COMMONWEALTH OF KENTUCKY

BEFORE THE

PUBLIC SERVICE COMMISSION

MAR 0 2 2000

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR APPROVAL OF AN ALTERNATIVE METHOD OF REGULATION OF ITS RATES AND SERVICE	) CASE NO. 98-426
APPLICATION OF KENTUCKY UTILITIES COMPANY FOR APPROVAL OF AN ALTERNATIVE METHOD OF REGULATION OF ITS RATES AND SERVICE	) CASE NO. 98-474

DIRECT REHEARING TESTIMONY OF LANE KOLLEN

ON BEHALF OF THE

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

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DIRECT REHEARING TESTIMONY OF LANE KOLLEN

I. SUMMARY

Q. Please state your name and business address.

A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. Have you previously filed testimony in this proceeding?

A. Yes. I previously filed Direct Testimony, Additional Direct Testimony, Response to Amended Applications Testimony and Rebuttal Testimony regarding the Companies' revenue requirements and the Companies' proposed alternate method of regulation.

Q. What is the purpose of your Direct Rehearing Testimony?

A. The purpose of my Direct Rehearing Testimony is to address those issues the Commission has set for rehearing, specifically, certain issues related to the implementation of the ESM, the Companies' proposal to allow them to request modification of the class revenue allocations, the quantification of the post-test year adjustments to "annualize" off-system sales revenues and purchased power expenses, and certain issues related to the removal of the environmental surcharge ("ECR") ratemaking components from the base revenue requirement.

Q. Please summarize your Direct Rehearing Testimony.

A. The implementation of the ESM should be on a jurisdictional ratemaking basis, and as such, should reflect the Commission's prior and future Orders. This understanding should be reflected directly in the Companies' ESM tariffs. However, the Commission should articulate the principles that it will apply regarding the application of its prior and future Orders in order to minimize confusion and minimize the damage that may be inflicted upon ratepayers due to the Companies' ability to interpret the Commission's Orders in their implementation of the ESM. Accordingly, I address the principles that the Commission should articulate, the specific adjustments that KIUC believes should be reflected, and the adjustments that the Companies have proposed be reflected. I also address the Companies' proposed ESM tariffs.

I address the Companies' proposal to allow them to request modification of the class revenue allocations. I recommend that the Commission reject this proposal. The proposal is not defined, unnecessary, and not the result of the Commission's decisions regarding the base rate reductions or the offering of an ESM. To the contrary, the Commission already has decided the allocation of the base rate reduction on the basis of total revenues. Any revenue changes due to the operation of the ESM similarly should be allocated on the basis of total revenues.

The Companies' quantifications of off-system sales revenues and purchased power post-test year adjustments provided to the Commission through post-hearing discovery responses and relied upon by the Commission in its Orders, are improperly quantified based upon information currently available and may contain other errors that will need to be identified through discovery by the parties.

The Commission should not accept the Companies' proposals to modify the jurisdictional allocation factors utilized in the Commission's Orders for the removal of the ECR rate base and expense components. However, KIUC now agrees that the Commission's adjustment to remove ECR revenues, as adjusted in response to the Companies' Motion for Correction, should be utilized. Finally, the Companies' quantifications of the effects of the Motion for Correction are incorrect due to errors in the tax components of the quantifications. Thus, even if the Commission accepts each item for which the Companies seek "correction," the Commission should not rely upon the Companies' quantifications of these items.

II. ESM IMPLEMENTATION

Q. What issues has the Commission set for rehearing related to the ESM implementation now that the Companies have accepted the Commission's ESM?

A. The Commission has set two issues for rehearing. First, the Commission has determined that it is necessary "to further investigate which decisions need to be reflected in the ESM calculation and how that should be reflected in that calculation." Second, the Commission has determined that it is necessary to address the ESM tariffs that will be implemented by the Companies pursuant to the Commission's Orders.

Q. Do you agree that the effects of prior and future Commission Orders should be reflected in the ESM calculations of earnings and earned return on common equity?

A. Yes. However, that general agreement should not be misconstrued as agreement that the Companies be allowed the unfettered opportunity to implement their interpretations of the Commission's prior Orders. To the contrary, the Commission should articulate the principles or guidelines it will employ in order to minimize confusion and to minimize any negative ratepayer impacts.

