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May 2, 2008

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MAY 02 2008

PUBLIC SERVICE
COMMISSION

VIA HAND DELIVERY

Stephanie L. Stumbo
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RE: The Plan of Louisville Gas and Electric Company for the Future Disposition of the Merger Surcredit Mechanism
Case No. 2007-00562

The Plan of Kentucky Utilities Company for the Future Disposition of the Merger Surcredit Mechanism
Case No. 2007-00563

Dear Ms. Stumbo:

Enclosed please find and accept for filing two originals and ten copies of the Joint Rebuttal Testimony of Lonnie E. Bellar on behalf of Louisville Gas and Electric Company and Kentucky Utilities Company in the above-referenced matters. Please confirm your receipt of this filing by placing the stamp of your Office with the date received on the enclosed additional copies and return them to me in the enclosed self-addressed stamped envelope.

Should you have any questions please contact me at your convenience.

Yours very truly,

Kendrick R. Riggs

KRR:ec
Enclosures
cc: Parties of Record

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF LOUISVILLE GAS AND)	
ELECTRIC COMPANY FOR THE)	CASE NO. 2007-00562
FUTURE DISPOSITION OF THE)	
MERGER SURCREDIT MECHANISM)	

In the Matter of:

THE PLAN OF KENTUCKY)	
UTILITIES COMPANY FOR THE)	CASE NO. 2007-00563
FUTURE DISPOSITION OF THE)	
MERGER SURCREDIT MECHANISM)	

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

Filed: May 2, 2008

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

2 A. My name is Lonnie E. Bellar. I am Vice President, State Regulation and Rates for
3 E.ON U.S. Services Inc., which provides services to Kentucky Utilities Company
4 (“KU”) and Louisville Gas and Electric Company (“LG&E”) (collectively “the
5 Companies”). My business address is 220 West Main Street, Louisville, Kentucky.
6 A statement of my professional history and education is attached to this testimony as
7 Appendix A.

8 **Q. What is the purpose of your testimony?**

9 A. The purpose of my testimony is to respond to various points Lane Kollen, the witness
10 for the Kentucky Industrial Utilities Customers, Inc. (“KIUC”), made in his testimony
11 in this proceeding. In particular, I will show that, rather than it being inequitable,
12 unjust, and unreasonable for the Companies’ merger surcredits to end on June 30,
13 2008, it would be inequitable, unjust, and unreasonable for the surcredits to continue
14 beyond June 30, 2008, in view of the Companies’ current and significant under-
15 earnings, which have denied the Companies the benefit of their share of the merger
16 savings in 2007, and because the Companies plan to file new base rate applications
17 between June 30, 2008, and September 30, 2008.

18 **Q. Do you agree with Mr. Kollen’s assertion in his testimony that the Companies’**
19 **proposal to end the merger surcredit in this proceeding is “inequitable, unjust,**
20 **and unreasonable” because it “shifts the historic[al] equal sharing so that the**
21 **Companies retain 100% of the merger savings and ratepayers are denied any**
22 **share of the savings?”**

1 A. No. The Companies' proposal does not "shift[]" the historic equal sharing so that the
2 Companies retain 100% of the merger benefits,"¹ leaving the Companies' customers
3 with no such benefits; rather, it allows the Companies to apply the merger benefits
4 towards the carrying charges associated with their ongoing investment in facilities to
5 serve customers, the cost of which is not already included in existing base rates,
6 during the short period between July 1, 2008, and the date on which new base rates go
7 into effect for the Companies – which the Companies anticipate will be no later than
8 April 1, 2009. Once new base rates go into effect, customers' rates will directly
9 reflect the benefit of 100% of the merger savings – indefinitely. Therefore, there is
10 nothing "inequitable, unjust, and unreasonable" about the Companies' merger
11 surcredit disposition proposal, which the Companies respectfully request the
12 Commission to approve.

13 **Q. Is there any dispute whether the Companies' merger surcredit tariffs will**
14 **remain in effect through June 30, 2008?**

15 A. No. There is no question that the tariffs will remain in effect through June 30, 2008.
16 By that date, the merger surcredit will have provided a total of \$143.4 million in
17 savings to KU's customers and \$145.7 million to LG&E's customers over the ten-
18 year period the surcredit rate mechanism will have been in effect. By any accounting,
19 the Companies' customers already have benefited enormously from the Companies'
20 sound business decision to merge.

