

BEFORE THE
PUBLIC SERVICE COMMISSION OF KENTUCKY

IN THE MATTER OF:

General Adjustments in)
Electric and Gas Rates of)
Louisville Gas and Electric Company)

CASE NO. 10064

TESTIMONY AND EXHIBITS

OF

LANE KOLLEN

ON BEHALF OF THE

KENTUCKY INDUSTRIAL UTILITY CONSUMERS

KENNEDY AND ASSOCIATES
ATLANTA, GEORGIA

FEBRUARY 1988

KENTUCKY PUBLIC SERVICE COMMISSION

CASE NO. 10064

LOUISVILLE GAS AND ELECTRIC COMPANY

DIRECT TESTIMONY OF LANE KOLLEN

1 Q. Please state your name and business address.

2

3 A. My name is Lane Kollen. My business address is Kennedy and Associates,
4 Suite 475, 35 Glenlake Parkway, Atlanta, Georgia 30328.

5

6 Q. What is your occupation and by whom are you employed?

7

8 A. I am a utility rate and planning consultant holding the position of Manager,
9 Financial Consulting with the firm of Kennedy and Associates.

10

11 Q. Would you please describe your education and professional experience?

12

13 A. Yes. I received my Bachelor of Business Administration with honors in
14 Accounting from the University of Toledo. I also received a Master of
15 Business Administration from the University of Toledo. I am a Certified
16 Management Accountant (CMA) and a Certified Public Accountant (CPA).

17

18 I began my professional career with The Toledo Edison Company in 1976 in the
19 Budget and Accounting Reports Section of the Accounting Division. I assisted
20 in preparing the company's operating budgets, management financial and
21 operating reports, and financial reports to the SEC (10-K, 10-Q), the FERC

1 (Form 1 and others), state regulatory agencies, shareholders (quarterly and
2 annual reports) and others.

3
4 In 1978, I was promoted to the Tax Department where I conducted tax
5 research, prepared schedules supporting federal, state and local tax returns,
6 developed tax, plant and depreciation related support for the company's rate
7 cases, responded to tax related audit requests, and prepared tax, plant and
8 depreciation related schedules for management reports, budgets, and forecasts.
9 I also performed extensive depreciation analysis with the consulting firm of
10 Gilbert and Associates.

11
12 In late 1979, I was promoted to the Auditing Department where I assisted in
13 and conducted numerous audits, primarily operational in nature. I was involved
14 in audits of nuclear and coal plant construction and operating records.

15
16 In 1980, I transferred to the Corporate Planning Department and was later
17 promoted to Financial Planning Supervisor. In this capacity, I was responsible
18 for computer modeling and the financial evaluation of the company's strategic
19 plans. I was responsible for the preparation of the capital budget, various
20 forecast filings with regulatory agencies, and assistance in rate and other
21 strategy formulation. I utilized the strategic planning model PROSCREEN II
22 and other software products to evaluate capacity swaps, sales, sale/leasebacks,
23 cancellations, write-offs, unit power sales, and long term system sales, among
24 other strategic options.

1 In 1983, I joined the consulting group at Energy Management Associates. I
2 specialized in utility finance, computer financial modeling and utility
3 accounting issues. I also directed consulting and software projects utilizing
4 PROSCREEN II and ACUMEN proprietary software products to support utility
5 rate case filings, budgets, internal management and external reporting, and
6 strategic and financial analyses.

7
8 In early 1986, I joined Kennedy and Associates where I specialize in revenue
9 requirements analyses, taxes, evaluation of rate and financial impacts of
10 traditional and non-traditional ratemaking and other utility strategic and
11 financial issues. I have developed and presented papers on utility rate and
12 tax issues at Energy Management Associates and ELCON industry conferences.

13
14 I have appeared as an expert witness on accounting and planning issues before
15 regulatory commissions in Kentucky, Louisiana, Minnesota and West Virginia.
16 My qualifications and regulatory appearances are further detailed in my Exhibit
17 ___(LK-1).

18
19 **Q. On whose behalf are you presenting testimony?**

20
21 **A.** I am appearing on behalf of the Kentucky Industrial Utility Customers
22 ("KIUC"), a group which includes the largest industrial customers on the
23 Louisville Gas and Electric ("LG&E") system.

24
25 **Q. What is the purpose of your testimony?**

1

2 A. The purpose of my testimony is to recommend a base revenue reduction of
3 \$25.2 million for LG&E and to recommend an additional one year credit to base
4 rates of \$8.6 million for the repayment of unprotected excess deferred taxes.
5 This testimony consolidates the revenue requirement impacts of testimony
6 presented by Dr. Kennedy and Mr. Baron in this proceeding.

7

8 **Q. Please summarize your recommendations to the Commission.**

9

10 A. I recommend a permanent base revenue reduction of \$25.2 million compared to
11 the total increase of \$49.9 million requested by LG&E. This permanent base
12 revenue reduction would result in a \$28.3 million reduction for electric
13 operations offset by a \$3.1 million increase for gas operations. In addition, I
14 recommend a special one year credit to base rates to repay ratepayers for
15 unprotected excess deferred income taxes previously collected from them but
16 no longer owed as a result of the tax rate reductions incorporated in the Tax
17 Reform Act of 1986. This one year credit represents an additional reduction
18 in revenue requirements of \$8.6 million for the first year after the decision in
19 this proceeding, allocated \$7.7 million to electric operations and \$0.9 million to
20 gas operations. The total first year revenue reduction is therefore \$33.8
21 million, consisting of a \$36.1 million electric revenue reduction and a \$2.3
22 million gas revenue increase. My recommendation reflects the following
23 incremental adjustments to the LG&E filing:

24

INCREMENTAL REVENUE REDUCTION ADJUSTMENTS TO
LG&E'S FILING

	Electric (\$000)	Gas (\$000)	Total (\$000)
1. Application of Short Term Investments to Common Equity	\$12,978	\$1,442	\$14,420
2. Reduction in Return on Common Equity from 14.00% to 11.75%	17,725	1,969	19,694
3. Exclusion of Trimble County from Capitalization	49,799	-----	49,799
4. First Year Recovery of Trimble County and Return on Unamortized Balance (Increase)	(37,248)	-----	(37,248)
5. Reduction in LG&E Electric Revenue Weather Normalization Adjustment (Net of Expense)	2,645	-----	2,645
6. Reduction in O&M Expense for Out of Test Period Labor Expense Adjustment	1,808	540	2,348
7. Reduction in O&M Expense for Payroll Taxes Related to Labor Expense Adjustment	206	62	268
8. Reduction in O&M Expense for Non-Recurring Costs of Management Audit	1,138	340	1,178
9. Additional Reduction in O&M Expense for Unjustified Increases in Excess of Inflation & Sales Growth	<u>17,092</u>	<u>4,585</u>	<u>21,977</u>
<u>Total Incremental Reductions</u>	\$66,143	\$8,938	\$75,081
<u>LG&E Requested Increase</u>	<u>\$37,794</u>	<u>\$12,073</u>	<u>\$49,867</u>
<u>Total Permanent Base Revenue Reduction (Increase) from Current Rates</u>	<u>\$28,349</u>	<u>\$(3,135)</u>	<u>\$25,214</u>
<u>One Year Credit for Excess Deferred Taxes</u>	<u>\$ 7,710</u>	<u>\$ 857</u>	<u>\$ 8,567</u>
<u>Total First Year Revenue Reduction (Increase) from Current Rates</u>	<u>\$36,059</u>	<u>\$(2,278)</u>	<u>\$33,781</u>

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Q. Does the capital structure proposed by the Company in Fowler Exhibit 5 properly support LG&E's investment in utility property?

