Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

78. Please reference Woolridge testimony, at page 57, lines 11-14. Please list the number of "sell side" and "buy side" analysts that have contributed to each forecast of earnings growth compiled by Zacks, First Call and Reuters. Please provide a copy of the supporting data and source documents for the response.

Response

Zacks, First Call and Reuters do not report the analysts who have contributed to each forecast of earnings growth and therefore it is impossible to list the analysts as "sell side" or "buy side."

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

79. Please reference Woolridge testimony, at page 57, line 15-17. Please quantify the magnitude of the bias in each of the analysts' forecasts included in the sources from Zacks, First Call and Reuters.

Response

It is not possible to quantify the magnitude of the bias in each of the analysts' forecasts included in the sources from Zacks, First Call and Reuters.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

80. Please reference Woolridge testimony, at page 59, line 1. Please provide the workpapers and source documents for each of the growth rates indicated on the graph. In particular, specify the years covered by the forecasts of growth and the years covered by the actual growth for each date point.

Response

The information sought in this request is subject to a motion for confidential protection. Please see response to KPC-I-86, provided on CD, for a redacted copy of the response.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

81. Please reference Woolridge testimony, at page 61 and footnote 23. Please provide a complete copy of the source document.

<u>Response</u>

The document is provided on CD under Attachments as KPC-I-82A – Brown.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

82. Please reference Woolridge testimony, at page 68 and footnote 24. Please provide a complete copy of the source document.

Response

The document is provided on CD under Attachments as KPC-I-83A – Carleton.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

83. Please reference Woolridge testimony, at page 69 and footnote 25. Please provide a complete copy of the source document.

Response

The document is provided on CD under Attachments as KPC-I-84A – Roll.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

84. Please reference Woolridge testimony, at page 76 and Schedule JRW-10. Please provide the workpapers and source documents for the equity returns, including: the dates of the Value Line reports, the years covered by the Value Line forecasts, the values used to calculate the (i) Value Line projected four-year return (ii) S&P 500 one-year returns, and (iii) the S&P 500 actual four-year returns.

Response

The data is provided on CD in spreadsheet Data3.xls.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

85. Please reference Woolridge testimony, at Exhibit JRW-3 through JRW-10. Please provide an electronic copy of all schedules in their native format with all formulas intact.

Response

The electronic copy is provided on CD as KPC-1-85.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Respondent: OAG Witness Dr. J. Randall Woolridge

86. To the extent not provided in response to any prior request by Kentucky Power, please provide on diskette or CD all non-proprietary tabulations included in the Dr. Woolridge's testimony and all data necessary to recreate in their entirety, all analyses and calculations performed for the preparation of his testimony. Please provide this and all electronic data in Excel (or .txt format if appropriate), with all formulae intact. Please provide any record layouts necessary to interpret the data. Please include in the response electronic spreadsheet copies of all of the schedules and/or tables included in the testimony, with all formulae intact.

Response

The redacted information is provided on CD in the folder "KPC-1-86 – Forecasted EPS Growth Study."

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Witness Responsible: David H. Brown Kinloch

87. Please reference Brown Kinloch testimony at p. 15, lines 20-22 and p. 16, lines 1-2. If the Miscellaneous Service charge levels were unchanged in Kentucky Power Company's last rate case, when was the last time Miscellaneous Service Charges were increased? How much has the CPI changed since the last year in which the Miscellaneous Service Charges were increased?

ANSWER:

According to the Bureau of Labor Statistics figures, the Consumer Price Index rose 190% between December 1978 and December 2005. Kentucky Power Company's proposed increases for all Miscellaneous Charges in this case are above 190% for all charges except the Bad Check charge. For example, the two most frequent charges, "Reconnect for Non-Payment – Regular Hours" and "Termination of Field Trip", Kentucky Power has proposed to increase by 322% and 283% respectively, significantly above inflation since 1978.

Though Miscellaneous Charges were last increased in 1978, 1978 should not be used as a benchmark because Company not only agreed to the Miscellaneous Charges that are in use today in 1991, but also never sought to utilize its right to increase Miscellaneous Charges between rate cases under Section 10 of 807 KAR 5:011.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Witness Responsible: David H. Brown Kinloch

88. Please reference Brown Kinloch testimony at p. 16, lines 1-2. Is it Mr. Brown Kinloch's position that agreement to a settlement of a rate case means that each and every individual component of such settlement is fair, just and reasonable?

