an e·on company

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

RECEIVED

NOV 21 2006

PUBLIC SERVICE COMMISSION

Kentucky Utilities Company
State Regulation and Rates
220 West Main Street
PO Box 32010
Louisville, Kentucky 40232
www.eon-us.com

Kent W. Blake
Director
T 502-627-2573
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November 21, 2006

RE: ***AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF KENTUCKY UTILITIES COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING JULY 31, 2003, JANUARY 31, 2004, JANUARY 31, 2005, JULY 31, 2005, AND JANUARY 31, 2006 AND FOR THE TWO-YEAR BILLING PERIOD ENDING JULY 31, 2004 - CASE NO. 2006-00129***

Dear Ms. O'Donnell:

Please find enclosed and accept for filing the original and ten (10) copies of a Motion for Leave to File Corrected Evidence and Brief and Motion for Informal Conference in the above-referenced matter.

Kentucky Utilities Company ("KU") is correcting the testimony of Robert M. Conroy, pages 3 and 4 of Attachment 1 to the Response to Staff Request for Information Dated April 25, 2006, Question 2, and the Joint Brief of KU and Louisville Gas and Electric Company ("LG&E") to reflect a technical correction to KU's and LG&E's under-recovered position. KU is also including a redlined version of the testimony and Joint Brief identifying the corrections.

Corrections to the under-recovered positon can be found on pages 3, 5, and 9 of the Corrected Testimony and on pages 2, 4, and 5 of the Joint Brief as noted on the redlined version of each contained in the Attachment to the Motion. The under-recovery position has changed from $254,652 to $1,597,499. KU is proposing to collect this amount over the first 4 months after a Commission order in this proceeding as originally filed. We have also requested that an informal conference be scheduled on November 29, 2006, at 1:30 p.m. with all parties to the case so that we can explain this correction and answer any related questions. We believe this would be an effective means to expedite resolution of this proceeding.

Should you have any questions concerning the enclosed, please contact me at your convenience.

Sincerely,

Kent W Blake

Kent W. Blake

Enclosures

cc: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

NOV 21 2006

PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF KENTUCKY UTILITIES COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING JULY 31, 2003, JANUARY 31, 2004, JANUARY 31, 2005, JULY 31, 2005 AND JANUARY 31, 2006 AND FOR THE TWO-YEAR BILLING PERIOD ENDING JULY 31, 2004	)	CASE NO. 2006-00129

MOTION FOR LEAVE TO FILE CORRECTED EVIDENCE AND BRIEF AND MOTION FOR INFORMAL CONFERENCE

Pursuant to 807 KAR 5:001, Section 3(5), Kentucky Utilities Company ("KU") hereby moves the Kentucky Public Service Commission ("Commission") to issue an order granting leave to correct its testimony filed with the Commission. The corrected testimony, data response and brief are attached to and tendered with this motion. As grounds for its Motion for Leave to File Corrected Evidence and Brief, KU states as follows:

On June 19, 2006, KU submitted testimony and data responses that summarized, among other things, KU's cumulative under-recovery through the April 2006 billing month. Further review of that evidence however shows that the under-recovery position KU previously presented in this case must be corrected.

KU proposes to correct the calculation of its under-recovered position by eliminating the adjustment for the monthly true-up included in Column 5 of pages 3 and 4 to Attachment 1 to the Response to Staff Request for Information Dated April 25, 2006, Question No. 3. The correction is necessary because total ECR revenues already reflect a monthly adjustment for the previously identified mismatch between allowed and collected revenues. The monthly true-ups were put in place as a means to mitigate the size of any over- or under-recovery positions prior to an ECR review proceeding and only affect the final calculation of the under-recovered position to the extent they modified amounts actually collected. During an ECR review proceeding, the actual over- or under-recovery position should be calculated as the amounts KU should have collected for these periods less the amounts KU did collect for these periods.[1] Because the billing factor is adjusted monthly, a subsequent adjustment in the review case is unnecessary. To do otherwise would essentially double count the monthly true-up as it is already reflected in the ECR revenues received from customers and would result in KU collecting an amount other than what it was allowed to collect for the period under review.

In Case No. 2003-00236[2], LG&E's recovery position was determined by comparing collected revenues to revenue requirements restated for rate of return adjustments, prior period corrections *and previous over/under collections*.[3] KU, in the current ECR review cases, presented its under-collected position using the same methodology as previously used by LG&E in Case No. 2003-00236.[4]

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[1] "Retail E(m) Including All Adjustments" for all periods under review (Column 6 of pages 3 and 4 to Attachment 1 to the Response to Staff Request for Information Dated April 25, 2006, Question No. 3), less the actual amounts collected for these expense months during the review periods via "Actual ECR Revenues" and "ECR Revenue Recovered Through Base Rates" (Columns 11 and 12 of pages 3 and 4 to Attachment 1 to the Response to Staff Request for Information Dated April 25, 2006, Question No. 3)

[2] *In the Matter of: An Examination By The Public Service Commission Of The Environmental Surcharge Mechanism of Louisville Gas And Electric Company For The Two-Year Billing Period Ending April 30, 20003*, Case No. 2003-00236, Order (December 11, 2003).

[3] In its previous ECR review proceeding, LG&E mistakenly calculated its under-recovery position to include the adjustment for the monthly true-up, resulting in LG&E collecting $141,951 less from its customers than it was authorized to collect. *See In the Matter of: An Examination By The Public Service Commission Of The Environmental Surcharge Mechanism of Louisville Gas And Electric Company For The Two-Year Billing Period Ending April 30, 20003*, Case No. 2003-00236, LG&E Response to PSC July 31, 2003 Data Request No. 3, filed August 26, 2003; Attachment No. 1.

[4] KU however did not make a similar computation in its last ECR review proceeding because the true-up adjustment in the monthly ECR filing was established after the review period. *See In the Matter of: An Examination By The Public Service Commission Of The Environmental Surcharge Mechanism Of Kentucky Utilities Company For The Six-Month Billing Periods Ending January 31, 2001, July 31, 2002 and January 31, 2003 And For The Two-Year Billing Periods Ending July 31, 2000 and July 31, 2002*, Case No. 2003-00068, Orders (October 17, 2003 and May 4, 2004)

Subsequent to KU's submission of all responses to requests for information, and as a result of its on-going process improvement initiative, the methodology for calculating the cumulative under-recovery position was reviewed in October 2006. During this review KU determined that the previously used methodology to determine the over-under collected ECR revenue position was inaccurate.

The over/under-recovery position is the difference between total recoverable ECR costs and total ECR revenues. Total ECR revenues are the sum of all ECR revenues collected through base rates and ECR revenues collected through the billing factor, for the entire period under review. Total ECR-recoverable costs are the total of all environmental costs incurred during the review period and recoverable through the ECR, represented by Jurisdictional E(m) on ES Form 1.00 (plus, as necessary, adjustments for prior periods or as approved by the Commission) in the monthly ECR filing forms. Total recoverable costs presented in the review case include the monthly jurisdictional E(m) – or revenue requirement – as filed with this Commission and billed to customers on a monthly basis, revised for: (1) allowed rates of return restated to reflect actual costs of debt for each six-month period and returns on equity as authorized by the Commission in Case Nos. 2003-00434 and 2004-00426; (2) revisions to recoverable ECR rate base; and (3) revisions to recoverable operating expenses. Total recoverable costs do *not* include the monthly true-up for over- or under-collection; the true-up impacts the revenue KU collects but does not impact the costs that KU incurs or is allowed to recover.

As shown in the corrected testimony and schedule tendered herewith, KU incurred total ECR-recoverable costs of $85,237,139, and collected total ECR revenues of $83,639,640. Therefore, KU has under-recovered $1,597,499 of recoverable ECR costs; and the testimony and schedule previously submitted in the Case must be corrected to reflect the accurate calculation.

KU's Corrected Joint Brief is changed to reflect the accurate values described in this motion and the corrected testimony and data response.

Motion for Informal Conference

Further, KU hereby moves pursuant to 807 KAR 5:001, Section 4(4), the Commission to schedule an informal conference on Wednesday, November 29, 2006 at 1:30 pm (Eastern time) to discuss the technical correction of its calculation of the under-recovery position and answer any questions.

WHEREFORE, Kentucky Utilities Company respectfully requests that the Commission issue an order granting leave to file the tendered corrected testimony, data response and brief in this proceeding, and scheduling an informal conference for Wednesday, November 29, 2006 at 1:30 pm.

Dated: November 21, 2006

Respectfully submitted,

Kendrick R. Riggs
Stoll Keenon Ogden PLLC
2000 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202-2828
Telephone: (502) 333-6000

Elizabeth L. Cocanougher
Senior Corporate Attorney
E.ON U.S. LLC
220 West Main Street
Post Office Box 32010
Louisville, Kentucky 40232
Telephone: (502) 627-4850

Counsel for Kentucky Utilities Company

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the above and foregoing Motion was served, via United States mail, postage prepaid, to the following persons on the 21st day of November, 2006:

Elizabeth E. Blackford
Assistant Attorney General
Office of the Attorney General
Utility & Rate Intervention Office
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601-8204

David F. Boehm
Michael L. Kurtz
Boehm Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202

Counsel for Kentucky Utilities Company

Attachment to
Motion for Leave to File
Corrected Evidence and Brief

Case No. 2006-00129

Corrected Direct Testimony of Robert M. Conroy – Clean Version

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF KENTUCKY UTILITIES COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING JULY 31, 2003, JANUARY 31, 2004, JANUARY 31, 2005, JULY 31, 2005, AND JANUARY 31, 2006, AND FOR THE TWO-YEAR BILLING PERIOD ENDING JULY 31, 2004	)))))))))	CASE NO. 2006-00129

CORRECTED
DIRECT TESTIMONY OF

ROBERT M. CONROY
MANAGER, RATES
E.ON U.S. SERVICES INC.

Filed: November 21, 2006

Q. Please state your name, title, and business address.

A. My name is Robert M. Conroy. I am the Manager of Rates for E.ON U.S. Services Inc., which provides services to Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky, 40202. A complete statement of my education and work experience is attached to this testimony as Appendix A.

Q. Have you previously testified before this Commission?

A. Yes. I have previously testified before this Commission in proceedings concerning the Companies' fuel adjustment clauses and environmental surcharge mechanisms.

Q. What is the purpose of this proceeding?

A. The purpose of this proceeding is to review the past operation of the environmental surcharge KU billed during the five six-month billing periods ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005 and January 31, 2006, and the two-year billing period ended July 31, 2004. In the Commission's Order issued May 22, 2006, the Commission granted KU's motion to expand the current 6-month review of KU's environmental surcharge mechanism to include the billing period from February 1, 2006 through April 30, 2006 and expand the scope of the current 2-year review of KU's environmental surcharge mechanism to include the billing period from August 1, 2004 through April 30, 2005. Additionally, this proceeding determines the amount of environmental surcharge revenues to be incorporated or "rolled-into" base rates and the method for doing so.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to review the operation of the environmental surcharge during the billing period under review, discuss KU's proposed adjustment to the Environmental Surcharge Revenue Requirement based on the operation of the surcharge during that period and explain how the environmental surcharge factors were calculated during the period under review. Further, my testimony will recommend that the cumulative revenue requirement for the twelve-months ending with the expense month of February 2005 be incorporated or "rolled-into" electric base rates and identify the policy issue for the Commission's decision associated with the two methodologies for accomplishing the adjustment of KU's electric base rates. The testimony of William Steven Seelye, consultant and principal for The Prime Group, LLC, presents an alternative methodology for allocating the roll-in amounts to the various classes of service in a way that gives some recognition to the inter-class rate subsidies that currently exist in KU's base rates.

Q. Please review the operation of the environmental surcharge for the five six-month billing periods and the two-year billing period included in this review.

A. KU billed an environmental surcharge to its customers from February 1, 2003 through April 30, 2006. For purposes of the Commission's examination in this case, the monthly KU environmental surcharges are considered as the five six-month billing periods ended July 31, 2003; January 31, 2004; January 31, 2005; July 31, 2005 and January 31, 2006 (as extended to April 30, 2006 by the Commission's Order issued May 22, 2006), as well as the sixth six-month billing period ending July 31, 2004 which is part of the two-year billing period ending July 31, 2004 (as extended to February 28, 2005 by the Commission's Order issued May 22, 2006). In each month of all of these periods, KU calculated the environmental surcharge factors by using the costs incurred as recorded on its books and records for the expense months of December 2002 through February 2006.

Q. As a result of the operation of the environmental surcharge during the billing periods under review, is an adjustment to the revenue requirement necessary?

A. Yes. KU experienced a cumulative under-recovery of $1,597,499 for the billing periods ending April 30, 2006. KU's corrected response to Question No. 3 of the Commission Staff Request for Information shows the calculation of the $1,597,499 cumulative under-recovery. Therefore, an adjustment to the revenue requirement is necessary to reconcile the collection of past surcharge revenues with actual costs for the billing periods under review.

Q. Please explain the revisions to the retail jurisdictional revenue requirement (E(m)) caused by corrections to the monthly filing forms.

