkes' recommended slippage factor adjustment of 6.048% because it is based only on non-AMRP projects. I do not believe this to be a fair representation of ULH&P's prospective construction program. As I mentioned earlier, the AMRP currently accounts for 65% of ULH&P's annual gas plant in service. Omitting AMRP plant in service from the calculation distorts the picture. Mr. Henkes states at page 16 of his direct testimony that the slippage factor adjustment is 5.385%, if both AMRP and non-AMRP projects are used in the calculation. This percentage was subsequently corrected by Mr. Henkes in response to ULH&P-DR-01-013 to reflect the slippage factor of 2.955%. If the Commission decides to use a slippage factor adjustment and to include 2003 and 2004 in the calculation, I agree that 2.955% would be the appropriate slippage factor adjustment to use.

III. <u>AUTOMATED METER READING</u>

Q. WHAT DO YOU RECOMMEND REGARDING ULH&P'S RECOVERY OF AMR-RELATED COSTS?

A. ULH&P included costs in the forecasted test period for costs related to implementing new AMR technology. As I indicated in my responses to KyPSC-DR-02-104 and KyPSC-DR-03-046, Cinergy issued a request for proposal for vendors to bid on providing AMR-based meters. Cinergy evaluated the bids and developed a tentative plan to install AMR technology from 2006-2009, subject to approval by executive management. I recently learned that Cinergy management has not approved installation of AMR technology during 2006. As a result, I recommend that the costs related to AMR technology be removed from the forecasted test period. These costs have been removed in developing the forecasted test period rate base. The rebuttal testimony of Mr. William Don Wathen, Jr., discusses the impact of this change.

IV. <u>SALVAGE PRACTICES FOR DISTRIBUTION MAINS</u>

Q. AT PAGES 16 THROUGH 19 OF HIS TESTIMONY, MR. MAJOROS DISCUSSES THE SALVAGE RATE FOR ACCOUNT 2760 – DISTRIBUTION MAINS NET SALVAGE. CAN YOU GENERALLY DESCRIBE YOUR SALVAGE PRACTICES FOR CAST IRON AND BARE STEEL DISTRIBUTION MAINS?

A. When we install new plastic mains, we generally leave the existing cast iron or bare steel distribution main in place. There are several techniques used to install the new facilities. One technique, insertion, uses the existing facility as a conduit for the new main and the other techniques, directional bore and direct bury, do not. Since the inception of AMRP, we have used directional bore and direct bury as the construction methods of choice. This has resulted in lower amounts being charged to salvage for this account.

Q. DOES THIS REPRESENT A CHANGE FROM YOUR PRIOR PRACTICE?

A. Yes. Insertion was used as a major construction technique prior to 2001. This resulted in significantly higher amounts being charged to salvage for this account.

Q. WHEN DID THIS CHANGE OCCUR?

A. This change occurred predominantly after 2001 when we adopted directional boring as the standard practice for replacing cast iron and bare steel mains when used in small diameter pressure gas systems. Scheduling customer outages are more customer friendly and economical on larger projects when directional bore is used.

Q. DO YOU EXPECT TO CONTINUE THIS PRACTICE IN THE FUTURE?

A. Yes, I expect that we will continue to use directional boring on small diameter pressure systems and direct bury on standard pressure systems and large diameter pressure gas systems when replacing cast iron and bare steel mains because it is more economical.

V. CONCLUSION

Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?

A. Yes.

VERIFICATION

State of Ohio)
) **SS:**
County of Hamilton)

The undersigned, Gary J. Hebbeler, being duly sworn, deposes and says that he is Manager, Gas Engineering for Cinergy Services, Inc., and he has personal knowledge of the matters set forth in the foregoing testimony, and that the answers contained therein are true and correct to the best of his information, knowledge and belief.

Gary J. Hebbeler

Gary J. Hebbeler, Affiant

Subscribed and sworn to before me by Gary J. Hebbeler on this 15th day of July, 2005.

Anita M. Schafer

NOTARY PUBLIC

My Commission Expires:

NOTARY PUBLIC
STATE OF OHIO

ANITA M. SCHAFER
Notary Public, State of Ohio
My Commission Expires
November 4, 2009

CASE NO. 2005-00042
THE UNION LIGHT, HEAT AND POWER COMPANY
Calculation of Capital Construction Project Slippage Factor

Source: Response to Item 12, Staff's First Request

Part 3 - All Capital Construction Projects--Remove 2003 and 2004

Years	Annual Actual Cost	Annual Original Budget	Variance in Dollars	Variance as Percent	Slippage Factor
2004	N/A	N/A			
2003	N/A	N/A			
2002	23,299,272	22,297,422	1,001,850	4.493%	104.493%
2001	16,801,986	16,456,962	345,025	2.097%	102.097%
2000	11,509,574	11,929,132	-419,558	-3.517%	96.483%
1999	11,382,232	16,383,221	-5,000,989	-30.525%	69.475%
1998	10,290,744	9,954,863	335,881	3.374%	103.374%
1997	7,949,031	8,765,107	-816,076	-9.311%	90.689%
1996	6,789,015	7,748,000	-958,985	-12.377%	87.623%
1995	7,858,800	5,815,000	2,043,800	35.147%	135.147%
Totals	95,880,655	99,349,707	-3,469,052	-3.492%	96.508%
8 Year Average Slippage Factor (Mathematic Average of the Yearly Slippage Factors/8 years)					98.673%

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN ADJUSTMENT	)	
OF GAS RATES OF THE UNION LIGHT,	)	CASE NO. 2005-00042
HEAT AND POWER COMPANY	)	

REBUTTAL TESTIMONY OF

ROBERT C. LESUER

ON BEHALF OF

THE UNION LIGHT, HEAT AND POWER COMPANY

155037

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APPENDIX

I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Robert C. Lesuer. My business address is 200 Clarendon Street, Boston, Massachusetts 02116.

Q. WHAT IS YOUR CURRENT POSITION?

A. I am a Principal in the Performance, Measurement and Rewards practice section of Mercer Human Resource Consulting.

Q. PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL QUALIFICATIONS.

A. I hold a Bachelor of Science Degree in engineering from Northeastern University, a Master of Science Degree in engineering from Stanford University, and a Master of Business Administration Degree from the Wharton School of the University of Pennsylvania.

Q. PLEASE SUMMARIZE YOUR BUSINESS EXPERIENCE.

A. I have been consulting with the utility/energy industry for over 30 years. Earlier in my career, I worked for over seven years as an engineer for Stone & Webster Engineering Corporation and was involved in the engineering and design of electricity generating stations. Subsequently I obtained my graduate degree in business and commenced employment with Towers Perrin, a large consultancy firm which focuses on a variety of human resource issues including compensation. My area of consulting while at Towers Perrin ranged from cost reduction exercises to in-depth compensation reviews for numerous utility clients. I was with Towers Perrin for 21 years until 2003, when I left to join Mercer Human Resource Consulting.

Much of my experience (and most of the last ten years) involves designing base pay plans, incentive compensation plans and executive compensation plans. Attachment RCL-1 is a list of utilities for which I have provided compensation consulting services. I have testified in regulatory proceedings in Connecticut, Maine, Virginia, and Illinois on a variety of issues including compensation. I have also been a speaker on issues including compensation for utility/energy companies at various meetings of the American Gas Association, Edison Electric Institute, Electric Power Research Institute, and the National Association of Regulatory Commissioners.

Q. ARE YOU A MEMBER OF ANY PROFESSIONAL ORGANIZATIONS?

A. Yes. I am a member of WorldatWork, an association of compensation, benefits and total rewards professionals. I am also a member of the National Association of Stock Plan Professionals and the National Association of Corporate Directors.

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

A. I respond to Mr. Robert J. Henkes' testimony relating to whether ULH&P should be permitted to recover the costs of incentive compensation plans through its retail gas rates.

II. <u>REVIEW OF MR. HENKES' RECOMMENDATION</u>

Q. WHAT DOES MR. HENKES RECOMMEND REGARDING ULH&P'S INCENTIVE COMPENSATION PROGRAMS?

A. Mr. Henkes recommends at pages 37-38 of his testimony that the Commission should not allow ULH&P to recover incentive compensation costs through its rates because the incentive compensation programs "place more weight on the interests of ULHP's stockholders than the Company's customers."

Q. WHAT DOCUMENTS DID YOU REVIEW TO PREPARE FOR YOUR REBUTTAL TESTIMONY?

A. I reviewed the direct and rebuttal testimony of Mr. Timothy J. Verhagen, as well as Mr. Henkes' direct testimony. I reviewed the Cinergy Annual Incentive Plan, Long-Term Incentive Plan and Union Employees' Incentive Plan as described in Mr. Verhagen's testimony. I also reviewed reports on the competitiveness of Cinergy's compensation and benefits programs with other companies nationally and with companies in the utility industry.

Q. DO YOU AGREE WITH MR. HENKES' POSITION ON INCENTIVE COMPENSATION COSTS?

A. No, I do not. The Cinergy incentive compensation plans do not favor shareholders' interests over customers' interests. To the contrary, when employees attain the performance objectives in the Cinergy incentive compensation plans, this inures to the benefit of customers and shareholders. Customers benefit in three ways. First, customers benefit because the performance objectives identify objective criteria, such as attaining high reliability and safety scores, which result in better service for the customer. Secondly, customers also benefit from the performance objectives based on financial metrics such as net income, because it is in customers' interests to have a financially sound utility, as this will reduce the utility's cost to borrow money and provide the utility with the financial resources to make the capital expenditures and operation and maintenance expenditures necessary to provide safe, adequate and reliable utility service. Thirdly, the incentive compensation is part of the overall compensation package which is necessary to attract and retain talented employees, who will be better able to provide high quality utility service. Additionally, I note that Mr. Henkes does not appear to have prior experience in the design or management of compensation or incentive compensation plans.

