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April 19, 2004

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APR 29 2004

PUBLIC SERVICE
COMMISSION

Mr. Thomas M. Dorman
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

RE: In the matter of: An Adjustment of the Electric Rates, Terms and Conditions of Kentucky Utilities Company (2003-00434)

Dear Mr. Dorman:

Enclosed for filing on the above docket are eight (8) copies of the Response of The Kroger Co. to the First Data Request of the Commission Staff.

Very truly yours,

David Brown

David C. Brown by RDH

DCB:rdh

Enclosures

cc: Counsel of record

STITES & HARBISON PLLC
ATTORNEYS

Kentucky Utilities Company (2003-00434)

CERTIFICATE OF SERVICE

I hereby certify that a copy of the Response of The Kroger Co. to the First Data Request of the Commission Staff was served by e-mail on counsel for the Applicant and by mailing a true and correct copy, by regular U.S. mail to counsel for the Applicant and all parties on this the 19th day of April, 2004:

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KR091:000KR:372752:1:LOUISVILLE

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

(Orig-Ref)
RECEIVED

APR 1 9 2004

PUBLIC SERVICE
COMMISSION

In the Matter of:	)	
	)	
AN ADJUSTMENT OF THE GAS	)	CASE NO: 2003-00434
AND ELECTRIC RATES, TERMS	)	
AND CONDITIONS OF KENTUCKY	)	
UTILITIES COMPANY	)	

RESPONSE OF
THE KROGER CO.
TO THE FIRST DATA REQUEST
OF THE COMMISSION STAFF
DATED APRIL 6, 2004

FILED: APRIL 19, 2004

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to First Data Request of the Commission Staff dated April 6, 2004

Question No. 1

Responding Witness: Kevin C. Higgins

Q-1. The Direct Testimony of Kevin C. Higgins ("Higgins Testimony"), pages 5 through 15, proposes to reject the Kentucky Utilities Company's ("KU") "merger savings" adjustment. Assume for purposes of this question that the Commission approved Mr. Higgins' proposal. What adjustments would be necessary to recognize the fact that some customers have already received their merger savings credit dollars up front in the form of a discounted, lump-sum payment?

A-1. No further adjustments would be necessary to recognize the fact that some customers have already received their merger savings credit dollars up front. Mr. Higgins' proposal makes a distinction between the "merger savings" *adjustment* and the merger *surcredit.* Mr. Higgins' proposal to reject the "merger savings" adjustment is directed to KU's proposal to adjust its expenses upward by $19 million, an adjustment that would allow KU to build $19 million into rates for the benefit of its shareholders.

In contrast, Mr. Higgins proposes to retain the merger surcredit mechanism for the duration of its expected life, precisely to ensure equitable treatment between those customers who have already received their merger savings credit dollars up front and those who have not. [See Higgins Direct, p. 12, ln. 15 – p. 13, line 5.] Note that this is fair to the Company because in the context of the rate case, the merger surcredit paid to customers is customer-funded; that is, the revenue reduction to KU caused by the surcredit is built into the revenue requirements presented by the Company, resulting in a greater revenue deficiency, and thus, a greater requested rate increase. [See Seeyle Exhibit 13, p. 1.] If not for the fact that some customers have already received their credit upfront, the merger surcredit could be eliminated in the rate effective period in a revenue-neutral manner, so long as there was a corresponding adjustment to KU's revenues that reversed the reduction caused by the surcredit. However, because some customers have already received their surcredit up front, and others have not, the best way to ensure equity across customers going forward is to continue the surcredit as proposed by the Company. Consequently, if Mr. Higgins' proposal to eliminate the "merger savings" adjustment was adopted, no further adjustment to the surcredit mechanism would be necessary.

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to First Data Request of the Commission Staff dated April 6, 2004

Question No. 2

Responding Witness: Kevin C. Higgins

Q-2. Refer to the Higgins Testimony, pages 15 through 18, concerning Mr. Higgins' proposal to discontinue the Value Delivery Team ("VDT") surcredit.

a. Was Mr. Higgins aware that the amortization of the costs to achieve the VDT savings is included in the amounts returned to ratepayers through the VDT surcredit? Explain the response.

b. Assume for purposes of this question that the Commission approved Mr. Higgins' proposal. Explain how the unamortized balance of the costs to achieve the VDT savings would be handled for rate-making purposes.

