Lane Kollen

COMMONWEALTH OF KENTUCKY

BEFORE THE

PUBLIC SERVICE COMMISSION

IN THE MATTER OF: APPLICATION OF KENTUCKY UTILITIES COMPANY FOR APPROVAL OF AN ALTERNATIVE METHOD OF REGULATION OF ITS RATES AND SERVICE	:	CASE NO. 98-474
and	:	
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. Complainant	:	CASE NO. 99-083
v.	:	
KENTUCKY UTILITIES COMPANY	:	
Defendant	:	

REBUTTAL TESTIMONY

AND EXHIBITS

OF

LANE KOLLEN

ON BEHALF OF THE

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

J. KENNEDY AND ASSOCIATES, INC.
ATLANTA, GEORGIA

AUGUST 1999

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REBUTTAL 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"), 35 Glenlake Parkway, Suite 475, Atlanta, Georgia 30328.

Q. Have you previously filed testimony in this proceeding?

A. Yes. I previously filed Direct Testimony and Additional Direct Testimony addressing the level of base rate reduction necessary to ensure that the Company's rates are fair, just, and reasonable.

Q. What is the purpose of your Rebuttal Testimony?

A. The purpose of my Rebuttal Testimony is to update the quantifications of the Company's test year revenue requirement and to respond to the Response Testimony of the Company's witnesses.

Q. Please summarize your testimony.

A. <u>**Summary of Base Revenue Reduction**</u>

I recommend a base rate reduction of $55,807 ~~$55.5~~84 million in order to set the Company's base rates at fair, just, and reasonable levels. The base rate reduction is necessary and appropriate regardless of whether the Commission adopts an alternative rate plan. The quantification of this base rate reduction is detailed on my Rebuttal Exhibit___(LK-1), which follows the same format as Exhibit___(LK-1) to my Additional Direct Testimony.

Areas of Agreement with the Company

There are numerous areas of agreement between the KIUC and the Company. First, both have utilized calendar year 1998 for the test year, although the Company has proposed certain post test year adjustments with which I disagree. Second, both agree that methodologically the base revenue requirement should be determined without segregating the base, fuel, and environmental surcharge ("ECR") revenues and costs, although the Company disagrees with the KIUC proposal to roll-in the ECR to base rates and KIUC disagrees with certain adjustments proposed by the Company between base rates, fuel, and the ECR. Third, both agree that off-system sales revenues (non-all requirements) and transmission services revenues should be proportionately allocated to the Kentucky retail jurisdiction. Fourth, both agree that common equity should be adjusted to remove nonutility investments. Fifth, both agree that the Company's retained share of merger savings, as projected in the Case No. 97-300 merger proceeding, should be added to operating expenses.

Sixth, both agree that the one-time ECR refund should be added to revenues. Seventh, both agree that the Year 2000 compliance costs should be deferred and amortized to expense, although the Company proposes a three year amortization and KIUC proposes a five year amortization. Eighth, both agree that the liquidation of the Risk Management Trust should be deferred and amortized over five years. Ninth, both agree that advertising expenses should be removed. Tenth, both conceptually agree that depreciation expense should be annualized based upon year end plant, although KIUC does not agree with the Company's quantification.

Eleventh, both agree that revenues should be adjusted to reflect year end volumes of business, although KIUC and the Company differ on the quantification of the offsetting expense. Twelfth, both agree that there should be an adjustment to reflect the Commission's decision regarding off-system sales line losses, but not the FAC disallowance regarding the computation of jurisdictional sales.

The following table summarizes the KIUC and Company's revenue requirement quantifications for those issues where there is agreement regarding the need for an adjustment, but where there is disagreement regarding the quantification.

AREAS OF AGREEMENT
REGARDING ISSUES
REVENUE REQUIREMENT EFFECT
($Million)

Issue	KIUC Rev Req	KU Rev Req	Differ Rev Req
1. Net retained Share of Merger Savings	$6.973	$11.065	($4.092)
2. Year 2000 Compliance Costs Deferral and Amortization	(0.768)	(0.640)	(0.128)
3. Annualization of Depreciation Expense	0	0.854	(0.854)
4. Year-End Customers Annualization of Revenues	(4.216)	(2.608)	(1.608)
5. FAC Off-System Sales Line Losses	1.845	1.845	-
6. One-Time Refunds Incl ECR	(22.157)	(22.157)	-
7. Risk Management Trust Deferral & Amort	1.482	1.482	-
8. Advertising Expenses	(1.662)	(1.662)	-
Net Revenue Requirement Effect	$18.503	$11.821	($6.682)

Areas of Disagreement with the Company

There also remain numerous areas of disagreement between KIUC and the Company. First, KIUC recommends a return on equity of 9.70% compared to the Company's use of 12.5% as a threshold test of whether current rates are fair, just, and reasonable. Second, KIUC rejects the Company's projections for increased purchased power expense and reductions in off-system sales revenues projected for the year 2000 compared to the test year 1998. Third, KIUC does not agree with the Company's utilization of a temporary EPBR rate reduction ($20 million for both Companies in the first year of the Companies' Amended Plan) as a reduction to the determination of the permanent level of base revenues. The Company's approach is methodologically, procedurally, and quantitatively deficient. Fourth, KIUC does not agree that the effects of a hypothetical implementation of the EPBR should be reflected in the test year as a base rate revenue requirement. Fifth, KIUC rejects the adjustment to increase common equity on a selective basis for the merger costs writeoff.

Sixth, KIUC does not agree with either of the Company's adjustments for merger dispatch or OATT transmission cost. Seventh, KIUC does not agree with the Company's proposed adjustment for an annual ECR revenue reduction. Eighth, KIUC does not agree with the Company's selective proposed adjustment for TIA in the absence of other post-test year adjustments that would benefit ratepayers. Ninth, KIUC does not agree with the Company's proposal to weather normalize revenues. Tenth, KIUC does not agree with the Company's proposal to reflect projected post-test year labor cost increases.

The following table summarizes the issues where KIUC and the Company disagree.

AREAS OF DISAGREEMENT
REGARDING ISSUES
REVENUE REQUIREMENT EFFECT
($Million)

Issue	KIUC Rev Req	KU Rev Req	Differ Rev Req
1. Return on Equity	(1)	(1)	(1)
2. Post-Test Year Purchased Power Exp	0	$5.187	($5.187)
3. Post-Test Year Off-System Sales	0	10.717	(10.717)
4. EPBR Temporary Rate Reduction	0	10.600	(10.600)
5. Hypothetical 1998 EPBR Implementation	0	3.886	(3.886)
6. "Normal" Weather Revenues	0	(2.802)	2.802
7. Team Incentive Award	0	3.140	(3.140)
8. Labor and Labor-Related Expenses	0	1.371	(1.371)
9. Merger Dispatch and OATT	0	0.692	(0.692)
10. Annual ECR Revenues	0	5.000	(5.000)
Net Revenue Requirement Effect	$ 0	$37.791	($37.791)

(1) Company did not compute revenue requirement utilizing Rosenberg return.

II. AREAS OF DISAGREEMENT WITH THE COMPANY

Summary of Areas of Disagreement with the Company

Q. Please identify the proforma adjustments proposed by the Company with which you do not agree.

A. KIUC does not agree with the Company that the test year returns on common equity, either adjusted or unadjusted, are reasonable or that they demonstrate that existing rates are fair, just, and reasonable. KIUC does not agree that the 12.50% return on equity is a reasonable rate of return, as addressed by KIUC witness Mr. Baudino. In addition, KIUC does not agree with the following proforma adjustments proposed by the Company in its Rebuttal filing.