III. INDUSTRY STANDARDS ON INCENTIVE COMPENSATION

Q. WHAT PERCENTAGE OF OTHER COMPANIES IN THE UTILITY INDUSTRY OFFER THEIR EMPLOYEES INCENTIVE COMPENSATION PLANS?

A. In Mercer's 2004 Energy Industry Compensation Survey, 96 of 104 companies (92%) reported having incentive compensation plans. A copy of the Mercer study is at Attachment RCL-2. A similar study by Hewitt Associates in 2004 reported that 89% of energy companies had incentive plans. Hewitt is another major consulting firm in the field of compensation and benefits. A copy of the Hewitt study is at Attachment RCL-3.

In addition, Mercer's 2004/2005 Compensation Planning Survey indicated that the prevalence of incentive plans by employee groups within the Utility Industry *(as compared to other for-profit organizations)* is as follows: Executive – 86% *(88%)*; Management – 88% *(87%)*; Technical/Professional – 80% *(73%)*;

Nonexempt Clerical – 77% *(55%)*; Non union hourly – 66% *(46%)*. A copy of this Mercer study is at Attachment RCL-4.

The results of this Mercer study prove a number of points: (1) Annual incentive plans are very common in the utility industry; (2) companies in the utility industry are more likely to utilize incentive plans for non-management positions than other for-profit organizations; (3) incentive compensation plans in the utility industry tend to cover all employee classifications; and (4) most for-profit companies offer incentive compensation plans to their employees.

Q. HOW DO THE CINERGY INCENTIVE COMPENSATION PLANS COMPARE WITH THE INCENTIVE COMPENSATION PLANS PROVIDED BY OTHER UTILITY COMPANIES?

A. Both the Annual Incentive Plan ("AIP") and the Union Employee Incentive Plan ("UEIP") are very comparable with short-term incentive plans of other utilities in all aspects. I base this opinion on a review of the characteristics that define an incentive plan and the high degree of consistency between these characteristics and Cinergy's plans, such as:

- The use of a corporate measure of profitability such as net income, earnings per share, etc., helps to ensure affordability of the plan.

- The allocation of weighting among corporate, business unit, and individual metrics is very important since it concurrently emphasizes to participants that they are part of larger entity (corporate), need to help the performance of their team (business unit, such as Regulated Businesses), and have a clear "line of sight" to how they as individuals can help achieve team and corporate objectives (individual component).

- The use of measures that are measurable and specific to achieving operational excellence, such as measures of gas system interruption duration, operations and maintenance expense control, capital expenditure control, etc.

- Inclusion of metrics that are becoming constants in most utility incentive plans, i.e., customer satisfaction and safety.

In sum, the Cinergy incentive plans represent sound and appropriate designs that are consistent with other plans in place in the utility industry. Moreover, Cinergy's plans should be effective in achieving the dual objectives of focusing employees' attention on key success factors and helping to provide a competitive compensation package.

IV. <u>REASONS FOR INCENTIVE COMPENSATION</u>

Q. WHY DO UTILITY COMPANIES PROVIDE THEIR EMPLOYEES WITH INCENTIVE COMPENSATION PLANS?

A. The answer is really quite simple: because they work. Practical experience and research studies have for years shown that properly designed financial incentives enhance the ability of an organization to achieve its goals. When people can influence meeting goals and incentives are used as a part of employee pay, the organization's goals are much more likely to be achieved than when incentives aren't used.

Utility companies have designed their incentive plans around servicing the customer: quicker response times, shorter outage duration, etc. While the incentive plans reward employees for specific behaviors or achievement of certain goals, it is the customer who benefits from improved service and quality.

Q. ARE YOU AWARE OF ANY STUDIES ON WHETHER INCENTIVE COMPENSATION PLANS SIMILAR TO THE ONES USED BY CINERGY ARE EFFECTIVE IN ACCOMPLISHING THEIR INTENDED OBJECTIVES?

A. A comprehensive study "Variable Pay and Organizational Performance" conducted in 2004 by WorldatWork, Loyola University of Chicago, and the Hay Group of the effectiveness of incentive plans at 793 organizations. The study found that 70% of the participating organizations reported that variable pay was important to very important to the success of their organizations' competitive strategy.

In many respects the findings of the above study are not new. Another study conducted in 1985 by Richard A. Guzzo, et. al. of the University of Maryland, "The Effects of Psychologically Based Intervention Programs on Worker Productivity: a Meta Analysis," also concluded that properly designed financial incentives had very powerful positive effects on productivity.

These two studies taken together emphasize the notion that incentive plans can be effective, a concept that has been accepted for two decades.

Q. HAS INCENTIVE COMPENSATION GROWN AS A HIGHER PERCENTAGE OF OVERALL COMPENSATION IN RECENT YEARS AND, IF SO, WHY?

A. Yes, it has. In general, most industries have seen an increase in the use of incentive compensation in order to improve employee productivity, worker commitment, and customer satisfaction. The trend is to provide employees with more "pay at risk" aligned with performance goals, rather than a "fixed" compensation expense such as increased base pay. For example, a Mercer study published in July, 2002, "2002/2003 U.S. Compensation Planning Survey" observed: "Since 1999, 405 (30.8%) organizations have increased the number of employees eligible for short term incentives while 336 (26.2%) have increased the number of employees within the same level eligible for short-term incentives." In a follow-up study published in July 2004, "2004/2005 U.S. Compensation Planning Survey," the comparable numbers were 22% and 19%, respectively.

The reason for this continuing and expanding role of incentive compensation is the clear view among senior managers in all types of businesses in different industries that incentive compensation plans are necessary to both emphasize an organization's objectives and create a competitive compensation program.

Q. DOES INCENTIVE COMPENSATION PLAY A PART IN THE OVERALL COMPENSATION PACKAGE FOR AN EMPLOYEE?

A. Yes. Perhaps the single most important factor in an employee's decision to accept a job offer and to remain in that job is the overall level of compensation and benefits. A company's incentive compensation plan is an important part of the overall compensation package. Employees consider the normal levels of company payout under an incentive compensation plan as a component of compensation which they have a reasonable opportunity to obtain. All else equal, an employee would choose to work for a company that offered incentive compensation over another company with identical pay and benefit levels but without incentive compensation. Accordingly, incentive compensation is an important part of the pay and benefits packages which companies use to attract and retain skilled workers.

Q. WHAT WOULD OCCUR IF CINERGY ELIMINATED INCENTIVE COMPENSATION FROM ITS PAY AND BENEFITS PACKAGES?

A. Cinergy's pay and benefits plans, taken as a whole, would be less competitive with other companies nationally and in the utility industry. I would expect that Cinergy would have a more difficult time hiring and retaining talented employees because the most qualified employees would tend to accept jobs at companies where they could maximize their opportunities to earn the highest level of pay and benefits.

Q. HOW WOULD THIS IMPACT CUSTOMERS OF CINERGY'S UTILITY OPERATING COMPANIES LIKE ULH&P?

A. This would be detrimental to customers in three ways. First, Cinergy would ultimately have a less skilled work force as talented employees left for better paying positions, so the level of service could decline. Second, the remaining employees would likely be less productive, so customers could see higher rates for utility service because Cinergy could be forced to hire higher numbers of employees to replace the more productive employees who leave. Third, customers could experience higher rates resulting from additional expense for hiring and training employees.

V. CONCLUSION

Q: BASED ON THE FOREGOING, DO YOU HAVE AN OPINION AS TO WHETHER IT WOULD BE REASONABLE FOR ULH&P TO RECOVER THE COSTS OF ITS INCENTIVE COMPENSATION PLANS THROUGH ITS RETAIL GAS RATES?

A. Yes. Based on the customer benefits flowing from these incentive compensation plans, it would be reasonable for ULH&P to recover these costs in its rates.

Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?

A. Yes.

VERIFICATION

State of Massachusetts)
) **SS:**
County of Bristol)

The undersigned, Robert C. Lesuer, being duly sworn, deposes and says that he is a Principal in the Performance, Measurement and Rewards practice section for Mercer Human Resource Consulting, that he has personal knowledge of the matters set forth in the foregoing testimony, and that the answers contained therein are true and correct to the best of his information, knowledge and belief.

Robert C. Lesuer
Robert C. Lesuer, Affiant

Subscribed and sworn to before me by Robert C. Lesuer on this 13 day of July, 2005.

Yolande Janine Nadeau
NOTARY PUBLIC

My Commission Expires:

ubscribed and sworn to before me, a otary Public for the State of Massachusetts, County of Bristol.