ANSWER:

In Case No. 91-066, the Commission unanimously approved the proposed settlement of the case, and thus found the individual elements of the settlement to be fair, just and reasonable in the context of that settlement. Had the Commission objected to specific elements, it could have approved the settlement with the exception of any particular elements or disapproved the settlement entirely. The Commission approved the settlement as proposed, including the proposed Miscellaneous Charges, and those charges have been no less fair, just and reasonable than any of the other rates resulting from that settlement.

It should also be noted that Kentucky Power Company did not reach agreement with all parties on all the issues in Case No. 91-066. Specifically, an agreement on a proposal from the "Low Income Residential Customers" was not acceptable to the Company, and the settlement was put before the Commission that did not settle this issue. This demonstrates that had Kentucky Power not been in agreement with other parties with respect to the level of Miscellaneous Charges, that issue could have also been withheld from the settlement and dealt with separately by the Commission. Instead, all parties found the level of Miscellaneous Charges contained in the settlement to be acceptable.

Response of the Attorney General to
Initial Data Request of Kentucky Power Company to the Attorney General
Kentucky Power Company
Case No. 2005-00341

Witness Responsible: David H. Brown Kinloch

89. Please reference Brown Kinloch testimony at Exhibit DHBK-1. Please provide a copy of all written testimony and evidentiary transcripts of which Mr. Brown Kinloch provided in any jurisdiction in an electric base rate case proceeding since January 1, 2000.

ANSWER:

All requested cases in which Mr. Brown Kinloch has participated during this time period have been before the Kentucky Public Service Commission. He has never had copies of any transcripts of those proceedings, but the transcripts may be available at the Commission. Copies of the requested written testimonies may be found on the KPSC website under Case Documents, Non-Electronically Filed Cases in the FTP site under the folders for 2003-00433, 2003-00434, 2005-00125 and 2005-00187. The first two are in "pdf" files labeled "AG Testimony DavidHBrownKinloch" and the second two in files labeled "AG Testimony." A copy of the Rebuttal Testimony filed in 2003-165 is not available on the website and is attached.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

THE APPLICATION OF KENERGY CORP.)
FOR THE REVIEW AND APPROVAL) CASE NO. 2003-00165
OF EXISTING RATES)

REBUTTAL TESTIMONY OF DAVID H. BROWN KINLOCH

Q1: PLEASE STATE YOUR NAME AND ADDRESS.

A1: My name is David H. Brown Kinloch and my business address is Soft Energy Associates, 414 S. Wenzel Street, Louisville, KY 40204.

Q2: FOR WHOM HAVE YOU PREPARED REBUTTAL TESTIMONY?

A2: I have prepared this rebuttal testimony for the Office of the Attorney General for the Commonwealth of Kentucky.

Q3: PLEASE STATE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A3: I have received two master's degrees from Rensselaer Polytechnic Institute (RPI) in Troy, New York. I also received two undergraduate degrees from the same school. My master's degrees are a Master of Engineering in Mechanical Engineering and a Master of Science in Science, Technology and Values, received in 1979 and 1981 respectively. My undergraduate degrees are in Mechanical Engineering and Philosophy. Much of my master's work included preparing Electric Generation Planning studies for the Center for Technology Assessment at Rensselaer. From this work I published two technical papers with IEEE Power Generation Division, and was a contributing author on two others. I also did work on New York State's first Energy Masterplan, one of the first comprehensive long-term planning studies in the nation.

Q4: HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE THIS COMMISSION?

A4: Yes, I testified in the following rate cases: Louisville Gas & Electric Co. Case No. 2000-080, Case No. 90-158, Case No. 10064, and Case No. 9824; Kentucky Power Co. Case No. 91-066; Union Light Heat and Power Co. Case No. 92-346 and Case No. 91-370; Big Rivers Electric Corp. Case No. 9613 and Case No. 97-204; Delta Natural Gas Co. Case No. 97-066; Western Kentucky Gas Co. 95-010; East Kentucky Power Cooperative Case No. 94-336; Clark RECC Case No. 92-219; Jackson Purchase ECC Case No. 97-224; Meade County RECC Case No. 97-209; Green River EC Case No. 97-219, Henderson Union ECC Case No. 97-220, and Licking Valley RECC Case No. 98-321. I also presented testimony in cases involving each of East Kentucky Power's Cooperatives in the pass-through of rate reductions associated with Case No. 94-336. I also testified in the

