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PUBLIC SERVICE
COMMISSION

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
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Frankfort, Kentucky 40602-0615

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220 West Main Street
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Louisville, Kentucky 40232
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February 29, 2008

RE: ***AN INVESTIGATION OF THE ENERGY AND REGULATORY ISSUES IN SECTION 50 OF KENTUCKY'S 2007 ENERGY ACT***
Administrative Case No. 2007-00477

Dear Ms. O'Donnell:

Enclosed please find and accept for filing the original and ten (10) copies of the Direct Testimony of Lonnie E. Bellar in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to contact me.

Sincerely,

Rick E. Lovekamp

Rick E. Lovekamp

cc: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In re the Matter of:

AN INVESTIGATION OF THE ENERGY AND REGULATORY ISSUES IN SECTION 50 OF KENTUCKY'S 2007 ENERGY ACT	))))	**ADMINISTRATIVE CASE NO. 2007-00477**

TESTIMONY OF
LONNIE E. BELLAR
VICE PRESIDENT, STATE REGULATION AND RATES
E.ON U.S. SERVICES, INC.

Filed: February 29, 2008

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

A. My name is Lonnie E. Bellar. I am Vice President, State Regulation and Rates for E.ON U.S. Services Inc., which provides services to Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky. A statement of my professional history and education 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 environmental surcharge, fuel adjustment clause and other proceedings in my previous positions with the Companies. I am also the Companies' witness for the testimony being filed in this proceeding today by the Companies, Big Rivers Electric Corporation, East Kentucky Power Cooperative, Inc., Kentucky Power Company, and Duke Energy Kentucky, Inc ("Joint Parties").

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide the Companies' positions and proposals concerning Section 50 of the 2007 Kentucky Energy Act. These positions and proposals are meant to augment those taken by the Joint Parties in their joint testimony being filed contemporaneously with this testimony.

Q. What impediments prevent development and implementation of energy efficiency initiatives?

A. In the absence of energy efficiency or Demand-Side Management ("DSM") statutes or regulations, traditional cost-of-service-based utility rates provide a significant disincentive to implementing energy efficiency or DSM programs. Under traditional rate structures, utilities have a strong financial incentive to produce efficiently and to sell as much of their product(s) as possible, just like any other business. Energy efficiency and DSM programs, if they are effective, serve not only to reduce the quantity of energy utilities sell, they also reduce the need to build additional generation, which in turn can reduce the amount of return on equity utilities earn. This basic fact of economics presents the greatest single obstacle to the development and implementation of energy efficiency initiatives.

Q. What rate-making approaches might encourage further development and implementation of energy efficiency initiatives?

A. The cost-recovery and incentive provisions of Kentucky's DSM statute, KRS 278.285, provide an important part of the solution to the financial disincentive problem I discussed above; however, consideration of additional rate-making measures are advisable to help ensure the full elimination of impediments to the further development and implementation of energy efficiency initiatives. The Companies believe that all of the additional measures and structures I propose herein are within the Commission's current ratemaking authority.

One such rate-making measure is to allow annual reviews of utilities' financial results, with rate adjustments, to ensure utilities' revenues remain consistent with their approved rate designs. This approach would allow utilities to pursue energy efficiency programs even more aggressively because they could be assured of adequate revenue even if energy sales decrease, which presumably they would as a result of the effective implementation of energy efficiency programs. The Commission has used such a rate-making approach with jurisdictional utilities in the past.[1] Under this approach, in a general rate case the Commission would establish a level of revenue that would provide the utility a fair, just, and reasonable rate of return. Annually thereafter, but before the utility's next general rate case, the utility would determine if it achieved the base level of revenue in the previous period. If the utility received more revenues than the base level, the utility would distribute the overage to customers prospectively in the next period. If the utility received less than the base level, that amount would be added to the base level of revenues for the next period and would be recovered then. This arrangement would allow the utility to remain revenue neutral, even when sales decline due to effective energy efficiency programs.

Although no additional statutory authority is needed for the Commission to implement such annual reviews of utilities' financial results, with rate adjustments, they are a potentially important means of helping to remove impediments to the further development and implementation of energy efficiency programs. The Companies respectfully suggest that the Commission explore this rate-making approach with its jurisdictional utilities.

Q. In addition to annual reviews of utilities' financial results, with rate adjustments, what other rate-making measures do the Companies suggest to the Commission to help encourage the development and implementation of energy efficiency programs?

[1] *See In the Matter of: A Joint Application for the Approval of Demand-Side Management Programs, a DSM Cost Recovery Mechanism, and a Continuing Collaborative Process on DSM for Louisville Gas and Electric Company*, Case No. 1993-00150, Order (Nov. 12, 1993).

