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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE UNION LIGHT, HEAT AND POWER COMPANY D/B/A DUKE ENERGY KENTUCKY TO INCREASE ITS ELECTRIC RATES	)))	CASE NO. 2006-00172

NOTICE OF FILING AND CERTIFICATION OF SERVICE

I hereby give notice that I have filed the original and five true copies of these Responses to Requests for Information with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 this the 10th day of October, 2006, and certify that this same day I have served the parties by mailing a true copy, postage prepaid, to the following:

SANDRA P MEYER
PRESIDENT
DUKE ENERGY KENTUCKY INC
139 EAST FOURTH STREET
CINCINNATI OH 45202

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Response of the Attorney General to
Initial Data Request of Commission Staff to the Attorney General
Duke Energy Kentucky
Case No. 2006-00172

Witness Responsible:
ROBERT J. HENKES

Question 1: Refer to the Direct Testimony of Robert J. Henkes ("Henkes Testimony"), pages 7 and 26. Mr. Henkes recommends the annual increase in fuel revenue requirements of $20,040,364 proposed by Duke Energy Kentucky ("Duke Kentucky") on page 7, but disagrees with the treatment proposed by Duke Kentucky of the Back-Up PowerSales Agreement ("PSA") for the forecasted test period on page 26.

a. Based upon his understanding of the determination of the fuel revenue requirements of $20,040,364, is this revenue requirement impacted by Duke Kentucky's proposed version of the Back-Up PSA included in its forecasted test period? Explain the response.
b. If Duke Kentucky's proposed version of the Back-Up PSA impacts the determination of the fuel revenue requirements of $20,040,364, explain how Mr. Henkes' recommendations on pages 7 and 26 of his testimony are consistent.

Response: On page 26 of his testimony, Mr. Henkes recommends a reduction of $5,372,923 in the Forecasted Period Back-Up *capacity charges* to be recovered in DEK's base rates. The $5,372,923 represents the difference between (a) DEK's proposed Back-Up capacity charges of $10,431,923 based on the "refreshed pricing" approach, and (b) the Back-Up capacity charges of $5,059,000 based on the Back-Up PSA terms approved by the Commission in Case No. 2003-00252.

The fuel revenue requirement of $20,040,364 includes $11,365,778 for the variable replacement *energy* charges associated with the Back-Up Power Sale Agreement, to be recovered through DEK's FAC. It is Mr. Henkes' understanding that these variable replacement energy charges are not impacted by DEK's proposed version of the Back-Up PSA.[1]

Based on the above-described information, Mr. Henkes does not believe that the recommendations contained on pages 7 and 26 of his testimony are inconsistent.

[1] Mr. Henkes understands that, in accordance with the Back-Up PSA terms approved by the PSC in Case No. 2003-00252, the PSA's replacement energy charges are to be priced at the average variable cost per MWH of energy produced during the prior calendar month at the Plant for which back-up power is required. Mr. Henkes understands that DEK's projected PSA energy charges of $11,365,778 are based on this approved pricing method.

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Witness Responsible:
ROBERT J. HENKES

Question 2: Refer to the Henkes Testimony, page 8 and Schedule RJH-2.

a. Explain why Mr. Henkes believes it is reasonable to use a State Income Tax rate of 5.8 percent, which reflects a weighted average of the Kentucky, Ohio, and Cincinnati income tax rates.
b. Explain why Mr. Henkes has not included in his proposed gross revenue conversion factor a component for the Internal Revenue Code Section 199 Deduction.

Response:

a. Mr. Henkes did not adjust the Company's proposed "apportioned" state income tax rate of 5.8% to be consistent with his reflection of the Company's apportioned state income tax rate in the Company's prior gas rate case, Case No. 2005-00042.
b. Mr. Henkes did not review and address this particular tax issue in this case and, for that reason, did not adjust the gross revenue conversion factor to include any impact IRC Section 199 may have on the factor.

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Witness Responsible:
ROBERT J. HENKES

Question 3: Refer to the Henkes Testimony, pages 11 through 13 and Schedule RJH-5. Explain in detail why Mr. Henkes did not incorporate a "slippage" factor adjustment in his determination of the electric and gas jurisdictional rate bases.

Response: Mr. Henkes did not have the necessary data available to calculate the impact on the electric and gas jurisdictional rate bases of the electric and gas "slippage factors."

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Witness Responsible:
ROBERT J. HENKES

Question 4: Refer to the Henkes Testimony, pages 14 and 15 and Schedule RJH-8. To determine his proposed adjustment, Mr. Henkes has taken the average of the emission allowance sale proceeds for calendar year 2005 and the 12 months ended July 31, 2006. Explain in detail why this approach is reasonable, given that there is an overlap of 5 months between calendar year 2005 and the 12 months ended July 31, 2006.

Response: Please see Mr. Henkes' response to Question 15 of DEK.

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Witness Responsible:
ROBERT J. HENKES

Question 5: Refer to the Henkes Testimony, pages 16 and 17, Schedule RJH-9, and Duke Kentucky's response to the Attorney General's Second Data Request dated August 9, 2006, Item 8(b).

a. Explain why Mr. Henkes used the actual revenues for the period January 1 through July 31, 2006 for Woodsdale Unit 6 rather than the actual revenues for the 12 months ended July 31, 2006.
b. Since Mr. Henkes had actual revenue data available back to April 2005, explain why he based his adjustment on the most recent 12 months of available actual revenues rather than following an averaging approach.