Commission's reviews of LG&E's Trimble County power plant, Case No. 9934 and Case No. 9242, and the rate impact of the 25% disallowance of that project, Case No. 10320. In addition, I presented testimony in the Certificate of Convenience and Necessity cases for Kentucky Utilities, Case No. 91-115, LG&E and KU, Case No. 2002-00029, and East Kentucky Power, Case No. 92-112, Case No. 2000-056, Case No. 2000-079, Case No. 2001-053 and Case No. 2003-030. I have also testified in Fuel Adjustment Clause cases involving Louisville Gas and Electric, Case No. 96-524, and Kentucky Utilities, Case No. 96-523; and in Environmental Surcharge cases involving Kentucky Power, Case No. 96-489; Kentucky Utilities, Case No. 93-465; and Louisville Gas and Electric, Case No. 94-332. Other cases in which I presented testimony include the Kentucky Utilities' Coal Litigation Refund case, Case No. 93-113; the Big Rivers' sale of peaking capacity to Hoosier Energy case, Case No. 93-163; the Joint Application case with LG&E to establish Demand Side Management programs, Case No. 93-150; and the Louisville Gas and Electric and Kentucky Utilities merger case, Case No. 97-300, the LG&E Energy and PowerGen merger case, Case No. 2000-095; a Union Light, Heat and Power refund case, Case No. 2000-426: and the Union Light, Heat and Power generation acquisition case, Case No. 2003-0052.

Q5: DID YOU PRESENT INTERVENER TESTIMONY IN THIS CASE?

A5: No I did not.

Q6: WHY ARE YOU FILING REBUTTAL TESTIMONY?

A6: The Office of Attorney General asked me to review Kenergy's application in this case. I reviewed that application and agreed with Kenergy that there appears to be no reason to change existing rates at this time. Thus there was no need to file testimony in opposition of Kenergy's application. Kentucky Industrial Utility Customer (KIUC) has filed the testimony of Russell Klepper that calls for a reduction in rates for KIUC members only. In addition, a change is being requested in a contract between Kenergy and a KIUC member. Each of these proposals would ultimately have an adverse impact on other Kenergy members. The purpose of my testimony is to review and comment upon the recommendations put forth by Mr. Klepper and, insofar as these proposals disagree with Kenergy's application, to continue to support Kenergy.

Q7: WHAT HAS MR. KLEPPER PROPOSED WITH RESPECT TO KIUC MEMBERS SERVED BY KENERGY?

A7: Mr. Klepper proposes to eliminate any contribution by KIUC members to the TIER received by Kenergy. The TIER is the margin that a Cooperative receives that gives the utility the working capital needed to operate. Traditionally, the Commission has allowed cooperatives like Kenergy to recover a TIER of 2.00. In this case, Kenergy has calculated its TIER to be 1.97 after test year adjustments. Since the Kenergy TIER is in the 2.00 range, Kenergy has proposed leaving current rates unchanged.

Q8: ARE THERE PROBLEMS WITH THE PROPOSAL TO ELIMINATE ALL CONTRIBUTION BY KIUC MEMBERS TO KENERGY'S TIER?

A8: Yes, there are many. First, Mr. Klepper suggests that the elimination of a contribution to the Kenergy TIER, or margin, by KIUC members could simply be absorbed by Kenergy. This result would be a lower TIER for Kenergy. If the Commission allows Kenergy the TIER it believes is necessary for operations, and revenues from KIUC members are reduced, then the rates charged other customers will have to be increased to make up for the lost revenues from KIUC customers.

Second, this special rate treatment would only apply to KIUC members. Other customers could rightly say that fairness would dictate that if KIUC members need not make any contribution to Kenergy's margin, then they shouldn't have to either. Not only has KIUC failed to explain why members of a class who belong to KIUC should receive this treatment while non-members of like classes should not, if all customers made no contribution to Kenergy's margin, then its TIER would be 1.00, which would make the Cooperative very difficult to operate.

Third, KIUC members are already making a very small contribution to Kenergy's margin. If any customers should receive a reduction in their contribution to margins, it should be other customers that are paying much higher margins.

Q9: YOU STATE THAT THE KIUC MEMBERS ARE MAKING A SMALL CONTRIBUTION TO KENERGY'S MARGIN AND MR. KLEPPER STATES THAT THEY ARE PAYING A VERY HIGH MARGIN. WHAT IS THE DIFFERENCE BETWEEN YOUR ANALYSIS AND THAT OF MR. KLEPPER?

