**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

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|---|---|---|
| **THE APPLICATION OF KENTUCKY UTILITIES** | ) | |
| **COMPANY FOR A CERTIFICATE OF PUBLIC** | ) | |
| **CONVENIENCE AND NECESSITY TO** | ) | |
| **CONSTRUCT FLUE GAS DESULFURIZATION** | ) | **CASE NO. 2004-00426** |
| **SYSTEMS AND APPROVAL OF ITS 2004** | ) | |
| **COMPLIANCE PLAN FOR RECOVERY BY** | ) | |
| **ENVIRONMENTAL SURCHARGE** | ) | |

**DIRECT TESTIMONY OF**
**VALERIE L. SCOTT**
**DIRECTOR, FINANCIAL PLANNING AND ACCOUNTING – UTILITY OPERATIONS**
**LG&E ENERGY SERVICES INC.**

**Filed: December 20, 2004**

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

A. My name is Valerie L. Scott. I am Director of Financial Planning and Accounting – Utility Operations for LG&E Energy Services Inc., which provide services to Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively, "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky, 40202. A statement of my education and work experience is attached to this testimony as Appendix A.

**Q. Have you previously testified before this Commission?**

A. Yes. I have testified in hearings before this Commission in KU and LG&E rate proceedings, Case No. 2003-00434 and Case No. 2003-00433.

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

A. The purpose of my testimony is to explain KU's reporting and accounting for the operation and maintenance expenses associated with the pollution control projects in KU's 2004 Environmental Compliance Plan ("2004 Plan"), to demonstrate that the environmental compliance costs KU proposes to recover through its surcharge are not already included in existing rates and discuss the accounting treatment for the retirement of assets.

## I. Recording and Tracking of Environmental Surcharge Expenses

**Q. How will KU identify the operation and maintenance expenses incurred in connection with Project Nos. 21 and 22 in the KU 2004 Plan described in Mr. Malloy's testimony?**

A. KU's accounting system permits the tracking of costs in accordance with the Federal Energy Regulatory Commission's ("FERC") Uniform System of

Accounts. KU will include only its current incurred costs of environmental compliance approved by the Commission for recovery in the calculation of the environmental surcharge.

As explained in Mr. Malloy's testimony, Project No. 21 in KU's 2004 Plan involves the construction of Flue Gas Desulfurization ("FGD") equipment at Ghent Units 2, 3 and 4 and E.W. Brown Stations. KU intends to use FERC Account Nos. 502, Steam Expenses – Operation and 512, Maintenance of Boiler Plant, to identify and track the operation and maintenance expenses ("O&M") associated with the FGDs at Ghent and E.W. Brown once they become operational. KU will use subaccounts to track specific expenses, and location codes to track expenses by unit. KU currently incurs O&M expenses on the FGD serving Ghent Unit 1 which are included in base rates and are separately tracked. Since the FGDs included in Project 21 are new equipment there is no expense currently included in base rates for these units and KU will only include in its monthly surcharge filings the incremental O&M incurred on the new FGDs. (The accounting system used by KU allows for O&M expenses to be tracked by unit.) The KU limestone inventory and expense will increase due to the new FGDs and KU will include for recovery only the incremental limestone expense and inventory incurred for the new FGDs when they are operational. Limestone expense will be recorded in a subaccount of FERC Account No. 502 by individual unit allowing the Company to track the expense for these new units.

As explained in Mr. Malloy's testimony, Project No. 22 in KU's 2004 Plan involves the purchasing of emission allowances for all plants. KU will maintain an inventory account, in FERC Account No. 158, on the balance sheet for the allowances purchased. The inventory will be calculated using an average cost method, the purchased allowances will be combined with the allowances KU receives from Environmental Protection Agency at no cost to arrive at an average price. As KU uses allowances for steam units they will be expensed to FERC Account No. 509, Allowances, at the average price. KU will account for the emission allowance expenses by individual unit. Emission allowances expenses were included in KU's last rate proceeding, Case No. 2003-00434. KU currently excludes from Environmental Cost Recovery ("ECR") the amount of emission allowance inventory and expense included in base rates, and KU will continue to report only the allowance expense that is greater than the amount already included in base rates in Account No. 509.

**Q. How would KU account for the sale of emission allowances?**

A. If KU sells emission allowances to any third party, including LG&E, the sales will be made at the market price on the day of the sale. Gains on the sale of emission allowances, calculated as the sale proceeds less the average cost in inventory, will be credited to FERC Account No. 411.8, Gains from the Disposition of Allowances. Gains will be included in the calculation of the amount KU is seeking for recovery through the ECR.