Response:

a. Please see Mr. Henkes' response to Question 17b of DEK.
b. Mr. Henkes based his adjustment on the most recent 12 months of available actual revenues rather than following an averaging approach from April 2005 through July 31, 2006 to be conservative. The latter approach would have resulted in normalized annual RSG Make-Whole revenues of $4,175,339 rather than Mr. Henkes' reflected normalized annual revenue of $3,817,339.

   Calculation: total revenues for 16-month period 4/1/05 – 7/31/06 - $5,567,119. Average monthly revenue is $347,945. Annualized revenue is $347,945 x 12 = $4,175,339.

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Witness Responsible:
ROBERT J. HENKES

Question 6: Refer to the Henkes Testimony, pages 20 through 22 and Schedule RJH-11.

a. Provide the workpapers supporting the "Actual Average Annual Revenues for 2003 through 5/31/06" as shown in footnote 1 on Schedule RJH-11. Include all calculations, assumptions, and supporting workpapers
b. If the determination of these average revenues included the averaging of data for calendar year 2005 and the 12 months ended May 31, 2006, explain in detail why this approach is reasonable, since there would be an overlap of 7 months between calendar year 2005 and the 12 months ended May 31, 2006.

Response:

a. The response to Question 1 of DEK indicates normalized annual Other Operating Revenues of $578,936 based on actual Other Operating Revenue data for the years 2003, 2004 and 2005.[2] This total amount is broken out as follows:

	Actual Average Annual Rev. For 2003 through 2005
Acct. 451 Miscellaneous Service Revenues	$ 31,781
Acct. 451020 Miscellaneous Connection Charge	54,875
Acct. 451040 Temporary Facilities*	95,020 (1)
Acct. 451050 Customer Diversion	4,416
Acct. 451060 Bad Check Charge	17,957
Acct. 454020 Rent Elec Other Equipment	26,998
Acct. 454100 Pole Contact Revenues	135,628 (2)
Acct. 456865 Transmission Rev RB Interco	212,261
Total Other Operating Revenues	$578,936

(1) Average for 2004 and 2005
(2) Based on 2005 only

The source for the actual average annual Other Operating revenues for 2003 – 2005 in the above table is Attachment AG-1-26. Please note that the recommended annual revenues for account 451040 – Temporary Facilities of $95,020 is based on the average of 2004 and 2005

[2] Since actual Other Operating Revenues for the first 5 months of 2006 are not available in the record (only an annual amount for the 12-month period ended May 31, 2006 is available), the actual monthly 2006 Other Operating Revenues through May 2006 cannot be incorporated in the recommended "averaging" determination of the normalized Other Operating Revenues.

Response to Question 6 (continued):

since the revenues for 2003 were deemed to be unrepresentative. Also note that the recommended annual normalized revenues for account 454100 Pole Contact Revenues represent the actual revenues for 2005. Finally, please note that Mr. Henkes did not reflect any normalized revenues for several other Other Operating Revenue accounts because the actual revenues for these accounts were either deemed to be unrepresentative of future conditions or were inadvertently left out of the revenue normalization analysis by Mr. Henkes (e.g, the revenues in accounts 454050, 454155, 454200, 454850, 456020, 456040, and 456075).

b. See the response to Question 1 of DEK.

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Witness Responsible:
ROBERT J. HENKES

Question 7: Refer to the Henkes Testimony, pages 22 through 24.

a. Was Mr. Henkes aware that in its May 5, 1992 Order in Case No. 1991-00370[3] the Commission rejected Duke Kentucky's electric weather normalization adjustment based on a finding that the weather normalization methodology was not acceptable for rate-making purposes?
b. Was Mr. Henkes aware that Duke Kentucky has indicated the weather normalization methodology utilized in this case is essentially the same as the methodology rejected by the Commission in Case No. 1991-00370?
c. Does the fact that the Commission has previously rejected the weather normalization methodology utilized by Duke Kentucky in this case impact Mr. Henkes' recommendation to use a weather-normalized forecasted test period? Explain the response.

Response:

a. No.
b. No.
c. Yes. Mr. Henkes made his weather normalization adjustment in the current case to be consistent with the weather normalization adjustment approved by the Commission in the Company's most recent gas rate case, Case No. 2005-00042. Mr. Henkes was not aware that the Company's proposed and his recommended weather normalization adjustments in the current case are based on a weather normalization methodology which the Commission previously ruled to be unacceptable for ratemaking purposes in the Company's prior electric rate case, Case No. 1991-00370. While non-weather-normalized sales and revenue data is not currently available for the Forecasted Period, Mr. Henkes understands that this information will be provided by the Company by October 16, 2006.[4]

[3] Case No. 1991-00370, Application of The Union Light, Heat and Power Company to Adjust Electric Rates.

[4] As indicated in the response to PSC-3-25.

Witness Responsible:
ROBERT J. HENKES

Question 8: Refer to the Henkes Testimony, page 26. Explain why it is reasonable to propose an adjustment based on the terms of the Back-Up PSA as approved by the Commission in Case No. 2003-00252[5] when that Back-Up PSA was never executed by Duke Kentucky.