Q. What principles should the Commission employ?

A. First, the Commission should employ the methodological framework from each Company's most recent Commission Order, which includes a computation of capitalization, rate base, overall rate of return, and operating income on a jurisdictional basis, and in the case of LG&E, on an electric only basis. It also should remove all

ECR ratemaking components in the same manner as the Commission determines is appropriate in its Orders on Rehearing in these proceedings.

Second, the Commission should remove all recurring costs which it has disallowed in prior Orders, including those costs related to the Companies' unregulated activities, charitable contributions, and advertising.

Third, the Commission either should remove, or defer and amortize, all abnormal and nonrecurring costs over a certain dollar threshold, perhaps $1 million, because these normally are treated in that manner in base ratemaking proceedings. For example, in this proceeding, the Commission effectively removed the Companies' share of the merger costs from test year operating income. In addition, the Commission required that Year 2000 compliance costs be deferred and amortized. Given this prior Commission treatment of these types of abnormal and nonrecurring costs, the Commission should require that all costs associated with the announced merger of PowerGen and LG&E Energy, or any other future merger-related costs, be removed from the ESM earnings and return computations for the 2000 historic and subsequent test years unless the Commission authorizes some form of ratemaking recovery of such costs in future merger Orders.

Fourth, the Commission should not allow any post-test year adjustments. The ESM will operate annually on a defined historic test year basis and will measure historic test year overearnings or underearnings for sharing purposes. The ESM will not operate on the basis of a future test year. Any post test year changes to the historic test year ratemaking components necessarily will be captured in the next historic test year ESM filing. If the Commission does not preclude post-test year adjustments from the ESM filings in one year. there is a risk that the Companies will not remove the actual expense from the next year's ESM filing. which could result in double recovery of certain costs. Thus, the Commission's adoption of specific post test year adjustments, such as the adjustments in this proceeding for off-system sales revenues and purchased power expenses, should not be reflected in the Companies' ESM filings.

Fifth, the Commission should identify the annualization adjustments that it will allow in the ESM filings, but should preclude any adjustments that have an undefined "future" impact on earnings rather than a "current" impact on earnings. For example. the Companies, in their Petition for Rehearing and in their proposed ESM tariff language, seek an open-ended opportunity to adjust "revenues, expenses or both, in part or total, to be collected or incurred thereafter differently than in the period." This request effectively seeks authorization for the Companies to "interpret" the Commission's prior and future Orders in any manner they see fit, including the introduction of any post-test year adjustments the Companies may devise. Although certain annualization adjustments based upon actual historic test year information may be allowed, no post-test year adjustments should be allowed for the reasons previously described.

Sixth, all refund amounts for prior years accrued during the current historic test year should be removed from revenues. For example, if the Companies accrue $10 million for a refund liability related to prior years, the Companies should not be able to "recapture" 60% of that refund obligation through the ESM.

Q. Do you agree with the Companies' request to annualize the March 1, 2000 base rate reduction?

A. Yes. Such an adjustment is necessary in order to avoid a "doubling up" of the effects of the rate reductions that already have been ordered by the Commission.

Q. Are there other revenue effects of the Commission's Orders in these proceedings that must be annualized, consistent with the annualization of the March 1, 2000 base rate reduction?

A. Yes. First, the Commission also should require that the Companies annualize the revenue effects of the EPBR by increasing revenues for the 2000 test year by the amount of the EPBR rate reductions. This adjustment for the EPBR rate reductions should include the bill reduction component of the EPBR unless the bill reduction revenue effect already is netted in the Companies' proposed annualization of the March 1, 2000 base rate reduction. The effect of this proforma adjustment would increase the Companies' revenues and thereby increase their earnings. For purposes of their ESM filings, it would be improper and inconsistent for the Companies not to remove the EPBR rate reductions while at the same time annualizing the base rate reductions.