1. Increase to purchased power expense to reflect projected year 2000 market prices coupled with 1998 demand levels.

2. Reduction to off-system sales revenues to reflect projected year 2000 market prices coupled with projected year 2000 sales levels.

3. Reduction to revenues to reflect temporary EPBR rate reduction.

4. Reduction to revenues to reflect hypothetical implementation of EPBR tariff in 1998.

5. Increase to revenues to reflect "normal" weather.

6. Increase to O&M to reflect expansion of Team Incentive Award program.

7. Increase to O&M expense for labor and labor-related costs.

8. Increase to O&M expense for merger dispatch and OATT.

9. Reduction to annual ECR revenues.

<u>**Return on Common Equity**</u>

Q. Have you quantified the revenue requirement effect of the return on equity recommended by Mr. Baudino?

A. Yes. I have utilized the cost of common equity recommended by Mr. Baudino, in conjunction with the Company's jurisdictional regulated electric utility capitalization, in order to determine the return on capitalization component of the Company's revenue requirement. Each 1.0% change in the return on common equity affects the revenue requirement by $8.764 million. The effects of Mr. Baudino's return on equity are reflected in the base revenue computations detailed on my Rebuttal Exhibit__(LK-1).

<u>Post-Test Year Projected Purchased Power Expense</u>

Q. Please describe the Company's most recent proposed adjustment to test year actual purchased power expense.

A. The most recent version of the Company's proposed adjustment to test year purchased power expense is described in the Rebuttal Testimony of Company witness Mr. Bellar, who in turn relied upon future market price projections developed by Company witness Mr. Gallus. The Company has utilized forward market price projections for the year 2000 applied to 1998 actual demands in order to determine the "adjusted" test year purchased power expense. It did not reprice energy, as opposed to demand, purchases from the 1998 actuals.

Q. Has the Company changed its methodology for purposes of its Rebuttal filing compared to its response to PSC-4-KU-7, its listing of proforma adjustments provided to the Commission prior to the filing of Rebuttal Testimony?

A. Yes. In the most recent version of this proforma adjustment, the Company has changed the forward market price projection from 1999 to 2000. This adjustment has been a moving target.

Q. Are the forward market price projections for the year 2000 known and measurable?

A. No. The Company's forward market price projections are uncertain and speculative and should not be utilized by the Commission in order to compute a proforma adjustment to test year purchased power expense. In response to KIUC discovery (KIUC-4-LG&E-29), the Company described the sources for the forward market prices as the "Power Markets Weekly" publication and the Company's internal data base. Both sources are based upon telephone surveys. According to that same discovery response, no source documentation or computations exist for the Company's internal data base. Thus, these forward price projections are unverifiable.

In addition, the forward market price projections are extremely volatile as demonstrated on Mr. Gallus' Exhibit MG-1 and by the survey data underlying that exhibit provided by the Company in response to KIUC-4-LG&E-29. Electricity is one of the most volatile commodities traded on the futures exchanges. Forward market prices for a defined future period depend heavily upon perceptions of sellers and purchasers on any particular day, and change violently within any particular day, similar to futures prices for hog bellies, coffee, and other commodities. For example, during 1998, the summer 1999 forward market prices ranged from as low as $35 per mWh to as high as $160 per mWh, according to Exhibit MG-1. As a result of this volatility, the forward market price utilized depends upon what day and what time of day the price surveys were performed. Clearly, volatile forward market price projections are not an appropriate basis for quantifying test year purchased power costs.

Finally, in response to discovery (KIUC-4-LG&E-56), the Company confirmed that it actually has not entered into any contracts for summer 2000 purchases. Consequently, there are no actual LG&E/KU call option contracts; there are no actual LG&E/KU forward market prices; and there are no actual volumes. Thus, this adjustment cannot possibly be considered known and measurable.

Q. How do the forward market prices utilized for the Company's proposed purchased power adjustment compare to the forward market prices utilized for the Company's proposed off-system sales proforma adjustment?

A. Fundamentally, the market price projections utilized by the Company are different. For purchased power, the Company utilized survey prices for daily call options for July and August with several different strike prices. According to the Company's response to discovery (KIUC-4-LG&E-41), the market prices used for the purchased power adjustment are survey prices "for capacity purchased in advance for native load use." By contrast, for its off-system sales proforma adjustment, the Company utilized survey prices for "must-take on-peak firm energy on a monthly basis."

Q. Are there other conceptual and quantification problems with the Company's proposed purchased power proforma adjustment?

A. Yes. The Company failed to incorporate the effects of additional peaking capacity that it installed in 1999. In 1998, the Companies purchased an average of 252 mW on peak during the June through August summer peaking months. In 1999, the Companies installed 328 mW of new CT peaking capacity (Brown 6 and 7), according to the Company's response to KIUC-4-LG&E-48. This new CT capacity will more than meet the 1998 purchased demand levels. In addition, according to the same discovery response, the all-in running cost per mWh for the new peaking capacity is projected by the Company to be $25.31, or less than the year 1999 and 2000 forward market prices for purchases projected by the Companies. Thus, it would be reasonable to conclude that the Company will operate its own peaking units for the benefit of its native load ratepayers rather than purchasing power at the Company's projected forward prices.

To the extent that the Company's native peak load grows from 1998 to 2000, the Company will have a need to either construct additional capacity or purchase additional capacity. However, if that additional native load is considered in conjunction with the assessment of this proposed purchased post-test year power adjustment, then the Commission also should consider the additional base revenues the Company will receive as an additional post-test year proforma adjustment.

Q. What effect does the Company's failure to incorporate the new peaking capacity have on the Company's purchased power proforma adjustment?

A. First, the new peaking capacity eliminates the Company's proforma adjustment. Second, if the Commission adopts any post-test year adjustment to purchased power expense, then it should make a proforma adjustment in the opposite direction from the Company's. If any proforma adjustment is made it should be to eliminate the demand component from the test year 1998 actual purchase power expense. The correct proforma adjustment would be to reduce purchased power expense by $0.925 million for KU ($1.088 million times 85% Kentucky jurisdictional allocation factor) and by $0.533 million for LG&E. These amounts were derived from the Company's Exhibit LEB-1.

If the Commission accepts the Company's post-test year purchased power adjustment based upon year 2000 forward market prices, then it also should quantify the additional post-test year base revenues that the Company will receive due to increases in native load sales.

Q. Do you have any further comments regarding the Company's proposed purchased power adjustment?

A. Yes. First, this adjustment is methodologically inconsistent with the Company's proposed off-system sales adjustment. For the purchased power adjustment, the

Company utilized actual 1998 test year demand volumes. However, for the off-system sales adjustment, the Company ran its "planning model" in order to estimate the year 2000 sales volume. This methodological inconsistency is not merely accidental. It was intentional and the intended effect was to create a higher revenue requirement on a highly selective basis.

Second, the Company's proposed purchased power proforma adjustment utterly fails the matching principle underlying cost based regulation. This mismatch will occur between the post-test year levels of base revenues that will be recovered (in perpetuity unless and until there is another base rate proceeding) and the levels of fuel and purchased power that will be incurred. Adoption of the Company's adjustment will result in base revenue recovery of fuel and purchased power expenses that will not be incurred in the year 2000. If the Company operates its new peaking capacity in lieu of purchases for the benefit of its ratepayers, then its actual year 2000 fuel and purchased power expense will be lower. However, if the Commission adopts the Company's purchased power adjustment, the base revenues will not match the lower fuel and purchased power costs.