A-2. a. Based on his review of the Commission's Order in 2001-055, et al., it is Mr. Higgins' understanding that the VDT surcredit paid to ratepayers is net of the monthly amortization of the costs to achieve the VDT savings:

"Under the Value Delivery Surcredit mechanism, the estimated savings from the Workforce Reduction are netted against the monthly amortization of the deferred debits. The net savings are then shared 40 percent to ratepayers and 60 percent to shareholders, which is the same sharing ratio used in the ESM calculations. The ratepayers' portion of the net savings will be shown as a Value Delivery Surcredit on monthly bills." [Order, pp. 8-9]. Mr. Higgins interprets this language to mean that the costs to achieve the savings are amortized pursuant to the Order in 2001-055. That further, there is some amount of savings that has been identified that is netted against this amortization, and that 40 percent of these net savings are reflected in the VDT surcredit.

b. As a preliminary matter, note that Mr. Higgins' proposal makes a distinction between the VDT savings *adjustment* and the VDT *surcredit*. While Mr. Higgins proposes to eliminate both the adjustment and the surcredit, the elimination of the *adjustment* is his primary policy concern with respect to the VDT issue. In contrast, Mr. Higgins' proposal to eliminate the VDT *surcredit* (with corresponding adjustments to KU revenue) is revenue-neutral to customers and KU, and is proposed for the more limited purpose of tariff clarity: the elimination of an element in the tariff that becomes unnecessary following a general rate case. Mr. Higgins' primary VDT recommendation to eliminate the VDT savings adjustment can be adopted with or without the elimination of the VDT surcredit.

To the extent that the costs to achieve the VDT savings have resulted in actual cost savings to KU, these savings should be reflected in lower revenue requirements. Therefore, if Mr. Higgins' VDT proposal(s) are adopted, and actual net VDT savings have been realized, the unamortized balance of the costs to achieve the VDT savings should be recovered in rates through March 2005, as provided by the Order in 2001-055.

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KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to First Data Request of the Commission Staff dated April 6, 2004

Question No. 3

Responding Witness: Kevin C. Higgins

Q-3. Refer to the Higgins Testimony, pages 18 through 23, regarding the matter of KU's proposed "rate spread."

a. Mr. Higgins suggests two alternatives to KU's proposed rate spread for its increase in electric revenues. Explain why Mr. Higgins suggests more than one alternative.

b. Mr. Higgins indicates he prefers the alternative that he identifies as Alternative 1. Explain why this is his preferred alternative.

A-3. a. Rate spread requires that judgment be brought to bear in determining what is just and reasonable. Mr. Higgins believes that measuring the movement toward cost-of-service is generally the best benchmark for determining rate spread, as this approach explicitly balances the principles of cost causation and gradualism. However, one of the unique characteristics of this proceeding is that a significant number of rate schedules deserve a rate *decrease*. In his experience, Mr. Higgins has observed that Commissions are sometimes reluctant to award a rate decrease to any class – however deserving – in the context of an overall rate increase. In light of these circumstances, Mr. Higgins thought it would be useful to offer an option to the Commission in which no class was awarded a decrease, and in which the rate mitigation for the classes that are below cost-of-service is provided via the denial of a rate cut to those classes that would otherwise deserve a decrease. Mr. Higgins believes that either approach is within the bounds of just and reasonable.

b. As indicated in the Response to 3.a, Mr. Higgins believes that measuring the movement toward cost-of-service is generally the best benchmark for determining rate spread, as this approach explicitly balances the principles of cost causation and gradualism. It also has the merit of treating each customer class equally with respect to the cost-of-service standard.