Response: There are currently two alternative Back-Up PSA capacity charge numbers in the record. One represents a capacity charge from an unexecuted Back-Up PSA that has previously been approved by the Commission in Case No. 2003-00252. The other represents a capacity charge from an unexecuted new DEK-proposed Back-Up PSA that has not been approved by the Commission. Mr. Henkes has simply reflected the Back-Up PSA capacity charge number that has previously been approved by the Commission and has recommended that this capacity charge be replaced by the capacity charge that the Commission will eventually approve in this proceeding.

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[5] Case No. 2003-00252, The Application of The Union Light, Heat and Power Company for a Certificate of Public Convenience to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchased Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6), final Order dated December 5, 2003.

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Witness Responsible:
ROBERT J. HENKES

Question 9: Is Mr. Henkes aware of any reason why a Back-Up PSA based on the terms approved in Case No. 2003-00252 could not have been executed by Duke Kentucky shortly after the Commission's December 5, 2003 Order in Case No. 2003-00252?

Response: No.

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Witness Responsible:
ROBERT J. HENKES

Question 10: Does Mr. Henkes believe that the sole reason for Duke Kentucky's proposal to significantly increase the cost for the Back-Up PSA was Duke Kentucky's delay in executing a Back-Up PSA based on the terms approved in Case No. 2003-00252?

Response: Yes.

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Witness Responsible:
ROBERT J. HENKES

Question 11: Refer to the Henkes Testimony, pages 35 and 36. Concerning Edison Electric Institute ("EEI") dues:

a. In his testimony Mr. Henkes references the Commission's treatment of EEI dues in Case No. 1991-00370. In preparing his testimony, did Mr. Henkes review the treatment of EEI dues in Commission Orders issued since Case No. 1991-00370? Explain the response.
b. What was Mr. Henkes' recommendation concerning EEI dues in the last Louisville Gas and Electric Company base rate case, Case No. 2003-00433?[6]
c. Explain why the treatment of EEI dues in this case should be different than the Commission's treatment of EEI dues in Case No. 2003-00433.

Response:

a. No.
b. In the last LG&E electric rate case, Case No. 2003-00433, Mr. Henkes recommended that 72.16% of the Company's EEI dues be disallowed for ratemaking purposes. This disallowance percentage represented EEI activities devoted to legislative and regulatory policy advocacy and policy research; advertising, marketing and public relations. The Commission disallowed 45.35% of LG&E's EEI dues in that case, based on the disallowance of EEI activities devoted to legislative advocacy, regulatory advocacy and public relations.
c. In preparing his EEI recommendations in the current case, Mr. Henkes did not review his and the Commission's positions in this prior LG&E rate case. Mr. Henkes now believes that the Commission's ratemaking treatment for DEK's EEI dues should be the same as the EEI dues rate treatment by the Commission in the referenced prior LG&E case.

[6] Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company, final Order dated June 30, 2004.

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Witness Responsible:
ROBERT J. HENKES

Question 12: Refer to the Henkes Testimony, Schedule RJH-3. Mr. Henkes' testimony included two versions of Schedule RJH-3. One reflected Mr. Henkes' recommendations on capital structure and rate of return on equity ("ROE") as shown on page 9 of his testimony. The other version of Schedule RJH-3 reflects Duke Kentucky's proposed capital structure and an ROE of 9.50 percent. What is the purpose of the second Schedule RJH-3 and why was it not discussed in Mr. Henkes' testimony?

Response: The second Schedule RJH-3 was inadvertently included in Mr. Henkes' testimony schedules during the copying process.

Response of the Attorney General to
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Witness Responding:
Dr. J. Randall Woolridge

13. Refer to the *Direct Testimony of Dr. J. Randall Woolridge* ("Woolridge Testimony"), pages 4 and 5.

a. Provide a copy of the Jeremy Siegel article.

Response:

The requested article is provided on CD.

b. Both Jeremy Siegel and Alan Greenspan made the comments quoted in the testimony in 1999, which was before the market adjustment in 2000. Are there any studies after 1999 which researched the equity premium after the substantial drop in stock prices since 2000?

Response:

Greenspan's comments were not supported by any published studies. Siegel has performed studies covering over 100 years of stock return data. Hence, his comments do not pertain specifically to the late 1990's run-up in stock prices. Likewise, most of the studies cited on page 3 of Exhibit_(JRW-8), were conducted over long periods of time and therefore are not overly sensitive to the late 1990s. Furthermore, the surveys cited were all from the current year - 2006.

c. Were Mr. Siegel and Mr. Greenspan talking about the near future or the long-term?

Response:

Whereas they do not specifically say, it is Dr. Woolridge's opinion that Greenspan's comments relate more to the short-term and Siegel's to the long-term.

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Witness Responding:
Dr. J. Randall Woolridge

14. Refer to the Woolridge Testimony, page 6 and Exhibit JRW-2. Explain why an investor would forego the benefits of a tax cut and provide tacit approval to the company to lower dividend payouts in order to keep investors' expected return equal to that before the tax cut.

Response:

Investors do not determine corporate dividend payout policy, companies do.

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Witness Responding:
Dr. J. Randall Woolridge

15. Refer to the Woolridge Testimony, page 8. Concerning the proposed capital structure for Duke Kentucky:

a. Did Dr. Woolridge review the schedules and workpapers submitted by Duke Kentucky concerning the determination of the appropriate capital structure? Explain the response.