Post-Test Year Projected Off-System Sales Revenues

Q. Please describe the Company's most recent proposed adjustment to test year actual off-system sales revenues.

A. The most recent version of the Company's proposed adjustment to test year off-system sales revenues is described in the Rebuttal Testimony of Company witness Mr. Bellar, who in turn relied upon future market price projections developed by Company witness Mr. Gallus. The Company utilized forward market price projections for the year 2000 applied to projected year 2000 off-system sales developed by running "planning models" in order to determine the "adjusted" test year off-system sales revenues.

Q. Has the Company changed its methodology for purposes of its Rebuttal filing compared to its response to PSC-4-KU-7, its listing of proforma adjustments provided to the Commission prior to the filing of Rebuttal Testimony?

A. Yes. In the most recent version of this proforma adjustment, the Company has changed the off-system sales volumes from a three year historic average (1996-1998) to a projected level in the year 2000. The projected off-system sales levels in the year 2000 were developed through "planning studies" utilizing the "PROSYM hourly production cost model," according to the Rebuttal Testimony of Company witness

Mr. Bellar. Similar to the Company's purchased power adjustment, this adjustment also has been a moving target.

Q. Are the forward market price projections for the year 2000 known and measurable?

A. No. As I discussed in the preceding section on the purchased power adjustment, the Company's forward market price projections are uncertain and speculative. Those projections should not be utilized by the Commission in order to compute a proforma adjustment to test year off-system sales revenues. The data relied upon were acquired through telephone surveys and do not represent actual contract prices for the Companies in the year 2000.

Also, as previously discussed, the forward market price projections are extremely volatile. Forward market price projections are not an appropriate basis for quantifying test year purchased power costs and cannot legitimately support a known and measurable adjustment.

Q. Are the Company's projected year 2000 off-system sales volumes known and measurable?

A. No. The fact that the year 2000 sales volumes are not known and measurable further compounds the fact that the market price projections are not known and measurable for purposes of this adjustment. The projected year 2000 off-system sales were obtained from the PROSYM production cost planning model. Production cost planning models such as PROSYM require hundreds, if not thousands, of input assumptions. While such models certainly are useful for planning purposes and the evaluation of options, these models are virtually worthless for purposes of projecting the future with the degree of accuracy necessary for a known and measurable ratemaking adjustment.

The planning model projections are based entirely upon assumptions. As a result, the model cannot predict accurately the actual loads or availability of generating units of the LG&E Energy system or adjoining systems. The model can only predict the operation of the LG&E Energy and adjoining systems based upon the assumptions that are input. For example, the model must forecast, either as input assumptions or through computations based upon input assumptions, the LG&E Energy supply of available capacity and energy and the off-system demand for that capacity and energy. By contrast, the Companies sell off-system in a real world environment depending upon actual available capacity and energy compared to the requirements of other systems with price serving as the mediator between supply and demand. The only actual data available for the years 1998 through 2000 in this proceeding is for the test year 1998.

Q. Do you have any further comments regarding the Company's proposed off-system sales proforma adjustment?

A. Yes. First, the other conceptual and methodological problems that I addressed regarding the Company's purchased power adjustment are equally applicable to the off-system sales adjustment.

Second, the Commission undoubtedly is aware of the Company's dismal track record of predicting future market prices and load requirements in its nonregulated business activities. I would simply note that in 1998, LG&E Energy discontinued it merchant energy trading and sales business. LG&E Energy stated in its 1998 annual report to shareholders the following regarding these discontinued activities:

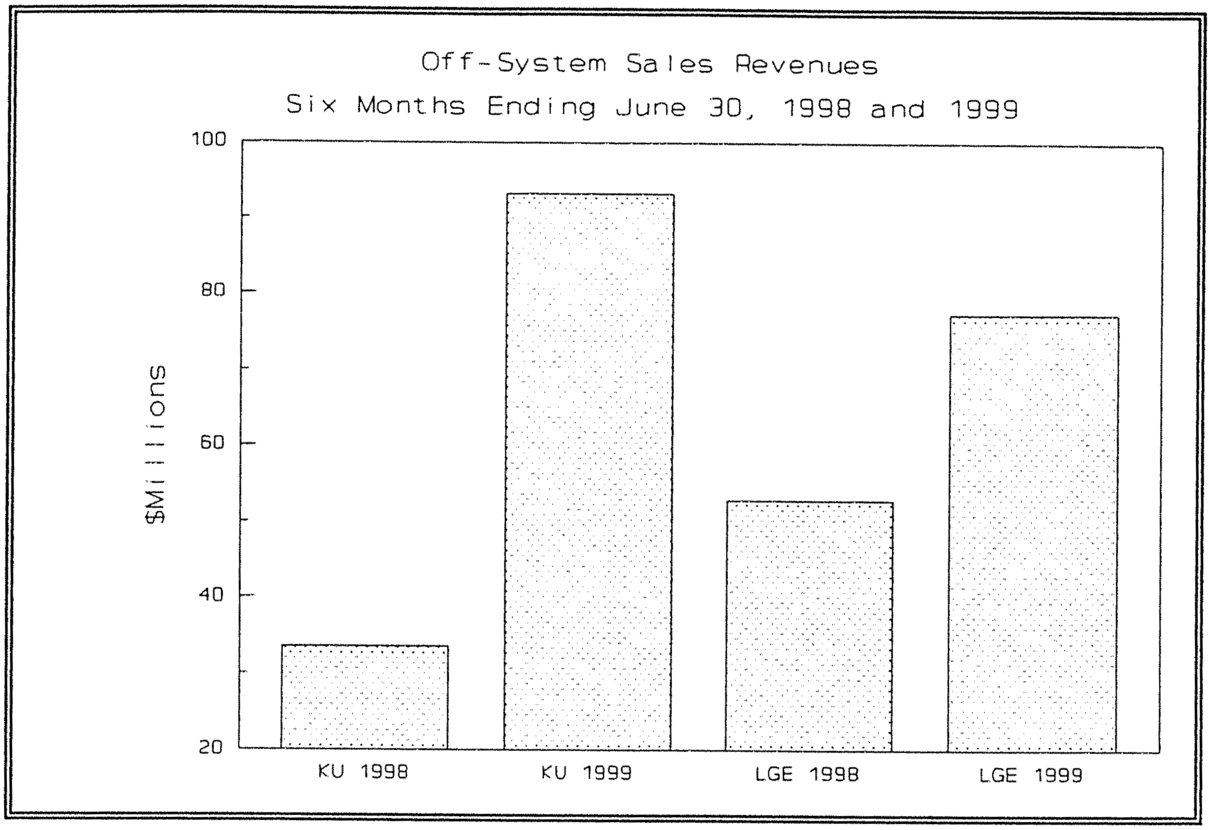
> **This business consisted primarily of a portfolio of energy marketing contracts entered into in 1996 and early 1997, nationwide deal origination and some level of speculative trading activities, which were not directly supported by the Company's physical assets. The Company's decision to discontinue these operations was primarily based on the impact that volatility and rising prices in the power market had on its portfolio of energy marketing contracts. Exiting the merchant energy trading and sales business enables the Company to focus on optimizing the value of physical assets it owns or controls, and to reduce the earnings impact on continuing operations of extreme market volatility in its portfolio of energy marketing contracts.**

It also should be noted that LG&E Energy's failure to accurately predict the future market conditions and prices resulted in a before tax writeoff in 1998 of $350 million. In my opinion, the Company's actual and dismal performance in the forward price markets is more than sufficient evidence for the Commission to conclude that it should not rely upon the Company's projections for the year 2000 in order to fabricate an off-system sales proforma adjustment.