A. No. It is significantly in excess of LG&E's investment in utility property which, if utilized for purposes of calculating the return revenue requirement, will overstate the Company's revenue requirements in this proceeding by \$14.5 million.

Q. Please explain why LG&E's proposed capital structure and resultant return revenue requirements are overstated.

A. In addition to supporting its investment in utility property, LG&E's capitalization is also supporting \$73.4 million in short term investments at test year end. Of this amount, \$12.25 million of maturities and sinking fund requirements should be excluded to provide consistency with amounts proformed against the actual test year end capital structure by LG&E. Consequently, LG&E seeks to earn a return on \$61.15 million in excess capitalization which is not utilized to support investment in utility property.

The Company is asking the Commission to approve a level of return revenue requirements on funds which have not been invested in utility plant. Deriving a return revenue requirement predicated upon excessive capitalization of \$61.15 million is equivalent to including an additional \$61.15 million of post test year end investment in rate base or requiring the ratepayers to support the carrying

1 costs of an investment or diversification program without receiving the
2 benefits of such a program. This is clearly improper and represents an abuse
3 of the ratemaking process.

4
5 **Q. How has the relationship between LG&E's short term investments, capitalization**
6 **and rate base changed since Case No. 8924?**

7
8 A. Growth in short term investments since the end of the August 31, 1983 test
9 year in Case No. 8924 has been explosive, increasing from a relatively minor
10 amount of \$9.0 million to the \$73.4 million level at test year end in this case.
11 This growth in short term investments has been fueled by growth in
12 capitalization in excess of the growth in investment in utility property.
13 Compelling evidence of this fact is contained in Exhibit SJB-4 of Mr. Baron's
14 testimony.

15
16 **Q. Please explain the importance of reducing ratemaking capitalization for the**
17 **amount invested by the Company in short term investments.**

18
19 A. An excessive capitalization level is a critical issue since the Commission's
20 methodology for computing the return component of revenue requirements in a
21 rate case relies upon the adjusted level of capitalization, not just capitalization
22 component ratios multiplied by their respective costs applied to the utility
23 investment represented by the rate base. Consequently, it is essential that the
24 balance of test year end short term investments be removed from the
25 ratemaking capitalization supporting the utility rate base.

1

2 **Q. How should the Company's excessive ratemaking capitalization be reduced to**
3 **reflect its non-utility short term investments?**

4

5 A. The most appropriate means of reducing overall capitalization for the amount
6 of short term investments is to apply the entire \$61.15 million to the test year
7 end balance of common equity. This is a widely accepted regulatory approach
8 for segregating utility and non-utility capitalization and investment. Another
9 approach, which is the minimally acceptable solution to this critical issue, is to
10 apply the \$61.15 million on a prorata basis to each of the capitalization
11 components in a manner similar to the allocation of the Job Development
12 Credit.

13

14 **Q. What are the arguments favoring the application of the short term investment**
15 **balance against common equity?**

16

17 A. The short term investment balance has steadily increased since the test year
18 end in Case No. 8924 from \$9.0 million to \$73.4 million at test year end in
19 this proceeding. Since the test year end in 1983, the outstanding preferred
20 stock balance has remained unchanged at \$118.0 million. The outstanding
21 balance of long term debt (including current amounts) has increased by \$51
22 million. However, the only new debt issued during this four year period was
23 pollution control debt which must be and has been specifically invested in
24 utility plant for pollution control facilities. Therefore, incrementally, this new
25 debt could not have been directly utilized to support short term investments.

1 That leaves only the growth in common equity since the test year ending
2 August 31, 1983 to support the growth in short term investments. That
3 growth in common equity has been phenomenal, a total of \$132.2 million or
4 31.4%. The common equity ratio has increased over the same four year period
5 from 36.03% to 44.43%. It is clear that growth in short term investments has
6 been financed through the common equity component of capitalization. This is
7 the first argument favoring the application of the short term investment
8 balance against common equity.

9
10 The amount of capitalization represented by the level of short term
11 investments is non-utility since it is not invested in utility operations. Many
12 state commissions, faced with the task of segregating utility operations from
13 diversified organizations, have attributed non-utility investments to common
14 equity holders and excluded the amount of non-utility investments directly
15 from the determination of common equity capitalization. This is appropriate
16 since the common equity holders are the investors in non-utility operations.
17 Utility and non-utility operations are usually organized as separate
18 corporations. Consequently, they issue debt in their own right which can then
19 be specifically attributed to utility or non-utility operations. Likewise with
20 preferred equity. LG&E has only debt and preferred stock directly
21 attributable to utility operations and none whatsoever for non-utility
22 operations. Consequently, the short term investments must represent an
23 investment by common equity holders. This is the second argument favoring
24 the application of the short term investment balance against common equity.

25

1 The interest and other income obtained from the short term investments is not
2 flowed through to the ratepayers. It is a below the line item which inures to
3 the direct benefit of common equity shareholders. This is the third argument
4 favoring the application of the short term investment balance against common
5 equity.

6
7 It is clear from a review of these arguments that application of the short term
8 investment balance against common equity rather than a prorata application
9 against the entire capitalization is the most appropriate means of reducing
10 capitalization to the level supporting utility investment.

11
12 **Q. What arguments favor application of the short term investment balance prorata**
13 **across the entire capitalization structure?**

14
15 **A.** The primary argument is that specific components of internal cash generation
16 or financing cannot be directly attributed to specific components of internal
17 cash, construction, or capitalization repayment requirements. All corporate
18 cash inflow is necessary to meet all corporate cash outflow requirements,
19 regardless of the source or disposition. Consequently, all cash generated in
20 excess of that required for operating expenses is effectively a return on and a
21 return of invested capital. This excess cash should either be utilized to
22 reduce capitalization on a prorata basis in the case of a company with a net
23 declining rate base investment or to avoid new financing on a prorata basis in
24 the case of a company investing in new assets with a net increasing rate base
25 investment.

1

2 There are two basic assumptions underlying these arguments. The first,
3 obviously, is that specific sources of cash cannot be identified with specific
4 uses of cash. This is not always true, particularly in the case of pollution
5 control debt, where there is a direct and traceable relationship between the
6 source and disposition. The second assumption is that the company will
7 maintain a continuous capital structure relationship between debt, preferred
8 equity and common equity over time, without increasing the relative weight of
9 one component at the expense of the other. This is not always true either.
10 In fact, LG&E's common equity ratio has increased from 36.03% at test year
11 end August 31, 1983 to 44.43% at test year end August 31, 1987. Clearly,
12 LG&E has not maintained a consistent capital structure which would be
13 necessary to support arguments favoring a prorata application of the short
14 term investment balance across all elements of the capital structure.

15

16 **Q. Have you quantified the revenue requirement effect of applying the adjusted**
17 **\$61.15 million short term investment balance against the common equity**
18 **component of capitalization?**

19

20 **A. Yes. Revenue requirements are reduced by \$14.5 million compared to the**
21 **Company's filing. My Exhibit ____ (LK-2) provides this computation including**
22 **the effects on the allocation of JDC across the modified capital structure.**
23 **Page 1 of this Exhibit _____ (LK-2) is predicated upon and comparable to**
24 **Fowler Exhibit 5 and page 2 is predicated upon and comparable to Fowler**
25 **Exhibit 6. Page 1 of Exhibit _____ (LK-2) reflects the common equity effect**

1 and the effect on the JDC revenue requirements. Page 2 of Exhibit ____ (LK-
2 2) reflects the incremental change in revenue requirements in the next to last
3 column of all primary and secondary effects of allocating the short term
4 investments against common equity.