A9: Mr. Klepper's claims are based on selective use of figures from the Kenergy Cost of Service Study. In his analysis, he does not include all expenses, and does not include all margins. He picks and chooses only the expenses and margins that make his clients look good, which results in a very skewed view. By contrast, I will examine "Total Operating Revenues", "Total cost of electric service", and "Total Margins". To demonstrate this difference, in Exhibit DHBK-1, I have done the same limited analysis that Mr. Klepper did, except I have included all costs that make up the cost of service. Mr. Klepper excluded both the cost of Purchased Power and Interest on Long Term Debt in the analysis done for his clients.

Including all costs to serve reveals a much different and more accurate picture. When all costs are included, Class A clients are not paying rates 100% percent more than their cost of service, as Mr. Klepper claims. They are paying only about one-tenth of one percent above their cost of service. When all costs are included, Class B clients are not paying 200% above their cost of service. They are actually paying only about one percent above their cost of service.

When all costs are included, the other two customer classes are paying much higher rates relative to their cost of service. The Class C Direct Serve customers are paying rates 8.56% above their cost of service, and the Regular Tariff customers are paying rates 2.26% above their cost of service. I am not recommending that rates be changed for any class, based on the Kenergy Cost of Service Study, but were I to do so, these are the classes for which rates should be lowered.

Q10: MR. KLEPPER CLAIMS THAT HIS CONCLUSIONS ARE BASED ON A COST OF SERVICE ANALYSIS. DO YOU AGREE?

A10: No. The problem with Mr. Klepper's analysis is that he wants to apply a traditional cost of service approach to Direct Serve customers. But a cost of service analysis includes, as a final step, an analysis of a rate of return on investment, which Mr. Klepper did not do. Instead Mr. Klepper only uses part of the cost of service analysis. In his modified approach, he only examines some of the costs, and then compares them to an intermediate result: Operating Margins.

Q11: WILL A TRADITIONAL COST OF SERVICE ANALYSIS WILL NOT WORK FOR DIRECT SERVE CUSTOMERS, AND IF NOT, WHY NOT?

A11: While the traditional cost of service methodology that Kenergy has done in this case is appropriate for Regular Tariff customers, it just doesn't work for Direct Serve customers. Direct Serve customers, while they are members of Kenergy, are actually served with Big Rivers transmission facilities. Thus, the investment in plant that Kenergy has to serve these large members, which provide over three-quarters of Kenergy's revenues, is virtually zero.

A cost of service analysis is based on a return on investment. If the investment to serve a particular customer is zero, or close to it, dividing any return, no matter how large or small, by zero will result in an infinite return. In reality, the investment is not zero, but very tiny. Though KIUC members alone make up almost three-quarters of all revenues, Kenergy has only $65,287 of plant invested to serve them. This figure, compared to $210 million in revenues is very small. No matter what margin is assigned to these customers, the rate of return will look gigantic due to dividing by a number, relatively speaking, which is close to zero.

Because of the problem of applying this analysis to Direct Serve customers, Kenergy is correct to separate them out before performing the traditional cost of service analysis. Mr. Klepper fails to recognize this problem and insists on applying a modified cost of service analysis to a situation where it just won't work properly. His conclusion is that the KIUC members, that account for almost three-quarters of Kenergy revenues and 85% of all sales, should make no contribution to Kenergy's margin. This conclusion would be expected from an analysis that divides a large number by zero, or a number close to zero.

Q12: IF THERE ARE PROBLEMS APPLYING THE TRADITIONAL COST OF SERVICE METHODOLOGY TO DIRECT SERVICE CUSTOMERS, WHAT TYPE OF ANALYSIS DO YOU RECOMMEND?

A12: When doing a cost of service analysis, a common way of allocating a revenue-related expense or credit across customer classes is to use each class's contribution to the utility's total revenue. Contribution to Total Revenue is a good allocator since it accounts for the different costs of serving different classes and also the different rates paid by different classes. Total contribution to revenue is a good proxy for what portion of the utility's business results from each rate class.

In Exhibit DHBK-2, I have analyzed the margins collected by each rate class compared to the Total Revenues generated by that class in current rates. This exhibit calculates each class's "Margin % of Revenues." This figure could be considered the "markup" Kenergy makes, above costs, to contribute to its margin. This exhibit shows that Regular Tariff customers have their power marked-up about 3 percent to contribute to Kenergy's margin. In contrast, the KIUC "Class A" members pay only about a tenth of one percent over cost to contribute to Kenergy's margin. The KIUC "Class B" members pay about a 1 percent markup. The Direct Serve customers that are not members of KIUC (Class C) pay almost an 8 percent markup over cost, which is about 8 times what Class B pays and over 50 times what Class A pays.