Third, it should be noted that LG&E Energy is not alone in its failure to accurately predict the future market conditions and prices. Cinergy recently defaulted on several delivery contracts due to market conditions and will recognize a loss of $73 million to settle its obligations. These facts illustrate the impossibility of "modeling" away market risk into a post-test year ratemaking adjustment with any degree of certainty.

Finally, this adjustment is completely unsupported by current data. The Company asserts that its 1998 off-system sales revenue was abnormally high by $10.717 million. The Company claims that it knows with certainty that its 1998 level of off-system sales revenue will not be repeated on an on-going basis into the future because the wholesale power market fundamentally changed following the June 1998 price spikes. I agree that the wholesale power market fundamentally changed after the June 1998 price spikes. However, market prices went <u>up</u>, not down. The 1998 test year reflects six months at the lower pre-spike market prices. In the post-test year periods, the Company will receive a full 12 months of off-system sales revenue at the new higher market prices. Thus, based upon actual post-test year data, the 1998 test year level of off-system sales is too low, not too high.

A review of recent actual off-system sales data supports an increase in off-system sales revenues, not the reduction proposed by the Company. For the first six months of 1998, KU's off-system sales revenue was $33.498 million. PSC-5-KU-11. For the first six months of 1999, KU's off-system sales revenue was $93.126 million. PSC-5-KU-11. This is an <u>increase</u> of $59.627 million, or <u>178%</u>! Beyond mere speculation about year 2000 market prices and year 2000 sales volume, this is real world evidence that the unadjusted 1998 test year data is conservative in favor of the utility. Therefore, if a proforma adjustment is made it should be to increase off-system sales revenue, not decrease it. The following graph portrays the relationship between the Company's 1998 and 1999 <u>actual</u> off-system sales revenue.



<u>Reduction in Revenues Due to EPBR Implementation</u>

Q. Please describe the Company's adjustment to reduce base revenues for the EPBR implementation.

A. The Company has reduced base revenues by $10.600 million to reflect its share of the EPBR base rate reduction that went into effect on July 2, 1999.

Q. Please explain why the Commission should reject this adjustment.

A. Fundamentally, the purpose of the base rate proceeding is to determine the base revenue requirement without the effects of temporary surcharges or surcredits. The EPBR is a separate tariff that operates as a surcredit mechanism to reduce rates. The EPBR rate reduction, due to the Settlement Agreement with the Attorney General, was placed into effect contingent upon the Commission's decision on the base revenue requirement and the potential implementation of an alternative rate plan. Upon a final order regarding these issues, the temporary EPBR rate reduction will be discontinued and replaced with a permanent base rate reduction. If the Commission rejects the Settlement Agreement with the Attorney General, there will be <u>no</u> temporary surcredit and the permanent base rate reduction will be too low by $20 million (for both Companies).

Second, the EPBR rate reduction depends upon the Commission adopting the EPBR and the Settlement Agreement with the Attorney General in a final order. If the Settlement Agreement with the Attorney General is not adopted, there is <u>no</u> EPBR rate reduction. KIUC has proposed an ESM as an alternative form of regulation and has recommended that the Commission adopt that plan in lieu of the EPBR.

Third, the EPBR rate reduction is temporary. It expires by its terms within five years even if the Commission adopts the Settlement Agreement with the Attorney General in a final order and doesn't otherwise order a permanent base rate reduction in this proceeding. Thus, after five years, The EPBR rate reduction will cease and rates will increase unless and until the Commission engages in another base rate proceeding.

Fourth, the EPBR rate reduction of $20 million for both Companies is only for the first year. In the second year of the EPBR, on July 2, 2000, there will be an EPBR rate increase of $12 million in order to achieve the **net** rate reduction of $8 million in the second through fifth years of the EPBR temporary rate reduction period pursuant to the Settlement Agreement with the Attorney General. Thus, if the Commission splits the base rate reduction between a permanent amount and the EPBR temporary amount, then the temporary amount should be the Company's share of $8 million, not the $20 million.

Fifth, if the Commission adopts the Company's adjustment, then the Company will overrecover $25.440 million over the second through fifth years of the EPBR temporary rate reduction and $10.6 million annually thereafter unless and until the Commission engages in another base rate proceeding. If retail competition is implemented in Kentucky at these excessive revenue levels, then any benefits, including stranded benefits, to ratepayers necessarily will be lower as well.

<u>**Hypothetical Implementation of EPBR Tariff in 1998**</u>

Q. Please describe the Company's request to reduce revenues in order to reflect the hypothetical implementation of the EPBR tariff in 1998.

A. The Company has proposed a proforma adjustment to reduce revenues, and thereby increase the base revenue requirement, in order to reflect a hypothetical implementation of its EPBR tariff in 1998. If the EPBR had been in effect during 1998, it would have resulted in EPBR rate reductions.

Q. Why should the Commission reject this adjustment?

A. Fundamentally, the Company is in error on this adjustment, even disregarding the issue of whether the EPBR is temporary or permanent. First, the purpose of the base revenue requirement review is to determine the level of revenue requirement necessary for fair, just, and reasonable rates <u>**before**</u> the implementation of an alternative form of regulation, if any ultimately is adopted permanently by the Commission. The EPBR is a separate tariff that operates as a surcredit mechanism to reduce rates.

Second, the Company's adjustment will increase the base revenue requirement, contrary to Mr. Willhite's testimony in Case Nos. 98-426 and 98-474 that the EPBR mechanism cannot operate to increase rates. However, the Company's proposed adjustment assumes that it somehow is entitled to recover through base rates any EPBR surcredit that would have been flowed through to ratepayers in the test year. This assumption is patently absurd, particularly for KU, because the hypothetical surcredit was due to poor service quality, as I explained in my Additional Direct Testimony.

Third, the Company's proposed adjustment negates the entirety of the ratepayer benefit that would have been obtained pursuant to the EPBR. As such, the value of the EPBR to ratepayers is nothing, assuming no post-test year change in the quantification of the EPBR surcredit revenues compared to the hypothetical 1998 implementation.

Fourth, the Company's proposed adjustment decimates the stated performance thresholds pursuant to the EPBR. For example, if the EPBR had been in effect in 1998, then KU ratepayers would have received a $1.814 million rate reduction to compensate them for the Company's poor service quality. If KU is allowed to recover an additional $1.814 million in base revenue requirements and KU's service quality is equally as poor in 1999 or some other year as it was in 1998, then the penalty through the EPBR will net to $0. Thus, the Company's proposed adjustment has the effect of lowering the stated performance thresholds for all components of the EPBR.

Fifth, the Commission has not permanently adopted the Company's EPBR but rather has temporarily implemented the EPBR pursuant to the Settlement Agreement with the Attorney General. KIUC has proposed an Earnings Sharing Mechanism ("ESM") as an alternative form of regulation that represents a comprehensive measure of performance and provides for a fair and equitable sharing of performance benefits between the Company and its ratepayers.

In summary, the Company's adjustment must be rejected. It is conceptually incorrect regardless of whether the Commission adopts the Company's EPBR, the KIUC ESM, some other alternative form of regulation, or rejects alternative regulation altogether.

<u>**Effects of "Normal" Weather on Revenues**</u>

Q. Please describe the Company's proposed weather normalization proforma adjustment to revenues.

A. The Company has quantified the effects on revenues of the actual test year deviation from a "normal" level of heating and cooling degree days. For the purposes of this adjustment, the Company utilized temperature data for the twenty years ending December 1996.