Second, the Commission should require that the Companies annualize their FAC revenues for January and February 2000. The annualization for those two months should assume that the FAC revenues are equal to recoverable fuel and purchased power expenses plus the effects of any FAC disallowances. Such proforma adjustments are necessary in order to assure that the Companies and ratepayers are held harmless from any differences in the ratemaking effects of the EPBR versus the FAC for January and February 2000.

Third, the Commission should require the Companies to annualize their FAC revenues in March through December 2000 and subsequent historic test years in order to increase the FAC revenues for any disallowances through the FAC for costs that are not recoverable either through the FAC or in base rates, such as imprudence and certain other disallowances. Otherwise, the Companies will be able simply to shift the recovery forum for these disallowed costs and thereby circumvent the intended effects of the Commission's FAC Orders.

Q. Do you agree with the Companies' request to reflect the sharing of merger savings with shareholders?

A. Yes, I agree that an adjustment is appropriate on a conceptual basis. It would be appropriate to allow the Companies to include their retained share of merger savings as an increase to operating expenses in the manner allowed by the Commission in its Orders in these proceedings. However, the Companies have not articulated the methodology for quantifying such an adjustment in the calendar years covered by the ESM in their Petition for Rehearing. The Commission should consider the fact that the savings projections in Case No. 97-300 were not on a calendar year basis, but rather were stated on a series of 12 month periods commencing with the consummation of the merger. Thus, the adjustments to reflect their retained share of merger savings should be four months of one 12 month savings period and eight months of the next 12 month savings period. For example, the first 12 month savings period ran from May 1998 through April 1999. The second 12 month savings period runs from May 1999 through

April 2000. Accordingly, the adjustment for the 2000 historic test year should include 4 months of the second 12 month savings period and 8 months of the third 12 month savings period. The adjustment for the subsequent historic test years should follow a similar pattern.

In addition, the Commission may wish to make clear that the Companies are not allowed to increase their common equity capitalization by the unamortized shareholder portion of the costs to achieve merger savings, an issue that already has been decided by the Commission it its Orders in these proceedings.

Q. Do you agree with the Companies' request to adjust revenues in order to remove the effects of ESM over or under recoveries?

A. No, because the Companies did not describe in their Petition for Rehearing the rationale or the computational basis underlying the claimed "need to adjust revenues . . . to reflect any over- or under- earnings." The Companies have included a BA term in their proposed ESM tariffs, which they define as "the Balancing Adjustment which reconciles any over- or under-collection of the RA from the prior adjustment year." The Companies will or should employ deferral accounting for ESM over- or under-revenue collections, similar to the deferred fuel accounting they employed in the past, and presumably will employ in the future, for the FAC over- or under-collections. Thus, if the Companies' proposal is related to ESM over- or under-revenue collections, there is no need for the Companies to "adjust revenues" because of their ability to utilize deferral accounting. However, if the Companies meant to refer to the "revenue adjustment," included as the RA term in their proposed ESM tariffs, then I agree that the effects of the ESM on the revenues should be removed from each historic test year. If the ESM results in a rate reduction, then the Companies should be required to remove that effect through a proforma adjustment to increase revenues. Without such an adjustment, the effects of the earnings in one historic test year improperly would be compounded into subsequent historic test years.

Q. To the extent that the Companies are authorized to make adjustments to historic test year revenues and expenses, should the Commission also ensure that the appropriate related tax expense adjustments are made?

A. Yes. The Commission should ensure that all related income tax and other tax effects are reflected through proforma adjustments.

Q. Have you reviewed the Companies' proposed ESM tariffs?

A. Yes. I have reviewed the Companies' proposed ESM tariffs. My comments, including my recommendations, follow the format of the Companies' proposed tariffs.

<u>APPLICABLE</u>

1. The Company's proposed tariff language nowhere limits the application of the tariff for the "three year term with the earnings sharing reflected on bills rendered from 2001 through 2003" that was specified in the Commission's Order. The tariff language should reflect the limited time period specified in the Commission's Order.

AVAILABILITY OF SERVICE

2. The Commission's Order did not exclude the Curtailable Service Rider and Flood Wall Pumping. The Companies should be required to explain why such exclusions are appropriate.