21 **Q. Is there any dispute whether the Companies' customers will explicitly receive the**
22 **benefit of all of the merger savings when new base rates go into effect for the**
23 **Companies?**

¹ Direct Testimony of Lane Kollen at 7 (April 11, 2008)

1 A. No. Notwithstanding that the Companies' customers will have received over \$291
2 million through the merger surcredit through June 30, 2008, and the Companies will
3 not have received the benefit of their full share of the merger benefits due to their
4 ongoing investment in facilities to provide service to customers, the Companies'
5 customers will receive the benefit of all – 100% – of the merger savings through their
6 rates when new base rates go into effect for the Companies.

7 **Q. What, then, is at issue in these proceedings?**

8 A. Because the merger surcredit will continue as-is through June 30, 2008, but will end
9 no later than when new base rates go into effect for the Companies, the only question
10 at issue in this proceeding is: What is the most equitable, just, and reasonable
11 disposition of the merger surcredit during what the Companies anticipate will be a
12 short time between those two dates? KIUC appears to agree with this assessment
13 when Mr. Kollen states at page 18 of his testimony, "It is this interim period after
14 June 30, 2008 until base rates are reset that is at issue and over which the Companies
15 and KIUC disagree." The Companies submit that the most equitable, just, and
16 *reasonable disposition of the merger surcredit is to allow it to end by its own terms on*
17 *June 30, 2008.*

18 **Q. Have circumstances changed since the Commission first balanced in the**
19 **LG&E/KU merger and then rebalanced in 2003 the interests of customers and**
20 **shareholders in their respective portions of the merger surcredit?**

21 A. Yes. Since the 2003 rebalancing, the Companies have embarked upon the largest
22 construction program in their history to build facilities to serve their customers.
23 When the period from January 1, 2007, through December 31, 2008, ends, the

1 Companies will have invested approximately \$1.2 billion in generation, transmission,
2 and distribution facilities to serve customers. This investment includes projects such
3 as the new base load unit at Trimble County, transmission lines, a new transmission
4 control center, the construction of new distribution facilities, and the extension of
5 existing distribution facilities. The cost of this Construction Work in Progress is not
6 included in base rates, thus causing the current attrition in the Companies' earnings.

7 Moreover, the regulatory lag associated with changing base rates to reflect the
8 investment in these facilities to provide service will only exacerbate the impact of
9 merger surcredit on the Companies' current financial position.

10 This change in the circumstances, along with the Companies' commitment
11 explicitly and permanently to provide the benefit of 100% of the merger savings to
12 customers with the next change in base rates, makes continuation of the existing
13 arrangement (i.e., a 50/50 sharing of savings) unreasonable and inequitable.

14 **Q. To ensure that it would be only a short time between June 30, 2008, and when**
15 **new base rates go into effect for the Companies, would the Companies be willing**
16 **to commit to file base rate applications?**

17 A. Yes. If the Commission believed such a commitment would be appropriate condition
18 in connection with an order ending the merger surcredit on June 30, 2008, the
19 Companies would be willing to submit a written commitment to file base rate
20 applications between June 30, 2008, and September 30, 2008. The Companies
21 therefore anticipate that their new base rates will go into effect – and customers will
22 explicitly receive 100% of the merger savings – as soon as January 1, 2009, and no
23 later than April 1, 2009. This relatively brief and fixed period during which the

1 merger surcredit will no longer be in place is wholly reasonable, just, and equitable,
2 given the Companies' significant and ongoing investment in facilities to serve their
3 customers.

4 **Q. Mr. Kollen states in his testimony that the Companies' proposal to end the**
5 **merger surcredit "disrupts the status quo and the Commission's careful balance**
6 **between the Companies and their ratepayers." Does the Companies' proposal**
7 **do any such thing?**