Q. **Does the Company deny that this adjustment requires the exercise of considerable judgment?**

A. No. However, Company witness Mr. Willhite sidesteps the issue by arguing that "the focus should be on achieving accurate and reasonable results based on sound statistical modeling and test results."

Q. **How should the Commission determine whether the results are "accurate and reasonable?"**

A. Mr. Willhite doesn't enlighten us in that quest, other than to argue that the parties had access to the "IRP models and methodologies of compiling weather data" in conjunction with the Company's IRP filing in 1996.

Mr. Willhite also believes that this proceeding provides an adequate opportunity to make a "thorough assessment" of the data sets, methodologies, and results of the Company's weather normalization adjustment, although he offers no assistance in that review.

<u>Post-Test Year Team Incentive Award</u>

Q. Please describe the Company's proposed post-test year Team Incentive Award proforma adjustment.

A. The Company has proposed an adjustment to O&M expense in order to reflect an expansion of the eligibility for Team Incentive Award compensation after the end of the test year.

Q. In your Direct Testimony, you described the Company's proposed adjustment as "a selective single issue post test year adjustment . . . [that] fails to consider all other increases and decreases in the cost of service that should be considered" if the test year were to be changed to calendar year 1999 rather than 1998. Did the Company substantively address this violation of the ratemaking principles underlying the composition of a test year?

A. No. Company witness Mr. Robinson simply brushed aside this concern by stating that the adjustment "does not rely upon the 1999 budget information." Regardless of whether that statement is correct, the Company's proposed adjustment violates the very essence of the test year concept. The Company chose to utilize calendar year 1998 as the test year. It could have chosen calendar year 1999 for the test year, but did not. If the Company had chosen a 1999 test year, then the Commission could reflect in the calendar year 1999 test year the higher revenues due to sales growth, lower expenses due to merger savings, and all other changes in the Company's cost of service. However, the Company steadfastly has refused to provide any 1999 information, including budget information, unless it resulted in an increase in the revenue requirement. Thus, the Company's adjustment is another attempt to game the regulatory process in its favor and against its ratepayers. The Commission should not allow this attempted abuse of the regulatory process.

Q. Did the Company respond to your concern that, if the award is based upon actual achievement in 1999, then not only is it a selective post-test year adjustment, it also cannot possibly be known and measurable?

A. No. Again, this concern was not addressed by Mr. Robinson. The Company confirmed, in response to discovery (KIUC-4-KU-67(e)) that the actual 1999 TIA expense will be based upon actual achievement in 1999. In the absence of actual 1999 results, the Company necessarily made certain assumptions regarding that achievement in order to quantify the adjustment. 1999 performance inherently in not known and measurable for purposes of the 1998 test year any more than the market price of year 2000 off-system sales is known and measurable or any more than the market price of Internet stocks at the end of the year 1999 is known and measurable.

Q. Did the Company address your concern that if the TIA represented a pay for performance, that there should be an offsetting proforma adjustment for the "performance," such as increased productivity, reduced expenses, or increased revenues?

A. No. Once again, the Company simply has failed to justify this selective post-test year adjustment in the absence of consideration of all other changes to the Company's cost of service.

Q. If the Commission were to allow the Company its proposed TIA proforma adjustment, should the Commission also reflect other adjustments to the cost of service?

A. Yes. First, I would propose that the increase in retail and off-system sales in the first quarter 1999 be annualized and utilized as a post-test year proforma adjustment and a reduction to the Company's revenue requirement. LG&E retail electric sales volumes in the first quarter 1999 were up 10%. KU retail electric sales volumes for the first quarter 1999 were up 5%.

Second, I would propose that the increase in merger savings, net of the Company's retained share in 1999 compared to 1998, be utilized as a post-test year proforma adjustment and a reduction to the Company's revenue requirement.

<u>**Labor and Labor-Related Costs Post-Test Year Adjustment**</u>

Q. Please describe the Company's proposed labor and labor-related costs proforma adjustment to O&M expense.

A. The Company's proposed proforma adjustment, as detailed on Exhibit MDR-LG&E-5 (LG&E) and the Company's response to KIUC-3-KU-39 (KU), consists of two components. The first component consists of labor payroll and payroll taxes costs. The second component is fringe benefits, including health insurance, pensions and SFAS 106, dental insurance, group life insurance, and a "union 401(k) match."

The quantification of the labor payroll and payroll taxes adjustment is detailed on Exhibit MDR-LG&E-5 page 2 of 4. In Step 1 on that page, the Company utilized "annualized amounts based upon year-end headcounts and the last payrolls of the year," according to its response to KIUC-4-LGE-12. In Step 2 on that page, the Company then computed "adjustments to annualize 1998 labor increase," including the effects of payroll taxes.

The quantification of the fringe benefits adjustment is detailed on Exhibit MDR-LG&E-5 page 3 of 4. For each of the Company's fringe benefits, the Company utilized post-test year 1999 amounts less 1998 actual amounts in order to quantify the adjustment. The 1999 amounts for health insurance, dental insurance, and group life insurance were "based on [the] January 1999 payment[s]" for each of these benefits. The 1999 pensions and SFAS 106 amounts were "estimated," with no further support provided. The union 401(k) match post test year adjustment was computed by increasing the matching percentage of 33% in the actual 1998 test year to 50% in the 1999 post-test year period.

Q. Should the Commission accept the Company's proposed labor and labor-related costs proforma adjustment?

A. No. First, this adjustment violates the matching principle underlying the concept of a representative test year. This adjustment is another example of the use of selective single issue post-test year adjustments in order to improperly increase the Company's revenue requirement without consideration of all other increases and decreases in the cost of service during the post-test year period.

Second, the Company has inaccurately portrayed the labor and payroll tax component of this adjustment as an annualization adjustment to reflect wage increases that occurred throughout the test year 1998. However, the Company's Step 1 computation already includes those increases on an annualized basis by utilizing the last payrolls of the year. Thus, in reality, the Company's labor and payroll tax component of this adjustment either is in error or represents another hidden post-test year adjustment. In either event, this component of the adjustment is inappropriate.

Third, the fringe benefit component of the Company's proposed proforma adjustment is intended to capture projected increases in the Company's fringe benefits expenses in 1999. This is not an annualization adjustment, but rather a post-test year adjustment. In addition, the quantifications of the 1999 amounts are questionable. One month of payments does not necessarily represent one twelfth of the annual amount. The Company has provided no evidence that the 1999 annual amount for these fringe benefits is or will be equivalent to the January 1999 payment multiplied by 12. The Company steadfastly has refused to provide any 1999 budget information, or at least any information identified as such in response to KIUC discovery. In addition, the "estimated" amounts for pensions and SFAS 106 are totally devoid of any documentary support. Finally, the union 401(k) match is included without explanation regarding whether this is required under an existing union contract or whether the Company estimates that it will increase the matching percentage through contract negotiations with the union.

Fourth, the Company failed to reflect any reduction in employee levels in its 1999 projections. Obviously, any reduction in employee levels would have reduced the Company's proposed proforma adjustment, and perhaps would have resulted in a negative expense adjustment. From January 1998 to December 1998, LG&E reduced its employee headcount by 114 positions, or approximately 5%, according to the Company's response to KIUC-4-LG&E-13. Assuming a similar 5% reduction in employees for KU, its labor expense, excluding any effects on payroll taxes and fringe benefits, and therefore its revenue requirement, would be reduced by $3.721 million in 1999 compared to 1998. This reduction in labor expense far exceeds the Company's proposed labor and labor-related costs post-test year adjustment. Thus, when projected reductions as well as projected increases are considered, the Company's O&M expense for 1999 will be lower, not higher.