Exhibit DHBK-2 also examines what portion of the total margin each class pays. When each class's percentage of total margin is examined, these differences are even more striking. While Class A accounts for over two-thirds of Kenergy's revenues, it only contributes about 8% of Kenergy's total margin. This is quite a contrast to another Direct Serve class, Class C, which contributes only 3.5% of Kenergy's revenues and pays almost a quarter of the Kenergy's total margin.

I disagree with Mr. Klepper's conclusion that the KIUC members are paying too much of Kenergy's margin. In fact, the analysis in Exhibit DHBK-2 suggests that KIUC members may not be paying their fair share of Kenergy's margin.

Q13: BASED ON YOUR ANALYSIS, DO YOU BELIEVE THAT KIUC MEMBERS ARE PAYING THEIR FAIR SHARE OF KENERGY'S MARGIN?

A13: No. In combination, all of the KIUC members are contributing just 15 percent of the total margin, while they make up about three-quarters of Kenergy's revenues. By contrast, the other Direct Serve customers that are not KIUC members contribute almost 25 percent of Kenergy's total margin though they constitute only 3.5 percent of Kenergy's total revenues. Looking only at Direct Serve customers, the non-KIUC customers make over 60 percent of the Direct Serve contribution to Total Margins, but are less than 5 percent of the Direct Serve revenues. It would appear that KIUC members are not pulling their weight with respect to Direct Serve contributions to Kenergy's margin, and instead are relying on non-KIUC member to contribute the majority of the margins from Direct Serve customers.

Q14: ARE YOU RECOMMENDING THAT KENERGY RAISE RATES FOR DIRECT SERVE CLASSES A AND B, TO BE ABLE TO LOWER RATES FOR DIRECT SERVE CLASS C?

A14: No. I agree with Kenergy's position that rates should not be raised for any customers at this time.

Q15: MR. KLEPPER ALSO REQUESTED THAT THE COMMISSION MODIFY THE CONTRACT BETWEEN WEYERHAEUSER AND KENERGY. DO YOU AGREE WITH THE MODIFICATION HE HAS PROPOSED?

A15: No. The contract between Weyerhaeuser and Kenergy for the Weyerhaeuser co-generation project states that KIUC may challenge the level of the distribution charge in the contract, but KIUC "shall not assert, as a basis for reducing the amount of the Distribution Fee, the fact that the Distribution Fee is imposed on self-generated power in addition to purchased power . . . ". Mr. Klepper says that arguing that there is no cost of service justification to impose a distribution fee on self generated power is not contrary to the agreement that the parties shall not seek to reduce the Distribution Fee because it is imposed on self-generated power. No change in the cost to Kenergy of the self generated power has occurred since the parties agree to the imposition of the distribution fee on that power. Mr. Klepper is only looking to undo Kenergy's benefits under the contract.

Not only are Mr. Klepper's arguments contrary to the terms of the contract, now is not the time to complain. If Mr. Klepper believed that the distribution fee was not justified, he should have advised his client not to sign the contract in the first place (on page 4 of Mr. Klepper's testimony, he states that he has "continuously" worked on the Kenergy issues for KIUC since 1992). The contract contained specific provisions that prohibit the challenging of this fee. If his client felt that the contract terms were unreasonable, and were in violation of PURPA, a case could have been brought before the Commission to correct the perceived problem. This issue should have been resolved by the Commission before the project proceeded.

Q16: IF THE COMMISSION DID AGREE TO THE CONTRACT MODIFICATION SUGGESTED BY MR. KLEPPER, WOULD THIS HAVE IMPLICATIONS FOR OTHER KENERGY CUSTOMERS?

A16: Yes. Revenues lost from this customer would have to be recovered from other customers to keep Kenergy whole. The Commission needs to consider the potential revenue impact on the rest of Kenergy's customers before adopting Mr. Klepper's proposed contract modification.

Q17: WHAT RECOMMENDATIONS DO YOU HAVE FOR THE COMMISSION IN THIS CASE?