A. While preparing the responses to the Commission Staff Request for Information, KU determined that depreciation expense, property tax expense, accumulated depreciation, and accumulated deferred income taxes were misstated in previously filed monthly environmental surcharge filing forms. KU is resubmitting a monthly calculation, with all revisions, of environmental compliance rate base related to the Post-1994 Plan as an attachment to the response to the Commission Staff Request for Information Question No. 3. The refiled, corrected rate base for each month resulted in a decrease to cumulative Retail E(m) of $1,098,917 as shown in KU's amended response to Question No. 1(b) of the Commission Staff Request for Information.

Q. Please explain why the adjustments to the retail jurisdictional revenue requirement (E(m)) should be made due to changes in the cost of pollution control long term debt.

A. The adjustments are necessary to reflect the changes in the actual cost of pollution control long term debt that is used in the determination of the return on environmental rate base associated with the 1994 Plan and are in compliance with the Commission's Order in Case No. 2000-439. KU determined that changes in the actual cost of pollution control long term debt resulted in a decrease to cumulative Retail E(m) of $2,450,916 as shown in KU's response to Question No. 1(a) of the Commission Staff Request for Information.

Q. **Please explain why the adjustments to the retail jurisdictional revenue requirement (E(m)) should be made due to changes in the overall rate of return on capitalization**.

A. The adjustments are necessary to reflect the actual changes in the overall rate of return on capitalization that is used in the determination of the return on environmental rate base associated with the Post 1994 Plans and are in compliance with the Commission's Order in Case No. 2000-439. KU determined that changes in the actual cost of long term debt and capital structure resulted in a decrease to cumulative Retail E(m) of $365,405 as shown in KU's amended response to Question No. 1(b) of the Commission Staff Request for Information .

Q. Is KU proposing any modifications to the operation of the environmental surcharge going forward?

A. Not in this proceeding.

Q. What kind of adjustment is KU proposing in this case as a result of the operation of the environmental surcharge during these billing periods?

A. KU is proposing that the cumulative under-recovery of $1,597,499 be recovered over the four months following the Commission's Order in this proceeding. Specifically, KU recommends that the Commission approve the increase of the Environmental Surcharge Revenue Requirement by $399,375 per month for the first three months, and $399,374 for the fourth month beginning in the first full billing month following the Commission's Order in this proceeding. This method is consistent with the method of implementing previous over- or under-recovery positions in prior ECR review cases.

Q. What costs were included in the calculation of the environmental surcharge factors for the billing periods under review?

A. The capital and operating costs included in the calculation of the environmental surcharge factors for these billing periods were the costs incurred each month by KU from December 2002 through February 2006, as detailed in the attachment to Question No. 3 of the Commission Staff Request for Information, incorporating all required revisions. All capital and operating costs are for the pollution control projects identified in the Commission's July 19, 1994 Order in Case No. 93-465, the Commission's April 18, 2001 Order in Case No. 2000-439, the Commission's February 11, 2003 Order in Case No. 2002-00146, and the Commission's June 20, 2005 Order in Case No. 2004-00426. The environmental rate base amount and pollution control expenses are reasonable and accurate, and are based upon KU's business records.

The monthly environmental surcharge factors applied during the billing periods under review were calculated consistent with the Commission's determinations in KU's previous applications to assess or amend an environmental surcharge, as well as determinations made in previous review cases, most recently Case No 2003-00068. The depreciation rates used to calculate the depreciation expenses were changed following the Commission's approval of the new rates in Case No. 2001-140. The monthly environmental surcharge reports filed with the Commission during this time reflect the various changes to the reporting forms ordered by the Commission from time to time.

Q. Should the Commission in this case approve the incorporation into KU's base electric rates the environmental surcharge amounts found just and reasonable for the two-year billing period, as extended by the Commission's Order issued May 22, 2006, ending April 2005?

A. Yes. It is appropriate, at this time, to incorporate surcharge amounts found just and reasonable for the two-year billing period, as extended by the Commission's Order issued May 22, 2006, ending April 2005 into electric base rates. KU recommends that a surcharge amount of $23,731,313 be incorporated into base rates at the conclusion of this case. KU determined the roll-in amount of $23,731,313 using the base-current methodology as proposed by Commission Staff and further recommends adoption of the base-current methodology to calculate the monthly environmental surcharge factors going forward. The details of this methodology and the calculation of the amount are presented as attachments to KU's response to Question No. 12 to the Commission Staff Request for Information.

Q. What methodology should the Commission use to accomplish the roll-in?

A. The Commission's April 25, 2006 Order in this case at Data Request No. 12 states that "the surcharge factor reflects a percentage of revenue approach, rather than a per kWh approach" and asks "taking this into consideration, explain how the surcharge amount should be incorporated into KU's base rates" and to provide any analysis that KU believes supports its position. The Commission previously approved KU's proposed roll-in methodology in Case No. 2003-00068[1] as part of the approval of a written unanimous settlement which spread the amount of the roll-in equally to every tariff subject to the environmental surcharge. In this proceeding, in response to the Commission's inquiry, KU is presenting the total revenue method and an alternative methodology for allocating the roll-in amounts to the various classes of service in a way that gives some recognition to the inter-class rate subsidies that currently exist in KU's base rates. While either method will effectively incorporate the correct amount of the surcharge revenues and expenses into base rates, the appropriateness of either method is a policy question for this Commission. The evidence presented by Mr. Seelye clearly shows there are classes with high rates of return providing larger contributions to the companies operating income than those classes with low rates of return. In previous environmental surcharge proceedings, the Attorney General and the Kentucky Industrial Utility Customers, representing their respective interests, have advanced proposals for correcting inter-class subsidies or have challenged any such movements towards addressing inter-class subsidies. KU will be guided by the

[1] *In the Matter of: An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending January 31, 2001, July 31, 2001, January 31, 2002, and January 31, 2003 and for the Two-Year Billing Periods Ending July 31, 2000 and July 31, 2002*, Case No. 2003-00068, Order (October 17, 2003).

Commission's decision in this case on whether the change in base rates associated with the ECR roll-in should be accomplished in a way that gives some recognition to the inter-class rate subsidies in current base rates.

Q. If the Commission accepts KU's recommendation to incorporate $23,731,313 into base rates, what will be the impact on KU's revenue requirement?

A. The incorporation of the recommended surcharge amounts into base rates will increase base rates and simultaneously reduce ECR revenues by an equal amount. Therefore, there will be no impact on KU's revenue requirement.

Q. What Base Environmental Surcharge Factor (BESF) is KU proposing to use for the amount rolled into base rates?

A. KU calculated a new BESF, using base revenues for the 12 months ending February 2006, of 3.21%. However, the actual BESF will be calculated using base revenues for the 12-month period ending with the month preceding the month in which the Commission issues an order approving the roll-in. The timing and method KU will use to determine the final BESF is consistent with the Commission's Order in Case No. 2003-00068.

Q. What rate of return is KU proposing to use for all ECR Plans upon the Commission's Order in this proceeding?

A. As shown in the response to the Commission Staff Request for Information Question No. 17, KU is recommending an overall rate of return of 11.52%, calculated using adjusted capitalization and the currently approved 10.50% return on equity.

Q. What is your recommendation to the Commission in this case?

A. KU makes the following recommendations to the Commission in this case:

a) The Commission approve the proposed increase to the Environmental Surcharge Revenue Requirement of $399,375 in the first three billing months and $399,374 in the fourth billing month following the Commission's decision in this proceeding;

b) The Commission should find environmental surcharge amounts for the two-year billing period ending April 2005 to be just and reasonable;

c) The $23,731,313 should be approved to be the amount to be incorporated into base electric rates for bills rendered on and after the second full billing month following the month in which an order is received in this case;

d) The Commission should decide as a matter of policy whether the Environmental Surcharge mechanism should be used to address the inter-class rate subsidies that currently exist in KU's base rates and based on that decision approve either the use of allocating the roll-in amount on the basis of class base rate revenues or a methodology that allocates the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in base rates;

e) The Base Environmental Surcharge Factor be reset to an amount based on the roll-in amount and the most recent 12-month period available following the Commission's Order in this proceeding; and

f) The rate of return on the Post-1994 Plan be established as 11.52%.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

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

The undersigned, **Robert M. Conroy**, being duly sworn, deposes and says he is Manager, Rates for E.ON U.S. Services Inc., and that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Robert M Conroy

ROBERT M. CONROY

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 21st day of November 2006.

Victoria B. Harper

(SEAL)
Notary Public

My Commission Expires:

Sept 20, 2010

APPENDIX A

Robert M. Conroy

Manager, Rates
E.ON U.S. Services Inc.
220 West Main Street
Louisville, Kentucky 40202
(502) 627-3324

Education

Masters of Business Administration
Indiana University (Southeast campus), December 1998. GPA: 3.9.
Bachelor of Science in Electrical Engineering;
Rose Hulman Institute of Technology, May 1987. GPA: 3.3

Center for Creative Leadership, Foundations in Leadership program, 1998.

Registered Professional Engineer in Kentucky, 1995.

Previous Positions

Manager, Generation Systems Planning	Feb. 2001 – April 2004
Group Leader, Generation Systems Planning	Feb. 2000 – Feb. 2001
Lead Planning Engineer	Oct. 1999 – Feb. 2000
Consulting System Planning Analyst	April 1996 – Oct. 1999
System Planning Analyst III & IV	Oct. 1992 - April 1996
System Planning Analyst II	Jan. 1991 - Oct. 1992
Electrical Engineer II	Jun. 1990 - Jan. 1991
Electrical Engineer I	Jun. 1987 - Jun. 1990

Professional/Trade Memberships

Registered Professional Engineer in Kentucky, 1995.

Corrected Direct Testimony of Robert M. Conroy – Redline Version

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF KENTUCKY UTILITIES COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING JULY 31, 2003, JANUARY 31, 2004, JANUARY 31, 2005, JULY 31, 2005, AND JANUARY 31, 2006, AND FOR THE TWO-YEAR BILLING PERIOD ENDING JULY 31, 2004	)	CASE NO. 2006-00129

~~AMENDED~~CORRECTED
DIRECT TESTIMONY OF

ROBERT M. CONROY
MANAGER, RATES
E.ON U.S. SERVICES INC.

Filed: November ~~June~~ 21, 2006

Q. Please state your name, title, and business address.

A. My name is Robert M. Conroy. I am the Manager of Rates for E.ON U.S. Services Inc., which provides services to Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky, 40202. A complete statement of my education and work experience is attached to this testimony as Appendix A.

Q. Have you previously testified before this Commission?

A. Yes. I have previously testified before this Commission in proceedings concerning the Companies' fuel adjustment clauses and environmental surcharge mechanisms.

Q. What is the purpose of this proceeding?

A. The purpose of this proceeding is to review the past operation of the environmental surcharge KU billed during the five six-month billing periods ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005 and January 31, 2006, and the two-year billing period ended July 31, 2004. In the Commission's Order issued May 22, 2006, the Commission granted KU's motion to expand the current 6-month review of KU's environmental surcharge mechanism to include the billing period from February 1, 2006 through April 30, 2006 and expand the scope of the current 2-year review of KU's environmental surcharge mechanism to include the billing period from August 1, 2004 through April 30, 2005. Additionally, this proceeding determines the amount of environmental surcharge revenues to be incorporated or "rolled-into" base rates and the method for doing so.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to review the operation of the environmental surcharge during the billing period under review, discuss KU's proposed adjustment to the Environmental Surcharge Revenue Requirement based on the operation of the surcharge during that period and explain how the environmental surcharge factors were calculated during the period under review. Further, my testimony will recommend that the cumulative revenue requirement for the twelve-months ending with the expense month of February 2005 be incorporated or "rolled-into" electric base rates and identify the policy issue for the Commission's decision associated with the two methodologies for accomplishing the adjustment of KU's electric base rates. The testimony of William Steven Seelye, consultant and principal for The Prime Group, LLC, presents an alternative methodology for allocating the roll-in amounts to the various classes of service in a way that gives some recognition to the inter-class rate subsidies that currently exist in KU's base rates.

Q. Please review the operation of the environmental surcharge for the five six-month billing periods and the two-year billing period included in this review.

A. KU billed an environmental surcharge to its customers from February 1, 2003 through April 30, 2006. For purposes of the Commission's examination in this case, the monthly KU environmental surcharges are considered as the five six-month billing periods ended July 31, 2003; January 31, 2004; January 31, 2005; July 31, 2005 and January 31, 2006 (as extended to April 30, 2006 by the Commission's Order issued May 22, 2006), as well as the sixth six-month billing period ending July 31, 2004 which is part of the two-year billing period ending July 31, 2004 (as extended to February 28, 2005 by the Commission's Order issued May 22, 2006). In each month of all of these periods, KU calculated the environmental surcharge factors by using the costs incurred as recorded on its books and records for the expense months of December 2002 through February 2006.

Q. As a result of the operation of the environmental surcharge during the billing periods under review, is an adjustment to the revenue requirement necessary?

A. Yes. KU experienced a cumulative under-recovery of $~~254,652~~1,597,499 for the billing periods ending April 30, 2006. KU's ~~amended~~corrected response to Question No. 3 of the Commission Staff Request for Information shows the calculation of the $~~254,652~~1,597,499 cumulative under-recovery. Therefore, an adjustment to the revenue requirement is necessary to reconcile the collection of past surcharge revenues with actual costs for the billing periods under review.