In short, the Company's post-test year adjustment is misleading, incorrectly computed, undocumented, speculative, and not known and measurable. The Commission should reject this adjustment. If any post-test year adjustment is adopted, it should reflect a projected further reduction in employee headcount.

III. AREAS OF AGREEMENT WITH THE COMPANY

<u>Summary of Areas of Agreement with the Company</u>

Q. Please identify the proforma adjustments agreed upon by both KIUC and the Company.

A. I have segregated these adjustments into two categories. The first category of proforma adjustments are those that are agreed upon conceptually and quantitatively by both KIUC and the Company. The adjustments in this first category are as follows.

1. Increase revenues to eliminate provision for ECR rate refund.

2. Increase revenues to reflect increase in customers and sales.

3. Increase sales for resale revenues in order to allocate off-system sales revenues from nonrequirements customers to Kentucky retail jurisdiction.

4. Increase transmission services revenues in order to allocate to Kentucky retail jurisdiction.

5. Increase O&M expense to reflect allocation to Kentucky retail jurisdiction of expenses related to Kentucky retail jurisdictional allocation of off-system sales to nonrequirements customers and transmission services revenues.

6. Increase O&M expense to remove actual Risk Management Trust refund and replace with amortization over five years.

7. Reduce common equity capitalization to remove nonutility investments.

The second category of proforma adjustments are those that are agreed upon conceptually by both KIUC and the Company, but where there is disagreement quantitatively. The adjustments in this second category are as follows.

1. Year 2000 compliance costs. KIUC recommends a five year amortization. The Company recommends a three year amortization.

2. Annualization of depreciation expense. KIUC recommends that the proforma adjustment be set to $0 because of problems in the Company's quantification.

3. Year end customer annualization of revenues. KIUC recommends that the Commission modify the "operating expense" ratio to exclude operating expenses other than fuel and variable O&M.

4. Net retained share of merger savings. KIUC recommends that the net savings (gross savings net of costs to achieve) be utilized for this adjustment consistent with the Commission's Case No. 97-300 Order.

<u>**Year 2000 Compliance Costs Amortization Period**</u>

Q. Please respond to the Company's proposal to amortize the Year 2000 compliance costs over a three year period rather than a five year period.

A. The Company has provided no affirmative arguments either in testimony or response to discovery (KIUC-4-KU-11(a)) in favor of a three year amortization period rather than a five year period. Company witness Mr. Robinson's testimony simply argued against the five year amortization period proposed by KIUC. However, his arguments do not withstand logical scrutiny.

The first argument postulated by Mr. Robinson was that the appropriate amortization period for Year 2000 compliance costs was unrelated to the merger surcredit period. I disagree. The recovery period for deferred costs inherently is a matter of judgment. That judgment must be exercised within the context of the timing of future rate changes. This exercise in judgment is pursuant to the ratemaking principle of "matching." For example, it would not be appropriate to amortize deferred costs over 15 months if the next rate proceeding reasonably is not anticipated for another four years. In this example, the Company's amortization expense and revenue would be matched only for the first 15 months during the four year period. For the remaining 33 months, there would be no matching. To the contrary, the Company would overrecover because it would continue to receive revenues each month but would have no offsetting amortization expense. Thus, the merger surcredit implementation period is relevant and should be a consideration in the determination of the appropriate amortization period.

The second argument postulated by Mr. Robinson is that Year 2000 costs were incurred for systems that had remaining lives of less than five years. However, the

Company was unable to support that claim in response to discovery. KIUC requested that the Company identify each system that required Year 2000 compliance expenditures (KIUC-4-KU-11(b)). The response was that this information was not available. In addition, KIUC requested that the Company identify and document each system's planned retirement date (KIUC-4-KU-11(d)). Again, the response was that this information was not available. Thus, the Company has not, and apparently cannot, factually support its statements. Thus, the Commission should ignore the Company's unsupported argument.

Annualization of Depreciation Expense

Q. Do you agree conceptually that depreciation expense should be annualized based upon year end gross plant in service levels?

A. Yes. However, the Company's computations are suspect given the error in LG&E's computations of this adjustment. LG&E's computations of this adjustment reflected an unsupported proforma **increase in amortization** of $2.208 million coupled with a **reduction in depreciation** expense of $0.353 million. Thus, absent the unexplained increase in amortization, there would have been a reduction in depreciation expense on an annualized basis. In addition, LG&E's computation of annualized depreciation expense included depreciation on CWIP **not closed** to plant-in-service at December 31, 1998. Depreciation expense is only computed on plant-in-service, and not on CWIP, pursuant to generally accepted accounting principles and the FERC Uniform System of Accounts. To the extent the CWIP would close to plant in service in 1999, the Company's depreciation expense adjustment incorporates a hidden post test year adjustment.

With respect to KU, I was unable to determine whether KU's plant balances also included CWIP not closed to plant in service or whether the balances had been reduced for retirement work in progress. However, given the errors in the LG&E quantification, I am unwilling to accept the KU quantification unless and until I can determine whether similar errors exist.

Q. Did the Company respond to these criticisms that you articulated in response to KU-3-KIUC-35?

A. No. Mr. Robinson acknowledged my response to the Company's discovery regarding this issue in his Response Testimony, but failed to address any of the criticisms or their applicability to KU.

Year End Customers Annualization of Revenues

Q. Do you agree with the Company's quantification of the year end customers annualization of revenues proforma adjustment?

A. No. I have reviewed the Company's quantification of the revenue effect of this proforma adjustment. Unfortunately, the Company's quantification of the revenue effect includes no adjustment to revenues for three of the large commercial classes of customers, although there are changes in the number of year-end customers compared to the test year average. In addition, I do not agree with the quantification of the offsetting expense adjustment.

Q. Have you computed the revenue effect of a year-end customer revenue adjustment for the three large commercial classes utilizing the Company's methodology?

A. Yes. The incremental effect is $14.240 million. In addition, I have computed the offsetting energy cost as $5.058 million based upon the 12.4 mills that I subsequently discuss. These computations are detailed on my Rebuttal Exhibit ____(LK-2). I have not reflected these adjustments in my recommended base revenue requirement in order to provide the Company a further opportunity to justify its computation. However, KIUC reserves the right to incorporate the adjustment if the Company does not adequately justify the computation.

Q. How did the Company quantify the offsetting expense adjustment?

A. The Company quantified the offsetting expense adjustment by applying an operating ratio to the revenue amount. The operating ratio was quantified by dividing O&M expenses, excluding wages and salaries, by revenues.

Q. Do you agree with the Company's utilization of the "operating ratio" approach?

A. No. This approach overstates the expense offset because most O&M expense, other than fuel expense, is not variable.

Q. Does the Company agree that most O&M expense, excluding fuel expense, is not variable?

A. Yes. In the development of its proposed proforma adjustment to reflect "normal" weather, the Company first quantified the effect of "normal" weather on revenues. The Company then computed the offsetting expense adjustment based upon an average "energy cost" of $12.40 per mWh for the test year, which it also referred to as "fuel," multiplied by the mWh associated with the "normal" weather adjustment. In other words, the Company correctly did not consider the entirety of O&M expense, excluding wages and salaries, as variable. The Company considered only $12.40 per mWh to be variable rather than utilizing the operating ratio approach.