RATE

3. The Commission's Order did not define the ER term in the manner proposed by the Companies. ER should be defined as the "actual" Kentucky retail jurisdictional sales revenue for the Current Reporting Period, not the "estimated" Kentucky retail jurisdictional sales revenue for the Current Adjustment Year. The use of actual data eliminates the necessity to develop forecasts for the purpose of this adjustment and is consistent with the use of actual total revenues for the ECR mechanism.

4. In addition, ER should be defined to be consistent with the definition of revenues utilized in the first paragraph of this section of the tariff, specifically, all Kentucky jurisdictional revenues, including the FAC, the ECR, and the Merger Surcredit Rider; and to be consistent with the exclusion of the Curtailable Service Rider and Flood Wall Pumping under the Availability of Service section of the tariff, if the Commission does not modify this exclusion provision. It is necessary to have a consistent definition between the revenues utilized to compute the ESMF and the revenues to which the ESMF will be applied.

TERMS AND CONDITIONS

5. There is no comprehensive statement that the Earnings Sharing Mechanism will be computed on a Kentucky jurisdictional basis. Although the Commission's Orders do not specifically state that it should be, there are numerous references in the Commission's Orders to specific components that should be computed on a Kentucky jurisdictional basis. A comprehensive statement should be included as paragraph 1(a) and the Company's proposed paragraphs 1(a) through 1(c) be shifted to 1(b) through 1(d).

6. Paragraph 1(a) of the Companies' proposed tariffs does not comply with the Commission's Orders. The Companies' proposed language states that "The Earnings Sharing Mechanism will (a) exclude all Kentucky jurisdictional revenues and expenses associated with the Kentucky Retail Fuel Adjustment Clause and the Environmental Surcharge." However, the Commission's Order states that "All revenues and expenses associated with the FAC and the environmental surcharge will be excluded in determining the return on equity." The difference is that the FAC and ECR revenues and expenses are not excluded from the ESM as a general principle, but rather are specifically excluded in the computation of the Company's jurisdictional earned return on common equity.

7. Paragraph 1(a) of the Companies' proposed tariffs should be modified further to refer to rate base or capitalization in addition to the reference to revenues and expenses associated with the FAC and ECR. Although the Commission's Orders do not state that the ECR rate base or capitalization should be excluded

from the computation of the return on common equity. it is clear that this was the Commission's intent based upon the derivation of the base revenue requirement in its Orders and the exclusion of the ECR revenues, expenses, **<u>and capitalization</u>**. from the base revenue requirements.

8. Paragraph 2(a) of this section of the Companies' proposed tariffs represents a material and inappropriate modification to the language contained in the Commission's Order. The Companies' proposed tariffs state "These calculations will recognize current and future orders of the Commission that cause revenues. expenses or both, in part or in total. to be collected or incurred differently than in the Current Reporting Period." I agree that the Companies' calculations should recognize the Commission's decisions in prior Orders. the Orders in these proceedings. and future Orders. to the extent the Commission's prior Orders are modified regarding the base revenue requirement. However. the language in the Companies' proposed tariffs would provide the Companies unfettered opportunity to develop and incorporate proforma adjustments based upon their interpretations and quantifications of the effects of post test year changes or annualizations/normalizations of historic test year revenues and expenses. Essentially, the Companies' proposed language would shift the ratemaking decision process from the Commission to the Companies. Such a result would not be acceptable.

I recommend that the cited language in the Companies' proposed tariffs be modified to read simply: "These calculations will recognize current and future orders of the Commission." In addition. the Commission may wish to insert the following phrase: "All proforma adjustments made or which were not made by the Company to the per books amounts shall be subject to the Commission's annual review, with the net effect of the Commission's review and determination of the correct amounts to be reflected in the subsequent true-up through the BA factor."

9. Paragraph 2(a) of the Companies' proposed tariffs states that "Revenues will be adjusted for off-system sales . . . " This language does not comport with the Commission's Orders, which state that "Revenues will be adjusted to include revenues from off-system sales." The Commission's Orders clearly instruct the Companies "**to include**" revenues from off-system sales. The Companies' proposed language is unnecessarily and improperly ambiguous as to how the adjustment should be reflected.