8 A. No. The Companies' proposal actually strikes the careful balance to which Mr.
9 Kollen refers by recognizing the change in circumstances caused by the Companies'
10 current construction of facilities to provide service to customers. As shown in
11 previous testimony and the Companies' responses to data requests in these
12 proceedings, the Companies under-earned in calendar year 2007, so much so that they
13 did not receive the benefit of their share of the merger savings. Given the
14 Companies' ongoing investment in facilities to provide service to customers and their
15 current construction plans, the Companies have every reason to believe that this trend
16 will continue through the balance of 2008 and throughout 2009 until base rates
17 change. In other words, though the Companies' customers received and continue to
18 receive their share of the merger savings, the Companies' shareholders have not
19 benefited from their share of the savings, though in theory they should receive merger
20 savings equal to those their customers receive. Indeed, using KIUC's approach,
21 which assumed a return on equity ("ROE") of just 10.0% for both Companies (the
22 very bottom of the Commission-approved ROE range), just in the year 2007 LG&E
23 did not benefit from approximately \$13.6 million of the merger savings it should have

1 received, and KU did not benefit from any of the \$19.0 million merger savings it
2 should have received.

3 The Companies' proposal to allow the merger surcredit to expire on its own
4 terms on June 30, 2008, is, therefore, much more in keeping with an equitable balance
5 of merger savings between the Companies and their customers, recognizing that the
6 Companies have not and are not benefiting from their share of the merger savings due
7 to their ongoing investment in facilities to serve customers, and taking into account
8 the fact that the Companies' customers will explicitly receive all of the merger
9 savings – indefinitely – no later than April 1, 2009. KIUC, on the other hand, would
10 urge the Commission to ignore these equitable factors entirely.

11 **Q. Does Mr. Kollen's approach overstate the amount of revenue by using only the**
12 **10% ROE?**

13 A. Yes, Mr. Kollen's approach overstates the revenue amounts which the Companies
14 are earning because it uses the very bottom of the range of returns on equity the
15 Commission found reasonable in the Companies' most recent base rate proceedings,
16 which produces results biased in favor of KIUC's position. The Commission
17 approved a 10.0% to 11.0% range of ROE in the Companies' most recent base rate
18 cases, with a midpoint of 10.5%. As shown in Exhibit 1 to the Companies' responses
19 to the Commission Staff's DR No.1 for both Companies, using a 10.5% ROE for
20 LG&E increases the revenue deficiency by approximately \$7.6 million and for KU by
21 approximately \$7.8 million. Using an 11.0% ROE for LG&E increases the revenue
22 deficiency by approximately \$15.2 million and for KU by approximately \$15.6
23 million.

1 **Q. Is it necessary and appropriate to consider the Companies' revenue deficiencies**
2 **in these proceedings?**

3 A. Yes. As the Commission knows, the Companies' current rates are based on the costs
4 of service from their most recent base rate cases, filed on December 29, 2003, which
5 have embedded 100% of the projected merger savings, from which the Companies
6 return to customers 50% of the merger savings through the merger surcredit. Since
7 then, the Companies' costs of service have risen as the Companies have invested in
8 new and existing facilities to serve customers, though the Companies have not yet
9 sought base rate relief to compensate for those capital investments. As a result, what
10 was at one time the Companies' net 50% share of merger savings has been eroded by
11 increasing investments in facilities to serve customers and other changes in their costs
12 of service. Therefore, though these are not base rate proceedings, it is necessary and
13 appropriate to discuss the Companies' increasing costs because, though they may not
14 be directly related to merger savings, they do indeed have a direct and ongoing
15 impact upon the Companies' ability to benefit from the shareholders' portion of
16 merger savings.

17 The direct impact the Companies' increased costs have on their ability to
18 benefit from merger savings is what makes it necessary and appropriate to discuss
19 said increased costs in this proceeding, and it shows why the Commission was right
20 not to accept arguments from KIUC concerning their claims of the Companies' over-
21 earnings in the proceedings establishing the merger surcredit. Unlike the case where
22 increasing costs directly impinge upon the Companies' ability to benefit from merger
23 savings, if the Companies were over-earning, it would not in any way impact the

1 Companies' customers' ability to enjoy the benefits of the merger surcredit.
2 Likewise, if the Companies truly were over-earning, it would not impact the
3 appropriate amount of any merger surcredit, which is supposed to reflect savings the
4 Companies realize from synergies, the value of which do not depend on the
5 Companies' revenues.