Q. Have you quantified the energy cost expense adjustment to offset the increase in revenues computed by the Company?

A. Yes. In order to quantify the offsetting expense adjustment, I multiplied the 149,696 mWh actually used by the Company to quantify the increase in revenues by the Company's $12.40 per mWh "energy cost." The net result is a year end customer annualization of revenues proforma adjustment of $4.216 million, consisting of the $5.918 million increase in revenues offset by my quantification of the related $1.702 million increase in variable costs. The computations are detailed on my Rebuttal Exhibit ____(LK-3).

<u>Net Retained Merger Savings</u>

Q. How did you quantify the KIUC adjustment for net retained merger savings?

A. I utilized the <u>net</u> first year savings (gross savings less costs to achieve) of $26.312 million projected by the Companies in Case No. 97-300 and utilized to develop the merger surcredit. I then determined the Companies retained shares at 50% and then allocated 47% to LG&E and 53% to KU in accordance with the Commission's Order in that proceeding.

Q. How did the Company quantify the net retained share of merger savings for purposes of its proforma adjustment to test year operating expenses?

A. The Company utilized the gross first year savings of $41.756 million projected by the Companies in Case No. 97-300. The Company then computed the 50% retained amount and allocated 47% to LG&E and 53% to KU.

Q. Should the Commission utilize the net savings or the gross savings for this proforma adjustment?

A. Clearly, the Commission should utilize the net savings. First, the sharing of savings between the Company and its ratepayers was based on 50% of the net savings. If the Company is now allowed to retain 50% of the gross savings, then the allocation of net savings will be 79% to the Company and 21% to its ratepayers. That result is simply wrong and is inconsistent with the Commission's Order in that proceeding.

Second, the Company's computation shifts 100% of the costs to achieve incurred in the test year to the ratepayers. Again, that is contrary to the Commission's Order in the merger proceeding and represents an inequitable sharing of savings and costs.

Q. Does this complete your Rebuttal Testimony?

A. Yes.

COMMONWEALTH OF KENTUCKY

BEFORE THE

PUBLIC SERVICE COMMISSION

IN THE MATTER OF: APPLICATION OF KENTUCKY UTILITIES COMPANY FOR APPROVAL OF AN ALTERNATIVE METHOD OF REGULATION OF ITS RATES AND SERVICE	:	CASE NO. 98-474
and	:	
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC. Complainant	:	CASE NO. 99-083
v.	:	
KENTUCKY UTILITIES COMPANY	:	
Defendant	:	

REBUTTAL EXHIBITS

OF

LANE KOLLEN

ON BEHALF OF THE

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

J. KENNEDY AND ASSOCIATES, INC.
ATLANTA, GEORGIA

AUGUST 1999

KENTUCKY UTILITIES COMPANY
SUMMARY OF REVENUE REQUIREMENT
12 MONTHS ENDING DECEMBER 31, 1998
($000)

	Unadjust Total KU	Unadjust "Other Juris"	Unadjust "KY Retail Juris"	Adjust to "KY Retail Juris"	Adusted "KY Retail Juris"
Capitalization (1)	1,208,493	160,914	1,047,579	NA	1,047,579
Required Overall Rate of Return	8.17%	8.17%	8.17%	8.17%	8.17%
Required Operating Income	98,714	13,144	85,570	0	85,570
Per Books Operating Income	125,388	36,947	88,441	30,404	118,845
Operating Income Surplus	26,674	23,803	2,871	30,404	33,276
Revenue Surplus	44,736	39,920	4,816	50,991	55,807
Electric Revenues before Rate Reduction	810,115	225,561	584,554	139,251	723,805
Rate Reduction as % of Electric Revenues	5.52%	17.70%	0.82%		7.71%
Return on Common Equity before Rate Reduction	14.13%	39.36%	10.25%		16.07%
Effect of 1% Change in ROE					8,764

Note 1: Capitalization utilized by Kentucky PSC in lieu of rate base. Approximately equal.

KENTUCKY UTILITIES COMPANY
SUMMARY OF COST OF CAPITAL
12 MONTHS ENDING DECEMBER 31, 1998
($000)

	Capital $ w/o ITC (1)	Capital % without ITC	COC w/o ITC (2)	Wtd COC without ITC	Capital $ with ITC	Capital % with ITC	COC with ITC	Wtd COC with ITC	Capital $ ITC Alloc
Long and Short Term Debt	543,584	45.83%	6.99%	3.20%	543,584	44.98%	6.99%	3.14%	553,616
Preferred Equity	39,799	3.36%	5.64%	0.19%	39,799	3.29%	5.64%	0.19%	40,533
Common Equity	602,808	50.82%	9.70%	4.93%	602,808	49.88%	9.70%	4.84%	613,932
Total Capitalization	1,186,191			8.32%	1,186,191				
Investment Tax Credit (3)					22,302	1.85%	0.00%	0.00%	
Total Capitalization with ITC					1,208,493			8.17%	1,208,081

Note 1: Capitalization amounts are for total Company and were provided by Company in supplemental response to Commission Question No. 11 parts (a) and (b) attached to Commission Order dated December 2, 1998.

Note 2: Cost of debt and preferred were provided by Company in response to PSC-4-KU-10(c). Cost of common provided by KIUC witness Baudino.

Note 3: Obtained from KU 1998 SEC Form 10-K page 153.

KENTUCKY UTILITIES COMPANY
SUMMARY OF RATE BASE
12 MONTHS ENDING DECEMBER 31, 1998
($000)

	Unadjust Total KU	Unadjust "Other Juris"	Unadjust "KY Retail Juris"	Adjust to "KY Retail Juris"	Adusted "KY Retail Juris"
Plant in Service	2,602,167	368,761	2,233,406	NA	2,233,406
CWIP	83,361	10,516	72,845	NA	72,845
Accumulated Depreciation	(1,208,183)	(177,620)	(1,030,563)	NA	(1,030,563)
Accumulated Deferred Inc Taxes (Net)	(291,840)	(44,302)	(247,538)	NA	(247,538)
Fuel Inventories	23,927	3,432	20,495	NA	20,495
M&S Inventories	24,248	3,502	20,746	NA	20,746
Net Regulatory Assets/Liabilities	(26,999)	(3,702)	(23,297)	NA	(23,297)
Customer Deposits	(10,354)	(659)	(9,695)	NA	(9,695)
Customer Advances	(1,265)	(53)	(1,212)	NA	(1,212)
Investment Tax Credit	(22,302)	(3,719)	(18,583)	NA	(18,583)
Total Rate Base	1,172,760	156,156	1,016,604	NA	1,016,604

KENTUCKY UTILITIES COMPANY
SUMMARY OF REVENUE REQUIREMENT
12 MONTHS ENDING DECEMBER 31, 1998
($000)

	Unadjust Total KU	Unadjust "Other Juris"	Unadjust "KY Retail Juris"	Adjust to "KY Retail Juris"	Adusted "KY Retail Juris"
Capitalization (1)	1,206,941	160,707	1,046,234	NA	1,046,234
Required Overall Rate of Return	8.19%	8.19%	8.19%	8.19%	8.19%
Required Operating Income	98,867	13,164	85,702	0	85,702
Per Books Operating Income	125,388	36,947	88,441	30,404	118,845
Operating Income Surplus	26,521	23,783	2,739	30,404	33,143
Revenue Surplus	44,479	39,886	4,593	50,991	55,584
Electric Revenues before Rate Reduction	810,115	225,561	584,554	139,251	723,805
Rate Reduction as % of Electric Revenues	5.49%	17.68%	0.79%		7.68%
Return on Common Equity before Rate Reduction	14.10%	39.33%	10.22%		16.04%
Effect of 1% Change in ROE					8,764