This 13 ***day of*** July 2005
Signed: Yolande Janine Nadeau
My commission expires: August 23, 2007

UTILITY COMPENSATION CLIENTS

ROBERT C LESUER
July 2005

- American Electric Power
- Atlanta Gas Light
- Central Vermont Public Service
- Connecticut Water Company
- Consolidated Edison
- Constellation Energy
- Energy East
- Florida Power & Light
- Florida Progress
- Great Plains Energy
- Houston Lighting and Power
- Maine Yankee
- National Grid
- Niagara Mohawk
- NStar
- NUI
- Northeast Utilities
- PECO Energy
- Southern Union
- TXU
- United Illuminating
- Vectren
- Vermont Yankee
- Washington Gas Light
- Wolf Creek Nuclear Operating Company

Hewitt

Hewitt Associates LLC

Survey Findings: Salary Increases 2004 and 2005 U.S. Version

Argentina	China	India	Philippines	Spain
Australia	Czech Republic	Ireland	Poland	Sweden
Austria	Dominican Republic	Italy	Portugal	Switzerland
Belgium	France	Japan	Puerto Rico	Thailand
Brazil	Germany	Malaysia	Singapore	United Kingdom
Canada	Greece	Mauritius	Slovakia	United States
Channel Islands	Hong Kong	Mexico	South Africa	Venezuela
Chile	Hungary	Netherlands	South Korea	

Participant Demographics by Industry

	Number of Participants
Manufacturing	
Aerospace	22
Agriculture	8
Automotive/Vehicle Manufacturing	27
Building Materials	11
Chemicals (not Pharmaceutical)	35
Computers & Related Products	30
Consumer Products–Durable Goods	39
Consumer Products–Nondurable Goods	23
Electronics/Electrical	33
Energy (Oil/Gas)	37
Food/Beverage/Tobacco	36
Forest & Paper Products/Packaging	20
Industrial Machinery/Equipment	15
Medical Devices/Products	18
Metals	3
Metal Fabrication	10
Mining/Milling/Smelting	3
Pharmaceutical	24
Printing	5
Rubber/Plastics/Glass	6
Textiles/Apparel Manufacturing	7
Other–Manufacturing	0
All Manufacturing	*412*
Service	
Accounting/Consulting/Legal	16
Banking/Finance	94
Business/Computer Services	32
Construction/Engineering	25
Education	14
Energy (Power/Gas)	72
Entertainment/Communications/Publication	25
Government	7
Health Care/Medical Services	91
Hospitality/Restaurants	22
Insurance–Life & Health	42
Insurance–Other	16
Insurance–Property & Casualty	89
Not–for–Profit (not Hospitals/Schools)	30
Real Estate	9
Research/Development	22
Retail (includes Wholesale & Distribution)	84
Telecommunications	34
Transportation Services	21
Other–Service	2
All Service	*747*
Multi-Industry	
Multi-Industry (3 or more different industries within co.)	26
All Multi-Industry	*26*
All Companies	*1,185*

Prevalence of Broad-Based Variable Pay Plans by Industry

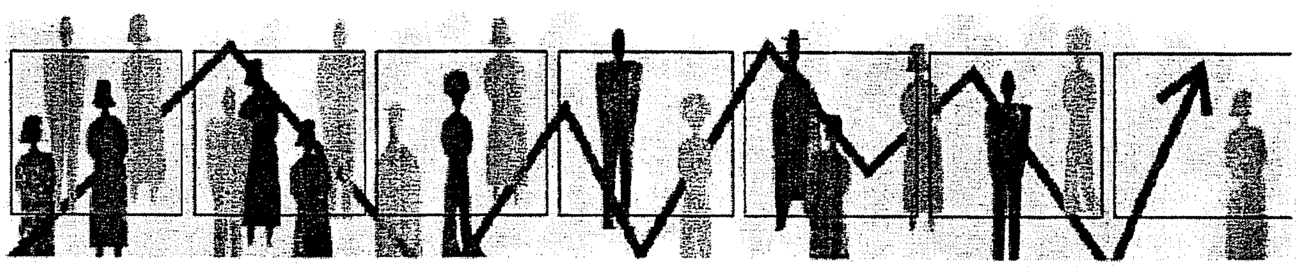
	% of Organizations Offering Variable Pay Plans	Total Number of Organizations Matching This Industry
Manufacturing		
Aerospace	82%	22
Agriculture	75%	8
Automotive/Vehicle Manufacturing	81%	27
Building Materials	82%	11
Chemicals (not Pharmaceutical)	89%	35
Computers and Related Products	93%	30
Consumer Products-Durable Goods	87%	39
Consumer Products-Nondurable Goods	83%	23
Electronics/Electrical	94%	33
Energy (Oil/Gas)	81%	37
Food/Beverage/Tobacco	75%	36
Forest & Paper Products/Packaging	85%	20
Industrial Machinery/Equipment	87%	15
Medical Devices/Products	89%	18
Metals	100%	3
Metals Fabrication	70%	10
Mining/Milling/Smelting	100%	3
Pharmaceutical	88%	24
Printing	40%	5
Rubber/Plastics/Glass	67%	6
Textiles/Apparel Manufacturing	86%	7
Other Manufacturing	–	–
All Manufacturing	*84%*	*412*
Service		
Accounting/Consulting/Legal	81%	16
Banking/Finance	86%	94
Business/Computer Services	81%	32
Construction/Engineering	72%	25
Education	29%	14
Energy (Power/Gas)	89%	72
Entertainment/Communications/Publication	60%	25
Government	71%	7
Health Care/Medical Services	45%	91
Hospitality/Restaurants	68%	22
Insurance-Life & Health	93%	42
Insurance-Other	81%	16
Insurance-Property & Casualty	67%	89
Not-for-Profit (not Hospitals/Schools)	63%	30
Real Estate	100%	9
Research/Development	64%	22
Retail (incl. Wholesale & Distribution)	81%	84
Telecommunications	97%	34
Transportation Services	71%	21
Other Service	50%	2
All Service	*74%*	*747*
Multi-Industry		
Multi-Industry (3 or more different industries within co.)	77%	26
All Multi-Industry	*77%*	*26*
All Companies	*78%*	*1,185*

Hewitt Associates

MERCER
Human Resource Consulting

2004/2005 US Compensation Planning Survey

A Study of Pay Increases, Incentive Compensation, and Emerging Practices



Short-term Incentives

Eighty-one percent of responding organizations have short-term incentive plans for at least some segment of their employee population, with the number growing to 88% when healthcare and non-profit organizations are excluded.

Highlights of the analysis of this information follow.

All Organizations	Executive		Management		Technical/ Professional		Nonexempt Clerical/Tech		Nonunion Hourly	
Percent with Incentive Program	81%	(1,093)	78%	(1,055)	64%	(867)	49%	(644)	40%	(416)
Target Percent	35%	(757)	15%	(741)	10%	(599)	5%	(431)	5%	(272)
Maximum Percent	55%	(660)	25%	(659)	15%	(536)	8%	(367)	8%	(248)
Actual 2003 Payout (as % of Base)	32%	(729)	15%	(736)	8%	(593)	5%	(434)	4%	(275)
Expected 2004 Payout (as % of Base)	31%	(669)	15%	(670)	10%	(547)	5%	(396)	5%	(257)

For-profit Organizations	Executive		Management		Technical/ Professional		Nonexempt Clerical/Tech		Nonunion Hourly	
Percent with Incentive Program	88%	(967)	87%	(962)	73%	(802)	55%	(590)	46%	(372)
Target Percent	35%	(668)	16%	(666)	10%	(557)	5%	(406)	5%	(254)
Maximum Percent	60%	(573)	26%	(585)	15%	(499)	8%	(345)	8%	(231)
Actual 2003 Payout (as % of Base)	35%	(646)	15%	(662)	9%	(554)	5%	(404)	5%	(253)
Expected 2004 Payout (as % of Base)	35%	(585)	15%	(690)	10%	(507)	5%	(367)	5%	(236)

Target, maximum, and payout statistics are medians.
Numbers in parentheses represent the number of organizations responding in that category.

Since 2001, 254 (22%) organizations have increased the number of employee levels eligible for short-term incentives while 218 (19%) organizations have increased the number of employees within the same level eligible for short-term incentives.

** Unless otherwise stated, 0's are excluded in all calculations.*

Participants were asked to identify the measures used to distribute short-term incentive compensation payouts. Key measures continue to be financial and operational (productivity) for all employee groups while customer satisfaction is deemed more important at the management level and below.

	% of Orgs Using Measures			
Employee Category	Financial	Operational	Customer Satisfaction	People
Executive	93%	56%	30%	26%
Management	90	61	33	26
Technical/Professional	83	57	31	21
Nonexempt Clerical/Technician	78	55	32	18
Nonunion Hourly	76	55	26	14

Types of Analysis Provided
The following pages provide analysis by organization size (based on number of employees) and by industry. Information is displayed by each employee grouping (e.g., executive, management, technical/professional, etc.). The following information is included:

Percent with Incentive Program - Based on the number of organizations responding to the question, the percent of organizations that provide short-term incentive programs for at least one employee group within the organization.

Target Percent - The target incentive percent based on the design elements of the incentive plan. The median of the responses is displayed.

Maximum Percent - The maximum incentive percent based on the design elements of the incentive plan. The median of the responses is displayed.

Actual 2003 Payout - Payout based on 2003 performance expressed as a percent of base pay. The median of the responses is displayed.

Expected 2004 Payout - Expected payout based on 2004 performance expressed as a percent of base pay. The median of the responses is displayed.