5
6 **Q. Have you quantified the revenue requirement effect of Dr. Jay B. Kennedy's**
7 **recommended 11.75% return on common equity?**

8
9 **A.** Yes. My Exhibit ____ (LK-3) provides this determination. The Company has
10 requested a 14.0% return on common equity utilizing a common equity balance
11 of \$600.0 million (Fowler Exhibit 6). Exhibit ____ (LK-2) provided the
12 determination, in the same format as Fowler Exhibit 6, of the revenue
13 requirement effects of reducing the common equity balance to \$535.8 million to
14 properly account for the short term investments while maintaining the
15 Company's requested 14.0% return on equity. My Exhibit ____ (LK-3) utilizes
16 the same \$535.8 adjusted common equity balance from page 2 of Exhibit ____
17 (LK-2) to provide an additional revenue requirements reduction for the lower
18 return on common equity. The additional reduction in revenue requirements
19 due to a reduction in return on common equity to 11.75% from the 14.0%
20 requested is \$19.7 million.

21
22 **Q. It is the position of KIUC that Trimble County should be cancelled. Have you**
23 **quantified the effects of this cancellation on revenue requirements?**

24
25 **A.** Yes. The effects are two-fold. The first effect is to exclude Trimble County

1 Construction Work in Progress from rate base and capitalization. This results
2 in an incremental reduction in revenue requirements of \$49.8 million, utilizing
3 an 11.75% return on common equity with capitalization adjusted for short term
4 investments. The computation of this amount, in a format similar to that of
5 Fowler Exhibit 6, is shown on my Exhibit _____(LK-4). The exclusion of
6 Trimble County is assumed prorata across the capital structure including JDC,
7 thereby resulting in a direct prorata reduction in the capitalization return
8 revenue requirement.

9
10 The second effect is to add back the revenue requirements for the Trimble
11 County cancelled investment reflecting a 35 year amortization period and a
12 full return on the unamortized balance. The determination of this amount
13 was made by my colleague, Mr. Baron, in his testimony and exhibits in this
14 proceeding. The revenue increase related to this second effect is \$37.2
15 million.

16
17 The net of the reduction and the increase effects just described is a reduction
18 in first year revenue requirements of \$12.6 million.

19
20 **Q. How does the test year level of non-fuel, non-gas supply operation and**
21 **maintenance expense requested by LG&E compare to the level granted by this**
22 **Commission in Case No. 8924?**

23
24 **A. There has been a dramatic 43.2% increase in "other" operation and maintenance**
25 **expense from the level approved in Case No. 8924. This cannot be explained**

1 simply by inflation and sales growth. This other O&M expense has increased
2 at a compound annual growth rate of 9.38% over the four year period. This
3 compares to compound annual growth for the same period in the Consumer
4 Price Index of 3.24% and sales growth of 2.42% for electric and -1.09% for
5 gas. The combined inflation and sales growth rates can only explain annual
6 rates of growth of 5.74% for electric and 2.11% for gas (4.95% combined).
7 Over the four year period, O&M expense has increased from \$118.0 million to
8 \$168.9 million, or \$50.9 million! These computations are summarized in my
9 Exhibit ____ (LK-5). This level of growth is obviously excessive.

10
11 O&M expense growth is clearly out of control. There is no other apparent
12 explanation. Inflation and sales growth, even though applied to all other O&M
13 expenses regardless of whether fixed or variable, only explains one half of the
14 average annual growth. In other words, \$25.8 million of the total \$50.9 million
15 growth in expense levels since the 1983 test year cannot be explained as the
16 result of inflation and sales growth. This extraordinary level of O&M
17 expense growth requires explanation and justification by the Company. No new
18 generating units have been added to the system since the last unit was added
19 at Mill Creek in 1982. There have been no new major regulatory or other
20 governmental mandates since 1983 which would directly require the incurrence
21 of additional O&M expense. Incurrence of O&M expense to improve
22 performance in the production area or productivity in any other area should
23 clearly have been offset with reductions due to improved efficiencies or cost
24 savings. Increases in excess of inflation and sales growth in the area of
25 medical costs fringe benefits have been offset with almost complete elimination

1 of pension expense for the test year.

2

3 **Q. Clearly, one must question where this extraordinary and excessive growth in**
4 **the O&M expense has occurred. Have you investigated this question?**

5

6 A. Yes. I have compared the 1983 test year actual level of expense to the 1987
7 test year actual level of expense on a functional basis in my Exhibit ___ (LK-
8 6). It is clear from this exhibit that there are three major areas of actual
9 growth on the electric side and two major areas of actual growth on the gas
10 side of the business.

11

12 Steam power production expense has increased by \$17.7 million or 42.2%.
13 Electric distribution expense has increased by \$8.8 million or 46.4%. Electric
14 administrative and general expense has increased by \$11.0 million or 63.5%.

15

16 Gas distribution expense has increased \$4.0 million or 35.2%. Gas
17 administrative and general expense has increased by \$3.1 million or 66.3%.

18

19 **Q. You have identified where this excessive O&M expense growth has occurred on**
20 **a functional basis, can you shed any light on the reasons why this level of**
21 **growth has been allowed to occur?**

22

23 A. The key phrase is "allowed to occur". The management of LG&E has allowed
24 this level of growth in O&M expense. Expenses don't just occur by
25 themselves. This is a fallacy often perpetuated in the utility industry.

1 Approval of budgeted increases and responsibility for actual increases are
2 functions of the management of the Company. Managers are expressly placed
3 into positions of management to manage the operations, not to act as mere
4 overseers and reporters of "uncontrollable" expenses. Most expenses are
5 directly controllable within the short to intermediate term; all expenses are
6 directly controllable in the long term.

7
8 LG&E management has not been diligent in controlling the growth in its O&M
9 expenses. It is the management of LG&E, not "uncontrollable external" cost
10 increases, which is responsible for inadequate management information tools
11 and unclosed performance loops. It is the management which is responsible
12 for excessive layering of management, for significant overstaffing and for a
13 deficient O&M expense budgeting process. It is the management which is
14 responsible for the lack of manpower planning and the failure to identify and
15 implement productivity improvement opportunities. These are critical
16 managerial deficiencies which have resulted in the excessive level of growth in
17 O&M expense since the 1983 test year.

18
19 The LG&E Management Audit dated August 1986 cites each one of these
20 reasons as a contributing factor to the high level of O&M expense incurred by
21 LG&E.

22
23 Q. Isn't LG&E attempting to address these deficiencies by implementing the
24 recommendations contained in the Audit Report?

25

1 A. Yes. However, they have reflected no forward savings from the
2 implementation of these recommendations in test year O&M expense. Yet
3 they request \$25.8 million in excessive and unjustified test year O&M expenses
4 which are largely the result of the same management deficiencies they are
5 currently attempting to resolve.

6

7 **Q. Shouldn't management of a utility retain a broad degree of discretion over the**
8 **level of expenses it incurs and ultimately attempts to recover from**
9 **ratepayers?**

10

11 A. No. There must be limits or otherwise in another four years (1991) O&M
12 expenses may increase another \$73 million, assuming the same 43% growth as
13 the last four years, even without Trimble County! There simply must be some
14 degree of ratepayer protection against unconstrained cost growth.

15

16 **Q. Are there currently any regulatory incentives for LG&E to control the growth**
17 **in its O&M expenses?**

18

19 A. There are currently no direct regulatory incentives for LG&E management to
20 control O&M expense growth except for specific Commission disallowances.