Note 1: Capitalization utilized by Kentucky PSC in lieu of rate base. Approximately equal.

replaced in errata

Rebuttal Exhibit___(LK-1)
Page 1 of 4

KENTUCKY UTILITIES COMPANY
SUMMARY OF OPERATING INCOME
12 MONTHS ENDING DECEMBER 31, 1998
($000)

	Unadjust Total KU	Unadjust "Other Juris"	Unadjust "KY Retail Juris"	Adjust to "KY Retail Juris"	Adusted "KY Retail Juris"
Operating Revenues					
Residential	238,898	18,107	220,791	4,216 (1)	225,007
Commercial and Industrial	344,907	18,048	326,859	(1,845) (2)	325,014
Public Street and Highway Lighting	6,483	207	6,276		6,276
Other Sales to Public Authorities	52,332	2,497	49,835		49,835
Sales for Resale	179,118	179,118	0	108,690 (3)	108,690
Provision for Refund	(23,724)	(1,567)	(22,157)	22,157 (4)	0
Other Operating Revenues	12,101	9,151	2,950	6,033 (5)	8,983
Total Operating Revenues	810,115	225,561	584,554	139,251	723,805
Operating Expenses					
Fuel, Purchased Power, and Other Oper Exp	465,630	143,534	322,096	82,235 (3),(5)	404,331
				6,973 (6)	6,973
				(768) (7)	(768)
				1,482 (8)	1,482
				(1,662) (9)	(1,662)
Maintenance Expense	63,608	9,756	53,852		53,852
Depreciation	86,657	12,016	74,641		74,641
Other Taxes	15,946	2,746	13,200		13,200
Federal and State Income Taxes	53,256	20,615	32,641	20,587	53,228
Other	(370)	(53)	(317)		(317)
Total Operating Expenses	684,727	188,614	496,113	108,847	604,960
Net Operating Income	125,388	36,947	88,441	30,404	118,845

Note 1: Year end customers revenue annualization less variable energy costs for all classes.
Note 2: FAC adjustment for off-system sales line losses.
Note 3: Reallocation of sales for resale revenues and related expenses to retail and FERC jurisdictions (KU response
Note 4: Nonrecurring; includes $21.5 million one-time ECR refund.
Note 5: Reallocation of transmission service revenues and related expenses to retail and FERC jurisdictions (KU response to KIUC#3-38(a) page 3 of 4.
Note 6: KU net retained merger savings.
Note 7: Net Year 2000 deferral and amortization over 5 years.
Note 8: Net Risk Management Trust deferral and amortization over 5 years.
Note 9: Elimination of advertising expenses.

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KENTUCKY UTILITIES COMPANY
SUMMARY OF COST OF CAPITAL
12 MONTHS ENDING DECEMBER 31, 1998
($000)

	Capital $ w/o ITC (1)	Capital % without ITC	COC w/o ITC (2)	Wtd COC without ITC	Capital $ with ITC	Capital % with ITC	COC with ITC	Wtd COC with ITC	Capital $ ITC Alloc
Long and Short Term Debt	543,584	45.83%	6.99%	3.20%	532,077	44.08%	6.99%	3.08%	541,909
Preferred Equity	39,799	3.36%	5.64%	0.19%	40,000	3.31%	5.64%	0.19%	40,739
Common Equity	602,808	50.82%	9.70%	4.93%	612,562	50.75%	9.70%	4.92%	623,881
Total Capitalization	1,186,191			8.32%	1,184,639				
Investment Tax Credit (3)					22,302	1.85%	0.00%	0.00%	
Total Capitalization with ITC					1,206,941			8.19%	1,206,529

Note 1: Capitalization amounts are for total Company and were provided by Company in supplemental response to Commission Question No. 11 parts (a) and (b) attached to Commission Order dated December 2, 1998.

Note 2: Cost of debt and preferred were provided by Company in response to PSC-4-KU-10(c). Cost of common provided by KIUC witness Baudino.

Note 3: Obtained from KU 1998 SEC Form 10-K page 153.

Rebuttal Exhibit ___ (LK-1)
Page 3 of 4

KENTUCKY UTILITIES COMPANY
SUMMARY OF RATE BASE
12 MONTHS ENDING DECEMBER 31, 1998
($000)

	Unadjust Total KU	Unadjust "Other Juris"	Unadjust "KY Retail Juris"	Adjust to "KY Retail Juris"	Adusted "KY Retail Juris"
Plant in Service	2,602,167	368,761	2,233,406	NA	2,233,406
CWIP	83,361	10,516	72,845	NA	72,845
Accumulated Depreciation	(1,208,183)	(177,620)	(1,030,563)	NA	(1,030,563)
Accumulated Deferred Inc Taxes (Net)	(291,840)	(44,302)	(247,538)	NA	(247,538)
Fuel Inventories	23,927	3,432	20,495	NA	20,495
M&S Inventories	24,248	3,502	20,746	NA	20,746
Net Regulatory Assets/Liabilities	(26,999)	(3,702)	(23,297)	NA	(23,297)
Customer Deposits	(10,354)	(659)	(9,695)	NA	(9,695)
Customer Advances	(1,265)	(53)	(1,212)	NA	(1,212)
Investment Tax Credit	(22,302)	(3,719)	(18,583)	NA	(18,583)
Total Rate Base	1,172,760	156,156	1,016,604	NA	1,016,604

Rebuttal Exhibit ___ (LK-1)
Page 4 of 4

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Kentucky Utilities Company
Adjustment of Electric Revenues and Expenses
to Reflect Customers Served at December 31, 1998
Rate Schedules LCI TOD, HLF, and MP

	Adjustment to Revs
Total KY Jurisdictional Revenue Adjust. Computed by KU	$5,918,193
<u>Incremental Revenue Adjustment:</u>	
Commercial (large)	
LCI TOD	7,403,963
HLF	1,133,476
MP	(215,710)
Total Incremental Adjustment	8,321,729
Total Gross Rev. Adjustment Due to Y/E Customer Annualization	14,239,922
<u>Energy Cost Offset</u>	
Total Y/E kWh Adjustment Computed by KU	(445,028,085)
KU "Energy Cost"	12.4 mills
Annualization Adjustment	11/12
Expense Offset to Y/E Customer Revenues	(5,058,486)
NET ADJUSTMENT	**$9,181,436**

Kentucky Utilities Company
Expense Offset to Y/E Customer Revenue Adjustment
Year End kWh Adjustment less
Rate Schedules LCI TOD, HLF, and MP
December 31, 1998

	Year End kWh Adjustment
Total All Classes Computed by KU	445,028,085
Less:	
Commercial (Large)	
LCI TOD	261,863,632
HLF	39,808,789
MP	(6,340,341)
Commercial Not Used by KU	295,332,080
Net Used by KU	149,696,005
KU "Energy Cost"	12.4 mills
Annualization Adjustment	11/12
Expense Offset to Y/E Customer Revenue Adjustment	$1,701,545

Louisville Gas and Electric Company
Expense Offset to Y/E Customer Revenue Adjustment
Year End kWh Adjustment
December 31, 1998

	Year End kWh Adjustment
Total All Classes Computed by LG&E	31,487,397
LGE "Energy Cost"	12.4 mills
Expense Offset to Y/E Customer Revenue Adjustment	$390,444