Response:

Yes, Dr. Woolridge reviewed the papers associated with the Company's proposed capital structure.

b. Is Dr. Woolridge aware of any errors in the assumptions or calculations used by Duke Kentucky to determine the proposed capital structure? Explain the response.

Response:

No.

c. Explain in detail why Dr. Woolridge believes the capital structure proposed by Duke Kentucky should not be used. Include with this discussion the specific reasons supporting this conclusion.

Response:

The specific reason is that the group of companies evaluated by Dr. Woolridge has capital structure with a lower common equity ratio. By using an average of the group and DEK, I am proposing a capital structure which is more reflective of the group and which is fair to DEK.

d. Dr. Woolridge proposes that the appropriate capital structure for Duke Kentucky should be an average of Duke Kentucky's proposed capital structure with the average capital structure of his proxy Group A companies. Explain in detail why Dr. Woolridge believes this approach is necessary and reasonable. Include in this discussion his reasons for averaging the two capital structures together rather than using the average capital structure of his proxy Group A companies.

Response:

See response to 15-c.

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Witness Responding:
Dr. J. Randall Woolridge

e. Has Dr. Woolridge reviewed previous decisions by this Commission concerning the utilization of a hypothetical capital structure to determine a utility's revenue requirements? Explain the response.

Response:

No.

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Witness Responding:
Dr. J. Randall Woolridge

16. Concerning Dr. Woolridge's proxy Group A companies, indicate which companies are combined natural gas and electric utilities, charge a regulated bundled rate, and are also part of a multi-state energy holding company system.

Response:

Schedule JRW-3 provides the states in which the utilities operate. The utilities that are listed as pure electric companies by AUS Utility Reports include American Electric Power, DPL, Inc., Duquesne Light, First Energy, IDACPRP, Progress Energy, and Southern Co. Dr. Woolridge is not aware of which combination companies charge a bundled rate.

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Witness Responding:
Dr. J. Randall Woolridge

17. Concerning Dr. Woolridge's proxy Group B companies, indicate which companies are combined natural gas and electric utilities, charge a regulated bundled rate, and are also part of a multi-state energy holding company system.

Response:

Schedule JRW-3 provides the states in which the utilities operate. The utilities are listed as pure electric companies by AUS Utility Reports include ALLETE, American Electric Power, Central Vermont, Cleco, Edison Intl, El Paso Electric, FPL Group, First Energy, Green Mountain Power, Hawaiian Electric, IDACPRP, Progress Energy, Pinnacle West, and Southern Co. Dr. Woolridge is not aware of which combination companies charge a bundled rate.

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Witness Responding:
Dr. J. Randall Woolridge

18. Refer to the Woolridge Testimony, pages 21 and 22.

a. Explain how Dr. Woolridge's adjustment of multiplying dividend yields by one half the expected growth rate, as described on page 22, satisfies the necessary adjustment as described on page 21.

Response:

Given the uncertainty regarding the magnitude of a dividend increase, as well as the timing of the divided increase (does it occur in the next quarter or not?), as well as the regulatory issue of applying the result to a test-year rate base, it is Dr. Woolridge's opinion that his approach provides for a good approximation of the necessary adjustment.

b. Provide documentation and any official guidelines used by analysts that direct and instruct how dividend yields should be adjusted.

Response:

Dr. Woolridge is not aware of any official guidelines.

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Witness Responding:
Dr. J. Randall Woolridge

19. Refer to the Woolridge Testimony, page 26 and Exhibit JRW-7.

a. Explain the pros and cons of using each of the data series of Earnings Per Share ("EPS"), Dividends Per Share ("DPS"), and Book Value Per Share ("BVPS") individually for calculating the growth in dividend figure to be used in the Discounted Cash Flow ("DCF") model.

Response:

According to the DCF model, DPS, EPS, and BVPS should all have the same rate of growth. Over short-term periods of time, these growth rates may differ, Dr. Woolridge is attempting to gauge an overall long-term rate of growth for all three.

b. Explain how taking the collective average of the individual EPS, DPS, and BVPS series mean and median values provides a meaningful estimate of dividend growth as used in the DCF model.

Response:

See reponse to 19 a.

c. Explain why it is valid to use the calculated internal growth rate as a meaningful estimate of dividend growth as used in the DCF model.

Response:

See discussion on page 24 of Dr. Woolridge's testimony.

d. Explain why using internal growth as a proxy for dividend growth does not introduce a certain amount of circularity into the calculation.

Response:

In a sense, it does. However, that is one reason that it is not the only growth rate measure considered in arriving at a DCF growth rate.

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Witness Responding:
Dr. J. Randall Woolridge

20. Refer to the Woolridge Testimony, pages 34 and 35. Provide legible copies of the articles cited in footnotes 9, 10, and 11.

Response:

The articles are provided on CD.

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Witness Responding:
Dr. J. Randall Woolridge

21. Refer to the Woolridge Testimony, page 40 and Exhibit JRW-8, page 5 of 5.

a. It appears that the Real EPS Growth figure was calculated using a compound annual growth rate formula. Explain why this formula is a better choice than using an average annual growth rate for EPS over the period.