21

22 **Q. Are you proposing that the Commission disallow the portion of requested O&M**
23 **levels which cannot be explained by inflation and sales growth?**

24

25 A. Yes. The ratepayers should not be obligated to pay for expenses which have

1 resulted from an abdication of LG&E managerial responsibility. The excessive
2 growth in O&M above inflation and sales growth is \$25,771,000, consisting of
3 \$20,244,000 in electric and \$5,527,000 in gas expenses (Exhibit_____(LK-5).
4 These expenses should be disallowed absent a conclusive and reasonable
5 justification by the Company for such expenses. The simple fact that they
6 were incurred should not result in the conclusion that they are recoverable.

7
8 **Q. Are you proposing that the Commission adopt some form of O&M expense**
9 **containment mechanism as an incentive for LG&E?**

10
11 **A.** Yes. In fact, other state regulatory commissions have utilized such
12 mechanisms to determine allowable O&M expense levels. For example, in
13 Florida, the Commission reviews the level of test year O&M expenses for
14 reasonableness by comparing the requested level of expense to an inflation and
15 growth adjusted base year (last test year) amount. Excessive amounts may be
16 disallowed for recovery purposes. A mechanism such as this is a simple, but
17 effective means of assuring that a utility will control its expenses.

18
19 **Q. The O&M expense containment mechanism you have outlined obviously**
20 **incorporates a disallowance penalty provision to the extent amounts requested**
21 **exceed the benchmark amount. Do you propose any reward provisions?**

22
23 **A.** Yes. If the Company has controlled its expenses to a level less than the
24 "benchmark" provided by the expense containment mechanism, I propose that
25 50% of the difference be shared between ratepayers and the Company. This is

1 a substantial incentive that would inure to both ratepayers and the Company
2 as a result of effective management cost control. This would clearly result in
3 a win-win situation for both.

4
5 **Q. Does the incentive mechanism you propose look at overall O&M expenses**
6 **rather than specific categories of O&M expense?**

7
8 **A.** Yes. An incentive mechanism could be developed which is based upon a
9 delineation of functional groupings such as Steam Power Production, Hydro
10 Power Production, Transmission, Distribution, etc or some other expense
11 grouping. However, adoption of an O&M expense benchmark methodology
12 reflecting more specific expense categorization would tend to restrict
13 management operating discretion. The more refined the categorization of
14 expenses, the stricter the compliance standard becomes. The broader the
15 categorization of expenses, the more discretion that is retained by the
16 management of the utility.

17
18 **Q. Please explain how a broader categorization of O&M expense results in**
19 **increased management discretion.**

20
21 **A.** The incentive mechanism is a means of constraining overall growth in O&M
22 expenses. However, management retains complete discretion in the specific
23 allocation of increases in overall recoverable expenses. Simplistically, an
24 increase in one cost area in excess of the overall allowed inflation and growth
25 adjusted percentage could be offset with lower increases or reductions in other

1 areas.

2

3 Further, management motivation is improved because of the incentive
4 provisions. If management can improve the Company's productivity and
5 otherwise restrict O&M expense growth below inflation levels, the Company's
6 shareholders as well as ratepayers clearly benefit.

7

8 **Q. What about major changes in O&M expenses such as severe storm damage or**
9 **major equipment failure?**

10

11 A. Most of these items are typically covered by insurance or by annual accruals
12 already embedded in rates customers pay. However, to the extent that major,
13 unexpected, or otherwise uncovered changes in O&M expenses occur, the
14 amounts could be specifically identified in future rate filings for specific
15 Commission action outside of the structure of the O&M benchmark expense
16 mechanism.

17

18 **Q. Have you identified any specific O&M expenses which should not be recovered**
19 **by the Company as test year expenses on an ongoing basis?**

20

21 A. Yes. The Company's proposed out of test year labor and payroll tax expense
22 adjustments included in their Adjustment D should not be allowed. Also,
23 implementation costs of the Management Audit recommendations treated as
24 expense for the test year should be removed as nonrecurring. Future
25 implementation costs should not be expensed, but instead capitalized by the

1 Company for future recovery.

2
3 **Q. Please describe the Company's proposed Adjustment D to reflect increases in**
4 **labor costs.**

5
6 A. The Company's adjustment to increase operating expense by \$3,132,927 is
7 detailed in Mr. Fowler's Exhibit 4 Schedule D page 2 of 4. The adjustment
8 consists of two primary components, an adjustment to annualize wage
9 increases placed into effect during the test year and an adjustment to reflect
10 wage increases placed into effect beyond the end of the test year. The
11 adjustment amounts are \$784,852 and \$2,348,075 for each component,
12 respectively.

13
14 **Q. Do you agree with the Company's proposed Adjustment D to reflect increases**
15 **in labor costs?**

16
17 A. Partially. I agree with the first component, an adjustment to increase
18 operating expenses by \$784,852 to annualize the effects of wage increases
19 granted during the test year but not in effect for the full twelve month
20 period. This is an appropriate adjustment to operating expense similar to the
21 Company's Adjustment I which annualized revenues based on test year end
22 customers.

23
24 I disagree, however, with reflecting the second component of the proposed
25 labor cost adjustment. This component of the adjustment reflects office

1 clerical and union wage increases which went into effect in October and
2 November 1987, respectively. These increases, while undoubtedly real, do not
3 reflect test year levels of expense. This is of utmost significance because of
4 the necessity to retain intra-test period consistency between revenues,
5 expenses and rate base.

6
7 The Company has attempted to formulate a hybrid historic/projected test year
8 utilizing a selected out of test period adjustment which inures to their benefit.
9 They have included this out of test period expense without incorporating
10 certain out of test year benefits which are also quantifiable and real, primarily
11 the additional revenues from anticipated continued sales growth. Consequently,
12 the Company has been inconsistent and unfair in proposing this adjustment.

13
14 The Commission should therefore continue to adhere to its historic test year
15 precedent. It would be patently unfair for the Commission to adopt the hybrid
16 historic/projected test year approach proposed by the Company without a
17 concurrent recognition of out of test period sales revenue growth.
18 Accordingly, the Company's operating expense should be reduced and operating
19 income should be increased before taxes by this proposed \$2,348,075 out of
20 period and inappropriate labor expense adjustment. This adjustment should be
21 allocated 77% or \$1,808,018 to electric and 23% or \$540,057 to gas consistent
22 with Fowler Exhibit 4 Schedule D page 2 of 4.

23
24 Q. Does your recommended reduction to the Company's proposed labor cost
25 increase adjustment included in Adjustment D also affect their proposed

1 **adjustment for payroll taxes included in Adjustment D?**

2

3 A. Yes. Fowler Exhibit 4 Schedule D page 3 of 4 provides details of LG&E's
4 proposed adjustment to payroll taxes. Each of the three payroll taxes, social
5 security, federal unemployment and state unemployment are affected to the
6 extent that the adjustment for each of the taxes is predicated upon the
7 Company's improper and inappropriate out of test period adjustment to increase
8 labor expense which I previously discussed. It is inappropriate to increase
9 operating expenses for the payroll taxes effects of an out of test period labor
10 cost adjustment for the same reasons that it is inappropriate to reflect the
11 Company's proposed adjustment for an increase in out of test period labor
12 costs.

13

14 Q. What is the amount of your recommended reduction for the portion of the
15 Company's Payroll Tax Adjustment which is related to the out of test period
16 labor cost adjustment?

17

18 A. I recommend a further reduction of \$267,927 to the Company's proposed
19 Adjustment D consisting of \$223,406 for social security, \$14,100 for federal
20 unemployment and \$30,421 for state unemployment taxes. The social security
21 and state unemployment tax amounts were obtained from Fowler Exhibit 4
22 Schedule D page 3 of 4 column 2 lines 5 and 7, respectively. The federal
23 unemployment tax amount was obtained from the Company's response to Item 2
24 of the KIUC Second Data request. This adjustment should be allocated 77% or
25 \$206,304 to electric and 23% or \$61,623 to gas consistent with the allocations

1 on Fowler Exhibit 4 Schedule D page 3 of 4.