Q. Please explain the revisions to the retail jurisdictional revenue requirement (E(m)) caused by corrections to the monthly filing forms.

A. While preparing the responses to the Commission Staff Request for Information, KU determined that depreciation expense, property tax expense, accumulated depreciation, and accumulated deferred income taxes were misstated in previously filed monthly environmental surcharge filing forms. KU is resubmitting a monthly calculation, with all revisions, of environmental compliance rate base related to the Post-1994 Plan as an attachment to the response to the Commission Staff Request for Information Question No. 3. The refiled, corrected rate base for each month resulted in a decrease to cumulative Retail E(m) of $1,098,917 as shown in KU's amended response to Question No. 1(b) of the Commission Staff Request for Information.

Q. **Please explain why the adjustments to the retail jurisdictional revenue requirement (E(m)) should be made due to changes in the cost of pollution control long term debt.**

A. The adjustments are necessary to reflect the changes in the actual cost of pollution control long term debt that is used in the determination of the return on environmental rate base associated with the 1994 Plan and are in compliance with the Commission's Order in Case No. 2000-439. KU determined that changes in the actual cost of pollution control long term debt resulted in a decrease to cumulative Retail E(m) of $2,450,916 as shown in KU's response to Question No. 1(a) of the Commission Staff Request for Information.

Q. **Please explain why the adjustments to the retail jurisdictional revenue requirement (E(m)) should be made due to changes in the overall rate of return on capitalization.**

A. The adjustments are necessary to reflect the actual changes in the overall rate of return on capitalization that is used in the determination of the return on environmental rate base associated with the Post 1994 Plans and are in compliance with the Commission's Order in Case No. 2000-439. KU determined that changes in the actual cost of long term debt and capital structure resulted in a decrease to cumulative Retail E(m) of $365,405 as shown in KU's amended response to Question No. 1(b) of the Commission Staff Request for Information .

Q. **Is KU proposing any modifications to the operation of the environmental surcharge going forward?**

A. Not in this proceeding.

Q. What kind of adjustment is KU proposing in this case as a result of the operation of the environmental surcharge during these billing periods?

A. KU is proposing that the cumulative under-recovery of $~~254,652~~1,597,499 be recovered over the four months following the Commission's Order in this proceeding. Specifically, KU recommends that the Commission approve the increase of the Environmental Surcharge Revenue Requirement by $~~63,663~~399,375 per month for the first three ~~four~~ months, and $399,374 for the fourth month beginning in the first full billing month following the Commission's Order in this proceeding. This method is consistent with the method of implementing previous over- or under-recovery positions in prior ECR review cases.

Q. What costs were included in the calculation of the environmental surcharge factors for the billing periods under review?

A. The capital and operating costs included in the calculation of the environmental surcharge factors for these billing periods were the costs incurred each month by KU from December 2002 through February 2006, as detailed in the attachment to Question No. 3 of the Commission Staff Request for Information, incorporating all required revisions. All capital and operating costs are for the pollution control projects identified in the Commission's July 19, 1994 Order in Case No. 93-465, the Commission's April 18, 2001 Order in Case No. 2000-439, the Commission's February 11, 2003 Order in Case No. 2002-00146, and the Commission's June 20, 2005 Order in Case No. 2004-00426. The environmental rate base amount and pollution control expenses are reasonable and accurate, and are based upon KU's business records.

The monthly environmental surcharge factors applied during the billing periods under review were calculated consistent with the Commission's determinations in KU's previous applications to assess or amend an environmental surcharge, as well as determinations made in previous review cases, most recently Case No 2003-00068. The depreciation rates used to calculate the depreciation expenses were changed following the Commission's approval of the new rates in Case No. 2001-140. The monthly environmental surcharge reports filed with the Commission during this time reflect the various changes to the reporting forms ordered by the Commission from time to time.

Q. Should the Commission in this case approve the incorporation into KU's base electric rates the environmental surcharge amounts found just and reasonable for the two-year billing period, as extended by the Commission's Order issued May 22, 2006, ending April 2005?

A. Yes. It is appropriate, at this time, to incorporate surcharge amounts found just and reasonable for the two-year billing period, as extended by the Commission's Order issued May 22, 2006, ending April 2005 into electric base rates. KU recommends that a surcharge amount of $23,731,313 be incorporated into base rates at the conclusion of this case. KU determined the roll-in amount of $23,731,313 using the base-current methodology as proposed by Commission Staff and further recommends adoption of the base-current methodology to calculate the monthly environmental surcharge factors going forward. The details of this methodology and the calculation of the amount are presented as attachments to KU's response to Question No. 12 to the Commission Staff Request for Information.

Q. What methodology should the Commission use to accomplish the roll-in?

A. The Commission's April 25, 2006 Order in this case at Data Request No. 12 states that "the surcharge factor reflects a percentage of revenue approach, rather than a per kWh approach" and asks "taking this into consideration, explain how the surcharge amount should be incorporated into KU's base rates" and to provide any analysis that KU believes supports its position. The Commission previously approved KU's proposed roll-in methodology in Case No. 2003-00068[1] as part of the approval of a written unanimous settlement which spread the amount of the roll-in equally to every tariff subject to the environmental surcharge. In this proceeding, in response to the Commission's inquiry, KU is presenting the total revenue method and an alternative methodology for allocating the roll-in amounts to the various classes of service in a way that gives some recognition to the inter-class rate subsidies that currently exist in KU's base rates. While either method will effectively incorporate the correct amount of the surcharge revenues and expenses into base rates, the appropriateness of either method is a policy question for this Commission. The evidence presented by Mr. Seelye clearly shows there are classes with high rates of return providing larger contributions to the companies operating income than those classes with low rates of return. In previous environmental surcharge proceedings, the Attorney General and the Kentucky Industrial Utility Customers, representing their respective interests, have advanced proposals for correcting inter-class subsidies or have challenged any such movements towards addressing inter-class subsidies. KU will be guided by the

[1] *In the Matter of: An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending January 31, 2001, July 31, 2001, January 31, 2002, and January 31, 2003 and for the Two-Year Billing Periods Ending July 31, 2000 and July 31, 2002*, Case No. 2003-00068, Order (October 17, 2003).

Commission's decision in this case on whether the change in base rates associated with the ECR roll-in should be accomplished in a way that gives some recognition to the inter-class rate subsidies in current base rates.

Q. If the Commission accepts KU's recommendation to incorporate $23,731,313 into base rates, what will be the impact on KU's revenue requirement?

A. The incorporation of the recommended surcharge amounts into base rates will increase base rates and simultaneously reduce ECR revenues by an equal amount. Therefore, there will be no impact on KU's revenue requirement.

Q. What Base Environmental Surcharge Factor (BESF) is KU proposing to use for the amount rolled into base rates?

A. KU calculated a new BESF, using base revenues for the 12 months ending February 2006, of 3.21%. However, the actual BESF will be calculated using base revenues for the 12-month period ending with the month preceding the month in which the Commission issues an order approving the roll-in. The timing and method KU will use to determine the final BESF is consistent with the Commission's Order in Case No. 2003-00068.

Q. What rate of return is KU proposing to use for all ECR Plans upon the Commission's Order in this proceeding?

A. As shown in the response to the Commission Staff Request for Information Question No. 17, KU is recommending an overall rate of return of 11.52%, calculated using adjusted capitalization and the currently approved 10.50% return on equity.

Q. What is your recommendation to the Commission in this case?

A. KU makes the following recommendations to the Commission in this case:

a) The Commission approve the proposed increase to the Environmental Surcharge Revenue Requirement of $399,375~~63,663~~ in the first three~~four~~ billing months and $399,374 in the fourth billing month following the Commission's decision in this proceeding;

b) The Commission should find environmental surcharge amounts for the two-year billing period ending April 2005 to be just and reasonable;

c) The $23,731,313 should be approved to be the amount to be incorporated into base electric rates for bills rendered on and after the second full billing month following the month in which an order is received in this case;

d) The Commission should decide as a matter of policy whether the Environmental Surcharge mechanism should be used to address the inter-class rate subsidies that currently exist in KU's base rates and based on that decision approve either the use of allocating the roll-in amount on the basis of class base rate revenues or a methodology that allocates the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in base rates;

e) The Base Environmental Surcharge Factor be reset to an amount based on the roll-in amount and the most recent 12-month period available following the Commission's Order in this proceeding; and

f) The rate of return on the Post-1994 Plan be established as 11.52%.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Robert M. Conroy**, being duly sworn, deposes and says he is Manager, Rates for E.ON U.S. Services Inc., and that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

____
ROBERT M. CONROY

Subscribed and sworn to before me, a Notary Public in and before said County and State, this _____ day of ~~June~~November 2006.

____
(SEAL)
Notary Public

My Commission Expires:

____

APPENDIX A

Robert M. Conroy

Manager, Rates
E.ON U.S. Services Inc.
220 West Main Street
Louisville, Kentucky 40202
(502) 627-3324

Education

Masters of Business Administration
Indiana University (Southeast campus), December 1998. GPA: 3.9.
Bachelor of Science in Electrical Engineering;
Rose Hulman Institute of Technology, May 1987. GPA: 3.3

Center for Creative Leadership, Foundations in Leadership program, 1998.

Registered Professional Engineer in Kentucky, 1995.

Previous Positions

Manager, Generation Systems Planning	Feb. 2001 – April 2004
Group Leader, Generation Systems Planning	Feb. 2000 – Feb. 2001
Lead Planning Engineer	Oct. 1999 – Feb. 2000
Consulting System Planning Analyst	April 1996 – Oct. 1999
System Planning Analyst III & IV	Oct. 1992 - April 1996
System Planning Analyst II	Jan. 1991 - Oct. 1992
Electrical Engineer II	Jun. 1990 - Jan. 1991
Electrical Engineer I	Jun. 1987 - Jun. 1990

Professional/Trade Memberships

Registered Professional Engineer in Kentucky, 1995.

Corrected Attachment 1 to Response to Question 3

Kentucky Utilities Company
Environmental Cost Recovery Surcharge
Calculation of E(m) and Jurisdictional Surcharge Billing Factor
Summary Schedule for Expense Months December 2002 through February 2006

Combined 1994 and Post 1994 Plan

(1) Expense Month	(2) Combined 1994 and Post 1994 Retail E(m)	(3) Adjustment to Retail E(m) for Allowance Exclusion	(4) Adjustment to Retail E(m) for (Over)/Under	(5) Adjustment to Retail E(m) for Monthly True-up	(6) Retail E(m) Including all Adjustments	(7) Average Monthly Retail Revenues	(8) Current Environmental Surcharge Factor (CESF)	(9) Base Environmental Surcharge Factor (BESF)	(10) Monthly Environmental Surcharge Factor (MESF)	(11) Actual ECR Revenues	(12) ECR Revenue Recovered Through Base Rates	(13) Combined Total Over/(Under) Recovery
		Question No. 2				ES Form 1.00	(6) / (7)		(8) - (9)			
Dec-02	1,467,676	(0)	-		1,467,675	53,869,377	2.72%	0.00%	2.72%	2,311,836	-	844,161
Jan-03	1,352,687	(0)	-		1,352,687	54,338,318	2.49%	0.00%	2.49%	1,905,993	-	553,307
Feb-03	1,589,529	(0)	-		1,589,528	55,279,792	2.88%	0.00%	2.88%	1,877,008	-	287,480
Mar-03	1,587,735	(0)	-		1,587,735	55,827,418	2.84%	0.00%	2.84%	1,814,947	-	227,211
Apr-03	1,622,752	(0)	-		1,622,752	55,998,256	2.90%	0.00%	2.90%	2,085,716	-	462,964
May-03	1,772,248	(0)	-		1,772,248	56,150,665	3.16%	0.00%	3.16%	2,581,906	-	809,658
Jun-03												
Jul-03			Case No. 2003-00068					Case No. 2003-00068				
Jun-03	1,927,669	(0)	-		1,927,669	56,240,084	3.43%	0.00%	3.43%	2,416,293	-	488,624
Jul-03	2,083,718	(0)	-		2,083,718	56,306,383	3.70%	0.00%	3.70%	2,803,674	-	719,956
Aug-03	2,096,376	(0)	-		2,096,376	55,872,180	3.75%	0.00%	3.75%	2,452,551	-	356,175
Sep-03	2,255,793	(0)	(500,171)		1,755,621	55,800,669	3.15%	3.03%	0.12%	(105,264)	604,575	(1,256,311)
Oct-03	2,589,108	(0)	(500,171)		2,088,936	55,757,523	3.75%	3.03%	0.72%	653,976	1,585,628	150,668
Nov-03	2,564,972	(0)	(500,171)		2,064,801	55,435,952	3.72%	3.03%	0.69%	1,471,882	1,763,608	1,170,689
Dec-03												
Jan-04												
Dec-03	2,770,620	(1)	(500,171)		2,270,448	55,639,805	4.08%	3.03%	1.05%	1,081,102	1,732,063	542,717
Jan-04	2,745,371	(0)	(500,171)		2,245,200	55,969,795	4.01%	3.03%	0.98%	(594,344)	1,504,435	(1,335,109)
Feb-04	3,215,981	(48)	(500,171)		2,715,762	56,205,075	4.83%	3.03%	1.80%	398,632	1,473,740	(843,391)
Mar-04	3,266,583	(48)	(500,171)		2,766,364	56,209,870	4.92%	3.03%	1.89%	1,054,644	1,416,747	(294,973)
Apr-04	3,484,976	(51)	(500,171)		2,984,754	56,786,599	5.26%	2.68%	2.58%	1,609,078	1,573,168	197,492
May-04	3,293,684	(46)	(500,171)		2,793,467	57,178,307	4.89%	2.68%	2.21%	1,576,134	954,792	(262,540)
Jun-04												
Jul-04								Case No. 2003-00434				
Jun-04	3,752,873	(50)	(500,171)		3,252,652	57,687,839	5.64%	2.68%	2.96%	1,282,367	184,757	(1,785,528)
Jul-04	2,442,913	(240)	(500,171)		1,942,501	57,977,804	3.35%	0.30%	3.05%	1,115,530	183,812	(643,160)
Aug-04	2,430,709	(248)	(520,166)		1,910,294	58,740,675	3.25%	0.30%	2.95%	1,099,282	162,720	(648,292)
Sep-04	2,264,458	(234)	-		2,264,225	59,157,003	3.83%	0.30%	3.53%	1,676,595	155,050	(432,580)
Oct-04	2,092,529	(218)	-		2,092,310	59,769,681	3.50%	0.30%	3.20%	1,958,572	184,567	50,828
Nov-04	2,214,858	(244)	-		2,214,614	60,841,133	3.64%	0.30%	3.34%	2,279,163	205,773	270,322
Dec-04												
Jan-05												