Response:

The *compound annual growth rate* measures the actual growth rate over a period of time. The average is simply the average of the annual growth rates and will overstate actual growth over a period of time.

b. Provide a legible copy of the Ibbotson and Chen article cited in footnote 13.

Response:

The article is provided on CD.

c. On line 10, explain how real Gross Domestic Product growth, which has averaged 3.5 percent over the past 80 years according to McKinsey, was calculated.

Response:

McKinsey does not provide the specifics of their calculation.

d. Provide a legible copy of the Goedhart article referenced in footnote 16.

Response:

The article is provided on CD.

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Witness Responding:
Dr. J. Randall Woolridge

22. Refer to the Woolridge Testimony, page 47. Dr. Woolridge states that if the Commission were to adopt Duke Kentucky's proposed capital structure, his recommended return on equity would be 9.0 percent. Explain why the recommendation would change based on the capital structure adopted. Include any analyses or studies performed or relied on by Dr. Woolridge to support this alternative recommendation.

Response:

The response reflects Dr. Woolridge's opinion. No studies were performed.

Witness Responding:
Michael J. Majoros, Jr.

23. Refer to the Direct Testimony of Michael J. Majoros, Jr. ("Majoros Testimony"), page 5 of 54. Mr. Majoros states that his depreciation rate recommendations result in a $9,500,000 reduction compared to Duke Kentucky's depreciation witness, Mr. Spanos. On page 41 of the Henkes Testimony, Mr. Henkes states that Mr. Majoros's depreciation recommendations reduce Duke Kentucky's forecasted test period depreciation expenses by $9,996,000.
    a. Provide the determination of both the $9,500,000 and $9,996,000 reductions. Include all calculations, workpapers, assumptions, and other supporting documentation.
    b. Indicate which of the two reductions in depreciation expense is correct.
    c. When determining the proposed depreciation expense using the depreciation rates proposed by Mr. Majoros, were those rates applied to the depreciable plant balances as of December 31, 2005 or December 31, 2007? If the forecasted test-period balances were not used, explain why the plant balances as of December 31, 2005 produce a reasonable adjustment.

Response:

a. The $9.5 million is calculated by taking Mr. Spanos's proposed $30,951,990 accrual based on **December 31, 2005** plant balances and subtracting Mr. Majoros's recommended $21,463,712 accrual, based on the same plant balances. The difference is $9,488,278.

   The $9.996 million is calculated on Mr. Henkes' Schedule RJH-18. It is the difference between the Company's calculated depreciation expense using its proposed rates and plant balances based on the thirteen-month average as of **December 31, 2007** plant balances ($32.810 million, as shown on Company Schedule B-3.2) and the AG's recommended depreciation expense calculated using Mr. Majoros's recommended rates and the same December 31, 2007 plant balances. Mr. Majoros's rates result in a $22.814 million accrual, a difference of $9.996 million.

   The attached workpaper, provided on CD shows the calculation of the $22.814 million accrual based on Mr. Majoros's recommendations. Please see Exhibit___(MJM-6) for the calculation of the $21,463,712 accrual based on December 2005 plant balances. See pages III-4 to III-6 of Mr. Spanos's depreciation study for the calculation of his proposed $30,951,990 accrual based on December 2005 balances. See the

Witness Responding:
Michael J. Majoros, Jr.

Company's Schedule B-3.2 for the calculation of its proposed $32.810 million accrual based on December 31, 2007 plant balances.

b. Both are correct numbers, they are based on different plant balances. The $9.996 million is the correct number for the test year and should be used in any revenue requirement calculations.

c. See the response to part a. Mr. Majoros typically calculates his recommended depreciation rates (and writes his testimony) using the same plant balances that the Company's witness used to calculate his or her proposed rates. In most cases those rates are then applied to the test year plant balance, as directed by the revenue requirement witness.

Witness Responding:
Michael J. Majoros, Jr.

24. Refer to the Majoros Testimony, page 6 of 54. Mr. Majoros states, "For example, Mr. Spanos is proposing straight line, equal life group depreciation combined with the remaining life technique."
    a. Does Mr. Majoros agree that this approach is the same as was used in Duke Kentucky's last gas and common plant depreciation study?
    b. Does Mr. Majoros agree that the Commission in Case No. 2005-00042[1] approved Duke Kentucky's last gas and common plant depreciation study, with some modifications?
    c. Does Mr. Majoros agree it would be desirable for a combination utility like Duke Kentucky to have its depreciation studies for its gas and electric operations reflecting the same approaches and methodologies?

Response:

a. Yes.

b. Yes.

c. Not necessarily. Mr. Majoros is concerned that application of the principle will produce an inappropriate result relative to past practices. As stated in his testimony, Mr. Majoros recommends that if the Commission decides to adopt ELG, it should only be on a going-forward basis. Retroactive application of ELG produces an unwarranted increase to depreciation rates.

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[1] Case No. 2005-00042, An Adjustment of the Gas Rates of The Union Light, Heat and Power Company, final Order dated December 22, 2005.

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Witness Responding:
Michael J. Majoros, Jr.

25. Refer to the Majoros Testimony, page 10 of 54. Mr. Majoros states that an excessive depreciation rate is one that produces more depreciation expense than necessary to return the cost of a company's capital asset over the life of the asset.

    a. This definition of excessive depreciation rate does not include any references to legal asset retirement obligations ("ARO") and costs of removal. When determining whether a depreciation rate is excessive, should these two items also be considered and recognized? Explain the response.

    b. Does Mr. Majoros agree that depreciation, as defined in the Federal Energy Regulatory Commission's ("FERC") Uniform System of Accounts, and adopted by this Commission, defines depreciation as the loss of service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance?