2

3 Q. Why should the costs of implementing the recommendations of the Management
4 Audit be excluded from test year operating expenses?

5

6 A. There are several reasons. Foremost is the nature of the costs necessary to
7 implement these Management Audit recommendations. Most of the
8 implementation costs are nonrecurring. Costs of operating new systems and
9 other ongoing costs incurred after the implementation of the recommendations
10 are expected to be more than offset with cost savings due to higher
11 productivity and performance. Implementation costs are comparable to a
12 capital investment made in equipment to reduce labor costs or otherwise
13 produce production efficiencies. Consequently, future implementation costs
14 should not be recognized as an ongoing expense. They should instead be
15 capitalized for future recovery by the Company.

16

17 In addition, the Company has not reflected any expected future savings from
18 test year levels in their requested level of test year O&M expense.

19

20 In effect, the Company is asking the Commission to approve one year recovery
21 on an ongoing basis for the implementation cost capital investments, while
22 concurrently denying the ratepayers the very savings that the implementation
23 cost capital investments are intended to produce. This is certainly an
24 incongruous proposition.

25

1 Q. Have you been able to identify and quantify the test year costs of
2 implementing the Management Audit recommendations?

3

4 A. Yes. I have summed the test year expense amounts contained in the
5 Company's response to the Commission Order dated January 15, 1988 Item No.
6 1. The total amount included in test year expense is \$1,477,900. This should
7 be disallowed as a non-recurring "expense" and future costs capitalized for
8 possible future recovery. I have allocated the total 77% or \$1,138,000 to
9 electric and 23% or \$339,900 to gas.

10

11 Q. Please explain the concept of deferred taxes.

12

13 A. Deferred taxes are created when a utility company is allowed extra deductions
14 for income tax purposes which are not concurrently flowed through to
15 ratepayers. In such cases, the benefits of these extra deductions are
16 "normalized" by returning them to ratepayers over several years.
17 Normalization levelizes the financial and ratemaking total tax expense effects
18 of book/tax timing differences between periods. The most significant of these
19 book/tax timing differences is usually liberalized depreciation. However, other
20 important tax benefits are also normalized.

21

22 During the period of time that actual tax benefits exceed financial or
23 ratemaking recognition, "positive" deferred taxes are created by allowing a
24 regulated utility to recover tax expense in rates as if no special tax benefits
25 had occurred. Since customers have paid these taxes as if these benefits did

1 not exist, a liability is created to recognize the extra dollars paid by
2 customers. This deferred tax balance is created and continues to grow until
3 the timing differences reverse. Once the timing differences begin to reverse,
4 the regulated utility recovers less than what it must pay in associated actual
5 taxes and the accumulated balance is drawn down to zero over the remaining
6 period of the timing difference. For certain book/tax timing differences,
7 "negative" deferred taxes (an asset) are created and then reversed. If the net
8 of the various accumulated deferred tax balances is positive (a liability), then
9 the ratepayers have prepaid future utility tax liabilities.

10
11 **Q. Please explain how the 1986 Tax Reform Act created an excess of accumulated**
12 **deferred income taxes.**

13
14 **A.** The accumulated deferred tax buildup and subsequent reversal to zero which I
15 previously described assumes a consistent tax rate for all associated periods.
16 If the tax rate changes at any point, a utility will ultimately owe either more
17 or less in taxes depending on whether the rate went up or down and whether
18 they were in a net negative or net positive accumulated deferred tax balance
19 position. Most electric utilities, including LG&E, are in a net positive
20 (liability) deferred tax position. Consequently, when the tax rate declined to
21 34% on July 1, 1987, from the previous 46%, LG&E's liability for future taxes
22 was correspondingly reduced. The difference between what was expected to be
23 owed, and therefore previously collected from ratepayers, is termed an excess
24 deferred tax.

1 Q. In the case of a regulated utility, such as LG&E, who is entitled to the benefit
2 of this government "grant" of excess deferred taxes resulting from the
3 reduction of in corporate income tax rates?

4

5 A. Very clearly it is the ratepayers who have previously paid for these taxes
6 which are now no longer required to be paid.

7

8 Q. Is there any controversy related to the issue of excess deferred taxes in this
9 proceeding?

10

11 A. Yes. There are three areas of controversy. The first is the date at which the
12 excess deferred tax balance should be determined for purposes of this
13 proceeding. The second is the timing of the repayment of the excess deferred
14 taxes to the ratepayers. The third is whether or not a state deferred tax
15 deficiency should be netted against and thereby reduce the amount of the
16 excess federal deferred tax. I will further discuss each one of these areas of
17 controversy.

18

19 Q. Starting with the first issue of controversy, what is the appropriate date at
20 which the excess deferred tax balance should be determined for purposes of
21 this proceeding?

22

23 A. The appropriate date is August 31, 1987 since this is the date at which the
24 rate base was determined (Fowler Exhibit 8, page 1 of 2). The Company has
25 suggested that it is more appropriate to utilize December 31, 1987 balances "...

1 since deferred taxes are calculated on annual additions, booked on a monthly
2 basis and adjusted to actual on an annual basis, the amount of any proposed
3 "excess" deferred tax adjustment is constantly changing" (response to First
4 Data Request of Attorney General, Item 20, page 2 of 4).

5
6 The Company's argument for the utilization of a December 31, 1987
7 computation of excess deferred taxes should be rejected. LG&E did not select
8 a test year ending December 31, 1987. They selected a test year ending
9 August 31, 1987. Since each component of rate base constantly changes, it is
10 simply inappropriate to selectively change the date for the determination of
11 the accumulated deferred tax balance and the related income effects. A test
12 year is defined along with a specific rate base date certain for the precise
13 reason of assuring consistency between related operating income and rate base
14 components. It is therefore inconsistent and inappropriate to use any date
15 other than the rate base date certain of August 31, 1987 for the computation
16 of excess deferred tax balances.

17
18 Furthermore, the December 31, 1987 balance of excess deferred taxes is lower
19 than that which existed at test year end August 31, 1987. To suggest that the
20 Commission selectively utilize a lower December 31, 1987 balance for this one
21 item is self-serving, since this would result in a transfer of these excess
22 deferred taxes, previously paid for by ratepayers, to the Company's
23 shareholders. This is patently unfair and would represent an irretrievable loss
24 to the ratepayers.

1 Q. Please explain the second area of controversy, which is the timing of the
2 repayment of the excess deferred taxes to the ratepayers.

3

4 A. The 1986 Tax Reform Act specifically addressed the timing of the repayment of
5 excess deferred tax amounts in Section 203(e) as follows:

6

7 "A normalization method of accounting shall not be treated as being
8 used with respect to any public utility property for purposes of
9 section 167 or 168 of the Internal Revenue Code of 1986 if the
10 taxpayer, in computing its cost of service for ratemaking purposes
11 and reflecting operating results in its regulated books of account,
12 reduces the excess tax reserve more rapidly or to a greater extent
13 than such reserve would be reduced under the average rate
14 assumption method."

15

16

17

18 Q. Please explain the implications of Section 203(e) and how this provision affects
19 the timing of the excess deferred tax repayments to ratepayers.

20

21 A. By its reference to the normalization requirements of Code Sections 167 and
22 168, Section 203(e) effectively creates two categories of excess deferred taxes.
23 The delineation relates to whether Sections 167 and 168 of the Code require
24 normalization of particular timing differences. Those deferred taxes which are
25 required by Sections 167 and 168 are generally described as protected.
26 Required, and therefore protected, excess deferred taxes are related to
27 liberalized depreciation and salvage timing differences according to Section 168.
28 All other deferred taxes which are not specifically required under these code
29 sections are considered unprotected. The distinction between protected and
30 unprotected excess deferred taxes is important because it determines the
31 maximum rate at which the related excess deferred taxes may be repaid to

1 ratepayers.