**Q. What book depreciation rates will be used in the calculation of the depreciation expense for the new and additional pollution control facility?**

**A.** The book depreciation rate to be used for the FGDs at Ghent and Brown will be the same as used currently on the Ghent Unit 1 FGD. This rate is set forth in the

Company's most recent Depreciation Study, completed as of December 31, 1999 and on file with and approved by the Commission in Case No. 2001-140.

**Q. What deferred income taxes are associated with pollution control facilities and equipment?**

A. Deferred income taxes are recorded for all book versus tax temporary timing differences. These new pollution control facilities are eligible for accelerated tax depreciation and amortization. The pollution control facilities will generally fall into a 20-year Modifed Accelerated Cost Recovery (MACRS) life, or be eligible for U.S. Tax Code Section 169 amortization over a five-year life. Facilities constructed after September 11, 2001 and placed in service before January 1, 2006 may be eligible for the recently enacted 30% or 50% "bonus" depreciation in accordance with U.S. Tax Code Section 168(K).

**Q. Please explain how property taxes associated with the new and additional pollution facilities are calculated.**

A. Pollution control facilities located in Kentucky are generally categorized as manufacturing machinery. This class of property is exempt from local property tax and is taxed only at the state property tax rate of $0.15 per $100 of assessed value.

**Costs Not Already Included In Existing Rates**

**Q. Are any of the capital expenditures for the new and additional pollution control facilities in this case already included in existing rates?**

A. No. None of the capital costs for the new and additional pollution control facilities for which KU is seeking recovery in this case are already included in existing rates. The current base rates were determined to be fair, just and reasonable by the Commission in its order issued in Case No. 2003-00434 on June 30, 2004. In making that determination, the Commission evaluated the reasonableness of KU's regulated return from Kentucky jurisdictional operations using the twelve month period ending September 30, 2003 as the test period, adjusted for known and measurable changes. None of the capital expenditures for the new and additional pollution control facilities in this case were incurred by KU during or prior to the twelve-month period ending September 30, 2003 or included as adjustments thereto.

**Q. Are any of the operation and maintenance expenses for the new and additional pollution control facilities in this case already included in existing rates?**

A. No. As previously explained, all O&M expenses for which KU is seeking recovery are associated with new assets. Therefore, KU's existing rates do not include any O&M expenses for these facilities.

**Q. Will the installation of the new pollution control facilities replace or cause existing facilities to be retired?**

A. Yes. Project No. 19 includes a capital replacement of existing assets. During the construction of the project, as existing pipe is replaced, labor associated with the removal will be charged to Retirement Work in Process ("RWIP"). Upon completion of the project, the book value of the assets replaced will be removed from the Plant in Service account. Accumulated Depreciation and all associated RWIP charges will be removed from the Reserve for Accumulated Depreciation account and the monthly ECR filings will be adjusted to reflect the retirements. Similarly, Project 21 (FGDs) will result in the retirement of certain assets. However, the extent to which existing plant will be removed from service will not be determined in its entirety until the projects are actually under construction. As described above, when appropriate, KU will adjust the monthly ECR filings to reflect asset retirements in conformity with prior Commission Orders and consistent with KU's current practice.

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

**A** Yes it does.

## VERIFICATION

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

The undersigned, **Valerie L. Scott**, being duly sworn, deposes and says she is Director, Financial Planning and Accounting – Utility Operations for LG&E Energy Services Inc., that she 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 her information, knowledge and belief.

Valerie L. Scott

**VALERIE L. SCOTT**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 16th day of December, 2004.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

# APPENDIX A

**Valerie L. Scott**

Director, Financial Planning and Accounting – Utility Operations
LG&E Energy Services Inc.
220 West Main Street
Louisville, Kentucky 40202
(502) 627 – 3660

**Professional Memberships**

American Institute of Certified Public Accountants
Kentucky Society of Certified Public Accountants

**Education**

University of Louisville, Masters of Business Administration (with high distinction), 1994
University of Louisville, Bachelor of Science in Commerce with a major in Accounting (with high honors), 1978

**Previous Positions with LG&E Energy Corp.**

February 1999 - August 2002 – Director, Trading Controls & Energy Marketing Accounting
May 1998 - February 1999 – Manager, Trading Controls and Manager, Financial Planning, Reporting and Special Projects
July 1993 - May 1998 – Manager, Corporate Internal Auditing
October 1991 – July 1993 – Senior Staff Accountant