Kentucky Utilities Company
Environmental Cost Recovery Surcharge
Calculation of E(m) and Jurisdictional Surcharge Billing Factor
Summary Schedule for Expense Months December 2002 through February 2006

			OMU NOx									
Dec-04	2,605,069	(235)	-		2,604,834	61,431,600	4.24%	0.30%	3.94%			
Jan-05	2,077,647	(119)	-		2,077,528	62,084,082	3.35%	0.30%	3.05%			
Feb-05	2,056,042	(121)	-		2,055,921	62,627,307	3.28%	0.30%	2.98%	4,312,170	193,261	1,900,597
Mar-05	2,106,564	(122)	166,667		2,273,109	63,863,061	3.56%	0.30%	3.26%	1,381,557	190,718	(505,253)
Apr-05	2,405,379	(132)	83,333		2,488,580	64,427,841	3.86%	0.30%	3.56%	1,226,103	171,929	(657,889)
May-05	1,268,107	(121)	83,333		1,351,319	64,590,724	2.09%	0.30%	1.79%	1,665,912	157,782	(449,416)
Jun-05										2,204,030	181,271	(103,279)
Jul-05										1,597,764	210,596	457,042
Jun-05	2,538,778	(26)	83,333		2,622,085	65,238,233	4.02%	0.30%	3.72%			
Jul-05	2,317,179	(26)	83,333		2,400,486	66,259,682	3.62%	0.30%	3.32%			
Aug-05	2,330,890	(26)	83,333		2,414,197	68,147,986	3.54%	0.30%	3.24%	3,098,332	205,558	681,805
Sep-05	2,286,205	(25)	83,333		2,369,513	69,795,818	3.39%	0.30%	3.09%	2,493,516	207,382	300,412
Oct-05	2,279,654	(27)	83,333		2,362,960	71,085,369	3.32%	0.30%	3.02%	875,785	177,188	(1,361,224)
Nov-05	2,081,572	(24)	83,333		2,164,881	71,913,089	3.01%	0.30%	2.71%	1,475,513	163,482	(730,518)
Dec-05	2,288,991	(26)	83,333		2,372,298	72,999,224	3.25%	0.30%	2.95%	2,346,498	200,822	184,360
Jan-06	2,259,458	(10)	83,333		2,342,781	73,493,837	3.19%	0.30%	2.89%	2,199,122	211,922	246,163
Feb-06	2,390,988	(11)	83,333		2,474,310	73,672,517	3.36%	0.30%	3.06%	1,739,101	191,601	(441,596)
Mar-06										1,696,177	188,451	(458,153)
Apr-06										2,010,083	173,309	(290,919)
									Total Collected	67,128,935	16,510,705	
	90,178,339				85,237,139						83,639,640	(1,597,499)

Corrected Joint Brief of KU and LG&E – Clean Version

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF KENTUCKY UTILITIES COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING JULY 31, 2003, JANUARY 31, 2004, JANUARY 31, 2005, JULY 31, 2005 AND JANUARY 31, 2006 AND FOR THE TWO-YEAR BILLING PERIOD ENDING JULY 31, 2004	)	**CASE NO. 2006-00129**

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING OCTOBER 31, 2003, APRIL 30, 2004, OCTOBER 31, 2004, OCTOBER 31, 2005, AND APRIL 30, 2006, AND FOR THE TWO-YEAR BILLING PERIOD ENDING APRIL 30, 2005	)	**CASE NO. 2006-00130**

CORRECTED JOINT BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

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FILED: **November 21, 2006**

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Corrected Joint Brief was served on the following parties of record this 21st day of November 2006, by mailing a copy thereof, postage prepaid, via U.S. mail to:

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COMMONWEALTH OF KENTUCKY

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AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING OCTOBER 31, 2003, APRIL 30, 2004, OCTOBER 31, 2004, OCTOBER 31, 2005, AND APRIL 30, 2006, AND FOR THE TWO-YEAR BILLING PERIOD ENDING APRIL 30, 2005	)	**CASE NO. 2006-00130**

JOINT BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively, the "Companies"), for their Joint Brief, state as follows:

I. INTRODUCTION

The purpose of these proceedings is to review the past operation of the environmental surcharge KU billed during the five six-month billing periods ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005 and January 31, 2006, and the two-year billing period ended July 31, 2004. In the Commission's Order issued May 22, 2006, the Commission granted KU's motion to expand the current 6-month review of KU's environmental surcharge mechanism to include the billing period from February 1, 2006 through April 30, 2006 and expand the scope of the current 2-year review of KU's environmental surcharge mechanism to include the billing period from August 1, 2004 through April 30, 2005.

The purpose of these proceedings is also to review the past operation of the environmental surcharge LG&E billed during the six-month billing periods ending October 31, 2003, April 30, 2004, October 31, 2004, October 31, 2005, and April 30, 2006 and the two year billing period ending April 30, 2005, as well as to determine the appropriate amount of environmental surcharge revenue to incorporate into base rates for both Companies through a "roll-in" of environmental costs and expenses.

The Companies submit that their under-collected amounts, proposed roll-in amounts, suggested roll-in methodologies, and rates of return are reasonable and supported by the record of these proceedings. The Companies therefore request that the Commission:

a. Approve KU's proposed increase to its Environmental Surcharge Revenue Requirement of $399,375 per month for the first three months, and $399,374 for the fourth month following the Commission's decision in this proceeding, and likewise approve LG&E's proposed increase to its Environmental Surcharge Revenue Requirement of $576,005 per month for the first six months and $576,006 per month for the next six months following the Commission's decision in these proceedings;

b. Find environmental surcharge amounts for the two-year billing period ending April 2005 to be just and reasonable;

c. Find that LG&E should eliminate the expense reduction ordered in Case No. 2002-00147 from its monthly ECR filings beginning with the expense month of July 1, 2004;

d. Approve \$23,731,313 (KU) and \$8,669,729 (LG&E) to be the amounts to be incorporated into base electric rates for bills rendered on and after the second full billing month following the month in which an order is received in these cases;

e. Decide as a matter of policy whether the Environmental Surcharge mechanism should be used to address the inter-class rate subsidies that currently exist in the Companies' base rates and based on that decision approve either the use of allocating the roll-in amount on the basis of class base rate revenues or a methodology that allocates the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in base rates;

f. Reset the Companies' Base Environmental Surcharge Factors to amounts based on the roll-in amounts and base revenues from the most recent 12-month period available following the Commission's Order in these proceedings; and

g. Establish the rate of return for KU's Post-1994 Plan to be 11.52%, and the rate of return for LG&E's Post-1995 Plan to be 11.23%.

II. OVER- AND UNDER-COLLECTION

A. KU

KU billed an environmental surcharge to its customers from February 1, 2003 through April 30, 2006.[1] For purposes of the Commission's examination in this case, the monthly KU environmental surcharges are considered as the five six-month billing periods ended July 31, 2003; January 31, 2004; January 31, 2005; July 31, 2005 and January 31, 2006 (as extended to April 30, 2006 by the Commission's Order issued May 22, 2006), as well as the sixth six-month billing period ending July 31, 2004, which is part of the two-year billing period ending July 31,

[1] *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005, and January 31, 2006, and for the Two-Year Billing Period Ending July 31, 2004*, Case No. 2006-00129, Direct Testimony of Robert M. Conroy ("Conroy KU") at 2 (June 19, 2006).

2004 (as extended to February 28, 2005, by the Commission's Order issued May 22, 2006).[2] In each month of all of these periods, KU calculated the environmental surcharge factors by using the costs incurred as recorded on its books and records for the expense months of December 2002 through February 2006.[3]

As a result of the operation of the environmental surcharge during the billing periods under review, KU experienced a cumulative under-recovery of $1,597,499 for the billing periods ending April 30, 2006.[4] Therefore, an adjustment to the revenue requirement is necessary to reconcile the collection of past surcharge revenues with actual costs for the billing periods under review.[5]

KU proposes to recover over the four months following the Commission's Order in Case No. 2006-00129 the cumulative under-recovery of $1,597,499.[6] Specifically, KU recommends that the Commission approve the increase of the Environmental Surcharge Revenue Requirement by $399,375 per month for the first three months, and $399,374 for the fourth month following the Commission's Order in this proceeding.[7] This method is consistent with the method of implementing previous over- or under-recovery positions in prior ECR review cases.[8]

B. LG&E

LG&E billed an environmental surcharge to its customers from May 1, 2003 through April 30, 2006.[9] For purposes of the Commission's examination in this case, the monthly LG&E

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[2] Conroy KU at 2.
[3] Conroy KU at 2-3.
[4] Conroy KU at 3. KU's response to Question No. 3 of the Commission Staff Request for Information shows the calculation of the $1,597,499 cumulative under-recovery. The corrected versions of Mr. Conroy's testimony and KU's response to Question No. 3 were filed on November 21, 2006.
[5] Conroy KU at 3.
[6] Conroy KU at 5.
[7] Conroy KU at 5.
[8] Conroy KU at 5.
[9] *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Periods Ending October 31, 2003, April 30, 2004,*

environmental surcharges are considered as the five six-month billing periods ended October 31, 2003; April 30, 2004; October 31, 2004; October 31, 2005 and April 30, 2006, as well as the sixth six-month billing period which is the final six month period in the two-year billing period ending April 30, 2005.[10] In each month of these periods, LG&E calculated the environmental surcharge factors by using the costs incurred as recorded on its books and records for the expense months of March 2003 through February 2006.[11]

As a result of the operation of the environmental surcharge during the billing periods under review, LG&E experienced a cumulative under-recovery of $6,912,066 for the billing periods ending April 30, 2006.[12] Therefore, an adjustment to the revenue requirement is necessary to reconcile the collection of past surcharge revenues with actual costs for the billing periods under review.[13]

LG&E proposes to recover over the four months following the Commission's Order in Case No. 2006-00130 the cumulative under-recovery of $6,912,066.[14] Specifically, LG&E recommends that the Commission approve the increase of the Environmental Surcharge Revenue Requirement by $576,005 per month for the first six months and $576,006 per month for the next six months following the Commission's Order in this proceeding.[15] This method is consistent

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October 31, 2004, October 31, 2005, and April 30, 2006, and for the Two-Year Billing Period Ending April 30, 2005, Case No. 2006-00130, Direct Testimony of Robert M. Conroy ("Conroy LG&E") at 2 (June 19, 2006).

[10] Conroy LG&E at 2.

[11] Conroy LG&E at 2.

[12] Conroy LG&E at 2. LG&E's response to Question No. 2 of the Commission Staff Request for Information shows the calculation of the $6,912,066 cumulative under-recovery. The corrected versions of Mr. Conroy's testimony and LG&E's response to Question No. 2 were filed on November 21, 2006.

[13] Conroy LG&E at 2-3.

[14] Conroy LG&E at 5.

[15] Conroy LG&E at 5.

with the method of implementing previous over- or under-recovery positions in prior ECR review cases.[16]

III. THE ROLL-IN AMOUNTS ARE REASONABLE

The evidence of record shows the roll-in amounts and Base Environmental Surcharge Factors (BESF) provided by KU and LG&E are reasonable.