A. There are two kinds of measures the Companies respectfully suggest the Commission should consider to help the development and implementation of energy efficiency programs.

First, utilities should be able to capitalize all non-expense components of energy efficiency programs, to be recovered as part of energy efficiency program filings. Investments in smart metering, for example, would fall in the category of expenses the Companies believe should be capitalized in this way. This will allow utilities to earn a reasonable return on these investments, further encouraging investment in them.

Second, additional financial incentives will further encourage the development and implementation of energy efficiency programs. Such incentives could come in a number of forms. One would be to provide a durable incentive rate of return on equity ("ROE") for capital investments in energy efficiency programs. By "durable incentive rate of return on equity" I mean an incentive adder to ROE that persists across rate cases and that is not included in the calculation of a utility's earnings to depress the base ROE set in rate cases (e.g., a .25% incentive ROE adder).

Another possible incentive structure could be fair, reasonable and equitable distributions of energy efficiency program savings between customers and utility applicants. This would provide additional incentives to utilities while also providing savings to customers as compared to building and operating new power plants.

Q. Section 50 appears to favor several alternatives to the construction of new generation. What could the Commission do concerning purchased power, including purchased power from renewable resource generators, to make it a more competitive alternative to the construction of new generation?

A. Although utilities are now able to recover the cost of economic purchased power, it remains a less economically viable alternative to constructing new generation in part because utilities cannot capitalize any part of the cost thereof. This is particularly true of power purchased from renewable resource generators, which typically are higher-cost resources. To remedy that situation, the Companies respectfully propose that the Commission allow utilities to capitalize the demand cost portion of any purchased power contracts into which jurisdictional utilities enter. This will place such contracts on a more level economic footing with new construction, particularly with respect to renewable resource purchased power, and could result in a net reduction in the amount of new generation utilities propose.

Q. Please summarize the Companies' positions in addition to those of the Joint Parties this proceeding.

A. In brief, the Companies' additional positions are:

1) Under its current authority, the Commission can and should explore with utilities the possibility of annual reviews of utilities' financial results, with rate adjustments. Such an approach should help remove remaining economic impediments to the further development and implementation of energy efficiency programs.

2) The Commission can further help encourage energy efficiency programs by: (a) allowing utilities to capitalize their non-expense costs of energy efficiency programs, such as smart metering investments; and (b) providing additional economic incentives for energy efficiency, such as by granting incentive ROEs for energy efficiency investments and by allowing utilities to recover a percentage of the costs avoided by not constructing and operating new plants.

3) Allowing utilities to capitalize the demand cost portion of purchased power contracts will place such contracts on a more level economic footing with the construction of new generating units, particularly with respect to renewable resource purchased power, and could lead to a decrease in new generating units proposed.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Lonnie E. Bellar**, being duly sworn, deposes and says he is the Vice President State Regulation and Rates for E.ON U.S. Services Inc., 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.

Lonnie E Bellar

LONNIE E. BELLAR

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 29th day of February 2008.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

November 9, 2010

Appendix A

Lonnie E. Bellar
E.ON U.S. Services Inc.
220 West Main Street
Louisville, Kentucky 40202
(502) 627-4830

Education

Bachelors in Electrical Engineering;
University of Kentucky, May 1987
Bachelors in Engineering Arts;
Georgetown College, May 1987
E.ON Academy, Intercultural Effectiveness Program: 2002-2003
E.ON Finance, Harvard Business School: 2003
E.ON Executive Pool: 2003-2007
E.ON Executive Program, Harvard Business School: 2006
E.ON Academy, Personal Awareness and Impact: 2006

Professional Experience

E.ON U.S.

Vice President, State Regulation and Rates	Aug. 2007 – Present
Director, Transmission	Sept. 2006 – Aug. 2007
Director, Financial Planning and Controlling	April 2005 – Sept. 2006
General Manager, Cane Run, Ohio Falls and Combustion Turbines	Feb. 2003 – April 2005
Director, Generation Services	Feb. 2000 – Feb. 2003
Manager, Generation Systems Planning	Sept. 1998 – Feb. 2000
Group Leader, Generation Planning and Sales Support	May 1998 – Sept. 1998

Kentucky Utilities Company

Manager, Generation Planning	Sept. 1995 – May 1998
Supervisor, Generation Planning	Jan. 1993 – Sept. 1995
Technical Engineer I, II and Senior, Generation System Planning	May 1987 – Jan. 1993

Professional Memberships

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