A17: The rate reductions proposed in this case by KIUC for its members, and only for its members, would have an adverse impact on other customers. Analysis shows that the KIUC members, if anything, are not making an adequate contribution to Kenergy's margin with the rates now in place. Based on this analysis, I am recommending that the Commission reject the rate reductions Mr. Klepper has proposed only for KIUC members and that it leave current rates in place, as Kenergy has recommended.

Q18: DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A18: Yes it does.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

THE APPLICATION OF KENERGY CORP.	)	
FOR THE REVIEW AND APPROVAL	)	CASE NO. 2003-00165
OF EXISTING RATES	)	

REBUTTAL TESTIMONY OF DAVID H. BROWN KINLOCH

Q1: PLEASE STATE YOUR NAME AND ADDRESS.

A1: My name is David H. Brown Kinloch and my business address is Soft Energy Associates, 414 S. Wenzel Street, Louisville, KY 40204.

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A2: I have prepared this rebuttal testimony for the Office of the Attorney General for the Commonwealth of Kentucky.

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Q5: DID YOU PRESENT INTERVENER TESTIMONY IN THIS CASE?

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Third, KIUC members are already making a very small contribution to Kenergy's margin. If any customers should receive a reduction in their contribution to margins, it should be other customers that are paying much higher margins.

Q9: YOU STATE THAT THE KIUC MEMBERS ARE MAKING A SMALL CONTRIBUTION TO KENERGY'S MARGIN AND MR. KLEPPER STATES THAT THEY ARE MAKING A VERY HIGH CONTRIBUTION TO MARGIN. WHAT IS THE DIFFERENCE BETWEEN YOUR ANALYSIS AND THAT OF MR. KLEPPER?

A9: Mr. Klepper's claims are based on selective use of figures from the Kenergy Cost of Service Study. In his analysis, he does not include all expenses and does not include all margins. He picks and chooses only the expenses and margins that make his clients look good, which results in a very skewed view. By contrast, I have examined "<u>Total</u> Operating Revenues", "<u>Total</u> cost of electric service", and "<u>Total</u> Margins". In Exhibit DHBK-1, I have done the same analysis that Mr. Klepper did, except I have included <u>all</u> costs that make up the cost of service. Mr. Klepper excluded both the cost of Purchased Power and Interest on Long Term Debt in the analysis done for his clients.

Including all cost of service reveals a much different and more accurate picture. When all costs are included, Class A customers are not paying rates 100% percent more than their cost of service, as Mr. Klepper claims. They are paying only about one-tenth of one percent above their cost of service. When all costs are included, Class B customers are not paying 200% above their cost of service. They are actually paying only about one percent above their cost of service.

When all costs are included, two customer classes are paying much higher rates relative to their cost of service. The Class C Direct Serve customers are paying rates 8.56% above their cost of service, and the Regular Tariff customers are paying rates 3.06% above their cost of service. I am not recommending that rates be changed for any class based on the Kenergy Cost of Service Study, but were I to do so, these are the classes for which rates should be lowered.

Q10: MR. KLEPPER CLAIMS THAT HIS CONCLUSIONS ARE BASED ON A COST OF SERVICE ANALYSIS. DO YOU AGREE?

A10: No. The problem with Mr. Klepper's analysis is that he wants to apply a traditional cost of service approach to Direct Serve customers. But a cost of service analysis includes, as a final step, an analysis of a rate of return on investment which Mr. Klepper did not do. Instead Mr. Klepper only uses part of the cost of service analysis. In his modified approach, he only examines some of the costs, and then compares them to an intermediate result: Operating Margins.

Q11: WILL A TRADITIONAL COST OF SERVICE ANALYSIS NOT WORK FOR DIRECT SERVE CUSTOMERS, AND IF NOT, WHY NOT?

A11: While the traditional cost of service methodology that Kenergy has done in this case is appropriate for Regular Tariff customers, it just doesn't work for Direct Serve customers. Direct Serve customers, while they are members of Kenergy, are actually served with Big Rivers transmission facilities. Thus, the investment in plant that Kenergy has to serve these large members, which provide over three-quarters of Kenergy's revenues, is virtually zero.

A cost of service analysis is based on a return on investment. If the investment to serve a particular customer is zero, or close to it, dividing any return, no matter how large or small, by zero will result in an infinite return. In reality, the investment is not zero, but very tiny. Though KIUC members alone make up almost three-quarters of all revenues, Kenergy has only $65,287 of plant invested to serve them. Compared to $210 million in revenues, this figure is very small. No matter what margin is assigned to these customers, the rate of return will look gigantic due to dividing by a number, relatively speaking, which is close to zero.