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to First Data Request of the Commission Staff dated April 6, 2004

Question No. 4

Responding Witness: Kevin C. Higgins

Q-4. Refer to the Higgins Testimony, pages 24 through 28, regarding time-of-use rates for commercial customers.

a. Mr. Higgins recommends that KU adopt a voluntary time-of-use rate for commercial customers with monthly demands below 5,000 kw. Explain what minimum monthly demand threshold (if any) Mr. Higgins would recommend using for offering potential commercial customers time-of-use rates.

b. Mr. Higgins suggests having a time-of-use rate option that includes peak and off-peak energy prices and indicates that he does not believe it is necessary to have a two-tiered demand charge like that in KU's existing LCI-TOD rate. Explain why Mr. Higgins prefers two-tiered energy charges rather than two-tiered demand charges.

A-4. a. Generally, the minimum monthly threshold should be determined by the customer's willingness to pay for TOU metering. To the extent that a minimum threshold is desired, Mr. Higgins would recommend using 150 kw, which would be consistent with the minimum threshold of the corresponding LG&E rate schedule, for which he also recommends adopting voluntary TOU rates.

b. As utilities become more reliant on natural gas and purchases to meet on-peak energy needs, the importance of sending an energy price signal at all hours of the day grows. Two-tiered demand charges provide a much more limited TOU price signal to customers than a two-tiered energy charge. Once a peak demand has been incurred in a month, it is a sunk cost for that month, whereas energy costs are always relevant.

Moreover, Mr. Higgins believes the two-tiered demand charge in the LCI-TOD rate is flawed and thus sends irrational price signals. For instance, a hypothetical customer who only operated during peak periods would avoid the off-peak demand charge, and thus pay a lower overall demand charge than a customer with the same peak demand who operated around the clock. This result makes no sense. Even more perversely, a customer could theoretically shift load from the off-peak period to "under-utilized" portions of the on-peak period and save money by avoiding the off-peak demand charge. The fact that such results are theoretically possible indicates that the basic TOU design is flawed. These flaws are avoided by using a two-tiered energy charge.

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KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to First Data Request of the Commission Staff dated April 6, 2004

Question No. 5

Responding Witness: Kevin C. Higgins

Q-5. Refer to the Higgins Testimony, page 25, where it is stated that commercial customers with loads below 5,000 kw are capable of responding to time-of-use rates. Explain the nature of the responses to which Mr. Higgins refers. In the explanation, address in particular how retail establishments that are open 24 hours can respond to price signals.

A-5. In general, rates that recognize that energy is more costly during the on-peak hours of the day will elicit socially-beneficial price responsiveness during those periods. For example, a customer on energy-differentiated TOU rates is more likely to respond to the savings that are possible from a higher AC thermostat setting than a customer who is paying average energy rates during peak periods. This example of price-responsiveness is also applicable to retail establishments that are open 24 hours.

In addition, grocery establishments that are open 24 hours cab take the following actions:

- Push refrigeration defrost cycles to off-peak,

- Install lighting setback controls,

- Install skylights with lighting control systems (longer term),

- Defer case restocking, and

- Install alternative appliances and equipment, such as gas-fired desiccant dehumidification and absorption chillers.

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to First Data Request of the Commission Staff dated April 6, 2004

Question No. 6

Responding Witness: Kevin C. Higgins

Q-6. Refer to the Higgins Testimony, page 28, where it is stated that a general rate case is the best time to adopt a new time-of-use rate, as it allows for the full consideration of the revenue effects that accompany the rate schedule. Explain how the full consideration of the revenue effects can be known if the rate schedule is to be voluntary.

A-6. The revenue effects would have to be estimated based on forecasts of customer migration to the new schedule. Any revenue loss from migration would then be considered in the determination of the final revenue requirement for the class as a whole.

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Kentucky Utilities Company (2003-00434)

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE GAS AND ELECTRIC RATES, TERMS AND CONDITIONS OF KENTUCKY UTILITIES COMPANY	) CASE NO: 2003-00434

RESPONSE OF
THE KROGER CO.
TO THE FIRST DATA REQUEST OF
KENTUCKY UTILITIES COMPANY
DATED APRIL 6, 2004

FILED: APRIL 19, 2004