Response:

a. The fair value of an asset retirement cost associated with a legal ARO is a cost of the asset and therefore is capitalized and depreciated over the asset's life. Hence, at the end of that life, the asset and accumulated depreciation will be equal. Neither the depreciation rate nor the expense was excessive.

b. That is how it is defined, but remember, even the FERC USoA recognizes legal AROs. Mr. Majoros is not attempting to deny capital recovery to this company or any other company. Nor is Mr. Majoros attempting to deny this company or any other company, complete and timely recovery of incurred cost of removal.

   Mr. Majoros' sole objective is to establish correct depreciation rates and to protect the ratepayers interests, by applying methods and procedures specifically designed for that purpose and accepted elsewhere, including Mr. Spanos' home state.

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Witness Responding:
Michael J. Majoros, Jr.

26. Refer to the Majoros Testimony, page 14 of 54. Mr. Majoros states that Mr. Spanos' application of the equal life group approach to all prior vintages produces a composite remaining life which is inconsistent with past depreciation practices.
    a. Explain what Mr. Majoros means by "inconsistent with past depreciation practices."
    b. What group approach (equal life or vintage) and life technique (whole life or remaining life) was used for the 1975 depreciation rates for transmission and distribution plant and the 1997 electric general plant depreciation rates? Indicate how Mr. Majoros was able to determine which group approaches and life techniques were utilized in those depreciation rates.

Response:

a. ELG is a weighting procedure that results in a shorter composite remaining life for an account than does the alternative VG procedure. ELG's shorter remaining lives result in higher depreciation rates which in turn result in a higher accumulated depreciation balance. If VG has been used in the past, the reserve will be lower but correct assuming continuation of the use of VG. However, if ELG is adopted midstream and applied retroactively to all prior vintages, the accumulated depreciation will be incorrect. It will be too low. The mere application of a new weighting procedure creates a "reserve deficiency" relative to past practices. Thus, the resulting remaining life depreciation rate is increased, while it would not increase based on a continuation of VG all other things equal. In Mr. Majoros' opinion, if the Commission specifically adopts ELG, it should be on a going-forward basis.

b. Mr. Majoros believes the 1975 rates were probably straight line, broad group, whole-life rates. The 1997 rates were probably the same, but they may have also been remaining life rates. He bases these assumptions upon his knowledge of past trends and timing in depreciation rate calculations.

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Witness Responding:
Michael J. Majoros, Jr.

27. Refer to the Majoros Testimony, page 16 of 54. Mr. Majoros states that if the equal life group is accepted for Duke Kentucky, the Commission should require new depreciation studies every 3 years. Explain how Mr. Majoros determined the 3-year interval is appropriate and reasonable.

Response:

Mr. Majoros bases that recommendation on the FCC's approach. While it still regulated telephone companies, the FCC depreciation branch was the reigning expert on ELG.

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Witness Responding:
Michael J. Majoros, Jr.

28. Refer to the Majoros Testimony, pages 19 through 29 of 54.
    a. Based on his review, does Mr. Majoros believe Duke Kentucky is in compliance with the provisions of paragraph 38 of FERC's Order No. 631? Explain the response.
    b. Has Mr. Majoros prepared any analyses for any retirement of utility plant made by Duke Kentucky that compares the cost of removal incorporated into the depreciation rate and accrued for that utility plant with the actual cost of removal incurred at retirement?
        (1) If yes, provide all analyses.
        (2) If no, explain why such analyses have not been performed.
    c. On page 28 Mr. Majoros states, "Furthermore, even if it was highly probable that this money would all be spent for cost of removal, it is fair and reasonable for the Kentucky PSC to specifically recognize the ratepayers' security interest in these monies until they are actually spent on their intended purpose." Explain what Mr. Majoros means by the "ratepayers' security interest" and what is the basis for the claim such a security interest is created when developing and charging depreciation rates.
    d. In its December 22, 2005 Order in Case No. 2005-00042, the Commission expressly rejected the AG's recommendation that a regulatory liability should be created for non-legal AROs. Explain in detail what circumstances have changed since December 22, 2005 to support and justify the creation of a regulatory liability for Duke Kentucky's electric plant non-legal AROs.

Response:

a. Mr. Majoros assumes it is in compliance with FERC rules, but cannot tell from the filing.

b. See attached analysis showing net COR in Spanos's accruals, Majoros's accruals and actual accruals. The Company did not provide the COR regulatory liability by account.

c. Mr. Majoros assumes that when the Commission allows a utility to charge ratepayers for estimated future costs, it is with the implicit understanding that if those costs are not incurred, the money will be returned to ratepayers rather than transferred to the utility's income account.

d. Other Commission's have recognized the regulatory liability, and other commissions have adopted a normalized net salvage approach.

Witness Responding:
Michael J. Majoros, Jr.