2
3 According to Section 203(e), protected excess deferred taxes cannot be repaid
4 to the ratepayers any more rapidly than under the average rate assumption
5 method. Simplistically, this amounts to a straightline amortization of these
6 excess amounts over the remaining life of the underlying property. For LG&E,
7 the average remaining life of the underlying property is approximately 30
8 years! Unprotected excess deferred taxes do not fall under the restriction of
9 Section 203(e) and may be repaid to ratepayers over a shortened time period,
10 at the discretion of the appropriate regulatory body.

11
12 My recommendation for a one year return of excess deferred taxes is directed
13 toward only the unprotected excess deferred tax balance. However, it is
14 important to remember that the ratepayer is entitled to the repayment of all
15 excess deferred taxes. The delineation between protected and unprotected
16 refers only to the timing of that repayment and the degree of Commission
17 discretion which can be exercised.

18
19 **Q. Why is the distinction between protected and unprotected so important?**

20
21 **A.** If a utility such as LG&E violates the Section 203(e) requirements prohibiting
22 the repayment of protected excess deferred tax balances more rapidly than
23 under the average rate assumption method, the IRS will consider them to have
24 violated the normalization requirements under Section 168 of the Code.
25 Consequently, the utility could be unable to utilize accelerated tax depreciation

1 methods in calculating current and future taxes. This would be detrimental to
2 the utility company and the ratepayers.

3
4 **Q. How does the language of the 1986 TRA restrict the ability of the Kentucky**
5 **Public Service Commission in dealing with the excess deferred tax issue and is**
6 **this different from prior changes in the tax code?**

7
8 **A.** The 1986 TRA severely restricts the ability of the Commission to determine the
9 appropriate ratemaking repayment of excess deferred tax amounts. This
10 restriction was not present in earlier tax law changes, such as in 1979 when
11 the corporate tax rate dropped from 48% to 46% (addressed by the Commission
12 for LG&E in Case No. 8616). In the past, Congress has not taken a stand
13 restricting the ability of the individual commissions to determine the timing of
14 the repayment of newly created excess deferred taxes.

15
16 **Q. What is the relationship between the level of protected excess deferred taxes**
17 **and the unprotected excess deferred taxes for LG&E?**

18
19 **A.** The bulk (87%) of the LG&E excess deferred taxes are protected, leaving only
20 13% as unprotected and subject to the Commission's discretion for the timing
21 of their repayment. That means that ratepayers may have to wait for 30 years
22 to obtain the full excess deferred tax amounts which they prepaid to LG&E.
23 Considering the extreme limits placed on the Commission by the 1986 Tax
24 Reform Act, it is imperative that the Commission exercise its authority to
25 protect ratepayers by providing for a rapid repayment of the relatively small

1 amount of unprotected excess deferred taxes which are available for this
2 purpose and subject to the Commission's discretion.

3
4 I would strongly encourage the Commission to assert the discretion that has
5 been retained at the state level, by ordering a repayment of this 13%
6 unprotected portion of excess deferred taxes as rapidly as practicable.

7
8 **Q. What is your recommendation with respect to the timing of the repayment of**
9 **the unprotected excess deferred tax balances to the ratepayers?**

10
11 **A.** I recommend a one year credit to base rates to repay the unprotected excess
12 deferred taxes to the ratepayers as rapidly as practicable. Those excess
13 deferred taxes not specifically protected under Section 203(e) of the Act,
14 should be paid back as rapidly as practicable to those ratepayers who prepaid
15 them in the past. This is a fundamental matter of equity and fairness. In
16 this case, the shorter the period over which the utility pays its ratepayer
17 liability, the better the matching between those who paid the excess deferred
18 taxes in the past and those who should receive the repayment. The longer the
19 repayment period, the more inappropriately mismatched become the costs and
20 benefits.

21
22 **Q. What would be the best way to refund the excess deferred taxes?**

23
24 **A.** Ideally, it would be most appropriate to determine specifically which customers
25 had paid the amounts represented by the excess deferred taxes and immediately

1 refund those amounts specifically to them. Of course, this is not logistically
2 practical. Hence, the recommendation for a one year special credit to base
3 rates is clearly the most appropriate and practical resolution of the timing
4 issue. This credit would then expire automatically at the end of the one year
5 period.

6
7 **Q. Why is a one year refund period preferable?**

8
9 **A.** The funds could be returned in one month. However, there is no "typical"
10 month which would accurately reflect average usage patterns. The month
11 chosen would obviously seriously distort the allocation of the refund to
12 customers. A year is chosen because it will most accurately represent the
13 average usage of each customer and will as closely as practicable allocate the
14 refund to the same customers who originally paid these excess deferred taxes.

15
16 **Q. Why would a longer refund period be unacceptable?**

17
18 **A.** There are two fundamental issues of fairness at stake. First of all, LG&E's
19 customer base continues to grow. By stretching out the repayment period, new
20 customers, who never paid any of the excess deferred taxes, will receive a
21 windfall at the expense of the existing customers. The effect of the new
22 customers is to dilute the amount of the repayment. In addition, the longer
23 the repayment period, the fewer the original customers who prepaid the taxes
24 will remain on the system to receive the benefit of the repayment.

1 Secondly, it is simply a matter of bad policy to require customers to leave
2 these funds on deposit with the utility. There is nothing in the tax laws to
3 require customers to continue to provide these funds to the utility. Certainly,
4 ratepayers should not be forced to invest their funds for the benefit of the
5 utility and future ratepayers.

6
7 **Q. What amortization period does LG&E propose for the unprotected excess**
8 **deferred tax balance they have identified?**

9
10 **A.** They do not propose any rapid amortization period. They would repay the
11 unprotected excess deferred taxes in the same manner as is required for the
12 protected excess deferred taxes under Section 203(e) of the Tax Reform Act.
13 Consequently, they propose requiring ratepayers to wait as long as 30 years to
14 be fully repaid for certain of the excess deferred taxes which are unprotected
15 as well as the protected. This simply is not acceptable.

16
17 **Q. Has LG&E commented on the third area of controversy related to excess**
18 **deferred taxes, the issue of whether or not a state deferred tax deficiency**
19 **should be netted against, and thereby reduce, the amount of the excess federal**
20 **deferred tax?**

21
22 **A.** Yes. Their comments are contained in their response to the First Data
23 Request of the Attorney General Item 20, page 2 of 4. They comment in their
24 response that the Kentucky state income tax rate was increased in 1986 to
25 7.25% resulting in a state deferred tax deficiency, the opposite of the excess

1 situation which occurred in 1979 and 1987 when the federal income tax rates
2 were lowered. Consequently, the Company believes that if the Commission
3 orders an adjustment to rapidly repay the unprotected excess deferred income
4 taxes, they should reduce that unprotected excess by the full amount of the
5 state deferred income tax deficiency. However, the Company does not agree
6 that such an adjustment should be made.