III. CLASS REVENUE ALLOCATIONS

Q. Please describe the Companies' request to modify the Commission's Orders in order to allow them the flexibility to present proposals "that would justify adjustments to the rate-of return for each class."

A. The Companies have requested that the Commission modify its Orders in these cases in order to present such proposals "either in connection with an annual review of the operation of the earnings sharing mechanism or an unbundling study." The Companies have not stated any specific proposal as to how the Commission's Orders should be modified.

Q. Do you agree that the Commission should modify its Orders?

A. No. First, the Companies have made no specific proposal. The issues of cost of service and tariff design, other than the base rate reduction, the ESM, and the EPBR, were not raised by any party in these proceedings. The Commission should not provide any explicit authority for the Companies to propose such changes either in connection with its ESM filings or in connection with its unbundling report or any related proceedings. The requested explicit authority in conjunction with those filings is unnecessary and inappropriate given the Commission's decision to allocate the base revenue reductions on total revenues and given that the purpose for filing the rate unbundling report is "for informational purposes and a suggested methodology to accurately determine the generation, transmission, and distribution components of its rates," the latter description provided by the Commission in its February 17, 2000

Order on Rehearing. Clearly, the issue of rate rebalancing did not originate with the Commission's Orders in these proceedings.

Second, the Companies' requests for explicit authority to propose changes to class revenue allocations apparently applies to all revenues, not just ESM rate changes. If the Commission provides such explicit authority, it virtually will ensure that the Companies will append rate rebalancing requests to one or more of their ESM filings or their unbundling report filings. It is unlikely that the Companies would have requested such explicit authority if they had no intention of exercising it. The Commission should consider whether it wants either the ESM filings or the unbundling report filings, and any related proceedings, burdened by rate rebalancing issues.

IV. QUANTIFICATION OF CERTAIN POST YEAR ADJUSTMENTS

Q. The Commission's Orders relied upon purchased power costs provided by the Companies in response to post-hearing discovery for the twelve months ending August 31, 1999 rather than for the actual 1998 historic test year. Were the amounts provided to the Commission appropriate for purposes of quantifying the effect on the Companies' base revenue requirement?

A. No. The Companies simply utilized their gross cost of must take energy purchases, less amounts resold into the spot market, according to their response to Hearing Question Staff-15. The parties have not had an opportunity through discovery or otherwise to obtain the support for this quantification. Nevertheless, there appear to be certain conceptual and computational problems with the Companies' quantifications.

First, if the Companies' response to Hearing Staff-15 is to be utilized for a post-test year purchased power adjustment, then there also should be a post-test year adjustment to increase fuel adjustment clause revenues by the amount of the energy charges that would have been recovered by each Company through the fuel adjustment clause. The purpose of these cases is to establish the proper base revenue requirement on a going forward basis. If the Companies are allowed to recover any "must take" energy purchased power costs through the FAC in the future, then there will be a double recovery of such costs – once through base rates and again through the FAC. This is a very real issue. It has been KU's historic practice to claim that virtually all of its purchased power is made on an "economic dispatch basis" and thus fully recoverable through the FAC.[1]

Second, the Companies changed their approach to the quantification of a post-test year purchased power adjustment in Hearing Staff-15 compared to Response Exhibit LEB-1. The Companies initially proposed an "annualization" adjustment based upon 1998 actual purchased power <u>demand</u> and a projection of 2000 purchased power <u>demand</u> call option prices as detailed on Response Exhibit LEB-1. At hearing, the Staff requested that Response Exhibit LEB-1 be updated "in the same format" for actual purchases through August 1999.

> "Q. *Okay. Mr. Bellar, there's a couple of items of data we would like you to provide. In reference to your Response Exhibit LEB-1, which shows the derivation of your adjustment to purchased power expense, . . .*
>
> A. *Yes, sir.*
>
> Q. *. . . do you see that?*
>
> A. *The top section of that Exhibit shows 1998 actual purchases for native load. Can you provide, <u>in the same format</u>, the companies' 1999 actual purchases for native load for the months of January through August?*
>
> A. *Yes, we can do that."* TE Vol. V, p. 297 (emphasis added).