A. KU's Roll-In Amount Is Reasonable

The Commission should approve the incorporation into KU's base electric rates the environmental surcharge amounts found just and reasonable for the two-year billing period, as extended by the Commission's Order issued May 22, 2006, ending April 2005. KU recommends that a surcharge amount of $23,731,313 be incorporated into base rates at the conclusion of this case.[17] KU determined the roll-in amount of $23,731,313 using the base-current methodology as proposed by Commission Staff and further recommends adoption of the base-current methodology to calculate the monthly environmental surcharge factors going forward.[18] Although KU's recommendation to incorporate $23,731,313 into base rates will increase base rates, it will simultaneously reduce ECR revenues by an equal amount.[19] Therefore, there will be no net impact on KU's revenue requirement.[20]

B. LG&E's Roll-In Amount Is Reasonable

The Commission should likewise approve the incorporation into LG&E's base electric rates the environmental surcharge amounts found just and reasonable for the two-year billing period ending April 2005. LG&E recommends that a surcharge amount of $8,669,729 be

[16] Conroy LG&E at 6.
[17] Conroy KU at 6.
[18] Conroy KU at 6. The details of this methodology and the calculation of the amount are presented as attachments to KU's response to Question No. 12 to the Commission Staff Request for Information.
[19] Conroy KU at 8.
[20] Conroy KU at 8.

incorporated into base rates at the conclusion of this case.[21] LG&E determined the roll-in amount of $8,669,729 using the base-current methodology as proposed by Commission Staff and further recommends adoption of the base-current methodology to calculate the monthly environmental surcharge factors going forward.[22] Although LG&E's recommendation to incorporate the recommended surcharge amounts into base rates will increase base rates, it will simultaneously reduce ECR revenues by an equal amount.[23] Therefore, there will be no impact on LG&E's revenue requirement.[24]

C. The Companies' Base Environmental Surcharge Factors (BESF) Will Be Determined Using Latest Twelve Months within Issuance of KPSC Order

The Companies calculated, and propose to use, a new BESF for KU, using base revenues for the 12 months ending February 2006, of 3.21%.[25] The Companies likewise calculated, and propose to use, a new BESF for LG&E, using base revenues for the 12-months ending February 2006, of 3.36%.[26] However, the actual BESF will be calculated using base revenues for the 12-month period ending with the month preceding the month in which the Commission issues an order approving the roll-in.[27] The timing and method KU and LG&E will use to determine the final BESF is consistent with the Commission's Order in Case No. 2003-00068.[28]

IV. ROLL-IN METHODOLOGY

The Commission previously approved the Companies' proposed roll-in methodology as part of the approval of written unanimous settlements that spread the amount of the roll-in

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[21] Conroy LG&E at 7.
[22] Conroy LG&E at 7. The details of this methodology and the calculation of the amount are presented as attachments to LG&E's response to Question No. 11 to the Commission Staff Request for Information.
[23] Conroy LG&E at 8.
[24] Conroy LG&E at 8.
[25] Conroy KU at 8.
[26] Conroy LG&E at 9.
[27] Conroy KU at 8; Conroy LG&E at 9.
[28] Conroy KU at 8; Conroy LG&E at 9.

equally to every tariff subject to the environmental surcharge.[29] In these proceedings, in response to the Commission's inquiries, the Companies present two roll-in methodologies for the Commission's consideration -- the revenue methodology and an alternative methodology for allocating the roll-in amounts to the various classes of service in a way that gives some recognition to the inter-class rate subsidies that currently exist in the Companies' base rates. Though either method will effectively incorporate the correct amount of the surcharge revenues and expenses into base rates, the appropriateness of either method is a policy question for this Commission. In previous environmental surcharge proceedings, the Attorney General and the Kentucky Industrial Utility Customers, representing their respective interests, have advanced proposals for correcting inter-class subsidies or have challenged any such movements toward addressing inter-class subsidies.[30] The Companies will be guided by the Commission's decision in this case on whether the change in base rates associated with the ECR roll-in should be accomplished in a way that gives some recognition to the inter-class rate subsidies in current base rates.

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[29] *See In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending January 31, 200, July 31, 2001, January 31, 2002, and January 31, 2003, and for the Two-Year Billing Periods Ending July 31, 2000, and July 31, 2002,* Case No. 2003-00068, Order (October 17, 2003) (approving unanimous written settlement spreading amount of roll-in equally to every tariff subject to environmental surcharge); *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Two-Year Billing Period Ending April 30, 2003,* Case No. 2003-00236, Order (December 11, 2003) (spreading amount of roll-in equally to every tariff subject to environmental surcharge).

[30] *See, e.g., In the Matter of the Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00421, and *In the Matter of the Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct Flue Gas Desulphurization Systems and Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00426, Post-Hearing Brief of the Attorney General at 10-15 (May 31, 2005); *In the Matter of the Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00421, and *In the Matter of the Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct Flue Gas Desulphurization Systems and Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00426, Brief of Kentucky Industrial Utility Customers, Inc., at 3-19 (May 31, 2005).

A. The Revenue Method

This first approach, quite familiar to the Commission because it is the methodology used in prior roll-in proceedings, would allocate the Companies' roll-in amounts to the classes of service on the basis of base-rate revenues. "Base-rate revenues" are the revenues determined from the application of the company's base rates to test-year billing units and therefore exclude the application of all surcharges or surcredits from other cost recovery mechanisms, such as the fuel adjustment clause. Such an approach would have no impact on any subsidies currently built into base rates.

B. The Alternative Method

As an alternative to simply allocating the roll-in amount on the basis of base rate revenues, the Companies also present an allocation methodology for the Commission's consideration that would allocate the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in the Companies' rates. Although there are a number of considerations in determining the level and structure of the rates that a utility should charge its customers, there are two basic principles of fairness used in designing utility rates that stand out above all of the others.[31] The first principle of fairness is that customers should pay the costs that they impose on the system.[32] It is generally recognized by both experts and non-experts alike that a utility's rates should reflect the cost of providing service.[33] The second principle of fairness is that all customers should pay their fair share of their utility's margins (or

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[31] *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Periods Ending October 31, 2003, April 30, 2004, October 31, 2004, October 31, 2005, and April 30, 2006, and for the Two-Year Billing Period Ending April 30, 2005*, Case No. 2006-00130, Direct Testimony of William Steven Seelye ("Seelye LG&E") at 8 (June 14, 2006); *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005, and January 31, 2006, and for the Two-Year Billing Period Ending July 31, 2004*, Case No. 2006-00129, Direct Testimony of William Steven Seelye ("Seelye KU") at 8 (June 14, 2006).

[32] Seelye LG&E at 8; Seelye KU at 8.

[33] Seelye LG&E at 8; Seelye KU at 8.

operating income).[34] Though it is sometimes necessary to consider the value of service and the competitiveness of service, the starting point in assessing the reasonableness of the rates to be charged by a utility is to evaluate the cost of service.[35]

Designing rates that reflect the cost of providing service helps ensure that customers pay their fair share of the utility's costs.[36] In other words, implementing cost-based rates helps ensure that one class of customers does not subsidize another class of customers.[37] The Companies' current base rates contain subsidies between various rate classes, as the tables that follow show:[38]

TABLE 1

Kentucky Utilities Company
Summary of Class Rates of Return
Based on Service Rates Approved by the Commission
in Case No. 2003-00434

Rate Class	Rate of Return
Residential	2.42%
General Service	8.67%
Combined Light & Power	12.01%
Large Comm/Ind TOD	8.32%
Coal Mining Power	15.68%
Large Power Mine Power TOD	12.72%
All Electric School	7.43%
Water Pumping	2.74%
Street Lighting	3.76%
NAS	16.24%
Total	**6.33%**

[34] Seelye LG&E at 8; Seelye KU at 8.
[35] Seelye LG&E at 8-9; Seelye KU at 8-9.
[36] Seelye LG&E at 9; Seelye KU at 9.
[37] Seelye LG&E at 9; Seelye KU at 9.
[38] Table 1: Seelye KU at 4. Table 2: Seelye LG&E at 4.

TABLE 2 Louisville Gas and Electric Company Summary of Class Rates of Return Based on Service Rates Approved by the Commission in Case No. 2003-00433	
Rate Class	**Rate of Return**
Residential	3.45%
General Service	11.98%
Rate LC	10.00%
Rate LC-TOD	8.04%
Rate LP	11.52%
Rate LP-TOD	6.08%
Special Contract	3.72%
Special Contract	4.33%
Special Contract	6.19%
Lighting	3.45%
Total	**6.36%**

Under the Companies' proposed alternative methodology, the roll-in amount allocated to the customer classes under the revenue methodology would be adjusted by either a credit or charge depending on whether a class rate of return falls outside of a range of plus or minus 100 basis points around the overall rates of return for KU and LG&E.[39] For KU, customer classes with a rate of return falling between 5.33% and 7.33% would receive the revenue methodology allocation of the roll-in amount (i.e., the amount determined based on a base-rate allocation using the methodology applied in prior roll-in proceedings).[40] In other words, customer classes with a rate of return between 5.33% and 7.33% will not receive a credit or charge to correct for the rate subsidies that exist in base rates.[41] Likewise for LG&E, customer classes with a rate of return falling between 5.36% and 7.36% would receive the revenue methodology allocation of the roll-in amount (i.e., the amount determined based on a base-rate allocation using the methodology

[39] Seelye KU at 10; Seelye LG&E at 10.
[40] Seelye KU at 10.
[41] Seelye KU at 10.

applied in prior roll-in proceedings).[42] In other words, customer classes with a rate of return between 5.36% and 7.36% will not receive a credit or charge to correct for the rate subsidies that exist in base rates.[43] If a class rate of return is within plus or minus 100 basis points of the overall rate of return then the service rates can be considered to reasonably reflect the cost of providing service.[44]

For all customer classes with rates of return above the range – i.e., above 7.33% for KU and 7.36% for LG&E -- the revenue methodology roll-in amount would be adjusted downward by a credit amount which lowers the roll-in amount that would otherwise be allocated to the customer class.[45] For all customer classes with rates of return below the range – i.e., below 5.33% for KU and 5.36% for LG&E -- the revenue methodology roll-in amount would be adjusted upward by a charge amount which increases the roll-in amount that would otherwise be allocated to the customer class.[46] Under the alternative methodology for KU, $5,173,724 of the total roll-in amount of $23,731,313 would be used to correct the subsidies that currently exist in base rates.[47] The $5,173,724 correction for KU would be allocated as a credit to those rate classes with rates of return above 7.33% based on the total amount of subsidy above this threshold rate of return paid by each customer class.[48] Similarly, the $5,173,724 correction would be allocated as a charge to those rate classes with rates of return below 5.33% on the basis of the total subsidy below 5.33% received by each customer class.[49] Likewise for LG&E, under the alternative methodology, $2,005,940 of the total roll-in amount of $8,669,729 would be used

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[42] Seelye LG&E at 10.
[43] Seelye LG&E at 10.
[44] Seelye KU at 10; Seelye LG&E at 10.
[45] Seelye KU at 10; Seelye LG&E at 10.
[46] Seelye KU at 11; Seelye LG&E at 11.
[47] Seelye KU at 11.
[48] Seelye KU at 11.
[49] Seelye KU at 11.

to correct the subsidies that currently exist in base rates.[50] The $2,005,940 correction for LG&E would be allocated as a credit to those rate classes with rates of return above 7.36% based on the total amount of subsidy above this threshold rate of return paid by each customer class.[51] Similarly, the $2,005,940 correction would be allocated as a charge to those rate classes with rates of return below 5.36% on the basis of the total subsidy below 5.36% received by each customer class.[52] The amount used to correct the subsidies would thus be allocated to the affected rate classes in a symmetrical manner based on the amount of subsidy paid or the amount of subsidy received.

The amounts used to correct subsidies ($5,173,724 for KU, $2,005,940 for LG&E) were determined so that no rate class would receive less than 25 percent of the roll-in amount that the class would otherwise receive if the roll-in were allocated on the basis of base-rate revenues.[53] In other words, when the subsidy-correction amount is allocated on the basis of annual subsidies paid by those rate classes above 7.33% for KU and 7.36% for LG&E, the roll-in amounts for none of the classes are below 25% of the roll-in amount that would otherwise be allocated to the class using the revenue methodology.[54] This requirement would ensure that each class will bear a significant responsibility for the rolled-in costs, even though the cost of service study would suggest that some classes should not bear any responsibility for the costs based on the current level of subsidies.

The amounts used to correct subsidies also have the advantage of being sufficiently small that, though they serve to move in the direction of mitigating subsidies, they comport with the

[50] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3.
[51] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Seelye LG&E at 11.
[52] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Seelye LG&E at 11.
[53] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Seelye KU at 11; Seelye LG&E at 11.
[54] Seelye KU at 11; Seelye LG&E at 11.

ratemaking axiom of gradualism.[55] No part of this proposal should result in a "rate shock," but the proposal is nonetheless a step toward alleviating the significant subsidies between certain of the Companies' rate classes.

The Companies are aware of no statutory or regulatory obstacles to the approval and implementation of this alternative proposal. The Companies suggest that it may serve as a gradual means of correcting significant subsidies currently embedded in the Companies' base rates. Nevertheless, the Companies will be guided by the Commission's decision in these cases on whether the change in base rates associated with the ECR roll-in should be accomplished in a way that gives some recognition to the inter-class rate subsidies in current base rates.