7
8 **Q. Do you agree with LG&E's position on netting the federal excess with the**
9 **state deficiency in deferred taxes?**

10
11 **A.** No, for a very simple reason. The bulk of the total federal excess deferred
12 taxes (87%) are considered protected and are therefore not eligible for rapid
13 repayment to ratepayers under Section 203(e) of the 1986 Act. It follows that
14 a comparable amount of state deferred income tax deficiency should also be
15 treated similarly even though not statutorily required. This distinction places
16 the federal excess and the state deficiency on a comparable footing. In this
17 manner, the remaining 13% state deferred tax deficiency would be considered
18 as unprotected and netted against the unprotected federal excess deferred tax
19 amount to determine the appropriate amount available for rapid repayment to
20 ratepayers. Once again, timing is the issue. Just as the ratepayers are
21 entitled to all of the federal excess deferred tax amounts, both protected and
22 unprotected, the Company is entitled to recovery of the state deferred tax
23 deficiency. The question is the timing of the repayment or recovery. Equity
24 dictates that the federal excess and state deficiency simply be treated
25 consistently.

1

2 **Q. Have you computed the proper amount of unprotected federal excess deferred**
3 **taxes and a comparable unprotected state deferred tax deficiency net balance?**

4

5 A. Yes. The net balance available to the Commission to order repaid on a rapid
6 basis is \$5,287,172 as of August 31, 1987. This computation is contained in my
7 Exhibit _____ (LK-7) and is predicated upon the Company's Response to the
8 Attorney General's First Data Request Item No. 3 page 3 of 4 and page 4 of
9 4.

10

11 **Q. Have you computed the revenue effect of a one year credit to base rates for**
12 **the net amount of unprotected excess deferred taxes subject to the**
13 **Commission's discretion?**

14

15 A. Yes. The repayment of the \$5,287,172 of net unprotected excess deferred
16 taxes through a one year credit to base rates is \$8,567,292 on an incremental
17 basis. This computation is also contained in my Exhibit _____ (LK-6). In
18 computing the incremental revenue requirement effects, the net balance
19 available for rapid repayment as of August 31, 1987 must first be reduced by
20 the amount of unprotected excess deferred tax reversals already included in
21 the test year. I have estimated the amount included in the test year by the
22 Company by applying the excess percentage (26.09%) to the reversing
23 unprotected deferred taxes identified by them in their response to the
24 Commission's First Data Request Item 20(a)(1-5). To derive the revenue
25 requirement effect, the adjusted net balance of unprotected excess deferred

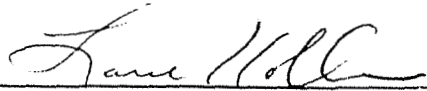
1 taxes is then grossed up to account for the current tax effect utilizing a
2 1.6336 revenue conversion factor $(1 + \text{tax rate} / (1 - \text{tax rate}))$ or $(1 + .38785 /$
3 $(1 - .38785))$.

4

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

6

7 **A. Yes.**


Lane Kollen

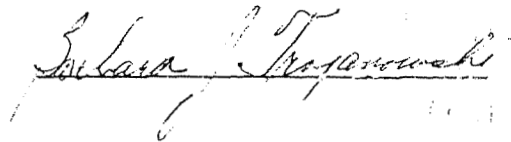
State of Georgia
County of Fulton

Subscribed and sworn to before me, a notary public in and for the State and County
aforesaid.

My commission expires

MY COMMISSION EXPIRES SEPT. 12, 1988

This 10th day of February 1988


Barbara Trapanowski

Kennedy and Associates
 Expert Testimony Appearances
 of
 Lane Kollen
 As of January 1988

Date	Case No.	Jurisdict.	Party	Utility	Subject Matter	Cross Exam
10/86	U-17282 Interim	Louisiana Commission	LPSC Staff	Gulf States Utilities	Cash Revenue Requirements Financial Solvency	Yes
11/86	U-17282 Interim Rebuttal	Louisiana Commission	LPSC Staff	Gulf States Utilities	Cash Revenue Requirements Financial Solvency	Yes
12/86	9613	Kentucky Commission	Attorney General Div. of Consumer Protection	Big Rivers Electric Corp	Revenue Requirements Accounting Adjustments Financial Workout Plan	Yes
1/87	U-17282 Interim	Louisiana 19th Judicial District Court	LPSC Staff	Gulf States Utilities	Cash Revenue Requirements Financial Solvency	Yes
3/87	General Order 236	West Virginia Commission	W. Va. Energy Users Group	Monongahela Power	Tax Reform Act of 1986	Yes
4/87	U-17282 Prudence	Louisiana Commission	LPSC Staff	Gulf States Utilities	Prudence of River Bend 1	Yes
4/87	M-100 Sub 113	N Carolina Commission	N Carolina Industrial Energy Consumers	Duke Power	Tax Reform Act of 1986	No
5/87	86-524-E-	West Virginia Commission	West Virginia Energy Users' Group	Monongahela Power	Revenue Requirements Tax Reform Act of 1986	Yes

Kennedy and Associates
 Expert Testimony Appearances
 of
 Lane Kollen
 As of January 1988

Date	Case No.	Jurisdicth.	Party	Utility	Subject Matter	Cross Exam
5/87	U-17282 Case In Chief	Louisiana Commission	LPSC Staff	Gulf States Utilities	Revenue Requirements River Bend 1 Phase-in Plan Financial Solvency	Yes
7/87	U-17282 Case In Chief Surrebutt	Louisiana Commission	LPSC Staff	Gulf States Utilities	Revenue Requirements River Bend 1 Phase-in Plan Financial Solvency	Yes
7/87	U-17282 Prudence Surrebutt	Louisiana Commission	LPSC Staff	Gulf States Utilities	Prudence of River Bend 1	Yes
7/87	86-524-E- Rebuttal	West Virginia Commission	West Virginia Energy Users' Group	Monongahela Power	Revenue Requirements Tax Reform Act of 1986	Yes
8/87	9885	Kentucky Commission	Attorney General Div of Consumer Protection	Big Rivers Electric Corporation	Financial Workout Plan	Yes
8/87	E-015/GR- 87-223	Minnesota Commission	Taconite Intervenors	Minnesota Power & Light	Revenue Requirements O&M Expense Tax Reform Act of 1986	Yes
10/87	870220-EI	Florida Commission	Occidental Chemical Corp.	Florida Power Corp.	Revenue Requirements O&M Expense Tax Reform Act of 1986	Settled
11/87	87-07-01	Conn. Dept. of Public Utility Control	Conn. Industrial Energy Consumers	Conn. Light and Power	Tax Reform Act of 1986	Yes

Revenue Requirement Associated
with Short Term Investments

	IG&E Filing before JDC	Adjustment for Short Term Investments	Adjusted for Short Term Investments	Percent of Total	Job Development Credit	Capitalization on Adjusted Commission Basis	Annual Cost Rate	Weighted Cost Rate	Return Required from JDC
First Mortgage Bonds	549,500,000		549,500,000						
Unamortized Premium on Bonds	688,579		688,579						
Total Bonds	550,188,579		550,188,579	46.52%					
Trust Demand Notes	24,000,000		24,000,000	2.03%					
Total Debt Capital	574,188,579		574,188,579	48.55%	51,878,725	626,067,304	7.62%	3.70%	3,953,159
Preferred Stock	118,000,000		118,000,000						
Preferred Stock Discount & Exp	(1,033,459)		(1,033,459)						
Total Preferred Stock	116,966,541		116,966,541	9.89%	10,568,087	127,534,628	8.09%	0.80%	854,958
Common Stock	380,830,660		380,830,660						
Capital Stock Discount	(788,282)		(788,282)						
Retained Income	172,527,487		172,527,487						
Total Common Equity	552,569,865	(61,150,000)	491,419,865	41.56%	44,400,458	535,820,323	14.00%	5.82%	6,216,064
Subtotal Capitalization	1,243,724,985	(61,150,000)	1,182,574,985	100.00%					
Job Development Credit	106,847,270	0	106,847,270		(106,847,270)				
Total Capitalization	1,350,572,255	(61,150,000)	1,289,422,255		0	1,289,422,255		10.32%	11,024,181