The Companies responded by replicating the 1998 actual purchases that had been originally provided on Response Exhibit LEB-1. However, the Companies changed their approach to quantifying the post-test year adjustment. No longer was the quantification an "annualization" adjustment that utilized the 1998 actual purchased power <u>demand</u> in conjunction with the actual 1999 demand call option prices. Rather,

[1] The Commission has previously recognized the importance of ensuring that only appropriate purchased power costs are recovered through the FAC. In its July 15, 1999 Order in Case No. 96-523, the Commission stated: "*In the absence of a clear definition of economic dispatch and in light of the Commission's past acceptance of KU's treatment of energy purchases from OMU, the Commission finds insufficient evidence to conclude that KU improperly accounted for its purchases from OMU. We find, however, that a strong need exists for a clear definition of economic dispatch and for specific standards regarding the reporting of purported economic dispatch transactions. Accordingly, the Commission will within 20 days of this Order establish a proceeding to address the issue with a view to establishing such definition and standards.*" (Order at 26).

the Companies jettisoned the entire concept of an annualization adjustment and then substituted another definition of purchased power costs for native load based upon must take energy purchased power. The Companies' response to Hearing Staff-15 was not an update of LEB-1 "in the same format." It relied on a new methodology. This new methodology should be rejected.

Third, the Companies' change in approach is an attempt to shift costs from the Companies to their ratepayers in contravention of the terms of the EPBR, which was implemented on July 2, 1999. Through the FCR component of the EPBR, the Companies accepted the risk of increased energy costs, including all or part of purchased power energy costs to the extent those costs previously were recovered through the FAC. Yet, the Companies now propose to recover, as an increase to the base revenue requirement, EPBR costs that were their responsibility, not the responsibility of their ratepayers.

Fourth, the Companies apparently have segregated their purchased power costs into three categories. The first category is the must take energy costs reflected in their proposed purchased power adjustments. The second category is the "purchases" offset against off-system sales revenues in order to quantify their proposed off-system sales revenues adjustments. The third category is the purchases reflected in their brokered sales margins, which the Companies consider to be unregulated. Absent detailed discovery regarding these allocations of purchased power costs to the three categories utilized by the Companies, the Companies may be double counting certain purchased power costs or otherwise structuring the allocations of these costs in order to maximize their base revenue requirements. This problem becomes even more acute once the

ESM starts. For example, if the Companies desired to deflate the earnings subject to ESM sharing, they could allocate the lowest cost purchased power to brokered transactions since these are considered by the Companies to be unregulated.

Finally, to the extent that the Companies' purchased power requirements were higher during the twelve months ending August 1999 due to higher sales to native load ratepayers, then the increased revenues from those sales to native load ratepayers should be utilized to reduce the post-test year purchased power adjustment. The Company has assumed that it received no revenue from increased native load sales. That assumption appears to be false. Thus, such an adjustment is necessary in order to avoid double recovery of a cost from ratepayers that has been recovered already, at least in part, through increased sales revenues from those same ratepayers.

Q. Is your review of the Company's purchased power adjustment quantified in response to Hearing Staff-15 complete?

A. No. There may be other problems with the Companies' quantifications. It will be necessary to obtain additional information from the Companies through discovery once they file their Direct Rehearing Testimony.

Q. The Commission's Orders relied upon off-system sales revenues provided by the Companies in response to post-hearing discovery for the twelve months ending August 31, 1999 rather than for the actual 1998 historic test year. Were the amounts provided to the Commission appropriate for purposes of quantifying the effect on the Companies' base revenue requirement?

A. No. First, it is important to realize that these proposed post-test year adjustments to off-system sales revenues, as well as the post-test year adjustments to purchased power expenses, require the unwinding of the EPBR that was in effect from July 2, 1999 through August 31, 1999 and the substitution for the FAC that was in effect prior to July 1, 1999 and that will be in effect again effective March 1, 2000. Thus, it is essential to determine to what extent, if any, the fuel and other energy costs (apparently, including "purchases") either would have been recovered through the FAC had it been in effect during July and August 1999 or was the responsibility of the Companies during those two months. Only in this manner will all sides of the "matching" equation properly be reflected in the base revenue requirement.