Short-term Incentives — Detail by Organization Size

	Executive		Management		Professional/ Technical		Nonexempt Clerical/Technician		Nonunion Hourly	
	Percent	# of Orgs	Percent	# of Orgs	Percent	# of Orgs	Percent	# of Orgs	Percent	# of Orgs
1 - 499 Employees										
% with Incentive Program	65%	185	65%	181	55%	158	41%	114	37%	79
Target % (median)	30%	124	15%	112	8%	101	6%	76	5%	53
Maximum % (median)	40%	112	22%	105	12%	98	7%	68	7%	50
Actual 2003 Payout as a percent of base (median)	25%	124	12%	119	8%	110	5%	78	4%	53
Expected 2004 Payout as a percent of base (median)	25%	127	13%	124	8%	112	5%	78	5%	57
500 - 999 Employees										
% with Incentive Program	77%	105	69%	95	58%	79	46%	62	38%	38
Target % (median)	30%	72	15%	67	8%	58	5%	45	5%	27
Maximum % (median)	43%	68	20%	64	14%	56	7%	40	7%	25
Actual 2003 Payout as a percent of base (median)	26%	73	14%	70	8%	59	5%	47	5%	26
Expected 2004 Payout as a percent of base (median)	26%	70	15%	65	10%	55	5%	44	5%	27
1,000 - 4,999 Employees										
% with Incentive Program	83%	399	80%	393	66%	319	52%	247	40%	163
Target % (median)	35%	278	15%	281	10%	221	5%	157	5%	101
Maximum % (median)	53%	234	24%	241	12%	190	8%	131	8%	93
Actual 2003 Payout as a percent of base (median)	30%	273	14%	282	8%	221	4%	164	4%	110
Expected 2004 Payout as a percent of base (median)	30%	241	15%	244	9%	199	5%	144	5%	98
5,000 - 9,999 Employees										
% with Incentive Program	90%	154	83%	151	67%	117	55%	94	45%	60
Target % (median)	39%	104	15%	105	10%	80	5%	84	5%	41
Maximum % (median)	60%	91	26%	95	16%	71	8%	53	7%	35
Actual 2003 Payout as a percent of base (median)	35%	97	15%	102	9%	78	5%	63	4%	39
Expected 2004 Payout as a percent of base (median)	36%	96	15%	97	10%	72	5%	57	4%	32
10,000+ Employees										
% with Incentive Program	92%	228	89%	222	72%	176	46%	109	37%	66
Target % (median)	40%	163	20%	158	10%	122	5%	80	5%	46
Maximum % (median)	75%	144	31%	140	16%	109	10%	68	9%	41
Actual 2003 Payout as a percent of base (median)	40%	150	18%	148	10%	113	5%	71	4%	43
Expected 2004 Payout as a percent of base (median)	40%	127	20%	129	10%	101	5%	65	5%	39

Short-term Incentives — Detail by Industry

	Executive		Management		Professional/ Technical		Nonexempt Clerical/Technician		Nonunion Hourly	
	Percent	# of Orgs	Percent	# of Orgs	Percent	# of Orgs	Percent	# of Orgs	Percent	# of Orgs
Service, Misc.										
% with Incentive Program	74%	25	77%	27	59%	20	44%	15	41%	11
Target % (median)	50%	11	18%	12	10%	10	5%	9	4%	6
Maximum % (median)	55%	10	19%	10	12%	10	5%	9	4%	6
Actual 2003 Payout as a percent of base (median)	46%	13	14%	14	10%	12	5%	8	5%	4
Expected 2004 Payout as a percent of base (median)	35%	13	10%	14	10%	12	5%	9	5%	5
Telecommunications										
% with Incentive Program	91%	31	94%	33	81%	29	76%	25	67%	16
Target % (median)	40%	24	16%	25	10%	23	5%	21	6%	13
Maximum % (median)	60%	20	22%	21	15%	20	7%	18	7%	12
Actual 2003 Payout as a percent of base (median)	40%	21	15%	26	10%	25	4%	20	3%	13
Expected 2004 Payout as a percent of base (median)	50%	21	18%	24	10%	22	5%	19	3%	11
Transportation										
% with Incentive Program	84%	21	81%	21	48%	12	26%	7	32%	7
Target % (median)	30%	13	12%	13	7%	9	4%	6	4%	4
Maximum % (median)	60%	12	27%	12	20%	9	9%	6	10%	4
Actual 2003 Payout as a percent of base (median)	25%	11	10%	11	7%	8	4%	5	4%	5
Expected 2004 Payout as a percent of base (median)	28%	12	12%	12	6%	9	4%	6	4%	4
Utilities										
% with Incentive Program	86%	36	86%	37	80%	33	77%	30	69%	21
Target % (median)	38%	26	15%	35	9%	32	6%	28	6%	18
Maximum % (median)	60%	27	23%	35	13%	32	9%	28	9%	18
Actual 2003 Payout as a percent of base (median)	33%	25	18%	33	8%	30	7%	26	6%	16
Expected 2004 Payout as a percent of base (median)	30%	21	12%	29	8%	25	6%	23	6%	16
Wholesale Distribution										
% with Incentive Program	85%	36	93%	37	75%	30	49%	19	51%	19
Target % (median)	40%	25	20%	26	10%	22	5%	11	6%	11
Maximum % (median)	50%	23	26%	25	12%	22	7%	10	7%	11
Actual 2003 Payout as a percent of base (median)	25%	23	14%	24	8%	19	4%	11	5%	12
Expected 2004 Payout as a percent of base (median)	30%	22	17%	22	7%	15	5%	9	5%	8

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Survey respondents self-classified their industry using the North American Industry Classification System (NAICS).

FIGURE E: U.S. RESPONSES BY INDUSTRY CLASSIFICATIONS

NAICS	Industry	n	Percent of Respondents
31	Manufacturing	710	28.1%
52	Finance & Insurance	390	15.4%
62	Health Care & Social Assistance	243	9.6%
51	Information (including Telecommunications)	222	8.8%
54	Consulting, Professional, Scientific & Technical Services	192	7.6%
92	Public Administration	107	4.2%
44	Retail Trade	104	4.1%
22	Utilities	100	4.0%
61	Educational Services	88	3.5%
48	Transportation	64	2.5%
42	Wholesale Trade	61	2.4%
81	Other Services (except Public Administration)	51	2.0%
53	Real Estate & Rental & Leasing	35	1.4%
56	Administrative & Support & Waste Management & Remediation	34	1.3%
21	Mining	33	1.3%
72	Accommodation & Food Services	29	1.1%
23	Construction	24	0.9%
71	Arts, Entertainment & Recreation	23	0.9%
11	Agriculture, Forestry, Fishing & Hunting	11	0.4%
55	Management of Companies & Enterprises	8	0.3%

NATIONAL DATA
U.S.

VARIABLE PAY – NONEXEMPT HOURLY NONUNION

2003				2004				2005		
Budgeted Incentive (as a percentage of base pay)		Actual Paid Incentive (as a percentage of base pay)		Budgeted Incentive Target (as a percentage of base pay)		Award Estimate (as a percentage of base pay)		Budgeted Incentive Target (as a percentage of base pay)		
%	n	%	n	%	n	%	n	%	n	INDUSTRY
7.2	6	8.4	6	8.7	8	8.9	7	8.2	6	Accommodation & Food Services
5.4	5	5.8	5	6.3	6	5.3	6	6.3	6	Administrative Support & Waste Mgmt.
*	*	*	*	*	*	*	*	*	*	Agriculture, Forestry, Fishing & Hunting
*	*	*	*	*	*	*	*	*	*	Arts, Entertainment & Recreation
*	*	*	*	7.7	5	8.7	5	7.1	5	Construction
4.3	40	4.9	43	5.0	41	4.6	37	5.1	37	Consulting, Prof., Scientific & Tech. Svcs.
4.5	8	4.6	9	3.2	11	3.4	11	4.9	7	Educational Services
5.9	120	6.0	130	5.6	133	5.5	132	5.7	125	Finance & Insurance
6.1	33	5.9	37	5.8	35	5.7	35	6.2	38	Credit Intermediation & Related Act.
6.7	27	6.8	30	6.3	28	5.6	30	6.9	28	Funds, Trusts & Other Financial Vehicles
5.2	50	5.4	52	4.9	53	5.4	55	4.5	51	Insurance Carriers & Related Act.
6.6	8	7.2	9	7.1	7	6.7	7	6.6	8	Securities, Commodities & Other Investments
5.7	34	2.1	35	3.0	34	2.2	31	3.5	35	Health Care & Social Assistance
8.7	23	2.0	24	3.1	28	2.2	23	2.7	25	Hospitals
3.5	11	2.3	12	2.8	8	2.2	8	2.1	10	Nursing, Ambulatory & Residential Care
4.2	46	3.8	49	5.1	46	4.7	45	3.3	43	Information
5.5	11	6.9	11	6.3	11	7.5	10	6.3	9	Internet Industries
2.7	11	3.0	14	5.3	12	4.5	12	6.0	12	Publishing Industries
4.2	24	3.4	24	4.4	23	3.5	22	4.5	22	Motion Picture, Sound Recording, Broadcasting
*	*	*	*	*	*	*	*	*	*	Mgmt of Companies & Enterprises
4.8	213	4.7	227	4.8	226	4.7	203	5.0	215	Manufacturing
4.4	37	4.2	40	4.0	39	4.0	35	4.4	33	Chemical Mfg.
5.6	38	4.4	37	5.3	40	5.5	31	5.6	38	Computer & Electronic Product Mfg.
3.8	12	2.9	14	3.7	14	3.7	13	3.8	14	Electrical Equip., Appliance & Component Mfg.
3.4	20	3.5	18	4.0	19	3.6	17	4.5	20	Food, Beverage & Tobacco Product Mfg.
4.2	5	5.1	6	3.8	7	3.9	6	4.1	6	Machinery Mfg.
4.4	14	4.0	17	4.7	13	4.7	12	4.8	13	Metal Mfg.
3.2	7	3.1	7	3.1	9	3.1	8	3.4	9	Paper Mfg., Printing & Related Act.
3.3	6	3.2	5	4.3	7	4.3	6	4.3	7	Plastics & Rubber Products Mfg.
*	*	*	*	*	*	*	*	*	*	Textile, Apparel, Leather & Allied Product Mfg.
5.6	11	5.2	12	5.7	11	5.5	12	6.5	11	Transportation Equipment Mfg.
5.5	60	5.9	65	5.4	65	5.3	60	5.3	59	Other Misc. Mfg.
5.9	15	7.1	17	6.9	17	5.6	14	6.0	15	Mining
1.8	9	1.4	9	1.9	11	1.1	9	1.9	9	Public Administration
6.5	10	6.8	10	6.7	10	6.2	9	5.8	10	Real Estate, Rental & Leasing
5.3	27	6.2	25	4.5	28	3.9	24	4.7	25	Retail Trade
4.5	27	4.4	29	4.1	26	3.9	28	6.4	23	Telecommunications
5.2	12	4.8	14	5.4	14	5.1	14	5.4	14	Transportation
*	*	*	*	*	*	*	*	*	*	Air Transportation
4.7	9	4.3	10	5.1	11	4.9	11	5.5	11	All Other Transportation
6.0	39	5.7	38	6.5	40	5.2	40	6.4	39	Utilities
6.6	28	5.0	28	4.7	25	4.3	23	5.0	23	Wholesale Trade
5.1	11	4.9	10	6.4	10	4.3	10	6.5	9	Other Services (except Public Admin.)
5.5	10	5.2	9	6.4	10	4.8	10	6.5	9	Religious, Grantmaking, Civic, Prof. & Similar Org.
5.2	653	5.0	695	5.1	654	4.7	655	5.3	652	Total