Because of the problem of applying this analysis to Direct Serve customers, Kenergy is correct to separate them out before performing the traditional cost of service analysis. Mr. Klepper fails to recognize this problem and insists on applying a modified cost of service analysis to a situation where it just won't work properly. His conclusion is that the KIUC members and customers that account for almost three-quarters of Kenergy revenues and 85% of all sales, should make no contribution to Kenergy's margin. This conclusion is to be expected from an analysis that divides a large number by zero, or a number close to zero.

Q12: IF THERE ARE PROBLEMS APPLYING THE TRADITIONAL COST OF SERVICE METHODOLOGY TO DIRECT SERVICE CUSTOMERS, WHAT TYPE OF ANALYSIS DO YOU RECOMMEND?

A12: When doing a cost of service analysis, a common way of allocating a revenue related expense or credit across customer classes is to use each class's contribution to the utility's total revenue. Contribution to Total Revenue is a good allocator since it accounts for the different costs of serving different classes and also the different rates paid by different classes. Total contribution to revenue is a good proxy for what portion of the utility's business results from each rate class.

In Exhibit DHBK-2, I have analyzed the margins collected by each rate class compared to the Total Revenues generated by that class in current rates. This exhibit calculates each class's "Margin % of Revenues." This figure could be considered the "markup" Kenergy makes, above costs, to contribute to its margin. This exhibit shows that the power of Regular Tariff customers is marked-up about 3 percent to contribute to Kenergy's margin. In contrast, the KIUC member "Class A" customers pay only about a tenth of one percent over cost to contribute to Kenergy's margin. The KIUC member "Class B" customers pay about a 1 percent markup. The Direct Serve customers that are not members of KIUC, Class C, pay almost an 8 percent markup over cost, which is about 8 times what Class B pays and over 50 times what Class A pays.

Exhibit DHBK-2 also examines what portion of the total margin each class pays. When each class's percentage of total margin is examined, these differences are even more striking. While Class A accounts for over two-thirds of Kenergy's revenues, it only contributes about 8% of Kenergy's total margin. This is quite a contrast to Direct Serve Class C, which contributes only 3.5% of Kenergy's revenues and pays almost a quarter of the Kenergy's total margin.

I disagree with Mr. Klepper's conclusion that the KIUC members are paying too much of Kenergy's margin. In fact, the analysis in Exhibit DHBK-2 suggests that KIUC members may not be paying their fair share of Kenergy's margin.

Q13: BASED ON YOUR ANALYSIS, DO YOU BELIEVE THAT KIUC MEMBERS ARE PAYING THEIR FAIR SHARE OF KENERGY'S MARGIN?

A13: No. In combination, all of the KIUC members are contributing just 15 percent of the total margin, while they make up about three-quarters of Kenergy's revenues. By contrast, the other Direct Serve customers that are not KIUC members contribute almost 25 percent of Kenergy's total margin though they constitute only 3.5 percent of Kenergy's total revenues. Looking only at Direct Serve customers, the non-KIUC customers make over 60 percent of the Direct Serve contribution to Total Margins, but are less than 5 percent of the Direct Serve revenues. It would appear that KIUC members are not pulling their weight with respect to Direct Serve contributions to Kenergy's margin, and instead are relying on non-KIUC member to contribute the majority of the margins from Direct Serve customers.

Q14: ARE YOU RECOMMENDING THAT KENERGY RAISE RATES FOR DIRECT SERVE CLASSES A AND B, TO BE ABLE TO LOWER RATES FOR DIRECT SERVE CLASS C?

A14: No. I agree with Kenergy's position that rates should not be raised for any customers at this time.

Q15: MR. KLEPPER ALSO REQUESTED THAT THE COMMISSION MODIFY THE CONTRACT BETWEEN WEYERHAEUSER AND KENERGY. DO YOU AGREE WITH THE MODIFICATION HE HAS PROPOSED?

A15: No. The contract between Weyerhaeuser and Kenergy for the Weyerhaeuser co-generation project states that Weyerhaeuser may challenge the level of the distribution charge in the contract, but Weyerhaeuser "shall not assert, as a basis for reducing the amount of the Distribution Fee, the fact that the Distribution Fee is imposed on self-generated power in addition to purchased power . . .". Mr. Klepper says that arguing that there is no cost of service justification to impose a distribution fee on self generated power is not contrary to the agreement that the parties shall not seek to reduce the Distribution Fee because it is imposed on self-generated power. No change in Kenergy's cost to serve the self generated power has occurred since the parties agreed to the imposition of the distribution fee on that power. Mr. Klepper is only looking to undo Kenergy's benefits under the contract.