Given the matching requirement and the need to unwind the EPBR and replace it with the FAC, it is necessary to determine the appropriate level of purchased "energy" costs that would have been recovered through the Companies' respective FACs and the appropriate level of "fuel" costs associated with the off-system sales that would have been credited to ratepayers through the FACs. The parties in this proceeding, other than the Companies, currently cannot make these determinations based upon the lack of underlying computational support to the Companies' response to Hearing Staff-16. Thus, KIUC reserves the right to address these "matching" issues in Response Testimony once it has had the opportunity to issue and review responses to discovery.

Second, as described previously in the discussion regarding the Companies' proposed purchased adjustments, it is not clear how the Companies categorized their purchased power expenses between the purchased power expense for purposes of 1) their proposed post-test year purchased power adjustments, 2) the purchased power offsets to their proposed off-system sales revenues adjustments, or 3) the purchased power offsets to their brokered sales revenues. Thus, KIUC also reserves the right to address these issues in Response Testimony once it has had the opportunity to issue and review responses to discovery.

Third, it is not clear how the Companies quantified the fuel, scrubber consumables, and "purchases" reflected on their response to Hearing Staff-16 page 2 of 2. It isn't even clear that the Companies have utilized the same definition or costs for this line item as it utilized for a similar line item on Response Exhibit LEB-2 because the Companies changed the term "energy" to the term "purchases." For example, the Companies now may have included demand purchased power costs in this line item. KIUC reserves the right to address these issues in Response Testimony once it has had the opportunity to issue discovery and review the Companies' responses.

Fourth, it is not clear why there is any margin adjustment for the test energy reflected in the Companies' response to Hearing Staff-16. To the extent that any of the test generation was recovered through the FAC, or any of the test generation increased the FCR component of the EPBR and offset any EPBR rate reductions, then ratepayers should not be required to pay again through a reduction to the off-system sales revenues recognized in the Companies' quantifications of these post test year adjustments. Although KIUC will explore this issue through discovery, the parties have had no previous opportunity to investigate this issue.

Fifth, the Companies appear to have failed to account for any "lost margins" due to electricity usage during construction of the Brown 6 and 7 units. Such "lost margins" would have increased the off-system sales post-test year annualization adjustment.

Finally, to the extent that off-system sales revenues were less due to increased native load requirements and revenues, then the Commission either should reflect proforma adjustments to increase revenues for the net increase in revenues from sales to native load ratepayers or reduce the purchased power post-test year adjustments in the manner that I described previously. Absent such adjustments, the Companies will be allowed to recover as a cost the post-test year reductions in margins on off-system sales while at the same time retaining the increased margins on native load sales.

V. REMOVAL OF ECR RATEMAKING COMPONENTS

Q. Did the Commission's Order utilize the proper jurisdictional allocation factors in order to remove the ECR investment and operating expenses from the base ratemaking components?

A. Yes. Contrary to the assertions of the Companies in their Motion for Correction dated January 20, 2000, the Commission did not err in the selection of the jurisdictional allocation factors for the ECR capitalization and operating expense components of the ECR revenue requirement as detailed in Appendix B to the Commission's Order. The Company has alleged that the average of the ECR jurisdictional allocation factors during the test year should be applied to all ECR revenue requirement components, other than ECR revenues.

The Company's claim should be rejected for at least two reasons. First, the purpose of removing the ECR revenue requirement components is to disaggregate the aggregate amounts included by the Companies in their revenue requirement computations and supporting cost of service study (KU only) relied upon by the Commission, the Companies, and all other parties. No party disputed the allocation factors developed by KU in its cost of service study filed with the Commission in response to KIUC-3-38 and utilized by all parties or the 100% jurisdictional allocation factors utilized by LG&E. Thus, when the ECR rate base, capitalization, and operating expenses are removed from the aggregate (base plus ECR) jurisdictional amounts, the removal necessarily must be on the same jurisdictional basis as those amounts initially were included.