Key: Mfg. = Industry Group
Mfg. = Industry Subgroup

* Fewer than five [illegible] respondents — No data

NATIONAL DATA U.S.

VARIABLE PAY – NONEXEMPT SALARIED

INDUSTRY	2003 Budgeted Incentive (as a percentage of base pay) %	n	2003 Actual Paid Incentive (as a percentage of base pay) %	n	2004 Budgeted Incentive Target (as a percentage of base pay) %	n	2004 Actual Estimate (as a percentage of base pay) %	n	2005 Budgeted Incentive Target (as a percentage of base pay) %	n
Accommodation & Food Services	5.5	7	3.9	8	5.5	8	4.8	8	5.4	8
Administrative Support & Waste Mgmt.	*	*	4.2	5	*	*	*	*	*	*
Agriculture, Forestry, Fishing & Hunting	*	*	*	*	*	*	*	*	*	*
Arts, Entertainment & Recreation	*	*	*	*	*	*	*	*	*	*
Construction	*	*	*	*	*	*	*	*	5.4	5
Consulting, Prof., Scientific & Tech. Svcs.	5.0	44	4.5	44	5.0	43	4.9	42	5.3	40
Educational Services	2.4	9	3.6	9	2.2	10	5.5	10	2.1	6
Finance & Insurance	5.7	134	8.3	141	5.7	140	6.6	135	5.5	130
Credit Intermediation & Related Act.	5.9	32	6.3	35	6.4	32	9.3	35	6.4	33
Funds, Trusts & Other Financial Vehicles	8.0	25	7.2	25	5.6	25	5.5	24	5.1	24
Insurance Carriers & Related Act.	4.7	54	5.0	58	4.9	52	5.1	57	5.0	58
Securities, Commodity & Other Investments	9.8	15	9.4	14	9.3	15	9.4	12	9.6	13
Health Care & Social Assistance	3.5	9	2.7	9	2.5	9	3.3	5	2.2	11
Hospitals	*	*	*	*	*	*	*	*	1.7	5
Nursing, Residential & Residential Care	5.4	5	2.8	5	3.8	5	3.4	5	2.7	6
Information	5.8	33	4.8	32	8.7	35	6.3	32	5.8	32
Internet Industries	*	*	*	*	10.2	6	14.0	5	*	*
Publishing Industries	6.5	8	8.1	9	6.7	9	5.0	10	6.6	8
Motion Picture, Sound Recording, Broadcasting	5.4	21	4.0	19	5.9	21	4.4	17	8.4	19
Mgmt. of Companies & Enterprises	*	*	*	*	*	*	*	*	*	*
Manufacturing	4.6	233	4.7	247	4.8	242	4.7	233	5.0	237
Chemical Mfg.	5.2	44	5.2	47	4.6	47	4.7	43	4.8	46
Computer & Electronic Product Mfg.	4.5	26	6.4	28	4.7	28	4.5	26	4.8	27
Electrical Equip., Appliance & Component Mfg.	4.2	16	3.5	17	4.1	16	3.9	16	4.0	17
Food, Beverage & Tobacco Product Mfg.	4.5	30	4.5	28	4.9	27	5.0	26	5.5	27
Machinery Mfg.	4.4	8	4.8	8	5.1	9	6.1	7	4.9	8
Metal Mfg.	4.1	19	4.3	21	4.7	17	5.8	17	5.8	19
Paper Mfg., Printing & Related Act.	4.0	10	2.8	10	3.8	10	2.4	9	3.6	9
Plastics & Rubber Products Mfg.	4.6	8	3.5	8	5.1	8	5.2	8	5.3	9
Textile, Apparel, Leather & Allied Product Mfg.	*	*	1.7	5	1.7	5	1.6	5	1.7	5
Transportation Equipment Mfg.	6.8	13	3.3	17	8.7	13	4.8	14	6.4	13
Other Misc. Mfg.	5.2	58	4.7	58	5.2	51	4.9	60	5.1	57
Mining	5.2	19	5.8	21	5.9	19	4.9	16	5.8	17
Public Administration	2.3	10	7.8	10	1.3	9	0.8	8	1.5	8
Real Estate, Rental & Leasing	8.3	9	7.5	9	8.4	10	7.3	8	7.7	7
Retail Trade	6.5	13	13.7	12	5.8	13	6.1	11	5.5	12
Telecommunications	6.0	17	5.8	17	5.2	21	5.3	19	7.0	18
Transportation	4.8	14	4.2	13	5.3	14	5.1	13	5.5	13
Air Transportation	*	*	*	*	*	*	*	*	*	*
All Other Transportation	4.0	12	3.9	14	4.8	12	4.9	11	4.9	11
Utilities	5.9	37	5.4	37	5.4	41	6.0	39	7.2	42
Wholesale Trade	6.7	13	5.4	13	4.8	15	4.4	14	5.2	13
Other Services (except Public Admin.)	*	*	*	*	5.5	5	*	*	5.4	6
Religious, Grantmaking, Civic, Prof. & Similar Org.	*	*	*	*	5.5	5	*	*	5.4	6
Total	5.2	615	5.4	641	5.3	647	5.4	614	5.5	619