Not only are Mr. Klepper's arguments contrary to the terms of the contract, now is not the time to complain. If Mr. Klepper believed that the distribution fee was not justified, he should have advised his client not to sign the contract in the first place (on page 4 of Mr. Klepper's testimony, he states that he has "continuously" worked on the Kenergy issues for KIUC since 1992). The contract contained specific provisions that prohibit the challenging of this fee. If his client felt that the contract terms were unreasonable, and were in violation of PURPA, a case could have been brought before the Commission to correct the perceived problem. This issue should have been resolved by the Commission before the project proceeded.

Q16: IF THE COMMISSION DID AGREE TO THE CONTRACT MODIFICATION SUGGESTED BY MR. KLEPPER, WOULD THIS HAVE IMPLICATIONS FOR OTHER KENERGY CUSTOMERS?

A16: Yes. Revenues lost from this customer would have to be recovered from other customers to keep Kenergy whole. The Commission needs to consider the potential revenue impact on the rest of Kenergy customers before adopting Mr. Klepper's proposed contract modification.

Q17: WHAT RECOMMENDATIONS DO YOU HAVE FOR THE COMMISSION IN THIS CASE?

A17: The rate reductions proposed in this case by KIUC for its members, and only for its members, would have an adverse impact on other customers. Analysis shows that the KIUC members, if anything, are not making an adequate contribution to Kenergy's margin with the rates now in place. Based on this analysis, I am recommending that the Commission reject the rate reductions Mr. Klepper has proposed only for KIUC members and that it leaves current rates in place, as Kenergy has recommended.

Q18: DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A18: Yes it does.

THE UNION LIGHT, HEAT AND POWER COMPANY
Case No. 2003 - 00252

Estimate of Revenue Requirement Impact
of Company Proposal to Treat ADITCs and ADITs
Below the Line

Line	Description	ADITCs	ADITs	Total
	Revenue Requirement Associated With ADITs and ADITCs Tax Expenses			
1	Total Amount 1/	$ 7,310,478	$ 83,388,148	
2	Composite Federal And State Income Tax Rate 2/	0.403625	0.403625	
3	Revenue Expansion Factors 3/	1/L2	1/(1-L2.)	
4	Factors	2.477547228	1.676797317	
5	Revenue Requirement of Tax Expense Impact (L1*L4)	$ 18,112,055	$ 139,825,023	$ 157,937,077
	Revenue Requirement Associated With Overstated Rate Base			
6	Average Rate Base Deduction L1/(2)	$ 3,655,239	$ 41,694,074	
7	Company Proposed Rate of Return adjusted to reflect ADITs and ADITCs	8.49%	8.49%	
8	Average Return L6xL7	310,330	3,539,827	
9	Average Remaining Life span of units 4/	22.65	24.75	
10	Additional Return Requirements from Overstated Rate Base	7,028,970	87,610,715	
11	Revenue Requirement Relating to Overstated Rate Base (L10x1.676797317)	$ 11,786,158	$ 146,905,412	158,691,570
	Revenue Requirement Associated With Excessive Equity Ratio			
12	Net Plant at July 1, 2004 5/		$ 384,481,040	
13	Fuel, M&S Inventory at July 1, 2004 5/		8,583,574	
14	Rate base at July 1, 2004		393,064,614	
15	Average Rate Base		196,532,307	
16	Company Proposed Return (8.8%) less Return Adjusted to Reflect ADITs and ADITCs (8.49%)		0.31%	
17	Additional Annual Return Resulting from Excessive Equity Ratio		609,250	
18	Times Remaining Life Span L17XL9		15,078,941	
19	Revenue Requirement Associated With Excessive Equity Ratio L18x1.676797317		$ 25,284,328	25,284,328
20	Total			$ 341,912,976

1/ Response to KyAG-01-037
2/ Company workpapers
3/ Expansion factors are different for tax expense versus tax credits.
4/ Calculated from CG&E's most recent depreciation study. Confidential Response to KyAG-DR-02-028. The remaining life spans are different because there are no ITCs relating to Woodsdale.
5/ Steffin JPS-3.