Second, the Companies' approach effectively would nullify the Commission's decisions in Case Nos. 95-060 and 94-332 to jurisdictionally allocate the ECR revenue requirements on the basis of total revenues. The nullification would occur because the ECR revenue requirements allocated to other jurisdictions (including off-system sales) then would be partially recovered through the Kentucky retail base revenue requirement. If the ECR revenue requirement components are not removed at the same jurisdictional level at which they are included in the aggregate (base plus ECR) revenue requirement, but rather at the lower ECR jurisdictional allocation factors proposed by the Company, then the difference in the two jurisdictional allocation approaches will be retained as a higher Kentucky retail base revenue requirement. Thus, there would be an incremental ECR revenue requirement improperly recovered through the base revenue requirement. Such a result should be rejected because it clearly is contradictory to the Commission's ECR jurisdictional allocation methodology.

The Commission should not be misled by the Companies' improper attempt to enhance their base revenue requirements and to circumvent the clearly stated intent of the Commission in the ECR proceedings to require off-system sales and other jurisdictional sales to bear a portion of the Companies' environmental costs.

Q. Did the Commission err in the quantification of the ECR revenues removed from the base revenues?

A. No, except for the jurisdictional allocation factor, which now has been corrected by the Commission. I have reconsidered this issue and now agree that the Commission properly quantified the ECR revenues removed from the base revenues for the test year.

Q. Do you have any further comments regarding KU's Appendix A Schedule KU-6?

A. Yes. KU has incorrectly computed the income tax effects of the Commission's alleged errors in its Appendix A Schedule KU-6. First, the Company did not correctly compute line 3 on this schedule under the "PSC Order" column. The amount should be positive $1,885,622, computed by multiplying the amount on the "Total Operating Income Adjustments" line times the 40.3625% federal and state income tax rate times negative 1. The Company incorrectly utilized the income tax adjustment stated on page 89 of the Commission's Order, which was computed based on ALL adjustments to operating income, not just the ECR adjustments. Although the Company made this error, it did not have an effect on the Company's quantification of the Commission's alleged errors because the Company ignored this amount in its derivation of the amount on that line in the "Correction to PSC Order" column.

Second, the Company did not correctly compute line 4 on this schedule under the "PSC Order" column. The amount should be negative $3.465 million, computed by multiplying the Commission's ECR capitalization adjustment (before jurisdictional allocation) of $148.370 million times the 5.85% ECR interest rate times the 40.6325 federal and state income tax rate time negative 1. The Company incorrectly utilized the income tax interest synchronization adjustment stated on page 88 of the Commission's

Order, which was computed based on ALL adjustments to the debt component of capitalization, not just the ECR adjustments.

~~The Company's second error on Schedule KU-6 improperly increased the quantification of the Commission's alleged errors by $0.687 million, computed as the difference in the income tax effect of interest synchronization between the correct $3.465 million and the Company's negative $3.056 million grossed up by the .595381 gross up factor to a revenue requirement.~~

Q. Do you have any further comments regarding LG&E's Appendix A Schedule LG&E-7?

A. Yes. Similar to KU, LG&E has incorrectly computed the income tax effects of the Commission's alleged errors in its Appendix A Schedule LG&E-7. First, the Company did not correctly compute line 3 on this schedule under the "PSC Order" column. The amount should be positive $1.272 computed by multiplying the amount on the "Total Operating Income Adjustments" line times the 40.3625% federal and state income tax rate times negative 1. The Company incorrectly utilized the income tax adjustment stated on page 90 of the Commission's Order, which was computed based on ALL adjustments to operating income, not just the ECR adjustments. Although the Company made this error, it did not have an effect on the Company's quantification of the Commission's alleged errors because the Company ignored this amount in its derivation of the amount on that line in the "Correction to PSC Order" column.

Second, the Company did not correctly compute line 4 on this schedule under the "PSC Order" column. The amount should be negative $0.221 million, computed by multiplying the Commission's ECR capitalization adjustment (assuming 100% jurisdictional allocation) of $9.719 million times the 5.60% ECR interest rate times the 40.6325 federal and state income tax rate time negative 1. The Company incorrectly utilized the income tax interest synchronization adjustment stated on page 90 of the Commission's Order. which was computed based on ALL adjustments to the debt component of capitalization. not just the ECR adjustments.

Q. Does this complete your Direct Rehearing Testimony?

A. Yes.