* Fewer than five survey respondents — No Data

Key: Mining = Industry Group; Metal Mfg. = Industry Subgroup

VARIABLE PAY – EXEMPT SALARIED

2003				2004				2005		
Budgeted Incentive (as a percentage of base pay)		Actual Paid Incentive (as a percentage of base pay)		Budgeted Incentive Target (as a percentage of base pay)		Award Estimate (as a percentage of base pay)		Budgeted Incentive Target (as a percentage of base pay)		
%	n	%	n	%	n	%	n	%	n	INDUSTRY
18.8	19	15.8	22	18.0	18	17.2	19	17.6	19	Accommodation & Food Services
12.5	15	10.4	13	13.4	17	8.3	15	12.7	15	Administrative Support & Waste Mgmt.
*	*	11.5	7	12.0	5	9.0	5	*	*	Agriculture, Forestry, Fishing & Hunting
8.7	6	6.8	7	8.7	5	8.3	5	9.3	5	Arts, Entertainment & Recreation
9.6	7	9.6	10	10.0	5	10.4	9	10.0	9	Construction
11.3	101	10.5	101	13.6	96	9.9	91	10.1	89	Consulting, Prof., Scientific & Tech. Svcs.
6.6	18	6.4	19	5.7	19	7.1	19	7.0	14	Educational Services
12.0	235	12.4	252	12.4	245	12.2	240	12.3	228	Finance & Insurance
12.3	57	13.0	65	11.8	61	11.9	60	12.0	59	Credit Intermediation & Related Act.
16.1	48	13.7	45	19.5	48	17.6	47	18.4	44	Funds, Trusts & Other Financial Vehicles
9.7	110	10.1	111	9.7	114	9.4	110	9.5	110	Insurance Carriers & Related Act.
19.0	14	19.5	18	21.1	16	22.1	15	19.6	16	Securities, Commodities & Other Investments
7.5	66	7.0	74	8.6	70	6.7	62	7.7	70	Health Care & Social Assistance
7.4	46	7.3	50	9.0	50	6.5	42	7.5	47	Hospitals
7.8	20	6.5	24	8.5	20	7.0	20	7.8	23	Nursing, Ambulatory & Residential Care
13.0	102	11.1	107	15.8	107	13.7	101	14.2	101	Information
10.8	18	9.7	18	15.8	18	13.2	17	12.1	17	Internet Industries
13.8	28	13.2	31	14.1	25	14.2	26	13.3	25	Publishing Industries
13.4	53	10.4	56	16.1	54	13.6	56	15.2	53	Motion Picture, Sound Recording, Broadcasting
14.3	7	8.7	7	16.5	6	10.1	8	15.7	7	Mgmt. of Companies & Enterprises
11.9	433	10.8	456	12.7	456	12.7	425	12.7	436	Manufacturing
12.5	70	11.3	72	13.7	73	13.4	69	12.6	67	Chemical Mfg.
10.5	71	8.3	71	11.7	72	10.2	63	11.7	64	Computer & Electronic Product Mfg.
10.5	23	10.1	25	9.9	23	9.9	22	9.8	24	Electrical Equip., Appliance & Component Mfg.
14.2	37	13.1	38	14.9	43	14.4	42	15.7	40	Food, Beverage & Tobacco Product Mfg.
12.0	17	11.1	17	13.3	20	14.9	17	15.4	20	Machinery Mfg.
11.0	25	11.5	20	11.0	25	11.8	23	12.5	27	Metal Mfg.
13.1	19	11.5	18	13.5	22	12.4	19	14.2	22	Paper Mfg., Printing & Related Act.
11.9	15	9.2	15	12.4	17	13.8	17	14.0	16	Plastics & Rubber Products Mfg.
11.0	9	7.4	11	14.0	11	13.5	11	13.5	12	Textile, Apparel, Leather & Allied Product Mfg.
10.4	20	7.1	24	9.9	21	8.1	21	10.7	21	Transportation Equipment Mfg.
12.3	126	11.5	132	13.1	131	13.7	120	12.4	119	Other Misc. Mfg.
14.0	28	14.1	30	14.2	29	11.9	25	13.7	25	Mining
3.3	20	3.7	21	4.5	16	5.2	18	3.8	16	Public Administration
17.9	20	17.8	22	18.5	24	18.1	22	17.3	20	Real Estate, Rental & Leasing
14.1	63	12.3	63	15.7	68	15.6	67	14.3	67	Retail Trade
11.1	55	11.0	56	11.4	58	10.4	53	14.2	49	Telecommunications
10.2	38	8.3	37	11.0	32	10.0	30	11.8	31	Transportation
8.3	8	6.7	7	8.2	7	7.7	8	9.0	7	Air Transportation
10.7	22	8.7	28	11.7	23	10.5	24	12.6	24	All Other Transportation
10.0	87	9.7	85	9.8	89	9.1	80	9.5	81	Utilities
15.0	42	12.0	40	15.3	42	13.5	39	14.8	40	Wholesale Trade
7.5	18	7.4	16	7.8	19	7.5	17	8.0	19	Other Services (except Public Admin.)
7.2	18	6.4	14	7.4	17	7.1	15	7.7	17	Religious, Grantmaking, Civic, Prof. & Similar Org.
11.7	1354	10.3	1420	12.4	1412	11.8	1307	12.0	1341	Total

Key: Vertical = Industry Group
Subvertical = Within Subgroup

* Fewer than five survey respondents. – No Data

NATIONAL DATA
U.S.

VARIABLE PAY – OFFICER/EXECUTIVE

INDUSTRY	2003 Budgeted Incentive (as a percentage of base pay) %	n	2003 Actual Paid Incentive (as a percentage of base pay) %	n	2004 Budgeted Incentive Target (as a percentage of base pay) %	n	2004 Award Estimate (as a percentage of base pay) %	n	2005 Budgeted Incentive Target (as a percentage of base pay) %	n
Accommodation & Food Services	45.9	18	37.1	21	41.7	19	41.4	17	40.9	17
Administrative Support & Waste Mgmt.	26.8	12	23.8	13	33.9	15	20.8	14	27.0	14
Agriculture, Forestry, Fishing & Hunting	*	*	28.1	6	31.4	5	15.8	5	*	*
Arts, Entertainment & Recreation	32.0	6	28.4	8	32.0	6	29.4	7	33.3	8
Construction	32.4	8	23.6	10	31.2	9	29.7	6	26.3	8
Consulting, Prof., Scientific & Tech. Svcs.	28.2	85	24.8	88	29.2	89	27.1	85	25.4	80
Educational Services	34.3	9	36.7	10	15.5	17	16.5	16	20.7	12
Finance & Insurance	33.6	238	34.7	238	34.9	234	35.2	234	34.5	229
Credit Intermediation & Related Act.	33.9	52	34.6	58	32.3	59	35.9	60	32.0	58
Funds, Trusts & Other Financial Vehicles	38.8	45	37.1	47	43.7	47	41.8	49	44.8	45
Insurance Carriers & Related Act.	32.1	99	34.2	109	33.0	107	33.7	106	32.3	105
Securities, Commodities & Other Investments	43.2	13	47.0	15	45.7	12	55.3	12	45.1	12
Health Care & Social Assistance	23.1	83	21.2	83	24.0	94	21.7	85	21.3	83
Hospitals	23.9	61	20.6	61	23.1	70	20.2	61	21.5	60
Nursing, Ambulatory & Residential Care	21.1	22	22.9	22	26.7	24	25.5	24	20.7	23
Information	40.7	105	31.8	105	40.7	106	39.8	105	40.6	99
Internet Industries	35.0	19	32.0	19	39.6	19	36.0	19	41.0	19
Publishing Industries	41.8	25	33.6	28	40.8	24	38.1	24	34.6	21
Motion Picture, Sound Recording, Broadcasting	42.8	61	30.9	58	41.1	63	41.3	62	42.6	59
Mgmt. of Companies & Enterprises	25.8	6	20.4	5	28.7	7	23.6	7	28.9	7
Manufacturing	35.4	369	31.9	408	36.0	431	36.7	398	36.9	401
Chemical Mfg.	34.6	63	32.8	68	36.8	69	37.4	63	35.8	60
Computer & Electronic Product Mfg.	36.1	62	31.0	61	40.0	68	33.2	59	37.2	59
Electrical Equip., Appliance & Component Mfg.	30.8	30	27.6	23	29.1	22	26.0	21	31.6	22
Food, Beverage & Tobacco Product Mfg.	39.5	40	37.0	39	40.7	44	38.0	42	38.7	44
Machinery Mfg.	41.4	15	34.7	15	38.5	18	44.4	15	46.7	16
Metal Mfg.	33.3	24	26.9	25	33.9	27	37.1	23	31.7	26
Paper Mfg., Printing & Related Act.	38.3	16	38.2	17	37.2	19	34.4	17	37.8	18
Plastics & Rubber Product Mfg.	29.0	12	24.7	13	30.0	14	35.3	15	31.5	15
Textile, Apparel, Leather & Allied Product Mfg.	37.8	10	32.4	12	48.0	11	48.6	11	37.2	11
Transportation Equipment Mfg.	39.7	15	20.9	18	38.8	19	31.2	18	41.1	17
Other Misc. Mfg.	33.6	110	33.5	119	39.9	121	28.2	113	37.4	112
Mining	37.7	27	33.4	28	37.2	28	37.2	25	36.8	25
Public Administration	15.0	15	13.8	17	20.2	16	19.8	15	16.2	13
Real Estate, Rental & Leasing	45.7	20	50.8	22	49.1	28	45.8	22	38.4	21
Retail Trade	40.4	59	36.0	58	43.6	67	40.7	67	40.7	63
Telecommunications	37.4	51	34.3	53	41.3	54	27.8	52	40.8	47
Transportation	30.5	25	27.3	28	39.1	27	38.4	25	37.7	26
Air Transportation	25.3	5	23.4	6	39.6	6	23.7	5	24.3	6
All Other Transportation	31.8	20	28.2	22	38.9	21	42.0	20	41.8	20
Utilities	30.3	59	29.7	54	32.3	62	34.2	59	32.9	60
Wholesale Trade	30.9	36	23.1	35	38.5	38	35.7	35	33.0	37
Other Services (except Public Admin.)	18.8	14	17.2	13	18.4	17	20.1	15	16.1	17
Religious, Grantmaking, Civic, Prof. & Similar Org.	14.8	12	12.2	11	12.9	15	17.0	13	12.6	15
Total	33.7	1248	31.2	1301	35.7	1359	34.4	1292	34.0	1273

* Fewer than five survey respondents – No Data

Key: Mining = Industry Group
Metal Mfg. = Industry Subgroup

WorldatWork.
The Professional Association for Compensation, Benefits and Total Rewards

Variable Pay and Organizational Performance

Survey Brief – February 2004

Survey of WorldatWork members by WorldatWork, Dow Scott, PhD, and Hay Group, LLC

Introduction

To determine the prevalence and the effectiveness of variable pay programs that are most commonly used in organizations today, WorldatWork partnered with Dow Scott (Professor of Human Resources, Loyola University Chicago) and Hay Group, LLC to conduct a survey of WorldatWork members. Respondents were asked to describe and evaluate their variable pay programs for management and professional employees as they related to:

- Prevalence of design and administrative features of variable pay programs
- Organizational effectiveness; and
- Communication and implementation of variable pay strategies and programs.