C. Rate Design: No Part of Roll-In Should Be Recovered Through Customer Charge

Also, under either roll-in methodology, the Companies should not recover any part of the roll-in amount through a customer charge. For schedules containing both energy and demand charges, the roll-in amount will be recovered through the demand charge; and for schedules containing an energy charge but no demand charge, the roll-in amount will be recovered through the energy charge.[56] For lighting rates consisting of a charge per fixture, the roll-in amount allocated to the lighting rates would be recovered through the charge per fixture, as in prior roll-ins.[57] Except for the lighting rates, the Companies' recommended approach would represent a departure from prior roll-ins.[58] In prior roll-ins the amounts allocated to each rate class were assigned to all components of base rates (customer charge, energy charge and demand charge, as

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[55] Attachments to KU's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Attachments to LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 4.
[56] Seelye KU at 14; Seelye LG&E at 14.
[57] Seelye KU at 14; Seelye LG&E at 14.
[58] Seelye KU at 14; Seelye LG&E at 14.

applicable) on a pro-rata basis.[59] The Companies' approach to converting the roll-in amount into unit charges is consistent with cost of service principles.[60]

V. RATE OF RETURN

Calculated using adjusted capitalization and using the currently approved 10.50% return on equity, the Companies recommend an overall rate of return of 11.52% for KU[61] and an overall rate of return of 11.23% for LG&E.[62] The Companies believe that these overall rates of return, based upon the currently allowed 10.50% rate of return on common equity for the environmental surcharge, are reasonable if not conservative.

The 10.50% rate of return was approved by the Commission in Case Nos. 2004-00421 and 2004-00426 on June 20, 2005, and became effective with the July 2005 billing month. Since the Commission's Orders on June 20, 2005, long-term interest rates have increased, as evidenced by the performance of 10- and 20-year Treasury bonds, A-rated utility bonds, and Aaa-rated corporate bonds for the period January 2005 through May 2006.[63] The Value Line Quarterly Economic Review forecasts that these increases in long-term interest rates will continue.[64]

The authorized 10.50% rate of return on common equity is also consistent with recently authorized returns by this Commission and across the country. The April 5, 2006, issue of Regulatory Research Associates Regulatory Focus shows that the average rate of return on

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[59] Seelye KU at 14; Seelye LG&E at 14.
[60] Seelye KU at 14-15; Seelye LG&E at 14-15.
[61] Conroy KU at 8. *See* KU Response to the Commission Staff Request for Information Question No. 17.
[62] Conroy LG&E at 9. *See* LG&E Response to the Commission Staff Request for Information, Question No. 16.
[63] *See* KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 11, Attachment 1; LG&E Response to Information Requested in Appendix B of Commission's Order Dated April 25,2006, No. 10, Attachment 1.
[64] *See* KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 11, Attachment 2; LG&E Response to Information Requested in Appendix B of Commission's Order Dated April 25,2006, No. 10, Attachment 2.

common equity authorized for electric and gas utilities during the first quarter of 2006 averaged 10.4% and 10.6%, respectively.[65]

Thus, the Companies conclude it would be reasonable, and somewhat conservative, to maintain prospectively the current authorized rate of return on common equity of 10.50% for ECR purposes.

VI. LG&E'S ELIMINATION OF EXPENSE REDUCTION FROM PRIOR CASE

One change in the calculation of the recoverable operating expenses under the Post 1995 Compliance Plan for LG&E is necessary. In the determination of the revenue requirement established in the September 4, 2003 Order in Case No. 2002-00147, the Commission ordered LG&E to exclude from environmental operating expenses, expenses of $271,119 associated with operators, the cost of which was included in LG&E's base rates at the time of the Order.[66] Since that time, LG&E has implemented new base rates, effective for service rendered on and after July 1, 2004, as approved by the Commission in its June 30, 2004 Order in Case No. 2003-00433.[67] LG&E's revenue requirements in that case did not include labor expense associated with the four employees, and LG&E's current base rates do not include labor expense associated with the four employees.[68] Therefore, there is no double recovery of this expense, and LG&E is eliminating the monthly exclusion for all expense months following the date of the Commission's Order establishing LG&E's new base rates.[69]

During the billing periods from September 2004 through the present, LG&E continued to calculate its monthly environmental surcharge calculations in compliance with the Commission's

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[65] *See* KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 11, Attachment 3; LG&E Response to Information Requested in Appendix B of Commission's Order Dated April 25,2006, No. 10, Attachment 3.
[66] Conroy LG&E at 4.
[67] Conroy LG&E at 4.
[68] Conroy LG&E at 4.
[69] Conroy LG&E at 4.

Order in Case No. 2002-00147 by reducing operating and maintenance expenses by a monthly amount of $22,593.[70]

This proceeding presents the first opportunity to remedy the operation of LG&E's environmental surcharge, as this is the first review of the operation of the surcharge for the periods impacted.[71] LG&E's under-recovery position includes the impact of eliminating the expense exclusion ordered by the Commission and LG&E proposes that eliminating this exclusion be approved for all months from July 2004 to present and continuing.[72] Upon issuance of an Order in this proceeding, LG&E proposes to eliminate this expense reduction from the monthly ECR filings and will include an adjustment for the period from March 2006 to the month preceding the Commission order in this proceeding in the appropriate six-month review periods in the future.[73]

VII. KU'S EMISSION ALLOWANCES IN BASE RATES

KU's current base rates were established by the Commission in its Order dated June 30, 2004 in Case No. 2003-00434 based upon its analysis of KU's revenue requirement found justifiable by the record and an electric revenue requirement recommended pursuant to a partial settlement and stipulation.[74] As part of the partial settlement and stipulation and as approved by the Commission's Order, KU's 1994 environmental compliance plan was removed from recovery through the environmental surcharge filings and recovered through base rates.[75] KU's rate base

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[70] Conroy LG&E at 5.
[71] Conroy LG&E at 5.
[72] Conroy LG&E at 5.
[73] Conroy LG&E at 5.
[74] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[75] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.

at September 30, 2003 included $69,415 in emission allowances inventory.[76] Therefore, KU's current base rates include a return on the jurisdictional portion of those allowances.

Upon the effective date of the roll-in, KU will continue to calculate a return on total environmental compliance rate base in its monthly filing forms.[77] The resulting revenue requirement will be reduced by the portion of ECR-related revenue collected through base rates as a result of the roll-in.[78] However, if KU does not continue to reduce its environmental rate base by the emission allowance inventory included in base rates, then KU will be including a calculated return on those allowances in its monthly environmental revenue requirement, and the monthly reduction resulting from the roll-in will not include an amount associated with that return.[79] Thus, the return on the allowance inventory balance of $69,415 is not reflected in KU's BESF.[80]

VIII. CONCLUSION

For the foregoing reasons stated in this brief and in their testimony, Kentucky Utilities Company and Louisville Gas and Electric Company request the Public Service Commission to enter orders that grant the Companies the following relief:

a. Approving KU's proposed increase to its Environmental Surcharge Revenue Requirement of $399,375 per month for the first three months, and $399,374 for the fourth month following the Commission's decision in this proceeding, and likewise approving LG&E's proposed increase to its Environmental Surcharge Revenue Requirement of $576,005 per month for the first six months and $576,006 per month for the next six months following the Commission's decision in this proceeding;

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[76] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[77] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[78] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[79] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[80] KU Response to Second Data Request of Commission Staff, Dated June 29, 2006, No. 6(a).

b. Finding environmental surcharge amounts for the two-year billing period ending April 2005 to be just and reasonable;

c. Finding that LG&E should eliminate the expense reduction ordered in Case No. 2002-00147 from its monthly ECR filings beginning with the expense month of July 1, 2004;

d. Approving $23,731,313 (KU) and $8,669,729 (LG&E) to be the amounts to be incorporated into base electric rates for bills rendered on and after the second full billing month following the month in which an order is received in these cases;

e. The Commission should decide as a matter of policy whether the Environmental Surcharge mechanism should be used to address the inter-class rate subsidies that currently exist in the Companies' base rates and based on that decision approve either the use of allocating the roll-in amount on the basis of class base rate revenues or a methodology that allocates the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in base rates; but whichever roll-in methodology is approved by the Commission, no part of the roll-in amount should be recovered through the customer charges of the rates.

f. Resetting the Companies' Base Environmental Surcharge Factors to amounts based on the roll-in amounts and base revenues from the most recent 12-month period available following the Commission's Order in these proceedings; and

g. Establishing the rate of return for KU's Post-1994 Plan to be 11.52%, and the rate of return for LG&E's Post-1995 Plan to be 11.23%.

Dated: November 21, 2006

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Corrected Joint Brief of KU and LG&E – Redline Version

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF KENTUCKY UTILITIES COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING JULY 31, 2003, JANUARY 31, 2004, JANUARY 31, 2005, JULY 31, 2005 AND JANUARY 31, 2006 AND FOR THE TWO-YEAR BILLING PERIOD ENDING JULY 31, 2004	)	**CASE NO. 2006-00129**

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING OCTOBER 31, 2003, APRIL 30, 2004, OCTOBER 31, 2004, OCTOBER 31, 2005, AND APRIL 30, 2006, AND FOR THE TWO-YEAR BILLING PERIOD ENDING APRIL 30, 2005	)	**CASE NO. 2006-00130**

CORRECTED JOINT BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

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FILED: ~~September 28~~November 21, 2006

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Joint Brief was served on the following parties of record this ~~28th~~ 21st day of ~~Sept~~November 2006, by mailing a copy thereof, postage prepaid, via U.S. mail to:

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COMMONWEALTH OF KENTUCKY

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JOINT BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively, the "Companies"), for their Joint Brief, state as follows:

I. INTRODUCTION

The purpose of these proceedings is to review the past operation of the environmental surcharge KU billed during the five six-month billing periods ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005 and January 31, 2006, and the two-year billing period ended July 31, 2004. In the Commission's Order issued May 22, 2006, the Commission granted KU's motion to expand the current 6-month review of KU's environmental surcharge mechanism to include the billing period from February 1, 2006 through April 30, 2006 and expand the scope of the current 2-year review of KU's environmental surcharge mechanism to include the billing period from August 1, 2004 through April 30, 2005.

The purpose of these proceedings is also to review the past operation of the environmental surcharge LG&E billed during the six-month billing periods ending October 31, 2003, April 30, 2004, October 31, 2004, October 31, 2005, and April 30, 2006 and the two year billing period ending April 30, 2005, as well as to determine the appropriate amount of environmental surcharge revenue to incorporate into base rates for both Companies through a "roll-in" of environmental costs and expenses.

The Companies submit that their under-collected amounts, proposed roll-in amounts, suggested roll-in methodologies, and rates of return are reasonable and supported by the record of these proceedings. The Companies therefore request that the Commission:

a. Approve KU's proposed increase to its Environmental Surcharge Revenue Requirement of $399,375 per month for the first three months, and $399,374 for the fourth month~~$63,663 in the first four billing months~~ following the Commission's decision in this proceeding, and likewise approve LG&E's proposed increase to its Environmental Surcharge Revenue Requirement of $576,005 per month for the first six months and $576,006 per month for the next six months~~$662,267 in the first four billing months~~ following the Commission's decision in these proceedings;

b. Find environmental surcharge amounts for the two-year billing period ending April 2005 to be just and reasonable;

c. Find that LG&E should eliminate the expense reduction ordered in Case No. 2002-00147 from its monthly ECR filings beginning with the expense month of July 1, 2004;

d. Approve $23,731,313 (KU) and $8,669,729 (LG&E) to be the amounts to be incorporated into base electric rates for bills rendered on and after the second full billing month following the month in which an order is received in these cases;

e. Decide as a matter of policy whether the Environmental Surcharge mechanism should be used to address the inter-class rate subsidies that currently exist in the Companies' base rates and based on that decision approve either the use of allocating the roll-in amount on the basis of class base rate revenues or a methodology that allocates the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in base rates;

f. Reset the Companies' Base Environmental Surcharge Factors to amounts based on the roll-in amounts and base revenues from the most recent 12-month period available following the Commission's Order in these proceedings; and

g. Establish the rate of return for KU's Post-1994 Plan to be 11.52%, and the rate of return for LG&E's Post-1995 Plan to be 11.23%.

II. OVER- AND UNDER-COLLECTION

A. KU

KU billed an environmental surcharge to its customers from February 1, 2003 through April 30, 2006.[1] For purposes of the Commission's examination in this case, the monthly KU environmental surcharges are considered as the five six-month billing periods ended July 31, 2003; January 31, 2004; January 31, 2005; July 31, 2005 and January 31, 2006 (as extended to April 30, 2006 by the Commission's Order issued May 22, 2006), as well as the sixth six-month billing period ending July 31, 2004, which is part of the two-year billing period ending July 31,

[1] *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005, and January 31, 2006, and for the Two-Year Billing Period Ending July 31, 2004*, Case No. 2006-00129, Direct Testimony of Robert M. Conroy ("Conroy KU") at 2 (June 19, 2006).