29. Refer to the Majoros Testimony, page 29 of 54.

   a. The non-legal ARO costs of $7,288,105 identified by Mr. Majoros reflect the net salvage accruals as shown on Exhibit MJM-1, page 3 of 3. Does Mr. Majoros agree that net salvage is comprised of gross salvage and cost of removal?
   b. Does Mr. Majoros agree that the total original cost of the depreciable plant associated with the $7,288,105 net salvage accruals is $1,044,907,843?
   c. Does Mr. Majoros agree that this amount of net salvage accruals divided by the total original cost of the depreciable plant equals .697 percent?

Response:

a. Net salvage is gross salvage less cost of removal. Mr. Majoros does not know if any gross salvage is included in Mr. Spanos's net salvage proposals. If any gross salvage was included, the non-legal ARO costs would be higher.

b. Yes.

c. Yes. However, Mr. Majoros does not understand why this is important. The $7.3 million amount is an annual accrual, which will grow at a compounded rate. The $1.045 billion amount is total plant in service, which will also grow, hence, accelerating the growth at .697 percent.

Witness Responding:
Michael J. Majoros, Jr.

30. Refer to the Majoros Testimony, page 33 of 54. Indicate when Statement of Financial Accounting Standards No. 143 became effective.

Response:

According to SFAS No. 143, "This Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. Earlier application is encouraged."[2]

[2] SFAS No. 143, p. 6.

Witness Responding:
Michael J. Majoros, Jr.

31. Refer to the Majoros Testimony, pages 42 and 43 of 54. Provide the basis for each statement concerning replacements, beginning at line 23 on page 42 and continuing through line 8 of page 43.

Response:

Based on Mr. Majoros's experience, this in universally the approach utilities use. ULH&P uses the approach – see the responses to AG-DR-01-181 and 183.

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Witness Responding:
Michael J. Majoros, Jr.

32. Refer to the Majoros Testimony, pages 45 through 46 of 54. Provide complete copies of the decision by the Kansas Corporation Commission and the Kansas Court of Appeals that are referenced on these pages. Also indicate if the decision by the Kansas Court of Appeals has been appealed and the current status of that appeal.

Response:

These are provided as attachments on CD. To the best of Mr. Majoros's knowledge, an appeal has not been filed.

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Witness Responding:
Michael J. Majoros, Jr.

33. Refer to the Majoros Testimony, Exhibit MJM-5, pages 3 and 4 of 4. Mr. Majoros states in his testimony that he opposes the use of the equal life group for Duke Kentucky's depreciation rates. Explain why for over half of the accounts shown on pages 3 and 4 Mr. Majoros uses the equal life group remaining life values.

Response:

This was an oversight. Snavely King will recalculate the rates. The results will be supplied when completed.

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Witness Responding:
Michael J. Majoros, Jr.

34. Refer to the Majoros Testimony, Exhibit MJM-6.
    a. Explain in detail why the use of a 5-year average net salvage component is reasonable.
    b. Explain in detail why it would not be reasonable to base the net salvage component on the average of all data years available, which based on the information contained in Exhibit MJM-10, pages 3 through 68 of 68 appears to be 16 years.

Response:

a. Mr. Majoros considers a 5-year period to be reasonable based on his judgment and precedent in other jurisdictions. However, other periods may also be reasonable.

b. Those pages, which Mr. Spanos prepared, contain total, three-year averages and five-year averages. Whatever period is selected, the Company is protected by virtue of the remaining life technique. Both overages and underages are factored into the next depreciation rate calculation.

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Witness Responding:
Michael J. Majoros, Jr.

35. Refer to the Majoros Testimony, Exhibit MJM-10, pages 1 and 2 of 68. It appears that there are nine plant accounts for which there is no summary of book values sheet. Explain in detail why it is reasonable to assume no net salvage for these nine plant accounts.

Response:

Mr. Majoros used Mr. Spanos's **complete** net salvage study in the calculation of his net salvage allowance. Presumably Mr. Spanos prepared a net salvage analysis for each account for which there was net salvage.

Mr. Majoros was able to find eight plant accounts with no summary of book values sheet. They are listed below with Mr. Majoros's comments.

Account	Comment
Steam Production	
3122 – Boiler Plant Retrofit Precipitators	Sub account – data may be included in account 3120
Other Production	
3401 – Rights of Way	Reasonable to assume no net salvage. See accts. 3501 and 3601
3401–Structures & Improvements	Unknown
3430 – Prime Mover	Unknown
Transmission	
3535-Station Equip. Electronic	Small sub account – any data may be included in accounts 3530 or 3532
Distribution	
3635 – Station Equip. Electronic	Small sub account – any data may be included in accounts 3620 or 3622
3682 – Line Transformers Customer	Small sub account – any data may be included in accounts 3680
3720 – Leased Property on Customer Premises	

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Witness Responding:
Steven W. Ruback

36. Refer to the Direct Testimony of Steven W. Ruback ("Ruback Testimony"), pages 12 and 13. Mr. Ruback proposes modifying the 12 Coincidental Peak ("12-CP") methodology proposed by Duke Kentucky, recognizing both class contributions to the 12 monthly peaks as well as capitalized energy.

a. Explain in detail how Mr. Ruback calculated Duke Kentucky's extra investment in non-peaking generating facilities and provide a Workpaper showing the calculation.

b. Explain whether Mr. Ruback agrees with Duke Kentucky that the Average 12-CP method is generally accepted in the utility industry and was approved by the Commission in Duke Kentucky's last rate case. In the explanation, include any changes at Duke Kentucky or within the electric industry subsequent to the company's last rate case that justify the modifications to the 12-CP methodology proposed by Mr. Ruback.

c. Explain whether the 12-CP and Average Demand methodology recommended by Mr. Ruback has been proposed in rate cases before in Kentucky, or in other states. If the 12-CP and Average Demand methodologies have been proposed or accepted in Kentucky or other states, identify the state and provide the case number in which the methodology was proposed and whether the methodology was adopted by the state commission.