This variable pay survey is the second study of pay practices in U.S. companies. The first survey (completed in early 2003) focused on the prevalence of "foundational" or base pay policies and practices, where this study focuses on variable pay programs and how these programs affect organizational performance.[1]

Organizations often operate multiple pay systems for several employee groups who may be eligible for a variety of variable pay programs. For this study, a decision was made to collect detailed information on the most prevalent variable pay program in place for managerial and professional employees. This is based on the following reasons:

- To make the collection and reporting of results practical.
- Management and professional employees have a pronounced influence on organizational performance.
- This group represents a fairly large number of employees where variable pay programs are typically an important part of their compensation package.
- Since compensation and human resource managers would likely be eligible for these variable pay programs, they should have detailed knowledge and informed opinions of how the variable pay programs operate both as a designer, administrator and recipient.

Information about sales and executive incentive plans were excluded from this study.

This report provides aggregated descriptive information concerning the types and characteristics of short-term cash based programs for management and professional employees in participating organizations managerial and professional employees. A more detailed examination of the data, including an analysis of the linkage to company performance, will be presented at the 49th Annual WorldatWork Conference in May 2004 in Boston, MA.

[1] Results from this study can be found at www.worldatwork.org under the Library/Research and Surveys page, and are published in an article by Dow Scott, Richard Sperling, Thomas McMullen and Marc Wallace. (2003) Linking Compensation Policies and Programs to Organizational Effectiveness. WorldatWork Journal. 12(4), 35-44.

Methodology

A representative sample of over 9,000 WorldatWork members was sent a web-link to the electronic survey instrument in late November 2003. Virtually all responses were from compensation professionals or human resource managers who had significant responsibility for compensation decisions. During a two-week period, a total of 958 members responded, a response rate of 11%. Responses from compensation managers from diverse industries and organizational sizes (via employee population) indicate a good cross section of companies. (See *Respondent Demographics* in Appendix).

Compensation managers representing organizations with less than 100 total employees or organizations with less than 30 professional and managerial employees were excluded from the analysis, as compensation practices for these organizations could be atypical and, thus, potentially distort the findings. In addition, responding organizations where neither managers nor professional employees are eligible to receive variable or incentive pay were also excluded from the more detailed analysis of the variable pay practices for this group. A valid or working sample of 793 organizations or 9% of the WorldatWork targeted sample remained for the data analysis. This represents variable pay programs covering approximately 2.8 million management and professional plan participants.

Key descriptive findings are highlighted in the following section. Additional relevant descriptive statistics are provided in this report's appendix.

Note: All percentages are rounded up from 0.5 and therefore may not equal to 100%.

Overall Response to Variable Pay Programs

Seventy percent (70%) of respondents believed that variable pay was important to very important to the success of their organizations' competitive strategy. Furthermore, 36% believed that it is moderately important for most employee groups and 44% believed that variable pay is important for all employee groups.

The following data excludes organizations that do not offer variable pay eligibility to both managers and professionals. However, 14% of this sample grants eligibility to managers only (Not in Senior Executive Team) while less than 1% only to professional employees.

Specifically, respondents detailed the types of variable pay programs for which managers and professionals are eligible and rated the effectiveness of those programs:

Table 1

Type of Variable Pay Program	% of Managers and Professionals Eligible	% Responded Strongly to Moderately Effective
Individual Performance Bonuses	79%	89%
Team Performance Bonuses	48%	83%
Gain-sharing Incentive	19%	72%
Profit or Revenue Sharing	46%	69%
Equity Programs	59%	68%
Spot / Other Cash-based Recognition Programs	75%	70%

These findings confirm our assumption that variable pay is a prevalent and important element in the competitive strategy of U.S. companies.

Detailed Examination of Short-term Variable Pay Programs

Compensation managers indicated the type of their primary annual (or short term) variable pay program for managerial and professional employees as follows:

Table 2

Annual (or short-term) Variable pay	% of Managers and Professionals That Use as Primary Vehicle
Individual Performance Bonuses	25%
Corporate or Company Measure	31%
Business Unit Measure	13%
Combination of Corporate, Business Unit, and Individual Performance	15%
Combined Individual and Team Performance Bonus	10%
Team Performance Bonuses	2%
Department Measure	1%
Other Types of Bonuses	3%

Although individual short-term cash bonuses are the primary variable pay program for 25% of managerial and professional employees and are rated as the most effective (*Table 1*), 75% of the organizations rely on multiple measurement metrics to motivate this group of employees.

When asked their view regarding leverage (i.e., variable pay as percentage of base pay), 73% of compensation managers believed that their managerial and professional employees were moderately to aggressively leveraged as compared to other companies in the labor market. As might be expected, higher paid professionals and managerial employees are more highly leveraged than those that are paid less, as shown below:

- Paid less than $50,000 are leveraged 0-9%;
- $50,000 to $99,000 are leveraged 10-24%;
- $100,000 to $149,000 are leveraged 10-39%;
- $150,000 to $199,000 are leveraged 10-59%;
- $200,000 to $299,000 are leveraged 40-79%.

Survey participants reported diverse reasons for providing variable pay programs to managerial and professional employees. "Improve organization or team financial performance" is the most frequently mentioned variable pay objective and "creating a more competitive total compensation market position" is the second.

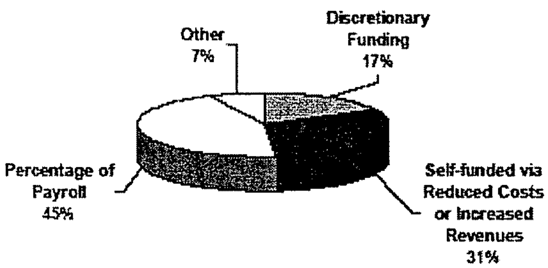
Table 3

Primary Objectives of Variable Pay Program for Managerial and Professional Employees (Respondents asked to select 3 most important)	Selection % from 793 Respondents
Improve organization or team financial performance	65%
Create a more competitive total compensation market position	58%
Improve individual performance or productivity	47%
Improve overall productivity	32%
Better recognize employee contributions	32%
Promote a sense of ownership	22%
Use variable pay to better manage compensation costs	17%
Improve employee involvement	12%
Support culture change	8%
Reduce employee turnover	7%

Three primary funding sources for the managerial and professional annual or short-term variable plans were identified, i.e., discretionary, percentage of payroll and self-funded (Figure 1). Most variable pay plans contain a hurdle or trigger feature that can cancel payouts, caps on how much an employee can receive and were paid annually (Tables 4-5).

Figure 1

Funding Sources of Variable Pay Programs
For Managerial and Professional Employees



- Percent of professional variable pay programs that have a hurdle or trigger that can cancel a payout: 82%
- Percent of programs with pre-established performance levels: 87%
- Percent of programs that are capped to how much an employee can receive: 80%

Table 4

If Plan Contains a Cap, the Maximum Percentage of the Variable Pay Target	% of Responses
100 – 124%	24%
125 – 149%	12%
150 – 199%	27%
200 – 249%	25%
250 – 300%	3%
Over 300%	1%
Not applicable	8%

Table 5

Primary Variable Pay Program Designed to Pay Out:	% of Responses
Annually	81%
Semi-annually	5%
Quarterly	7%
Monthly	1%
Achievement of objectives / milestones	2%

The large majority of the variable pay programs have been revised in the last five years (81%) with 47% revised during the last two years.

Human resources or the compensation department were the primary designers of the variable pay plan (66%) often with input from senior management. Compensation managers seldom involved employees who would be eligible for the program (77%).

Sixty-seven percent (67%) of compensation managers believe that most to all eligible employees understand the variable pay program.

Findings report in Table 6 indicates that variable pay plans are communicated in diverse ways and not communicated at all according to 7% of the respondents.

Table 6

Details and Updates of the Variable Pay Program are Communicated Through:	% of Responses
One-on-one discussions with their supervisor	55%
Written materials outlining plan	52%
Information posted in a public place or the intranet	31%
Employee meetings	34%
Variable pay information in NOT communicated	7%

Compensation managers were asked to rate their variable pay program for managers and professional employees on several dimensions. Listed below in Table 7 is the percentage of managers that said that the variable pay plan was effective or very effective for the stated dimension.

Table 7

Variable Pay Program Dimension	% Responded Effective to Very Effective
Overall effectiveness	64%
Motivational value of the program	55%
Funding mechanism	77%
Appropriateness of the variable pay plan measures	68%
Frequency of payouts	79%
Relationship between variable pay program payouts to organizational performance	72%
Relationship between variable pay program payouts to group or team performance	43%
Relationship between variable pay program payouts to individual performance	53%
Employee understanding the program	61%
Responsiveness to change	50%
Administrative ease	64%
Appropriate return on investment	62%

Overall, approximately two thirds of compensation managers seem to be satisfied with the outcomes of their variable pay programs.

However, this still indicates that a significant minority (one out of every three) are not satisfied.

The criteria used to judge the effectiveness of managerial and professional annual or short-term variable pay programs are shown in Table 8.