2004 (as extended to February 28, 2005, by the Commission's Order issued May 22, 2006).[2] In each month of all of these periods, KU calculated the environmental surcharge factors by using the costs incurred as recorded on its books and records for the expense months of December 2002 through February 2006.[3]

As a result of the operation of the environmental surcharge during the billing periods under review, KU experienced a cumulative under-recovery of $1,597,499~~254,652~~ for the billing periods ending April 30, 2006.[4] Therefore, an adjustment to the revenue requirement is necessary to reconcile the collection of past surcharge revenues with actual costs for the billing periods under review.[5]

KU proposes to recover over the four months following the Commission's Order in Case No. 2006-00129 the cumulative under-recovery of $1,597,499~~254,652~~.[6] Specifically, KU recommends that the Commission approve the increase of the Environmental Surcharge Revenue Requirement by $399,375 per month for the first three months, and $399,374 for the fourth month~~$63,663 per month beginning in the first full billing month~~ following the Commission's Order in this proceeding.[7] This method is consistent with the method of implementing previous over- or under-recovery positions in prior ECR review cases.[8]

B. LG&E

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[2] Conroy KU at 2.
[3] Conroy KU at 2-3.
[4] Conroy KU at 3. KU's response to Question No. 3 of the Commission Staff Request for Information shows the calculation of the $1,597,499~~254,652~~ cumulative under-recovery. The corrected versions of Mr. Conroy's testimony and KU's response to Question No. 3 were filed on November 21, 2006.
[5] Conroy KU at 3.
[6] Conroy KU at 5.
[7] Conroy KU at 5.
[8] Conroy KU at 5.

LG&E billed an environmental surcharge to its customers from May 1, 2003 through April 30, 2006.[9] For purposes of the Commission's examination in this case, the monthly LG&E environmental surcharges are considered as the five six-month billing periods ended October 31, 2003; April 30, 2004; October 31, 2004; October 31, 2005 and April 30, 2006, as well as the sixth six-month billing period which is the final six month period in the two-year billing period ending April 30, 2005.[10] In each month of these periods, LG&E calculated the environmental surcharge factors by using the costs incurred as recorded on its books and records for the expense months of March 2003 through February 2006.[11]

As a result of the operation of the environmental surcharge during the billing periods under review, LG&E experienced a cumulative under-recovery of <u>$6,912,066</u>~~$2,649,068~~ for the billing periods ending April 30, 2006.[12] Therefore, an adjustment to the revenue requirement is necessary to reconcile the collection of past surcharge revenues with actual costs for the billing periods under review.[13]

LG&E proposes to recover over the four months following the Commission's Order in Case No. 2006-00130 the cumulative under-recovery of <u>$6,912,066</u>~~$2,649,068~~.[14] Specifically, LG&E recommends that the Commission approve the increase of the Environmental Surcharge Revenue Requirement by <u>$576,005 per month for the first six months and $576,006 per month for the next six months</u>~~$662,267 per month, beginning in the first full billing month~~ following

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[9] *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Periods Ending October 31, 2003, April 30, 2004, October 31, 2004, October 31, 2005, and April 30, 2006, and for the Two-Year Billing Period Ending April 30, 2005*, Case No. 2006-00130, Direct Testimony of Robert M. Conroy ("Conroy LG&E") at 2 (June 19, 2006).
[10] Conroy LG&E at 2.
[11] Conroy LG&E at 2.
[12] Conroy LG&E at 2. LG&E's response to Question No. 2 of the Commission Staff Request for Information shows the calculation of the <u>$6,912,066</u>~~$2,649,068~~ cumulative under-recovery. <u>The corrected versions of Mr. Conroy's testimony and LG&E's response to Question No. 2 were filed on November 21, 2006.</u>
[13] Conroy LG&E at 2-3.
[14] Conroy LG&E at 5.

the Commission's Order in this proceeding.[15] This method is consistent with the method of implementing previous over- or under-recovery positions in prior ECR review cases.[16]

III. THE ROLL-IN AMOUNTS ARE REASONABLE

The evidence of record shows the roll-in amounts and Base Environmental Surcharge Factors (BESF) provided by KU and LG&E are reasonable.

A. KU's Roll-In Amount Is Reasonable

The Commission should approve the incorporation into KU's base electric rates the environmental surcharge amounts found just and reasonable for the two-year billing period, as extended by the Commission's Order issued May 22, 2006, ending April 2005. KU recommends that a surcharge amount of $23,731,313 be incorporated into base rates at the conclusion of this case.[17] KU determined the roll-in amount of $23,731,313 using the base-current methodology as proposed by Commission Staff and further recommends adoption of the base-current methodology to calculate the monthly environmental surcharge factors going forward.[18] Although KU's recommendation to incorporate $23,731,313 into base rates will increase base rates, it will simultaneously reduce ECR revenues by an equal amount.[19] Therefore, there will be no net impact on KU's revenue requirement.[20]

B. LG&E's Roll-In Amount Is Reasonable

The Commission should likewise approve the incorporation into LG&E's base electric rates the environmental surcharge amounts found just and reasonable for the two-year billing period ending April 2005. LG&E recommends that a surcharge amount of $8,669,729 be

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[15] Conroy LG&E at 5.
[16] Conroy LG&E at 6.
[17] Conroy KU at 6.
[18] Conroy KU at 6. The details of this methodology and the calculation of the amount are presented as attachments to KU's response to Question No. 12 to the Commission Staff Request for Information.
[19] Conroy KU at 8.
[20] Conroy KU at 8.

incorporated into base rates at the conclusion of this case.[21] LG&E determined the roll-in amount of $8,669,729 using the base-current methodology as proposed by Commission Staff and further recommends adoption of the base-current methodology to calculate the monthly environmental surcharge factors going forward.[22] Although LG&E's recommendation to incorporate the recommended surcharge amounts into base rates will increase base rates, it will simultaneously reduce ECR revenues by an equal amount.[23] Therefore, there will be no impact on LG&E's revenue requirement.[24]

C. The Companies' Base Environmental Surcharge Factors (BESF) Will Be Determined Using Latest Twelve Months within Issuance of KPSC Order

The Companies calculated, and propose to use, a new BESF for KU, using base revenues for the 12 months ending February 2006, of 3.21%.[25] The Companies likewise calculated, and propose to use, a new BESF for LG&E, using base revenues for the 12-months ending February 2006, of 3.36%.[26] However, the actual BESF will be calculated using base revenues for the 12-month period ending with the month preceding the month in which the Commission issues an order approving the roll-in.[27] The timing and method KU and LG&E will use to determine the final BESF is consistent with the Commission's Order in Case No. 2003-00068.[28]

IV. ROLL-IN METHODOLOGY

The Commission previously approved the Companies' proposed roll-in methodology as part of the approval of written unanimous settlements that spread the amount of the roll-in

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[21] Conroy LG&E at 7.
[22] Conroy LG&E at 7. The details of this methodology and the calculation of the amount are presented as attachments to LG&E's response to Question No. 11 to the Commission Staff Request for Information.
[23] Conroy LG&E at 8.
[24] Conroy LG&E at 8.
[25] Conroy KU at 8.
[26] Conroy LG&E at 9.
[27] Conroy KU at 8; Conroy LG&E at 9.
[28] Conroy KU at 8; Conroy LG&E at 9.

equally to every tariff subject to the environmental surcharge.[29] In these proceedings, in response to the Commission's inquiries, the Companies present two roll-in methodologies for the Commission's consideration -- the revenue methodology and an alternative methodology for allocating the roll-in amounts to the various classes of service in a way that gives some recognition to the inter-class rate subsidies that currently exist in the Companies' base rates. Though either method will effectively incorporate the correct amount of the surcharge revenues and expenses into base rates, the appropriateness of either method is a policy question for this Commission. In previous environmental surcharge proceedings, the Attorney General and the Kentucky Industrial Utility Customers, representing their respective interests, have advanced proposals for correcting inter-class subsidies or have challenged any such movements toward addressing inter-class subsidies.[30] The Companies will be guided by the Commission's decision in this case on whether the change in base rates associated with the ECR roll-in should be accomplished in a way that gives some recognition to the inter-class rate subsidies in current base rates.

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[29] *See In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending January 31, 200, July 31, 2001, January 31, 2002, and January 31, 2003, and for the Two-Year Billing Periods Ending July 31, 2000, and July 31, 2002,* Case No. 2003-00068, Order (October 17, 2003) (approving unanimous written settlement spreading amount of roll-in equally to every tariff subject to environmental surcharge); *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Two-Year Billing Period Ending April 30, 2003,* Case No. 2003-00236, Order (December 11, 2003) (spreading amount of roll-in equally to every tariff subject to environmental surcharge).

[30] *See, e.g., In the Matter of the Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00421, and *In the Matter of the Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct Flue Gas Desulphurization Systems and Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00426, Post-Hearing Brief of the Attorney General at 10-15 (May 31, 2005); *In the Matter of the Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00421, and *In the Matter of the Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct Flue Gas Desulphurization Systems and Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00426, Brief of Kentucky Industrial Utility Customers, Inc., at 3-19 (May 31, 2005).

A. The Revenue Method

This first approach, quite familiar to the Commission because it is the methodology used in prior roll-in proceedings, would allocate the Companies' roll-in amounts to the classes of service on the basis of base-rate revenues. "Base-rate revenues" are the revenues determined from the application of the company's base rates to test-year billing units and therefore exclude the application of all surcharges or surcredits from other cost recovery mechanisms, such as the fuel adjustment clause. Such an approach would have no impact on any subsidies currently built into base rates.

B. The Alternative Method

As an alternative to simply allocating the roll-in amount on the basis of base rate revenues, the Companies also present an allocation methodology for the Commission's consideration that would allocate the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in the Companies' rates. Although there are a number of considerations in determining the level and structure of the rates that a utility should charge its customers, there are two basic principles of fairness used in designing utility rates that stand out above all of the others.[31] The first principle of fairness is that customers should pay the costs that they impose on the system.[32] It is generally recognized by both experts and non-experts alike that a utility's rates should reflect the cost of providing service.[33] The second principle of fairness is that all customers should pay their fair share of their utility's margins (or

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[31] *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Periods Ending October 31, 2003, April 30, 2004, October 31, 2004, October 31, 2005, and April 30, 2006, and for the Two-Year Billing Period Ending April 30, 2005*, Case No. 2006-00130, Direct Testimony of William Steven Seelye ("Seelye LG&E") at 8 (June 14, 2006); *In the Matter of an Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005, and January 31, 2006, and for the Two-Year Billing Period Ending July 31, 2004*, Case No. 2006-00129, Direct Testimony of William Steven Seelye ("Seelye KU") at 8 (June 14, 2006).

[32] Seelye LG&E at 8; Seelye KU at 8.

[33] Seelye LG&E at 8; Seelye KU at 8.

operating income).[34] Though it is sometimes necessary to consider the value of service and the competitiveness of service, the starting point in assessing the reasonableness of the rates to be charged by a utility is to evaluate the cost of service.[35]

Designing rates that reflect the cost of providing service helps ensure that customers pay their fair share of the utility's costs.[36] In other words, implementing cost-based rates helps ensure that one class of customers does not subsidize another class of customers.[37] The Companies' current base rates contain subsidies between various rate classes, as the tables that follow show:[38]

TABLE 1

Kentucky Utilities Company
Summary of Class Rates of Return
Based on Service Rates Approved by the Commission
in Case No. 2003-00434

Rate Class	Rate of Return
Residential	2.42%
General Service	8.67%
Combined Light & Power	12.01%
Large Comm/Ind TOD	8.32%
Coal Mining Power	15.68%
Large Power Mine Power TOD	12.72%
All Electric School	7.43%
Water Pumping	2.74%
Street Lighting	3.76%
NAS	16.24%
Total	**6.33%**

[34] Seelye LG&E at 8; Seelye KU at 8.
[35] Seelye LG&E at 8-9; Seelye KU at 8-9.
[36] Seelye LG&E at 9; Seelye KU at 9.
[37] Seelye LG&E at 9; Seelye KU at 9.
[38] Table 1: Seelye KU at 4. Table 2: Seelye LG&E at 4.