Response:

36. a) Mr. Ruback has estimated the extra dollars invested as 56% of total power supply costs. The 56% is the Company's load factor. The work paper provided as Workpaper DR 1.a, estimates the investment made for lower unit energy costs by multiplying net production plant by 56%, the system load factor.

b) See 36.a.

The 12 CP method is generally accepted in the industry along with other production demand methodologies.

The change or justification for moving from the 12 CP to the 12CP & Average, since the last rate increase, is the sharp escalation in the prices coal, oil and gas, which are common fuel sources for generation. This sharp commodity price escalation justifies the Company's investments in existing plant in service for

Witness Responding:
Steven W. Ruback

base load facilities and intermediate units with a higher capital costs per Kilowatt but lower energy unit costs.

c) It is Mr. Ruback's understanding that the 12-CP and Average Demand methodology recommended by Mr. Ruback has been proposed in rate cases before in Kentucky, but Mr. Ruback does not know if the average demand portion was weighted by load factor and 12CP were weighted by 1 minus the load factor or whether there were sharp increases in commodity costs when the proposes were made.

Mr. Ruback has not conducted a survey of demand allocation methodologies used to allocate production costs by each state regulatory commission. However, a web search was conducted indicating that a peak and average method has been approved in Arkansas (See Attachment DR 2 pages 1 and 2) and Kansas (See Attachment DR 2 pages 3 thru 5).

Witness Responding:
Steven W. Ruback

37. Provide a schedule similar to Schedule M-2.3 in Volume 12 of Duke Kentucky's application that shows the resultant rates, including the customer charge, demand charge (if applicable), and energy charge for all customer classes using the cost-of-service study and rate design proposed by Mr. Ruback. Assume for the purposes of your response to this question that Duke Kentucky is granted the full increase that it has proposed in this case.

Response:

. Schedule M-2.3 in Volume 12 of Duke Kentucky's application is a proof of revenue statement showing the rate charges needed to produce the requested revenue increase. Mr. Ruback has not provided testimony regarding individual rate charges and therefore, has not calculated a proof of revenue statement.

Witness Responding:
Steven W. Ruback

38. Refer to the Ruback Testimony, page 11. Mr. Ruback states that, "A preponderance of peaking facilities is appropriate if the utility has a needle peak, but not if a utility has a reasonable load factor." On page 12, Mr. Ruback states that Duke Kentucky's annual load factor is a reasonable 56.66 percent. Explain whether Mr. Ruback believes Duke Kentucky's peaking facilities are excessive.

Response:

Mr. Ruback has no opinion as whether Duke Kentucky's peaking facilities are excessive.

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Witness Responding:
Steven W. Ruback

39. Refer to the Ruback Testimony, page 29. Mr. Ruback states that in Duke Kentucky's proposed Green Power ("GP") tariff, GP revenues will not be used to purchase or develop environmentally friendly resources, but instead will be used to purchase Renewable Energy Certificates ("REC") and carbon credits. Explain whether or not Mr. Ruback is aware of GP programs in Kentucky or in other jurisdictions that use RECs and carbon credits exclusively to fill GP portfolio requirements.

Response:

Mr. Ruback is not aware of GP programs in Kentucky or in other jurisdictions that use RECs and carbon credits exclusively to fill GP portfolio requirements.

Response of the Attorney General to
***Commission* Order of 26 September 2006**
Duke Energy Kentucky
Case No. 2006-00172

Witness Responsible:
ROBERT J. HENKES, COUNSEL

Question 40: There are adjustments and tariff changes proposed by Duke Kentucky that have not been specifically addressed by the AG's witnesses. For each of the following issues, provide the AG's position, if any:

a. Increase in labor expenses and labor fringe benefits expenses.
b. Treatment of the Annual Incentive Compensation expense.
c. Treatment of additional deferred income taxes as a result of changes in Ohio tax law and the recognition of these additional deferred income taxes as an "above the line" deferred tax liability.
d. Changes to six outdoor lighting tariffs.
e. Approach to continue the sharing of off-system sales margins.

Response:

a. Based on his review of the Company's proposed labor and labor fringe benefits expenses, Mr. Henkes has not taken exception to these proposed expenses in this case.
b. Mr. Henkes believes that the Company's proposed incentive compensation expenses included for ratemaking purposes in this case have been calculated in a manner consistent with the approach used by the Commission to calculate the allowable incentive compensation expenses in the Company's prior gas rate case, Case No. 2005-000452. For that reason, Mr. Henkes has not adjusted the Company's proposed incentive compensation expenses in this case.
c. Mr. Henkes did not review this tax matter and, therefore, cannot take a position on this matter.
d. The Attorney General has taken no position on the changes to the outdoor lighting tariffs.
e. The Attorney General has taken no position on the approach to continue sharing of the off-system sales margins.