Table 8

Criteria Management Uses to Judge Effectiveness of Their Programs (Respondents asked to select All That Apply)	Selection % from 793 Respondents
Business operating results	73%
Informal opinion gathering from senior leadership	35%
Employee satisfaction survey measures	30%
Employee productivity metrics	28%
Employee turnover or retention	27%
Informal opinion gathering from employees	23%
Management does not evaluate variable pay plan success	16%
Labor costs are controlled or lowered	9%

Compensation managers indicate that "line of sight", improving the linkages between payouts and performance and improving the communication of plan objectives are the most important ways to improve the variable pay programs (Table 9).

Table 9

How Variable Pay Programs Can Be Improved (Respondents asked to select 3 most important)	Selection % from 793 Respondents
Improve plan "line of sight" to individual or team efforts	60%
Improve linkage between payout and performance	57%
Improve communication of plan objectives	48%
Increase understanding of the variable pay plan	33%
Improve ease of administration	23%
Increase payout opportunities	23%
Ensure goals are viewed as more attainable	22%
Reduce conflicting goals	9%

Conclusions

This study indicates that variable compensation for most managerial and professional employees is still administered under fairly traditional – time tested – methodologies and processes such as individual bonus, profit sharing, gainsharing and equity programs. Compensation professionals believe that these processes are generally effective, as is evident by their widespread use and positive responses.

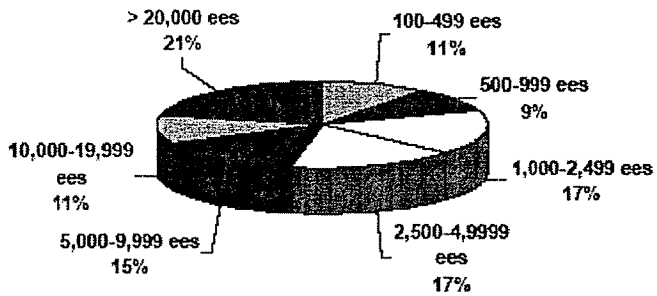
Program designs for short-term or annual cash variable pay programs are generally given high ratings for effectiveness by the survey respondents, but program implementation is not viewed as favorably. Relatively low marks are given for the effectiveness of the compensation programs' motivational value and communication to employees. Although individual variable pay plans are rated highly, most plans have a shared variable pay component.

The effectiveness of compensation programs is ultimately based on how those programs contribute to the effectiveness of the organization. Implementation, therefore, seems to be where organizations report an area of focus to improve overall compensation program effectiveness.

Respondents' Report - Appendix

Respondent Demographics

Responding Firms by Employee Size *



** Respondents with less than 100 employees are not included in this descriptive analysis.*

Responses by Industry

Table A-1

Industry Sector (Top 12)	# of Respondents	% of Valid (Non-missing) Responses
Manufacturing	175	26%
Finance & Insurance	146	22%
Information	56	8%
Healthcare & Social Assistance	46	7%
Utilities	48	7%
Professional, Scientific, & Technical Services	34	5%
Retail Trade	25	4%
Other Services (Except Public Administration)	15	2%
Real Estate & Rental & Leasing	14	2%
Transportation & Warehousing	12	2%
Accommodation & Food Services	9	1%
Wholesale Trade	9	1%

Descriptive Statistics of Variable Pay Study

All percentages are rounded up from .5 and therefore may not equal to 100%.

Table A - 2

Importance of Variable Pay to the Success of Organization's Competitive Strategy	% of Responses
Not important	1%
Minimally Important	8%
Moderately Important	21%
Important	38%
Very Important	32%

Table A - 3

Statement That Best Describes Management's Philosophy About the Use of Variable Pay	% of Responses
Not important or minimally important	2%
Unimportant for all but a few specific employee groups	19%
Moderately important for most employee groups	36%
Important for all employee groups	44%

Table A - 4

	Sample Size		# of Managers and Professional Employees				
	Valid	Missing	Min	Max	Mean	Median	Std. Dev.
Number of mangers & professional employees within your organization	758	35	30	250,000	3,688	800	13,105

Table A - 5

Annual (or short-term) Variable pay for Managerial and Professional Employees	% of Managers and Professionals That Use as Primary Vehicle
Corporate or Company Measure	31%
Individual Performance Bonuses	25%
Combination of Corporate, Business Unit, and Individual Performance	15%
Business Unit Measure	13%
Combined Individual and Team Performance Bonus	10%
Team Performance Bonuses	2%
Department Measure	1%
Other Types of Bonuses	3%

Table A - 6

Percentage of Managerial & Professional Employees That Are Eligible for Variable Pay in Table A - #	% of Responses
1 to 24%	13%
25 to 49%	8%
50 to 69%	5%
70 to 79%	3%
80 to 89%	5%
90 to 99%	9%
100%	55%
Not Sure	1%
Not Applicable	1%

Table A - 7

Manager's View Regarding Leverage (i.e. Variable Pay as a Percentage of Base Pay)	% of Responses
MINIMAL: Variable Pay as a percentage of base pay is LESS than the labor market	12%
MODERATE: Variable Pay as a percentage of base pay is COMPARABLE than the labor market	54%
AGGRESSIVE: Variable Pay as a percentage of base pay is HIGHER than the labor market	19%
No philosophy or view	8%
Not sure	5%
Not applicable	3%

Table A - 8

Approximate Variable Pay Target (or Typical Payout if the Plan Has No Target) As a Percentage of Salary						
% of Salary	Over $300,000	$200,000 - $299,999	$150,000 - $199,999	$100,000 - $149,000	$50,000 - $99,999	Less Than $50,000
	% of Responses					
0-9%	2%	3%	5%	9%	30%	60%
10 to 24%	3%	5%	19%	50%	57%	23%
25 to 39%	7%	19%	40%	29%	8%	2%
40 to 59%	21%	29%	15%	6%	1%	0%
60 to 79%	15%	7%	4%	1%	0%	0%
80 to 99%	5%	4%	1%	1%	0%	0%
100 to124%	6%	3%	2%	1%	0%	0%
125 to 149%	1%	1%	0%	0%	0%	0%
150 to 200%	2%	0%	0%	0%	0%	0%
Over 200%	1%	0%	0%	0%	0%	0%
Not applicable	38%	30%	15%	4%	4%	15%
Total	100%	100%	100%	100%	100%	100%

Table A - 9

Hurdle or Trigger That Can Cancel or Prevent a Payout	% of Responses
At the Corporate Level	49%
At the Business Unit Level	14%
At the Team Level	0%
At the Individual Level	3%
At Multiple Levels	16%
No	15%
Not Applicable	3%

Table A - 10

Timeframe When Current Primary Pay Program Was Last Substantially Revised (Or, if never substantially revised, instituted)	% of Responses
Over 10 years ago	7%
5 to 10 years ago	12%
3 to 5 years ago	18%
2 to 3 years ago	16%
1 to 2 years ago	22%
In the last year	25%

Table A - 11

Individuals / Function Responsible for Designing the Current Primary Variable Pay Plan (Assuming Senior Management Approval)	% of Responses
Solely Human Resources	18%
Human Resources with line management input	48%
Line management with Human Resources input	13%
Sole line management	2%
Other	19%

Table A - 12

Involvement of Plan Participants in the Variable Pay Program Design	% of Responses
Plan participants were NOT INVOLVED in the design	77%
Plan participants provided input via focus groups, suggestion boxes, etc.	12%
Plan participants provided recommendations for management approval	4%
Plan participants were involved in design of the plan	4%
Plan participants were involved in the design of the plan and heavily influenced the decision to implement the plan	1%
Other	2%

Table A - 13

Extent Do Eligible Employees Understand the Variable Pay Program	% of Responses
Virtually NO eligible employees understand the variable pay program	3%
MOST eligible employees DO NOT understand the variable pay program	12%
About HALF of the eligible employees understand the variable pay program	18%
MOST eligible employees understand the variable pay program	48%
Virtually ALL eligible employees understand the variable pay program	20%

About WorldatWork®

WorldatWork is the world's leading not-for-profit professional association dedicated to knowledge leadership in compensation, benefits and total rewards. Founded in 1955, WorldatWork focuses on human resources disciplines associated with attracting, retaining and motivating employees. Besides serving as the membership association of the professions, the WorldatWork family of organizations provides education, certification (Certified Compensation Professional - CCP®, Certified Benefits Professional - CBP™ and Global Remuneration Professional - GRP®), publications, knowledge resources, surveys, conferences, research and networking. WorldatWork Society of Certified Professionals and Alliance for Work-Life Progress (AWLP) are part of the WorldatWork family.

About Dow Scott

Dr. Dow Scott is both a Professor of Human Resources and the President of Performance Development International, Inc. (PDII). His teaching, research and consulting have focused on creating effective teams, performance improvement strategies, equitable pay and performance enhancing variable pay systems, and high performance organizations both in the U.S. and abroad. He often gets involved in evaluating variable pay programs that are currently in use or designing new programs that will enhance employee commitment and productivity. He has received national recognition both among academic and professional audiences for his research.

About Hay Group, LLC

Hay Group is a global Human Resources consulting firm that helps organizations get the most from their people by creating clarity, capability, and commitment. Founded in 1943 in Philadelphia, Hay works from 72 offices in 37 countries. Hay's areas of expertise include:

- Organizational effectiveness, role clarity, work design, and assessment;
- Selection and development;
- Compensation, benefits, and performance management;
- Executive remuneration and corporate governance; and,
- Employee and customer attitude research.

Based on 60 years of specific, documented evidence that people, not strategies, drive long-term success, Hay Group has built a worldwide presence in assisting organizations to achieve their goals.