Return on Common Equity
Test Year Ending August 31, 1987

	Adjustments					Adjusted Commission Basis	LG&E Adjustments as Filed	K&A Incremental Adjustments	Adjusted Proforma
	Per Books	JDC	Short Term Investments	Other					
Common Equity	551,536,406	44,381,971	(61,150,000)	1,033,459	535,801,836	-	-	535,801,836	
Net Operating Income	118,853,318	1,533,233			120,386,551	(8,521,016)	-	111,865,535	
Revenue Increase Applied for						49,867,355	(14,420,144)	35,447,211	
Income Taxes on Increase						(19,341,054)	5,592,853	(13,748,201)	
Interest Charges	(46,701,590)	(3,953,159)			(50,654,749)	2,423,718	-	(48,231,031)	
Net Operating Income	72,151,728	(2,419,926)			69,731,802	24,429,003	(8,827,291)	85,333,514	
Preferred Return Requirements	(9,466,299)	(854,958)			(10,321,257)	-	-	(10,321,257)	
Income Available for Common Stock	62,685,429	(3,274,884)			59,410,545	24,429,003	(8,827,291)	75,012,257	
Rates of Return					11.09%			14.00%	

Return on Common Equity
Test Year Ending August 31, 1987

	Per Books	Adjustments			Adjusted Commission Basis	LG&E Adjustments as Filed	K&A Incremental Adjustments	Adjusted Proforma
		JDC	Short Term Investments	Other				
Common Equity	551,536,406	44,381,971	(61,150,000)	1,033,459	535,801,836	-	-	535,801,836
Net Operating Income	118,853,318	1,533,233			120,386,551	(8,521,016)	-	111,865,535
Revenue Increase Applied for						49,867,355	(34,113,914)	15,753,441
Income Taxes on Increase						(19,341,054)	13,231,081	(6,109,972)
Interest Charges	(46,701,590)	(3,953,159)			(50,654,749)	2,423,718	-	(48,231,031)
Net Operating Income	72,151,728	(2,419,926)			69,731,802	24,429,003	(20,882,832)	73,277,973
Preferred Return Requirements	(9,466,299)	(854,958)			(10,321,257)	-	-	(10,321,257)
Income Available for Common Stock	62,685,429	(3,274,884)			59,410,545	24,429,003	(20,882,832)	62,956,716
Rates of Return					11.09%			11.75%

Return on Common Equity
 Test Year Ending August 31, 1987

	Adjustments				Adjusted	LG&E	Trimble Co.	K&A Other	Adjusted
	JDC	Short Term	Other	Commission	Adjustments	Adjustments	Adjustments	Incremental	Proforma
		Investments		Basis	as Filed			Adjustments	
Per Books									
Common Equity	551,536,406	44,381,971	(61,150,000)	1,033,459	535,801,836	-	(158,884,310)	-	376,917,526
Net Operating Income	118,853,318	1,533,233		120,386,551	(8,521,016)		(5,546,919)	-	106,318,616
Revenue Increase Applied for				49,867,355			(83,912,511)		(34,045,156)
Income Taxes on Increase				(19,341,054)					13,204,414
Interest Charges	(46,701,590)	(3,953,159)		(50,654,749)	2,423,718		14,301,712	-	(33,929,319)
Net Operating Income	72,151,728	(2,419,926)		69,731,802	24,429,003		8,754,793	(51,367,043)	51,548,554
Preferred Return Requirements	(9,466,299)	(854,958)		(10,321,257)	-		3,060,512	-	(7,260,745)
Income Available for Common Stock	62,685,429	(3,274,884)		59,410,545	24,429,003		11,815,305	(51,367,043)	44,287,809
Rates of Return				11.09%					11.75%

Operation & Maintenance Expense
 Benchmark Methodology
 Test Year Ending August 31, 1987

	Test Year Ending 8/31/83	Test Year Ending 8/31/87	
	-----	-----	
Average Consumer Price Index (CPI)	295.3	335.5	
Electric Sales (mmkwh)	7,599,988	8,363,485	
Gas Sales (mmcf)	49,151	47,036	
Combined Inflation & Sales Growth - Electric			
Combined Inflation & Sales Growth - Gas			
	Electric (\$000)	Gas (\$000)	Total (\$000)
	-----	-----	-----
Test Year 1983 Allowed O&M Expense	91,132	26,869	118,001
Inflation & Growth Factor	1.2503	1.0872	
	-----	-----	
Benchmark Test Year 1987 Expense	113,940	29,213	143,153
Company Filing Test Year 1987 Expense	134,184	34,740	168,924
	-----	-----	-----
Excess of Filing Over Benchmark	20,244	5,527	25,771
	=====	=====	=====

Comparison of Non-Fuel, Non-Gas Supply
Other O&M Expenses for Electric and Gas Operations

	Test Year Ending 8/31/83 (\$000)	Test Year Ending 8/31/87 (\$000)
	-----	-----
Electric		

Steam Power Production Excl Fuel	\$42,002	\$59,706
Hydraulic	1,033	1,901
Other Power Generation Excl. Fuel	367	354
Other Power Supply Excl PP & Interchange	191	282
Transmission	2,924	4,221
Distribution	18,922	27,706
Provision for Uncollectibles	2,444	1,943
Other Customer Accts Expense	4,371	5,374
Customer Service & Informational Exp.	666	996
Sales Expense	20	89
Administrative & General	17,285	28,264
	-----	-----
	\$90,225	\$130,836
Gas		

Gas Supply Other Expenses	\$86	\$109
Storage Expenses	5,032	5,017
Transmission Expenses	247	402
Distribution Expenses	11,226	15,176
Provision for Uncollectibles	1,456	808
Other Customer Accts. Expense	3,435	4,054
Customer Service & Informational Exp.	338	385
Administrative & General	4,612	7,670
	-----	-----
	\$26,432	\$33,621

TOTAL	\$116,657	\$164,457
-----	-----	-----

Unprotected Excess Deferred Taxes
Balance at August 31, 1987
& Revenue Effect of One Year Credit

	8/31/87 Balance Accum DFIT	Percent Excess	8/31/87 Balance Excess DFIT
	-----	-----	-----
Unprotected Federal Excess			

Depreciation - Pre 1971 (LG&E)	\$18,959,000	26.09%	\$4,945,826
Depreciation - Pre 1971 (OVTC)	241,000	26.09%	\$62,870
Pension Expense	3,349,900	26.09%	\$873,887
Hydro License Fee	728,000	26.09%	\$189,913
Insurance Reserve	(254,000)	26.09%	(\$66,261)
Management Audit Fees	250,000	26.09%	\$65,217
Interest Defeasance	119,000	26.09%	\$31,043
Unbilled Revenue	(1,456,000)	15.00%	(\$218,400)
Bad Debts	(136,000)	15.00%	(\$20,400)
CIAC/Customer Advances	(473,000)	15.00%	(\$70,950)
Other	431,000	15.00%	\$64,650

Total Unprotected Federal Excess @ 8/31/87			5,857,396
Unprotected State Deficiency			

Total State Deficiency			(4,385,600)
Less Protected Portion (87%)			3,815,472

Total Unprotected State Deficiency @ 8/31/87			(570,128)
Net Unprotected Excess Deferred Taxes @ 8/31/87			5,287,268
Less Amount Included in Test Year Operating Expenses			(42,800)

Adjusted Unprotected Excess Deferred Taxes @ 8/31/87			5,244,468
Revenue Factor (1+tax rate/(1-tax rate))			1.6336

Incremental Revenue Effect of One Year Credit to Base Rates			\$8,567,292
			=====