TABLE 2 Louisville Gas and Electric Company Summary of Class Rates of Return Based on Service Rates Approved by the Commission in Case No. 2003-00433	
Rate Class	**Rate of Return**
Residential	3.45%
General Service	11.98%
Rate LC	10.00%
Rate LC-TOD	8.04%
Rate LP	11.52%
Rate LP-TOD	6.08%
Special Contract	3.72%
Special Contract	4.33%
Special Contract	6.19%
Lighting	3.45%
Total	**6.36%**

Under the Companies' proposed alternative methodology, the roll-in amount allocated to the customer classes under the revenue methodology would be adjusted by either a credit or charge depending on whether a class rate of return falls outside of a range of plus or minus 100 basis points around the overall rates of return for KU and LG&E.[39] For KU, customer classes with a rate of return falling between 5.33% and 7.33% would receive the revenue methodology allocation of the roll-in amount (i.e., the amount determined based on a base-rate allocation using the methodology applied in prior roll-in proceedings).[40] In other words, customer classes with a rate of return between 5.33% and 7.33% will not receive a credit or charge to correct for the rate subsidies that exist in base rates.[41] Likewise for LG&E, customer classes with a rate of return falling between 5.36% and 7.36% would receive the revenue methodology allocation of the roll-in amount (i.e., the amount determined based on a base-rate allocation using the methodology

[39] Seelye KU at 10; Seelye LG&E at 10.
[40] Seelye KU at 10.
[41] Seelye KU at 10.

applied in prior roll-in proceedings).[42] In other words, customer classes with a rate of return between 5.36% and 7.36% will not receive a credit or charge to correct for the rate subsidies that exist in base rates.[43] If a class rate of return is within plus or minus 100 basis points of the overall rate of return then the service rates can be considered to reasonably reflect the cost of providing service.[44]

For all customer classes with rates of return above the range – i.e., above 7.33% for KU and 7.36% for LG&E -- the revenue methodology roll-in amount would be adjusted downward by a credit amount which lowers the roll-in amount that would otherwise be allocated to the customer class.[45] For all customer classes with rates of return below the range – i.e., below 5.33% for KU and 5.36% for LG&E -- the revenue methodology roll-in amount would be adjusted upward by a charge amount which increases the roll-in amount that would otherwise be allocated to the customer class.[46] Under the alternative methodology for KU, $5,173,724 of the total roll-in amount of $23,731,313 would be used to correct the subsidies that currently exist in base rates.[47] The $5,173,724 correction for KU would be allocated as a credit to those rate classes with rates of return above 7.33% based on the total amount of subsidy above this threshold rate of return paid by each customer class.[48] Similarly, the $5,173,724 correction would be allocated as a charge to those rate classes with rates of return below 5.33% on the basis of the total subsidy below 5.33% received by each customer class.[49] Likewise for LG&E, under the alternative methodology, $2,005,940 of the total roll-in amount of $8,669,729 would be used

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[42] Seelye LG&E at 10.
[43] Seelye LG&E at 10.
[44] Seelye KU at 10; Seelye LG&E at 10.
[45] Seelye KU at 10; Seelye LG&E at 10.
[46] Seelye KU at 11; Seelye LG&E at 11.
[47] Seelye KU at 11.
[48] Seelye KU at 11.
[49] Seelye KU at 11.

to correct the subsidies that currently exist in base rates.[50] The $2,005,940 correction for LG&E would be allocated as a credit to those rate classes with rates of return above 7.36% based on the total amount of subsidy above this threshold rate of return paid by each customer class.[51] Similarly, the $2,005,940 correction would be allocated as a charge to those rate classes with rates of return below 5.36% on the basis of the total subsidy below 5.36% received by each customer class.[52] The amount used to correct the subsidies would thus be allocated to the affected rate classes in a symmetrical manner based on the amount of subsidy paid or the amount of subsidy received.

The amounts used to correct subsidies ($5,173,724 for KU, $2,005,940 for LG&E) were determined so that no rate class would receive less than 25 percent of the roll-in amount that the class would otherwise receive if the roll-in were allocated on the basis of base-rate revenues.[53] In other words, when the subsidy-correction amount is allocated on the basis of annual subsidies paid by those rate classes above 7.33% for KU and 7.36% for LG&E, the roll-in amounts for none of the classes are below 25% of the roll-in amount that would otherwise be allocated to the class using the revenue methodology.[54] This requirement would ensure that each class will bear a significant responsibility for the rolled-in costs, even though the cost of service study would suggest that some classes should not bear any responsibility for the costs based on the current level of subsidies.

The amounts used to correct subsidies also have the advantage of being sufficiently small that, though they serve to move in the direction of mitigating subsidies, they comport with the

[50] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3.
[51] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Seelye LG&E at 11.
[52] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Seelye LG&E at 11.
[53] LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Seelye KU at 11; Seelye LG&E at 11.
[54] Seelye KU at 11; Seelye LG&E at 11.

ratemaking axiom of gradualism.[55] No part of this proposal should result in a "rate shock," but the proposal is nonetheless a step toward alleviating the significant subsidies between certain of the Companies' rate classes.

The Companies are aware of no statutory or regulatory obstacles to the approval and implementation of this alternative proposal. The Companies suggest that it may serve as a gradual means of correcting significant subsidies currently embedded in the Companies' base rates. Nevertheless, the Companies will be guided by the Commission's decision in these cases on whether the change in base rates associated with the ECR roll-in should be accomplished in a way that gives some recognition to the inter-class rate subsidies in current base rates.

C. Rate Design: No Part of Roll-In Should Be Recovered Through Customer Charge

Also, under either roll-in methodology, the Companies should not recover any part of the roll-in amount through a customer charge. For schedules containing both energy and demand charges, the roll-in amount will be recovered through the demand charge; and for schedules containing an energy charge but no demand charge, the roll-in amount will be recovered through the energy charge.[56] For lighting rates consisting of a charge per fixture, the roll-in amount allocated to the lighting rates would be recovered through the charge per fixture, as in prior roll-ins.[57] Except for the lighting rates, the Companies' recommended approach would represent a departure from prior roll-ins.[58] In prior roll-ins the amounts allocated to each rate class were assigned to all components of base rates (customer charge, energy charge and demand charge, as

[55] Attachments to KU's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 3; Attachments to LG&E's Response to Second Data Request of Commission Staff, Dated June 29, 2006, Question No. 4.
[56] Seelye KU at 14; Seelye LG&E at 14.
[57] Seelye KU at 14; Seelye LG&E at 14.
[58] Seelye KU at 14; Seelye LG&E at 14.

applicable) on a pro-rata basis.[59] The Companies' approach to converting the roll-in amount into unit charges is consistent with cost of service principles.[60]

V. RATE OF RETURN

Calculated using adjusted capitalization and using the currently approved 10.50% return on equity, the Companies recommend an overall rate of return of 11.52% for KU[61] and an overall rate of return of 11.23% for LG&E.[62] The Companies believe that these overall rates of return, based upon the currently allowed 10.50% rate of return on common equity for the environmental surcharge, are reasonable if not conservative.

The 10.50% rate of return was approved by the Commission in Case Nos. 2004-00421 and 2004-00426 on June 20, 2005, and became effective with the July 2005 billing month. Since the Commission's Orders on June 20, 2005, long-term interest rates have increased, as evidenced by the performance of 10- and 20-year Treasury bonds, A-rated utility bonds, and Aaa-rated corporate bonds for the period January 2005 through May 2006.[63] The Value Line Quarterly Economic Review forecasts that these increases in long-term interest rates will continue.[64]

The authorized 10.50% rate of return on common equity is also consistent with recently authorized returns by this Commission and across the country. The April 5, 2006, issue of Regulatory Research Associates Regulatory Focus shows that the average rate of return on

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[59] Seelye KU at 14; Seelye LG&E at 14.
[60] Seelye KU at 14-15; Seelye LG&E at 14-15.
[61] Conroy KU at 8. *See* KU Response to the Commission Staff Request for Information Question No. 17.
[62] Conroy LG&E at 9. *See* LG&E Response to the Commission Staff Request for Information, Question No. 16.
[63] *See* KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 11, Attachment 1; LG&E Response to Information Requested in Appendix B of Commission's Order Dated April 25,2006, No. 10, Attachment 1.
[64] *See* KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 11, Attachment 2; LG&E Response to Information Requested in Appendix B of Commission's Order Dated April 25,2006, No. 10, Attachment 2.

common equity authorized for electric and gas utilities during the first quarter of 2006 averaged 10.4% and 10.6%, respectively.[65]

Thus, the Companies conclude it would be reasonable, and somewhat conservative, to maintain prospectively the current authorized rate of return on common equity of 10.50% for ECR purposes.

VI. LG&E'S ELIMINATION OF EXPENSE REDUCTION FROM PRIOR CASE

One change in the calculation of the recoverable operating expenses under the Post 1995 Compliance Plan for LG&E is necessary. In the determination of the revenue requirement established in the September 4, 2003 Order in Case No. 2002-00147, the Commission ordered LG&E to exclude from environmental operating expenses, expenses of $271,119 associated with operators, the cost of which was included in LG&E's base rates at the time of the Order.[66] Since that time, LG&E has implemented new base rates, effective for service rendered on and after July 1, 2004, as approved by the Commission in its June 30, 2004 Order in Case No. 2003-00433.[67] LG&E's revenue requirements in that case did not include labor expense associated with the four employees, and LG&E's current base rates do not include labor expense associated with the four employees.[68] Therefore, there is no double recovery of this expense, and LG&E is eliminating the monthly exclusion for all expense months following the date of the Commission's Order establishing LG&E's new base rates.[69]

During the billing periods from September 2004 through the present, LG&E continued to calculate its monthly environmental surcharge calculations in compliance with the Commission's

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[65] *See* KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 11, Attachment 3; LG&E Response to Information Requested in Appendix B of Commission's Order Dated April 25,2006, No. 10, Attachment 3.
[66] Conroy LG&E at 4.
[67] Conroy LG&E at 4.
[68] Conroy LG&E at 4.
[69] Conroy LG&E at 4.

Order in Case No. 2002-00147 by reducing operating and maintenance expenses by a monthly amount of $22,593.[70]

This proceeding presents the first opportunity to remedy the operation of LG&E's environmental surcharge, as this is the first review of the operation of the surcharge for the periods impacted.[71] LG&E's under-recovery position includes the impact of eliminating the expense exclusion ordered by the Commission and LG&E proposes that eliminating this exclusion be approved for all months from July 2004 to present and continuing.[72] Upon issuance of an Order in this proceeding, LG&E proposes to eliminate this expense reduction from the monthly ECR filings and will include an adjustment for the period from March 2006 to the month preceding the Commission order in this proceeding in the appropriate six-month review periods in the future.[73]

VII. KU'S EMISSION ALLOWANCES IN BASE RATES

KU's current base rates were established by the Commission in its Order dated June 30, 2004 in Case No. 2003-00434 based upon its analysis of KU's revenue requirement found justifiable by the record and an electric revenue requirement recommended pursuant to a partial settlement and stipulation.[74] As part of the partial settlement and stipulation and as approved by the Commission's Order, KU's 1994 environmental compliance plan was removed from recovery through the environmental surcharge filings and recovered through base rates.[75] KU's rate base

[70] Conroy LG&E at 5.
[71] Conroy LG&E at 5.
[72] Conroy LG&E at 5.
[73] Conroy LG&E at 5.
[74] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[75] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.

at September 30, 2003 included $69,415 in emission allowances inventory.[76] Therefore, KU's current base rates include a return on the jurisdictional portion of those allowances.

Upon the effective date of the roll-in, KU will continue to calculate a return on total environmental compliance rate base in its monthly filing forms.[77] The resulting revenue requirement will be reduced by the portion of ECR-related revenue collected through base rates as a result of the roll-in.[78] However, if KU does not continue to reduce its environmental rate base by the emission allowance inventory included in base rates, then KU will be including a calculated return on those allowances in its monthly environmental revenue requirement, and the monthly reduction resulting from the roll-in will not include an amount associated with that return.[79] Thus, the return on the allowance inventory balance of $69,415 is not reflected in KU's BESF.[80]

VIII. CONCLUSION

For the foregoing reasons stated in this brief and in their testimony, Kentucky Utilities Company and Louisville Gas and Electric Company request the Public Service Commission to enter orders that grant the Companies the following relief:

a. Approving KU's proposed increase to its Environmental Surcharge Revenue Requirement of $399,375 per month for the first three months, and $399,374 for the fourth month~~$63,663 in the first four billing months~~ following the Commission's decision in this proceeding, and likewise approving LG&E's proposed increase to its Environmental Surcharge Revenue Requirement of $576,005 per month for the first six months and $576,006 per month

[76] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[77] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[78] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[79] KU Response to Information Requested in Appendix B of Commission's Order Dated April 25, 2006, No. 13.
[80] KU Response to Second Data Request of Commission Staff, Dated June 29, 2006, No. 6(a).

for the next six months~~$662,267 in the first four billing months~~ following the Commission's decision in this proceeding;

b. Finding environmental surcharge amounts for the two-year billing period ending April 2005 to be just and reasonable;

c. Finding that LG&E should eliminate the expense reduction ordered in Case No. 2002-00147 from its monthly ECR filings beginning with the expense month of July 1, 2004;

d. Approving $23,731,313 (KU) and $8,669,729 (LG&E) to be the amounts to be incorporated into base electric rates for bills rendered on and after the second full billing month following the month in which an order is received in these cases;

e. The Commission should decide as a matter of policy whether the Environmental Surcharge mechanism should be used to address the inter-class rate subsidies that currently exist in the Companies' base rates and based on that decision approve either the use of allocating the roll-in amount on the basis of class base rate revenues or a methodology that allocates the roll-in amount in a way that gives some recognition to the inter-class rate subsidies that currently exist in base rates; but whichever roll-in methodology is approved by the Commission, no part of the roll-in amount should be recovered through the customer charges of the rates.

f. Resetting the Companies' Base Environmental Surcharge Factors to amounts based on the roll-in amounts and base revenues from the most recent 12-month period available following the Commission's Order in these proceedings; and

g. Establishing the rate of return for KU's Post-1994 Plan to be 11.52%, and the rate of return for LG&E's Post-1995 Plan to be 11.23%.

Dated: ~~September 28~~November 21, 2006

Respectfully submitted,

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