6 **Q. Mr. Kollen appears to recognize the need to consider the Companies' under-**
7 **earnings by proposing that the KU merger surcredit be reduced by \$4.168**
8 **million due to KU's under-earning. Do the Companies agree with Mr. Kollen's**
9 **calculations to rebalance the merger surcredits?**

10 A. No. Mr. Kollen has chosen to use a 10.0% ROE for both Companies when
11 addressing the Companies' under-earnings in an attempt to bias the results in KIUC's
12 favor. Because 10.0% is the very bottom of the ROE range the Commission
13 approved for the Companies, it is not reasonable to use in these proceedings. As
14 shown in Table 1 below, to rebalance at the top of the ROE range would result in
15 eliminating entirely the KU merger surcredit, and a reduction in the LG&E merger
16 surcredit from \$19.427 million to \$10.180 million. The most reasonable ROE value
17 to use, however, would be the midpoint of the range, 10.5% ROE, which would result
18 in a reduction in the KU merger surcredit from \$18.969 million to \$7.148 million, and
19 a reduction in the LG&E merger surcredit from \$19.427 million to \$17.773 million.

1

Table 1			
Earnings Deficiency/(Sufficiency) at Range of ROEs, assuming elimination of the Merger Surcredit			
	10%	10.50%	11%
KU	(\$14,938,001)	(\$7,147,863)	\$642,274
Merger Surcredit	\$18,968,825	\$18,968,825	\$18,968,825
Adjusted Merger Surcredit	(\$14,938,001)	(\$7,147,863)	\$0
LG&E	(\$25,366,565)	(\$17,773,410)	(\$10,180,256)
Merger Surcredit	\$19,427,402	\$19,427,402	\$19,427,402
Adjusted Merger Surcredit	(\$19,427,402)	(\$17,773,410)	(\$10,180,256)

2

3 **Q. Do you agree with Mr. Kollen’s assertion page 9, lines 5 through 7, that “the**
4 **Companies’ computations are flawed and overstate the Companies base revenue**
5 **deficiencies by \$38.855 million for LG&E and \$37.838 million for KU if the**
6 **merger surcredits are discontinued as the Companies propose”?**

7 A. No. The Companies’ calculations accurately present their earned return for the
8 twelve-month period ending December 31, 2007. The merger surcredits were in
9 effect throughout that entire period of time. It is therefore necessary to reflect the
10 impact of these mechanisms and associated ratemaking treatment in the analysis.

11 **Q. Has Mr. Kollen accurately calculated the revenue deficiencies of LG&E and KU**
12 **at page 9 of his testimony?**

13 A. There are some minor differences that should be corrected. First, the Companies
14 believe that the LG&E amount on page 9, line 13 of his testimony should be \$25.228
15 million, not \$25.288 million. Secondly, the Companies believe the simple calculation

1 made to arrive at the numbers on page 9 of his testimony does not reflect the
2 difference between the tax rate used to tax-effect the adjustments to net operating
3 income in Exhibit 1 to the attachment to the Companies' responses to the
4 Commission Staff's DR No. 1 (for both Companies) and the gross-up revenue factor
5 in Exhibit 4 to the same attachment. When this difference is taken into consideration,
6 the revenue determinations identified by Mr. Kollen on page 9 of his testimony
7 should be \$25.366 million for LG&E and \$14.938 million for KU as shown in Table
8 1 above.

9 **Q. Is there any merit to Mr. Kollen's testimony that the Companies are trying to**
10 **circumvent base rate proceedings by addressing non-merger costs in these**
11 **proceedings?**

12 A. No, there is no merit in Mr. Kollen's assertions in this regard. The Companies have
13 already stated they are willing to commit to file base rate applications no later than
14 September 30, 2008, if making such a commitment is necessary to ending the merger
15 surcredits on June 30, 2008. Therefore, the Companies cannot fairly be said to be
16 avoiding base rate proceedings. Rather, as explained above, it is not possible to
17 discuss the Companies' lack of benefiting from their share of the merger savings
18 without addressing their overall earnings. What also must be taken into consideration
19 is the delay associated with the process for changing base rates, during which time the
20 ongoing attrition of the Companies' earnings will continue.

21 The delay of new rate implementation inherent in rate proceedings means that,
22 if the merger surcredits do not expire on June 30, 2008, the Companies will continue
23 to under-earn significantly until their new base rates go into effect. Allowing the

1 merger surcredits to expire on their own terms on June 30, 2008, will appropriately
2 balance the interests of customers and shareholders during this intensive period of
3 construction of facilities to serve customers.

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

5 **A. Yes.**

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

IEEE