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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF KENTUCKY UTILITIES COMPANY FOR THE VALUE DELIVERY SURCREDIT MECHANISM	) CASE NO. 2005-00351
THE PLAN OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE VALUE DELIVERY SURCREDIT MECHANISM	) CASE NO. 2005-00352

Response of the Attorney General to the Requests of Commission Staff Posed by Order Dated December 22, 2005

NOTICE OF FILING AND CERTIFICATION OF SERVICE

I hereby give notice that I have filed the original and ten true copies of the attached with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 this the 4th day of January, 2006, and certify that this same day I have served the parties by mailing a true copy, postage prepaid, to the following:

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Response of the Attorney General to the Requests of Commission Staff posed by Order dated December 22, 2005 Case Nos. 2005-00351 and 2005-00352

Witness Responsible:
ROBERT J. HENKES

Question 1: In his testimony no behalf of the AG, Robert J. Henkes recommends that the Value Delivery Team ("VDT") surcredit mechanisms of Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E be continued stating that "the status quo should be maintained and the original intent of the VDT mechanism should be upheld…."

a. Refer to Rives Exhibit 1, Reference Schedules 1.20 and 1.21 in the applications filed by LG&E and KU in Case Nos. 2003-00433[1] and 2003-00434,[2] respectively, and pages 8-9 of the Testimony of Valerie L. Scott filed on behalf of LG&E and KU in those cases. Explain whether these schedules and testimonies from Case Nos. 2003-00433 and 2003-00434 form, to some extent, the bases for Mr. Henkes's recommendation to continue the VDT surcredit mechanisms of KU and LG&E.
b. Refer to Item 7 of KU's and LG&E's responses to the Commission Staff's Supplemental Data Requests ("Staff's Supplemental Requests") of November 14, 2005. Does Mr. Henkes agree, or accept as factual, the answers provided in those responses? Explain the response.
c. Explain whether the answers in Item 7 of KU's and LG&E's responses to the Staff's Supplement *(sic)* Requests have any impact on Mr. Henkes' recommendation to continue the VDT surcredit mechanisms of KU and LG&E.

Responses:

a. Yes. I agree that the schedules and testimonies from Case Nos. 2003-00433 and 2003-00434 referenced in question 1a. form one of the bases for my recommendation to continue the VDT surcredit mechanisms of KU and LG&E. The relevant implications of the schedules and testimonies from Case Nos. 2003-00433 and 2003-00434 referenced in question 1a. are summarized in the tables on page 5 of Mr. Blake's LG&E and KU testimonies in the instant proceedings. As discussed by me on page 6 of my LG&E and KU testimonies, and as clearly shown in the tables on page 5 of Mr. Blake's testimonies, the current base rates of LG&E electric, LG&E gas and KU include $0 net ratepayer savings from the VDT

[1] Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms and Conditions of Louisville Gas and Electric Company.

[2] Case No. 2003-004334, An Adjustment of the Electric Rates, Terms and Conditions of Kentucky Utilities Company.

initiative and the only way through which the ratepayers receive their 40% share of the net VDT savings is through the Value Delivery Surcredit. The Companies' shareholders receive their 60% share of the net savings by way of a pro forma expense increase adjustment equal to 60% of the net VDT savings that is built into the current base rates. If the Value Delivery Surcredit were to be terminated, the ratepayers will no longer receive the benefits of any net VDT savings, while the Companies' shareholders will receive 100% of the net VDT savings. This would change the original sharing formula from 40/60 to 0/100. Using the LG&E electric 2003-00433 base rate VDT data in the table on page 5 of Mr. Blake's LG&E testimony as an example, what this means is that, after the VDT cost amortization has expired and the Value Delivery Surcredit has been terminated, LG&E's shareholders would receive the entire VDT gross savings of $33.3 million and the ratepayers would receive $0 savings. As explained in my testimony, it is my position that this is inequitable to the ratepayers and inconsistent with the original intent of the VDT surcredit mechanism.

b. With regard to the Companies' responses to KPSC-2-7(a) and (b), I agree that the labor and labor-related costs and pension and post-retirement expenses included in the Companies' most recent base rate cases reflected the impact (i.e., gross savings) of the WSP. Using LG&E electric's 2003-00433 rate case as an example, these gross WSP savings are part of the $33.3 million gross VDT savings in the table on page 5 of Mr. Blake's LG&E testimony. With regard to the Companies' responses to KPSC-2-7(c), I agree that the test years in the Companies' rate cases reflected the VDT cost amortization. Using LG&E electric's 2003-00433 rate case as an example, this test year VDT cost amortization amounted to $23.9 million (corrected) as shown in the 2nd line in the table on page 5 of Mr. Blake's LG&E testimony. As shown in the remaining lines of this same table in Mr. Blake's LG&E testimony, offsetting LG&E electric's test year VDT cost amortization against LG&E's electric VDT gross savings resulted in the reflection of $9.4 million for net VDT savings in the test year. This test year net VDT savings amount of $9.4 million was then removed from the test year (and, therefore, from base rate consideration) by (1) reducing the test year revenues with the ratepayer's 40% net VDT savings share of $3.8 million, and (2) increasing the test year expenses with a pro forma expense increase adjustment of $5.6 million to preserve the shareholder's 60% net VDT savings share. What this means is that, while LG&E electric's current base rates include the 60% shareholder share of the net VDT savings, the base rates include no ratepayer sharing of the net VDT savings. Rather, the ratepayers receive their 40% share of the net VDT savings through the separate Value Delivery Surcredit mechanism. The exact same facts apply to the ratepayers of LG&E gas and KU. Therefore, I disagree with the part of the Companies' response to

KPSC-2-7(c) that states that, "The test year also reflected .... the sharing of those [net VDT] savings between customers and the shareholder." This statement in partially incorrect. As explained in the foregoing discussion, while the pro forma adjusted test years used to set the base rates of LG&E electric and gas and KU in their most recent rate cases indeed reflected the shareholders' 60% net VDT savings portion, they did not include the ratepayers' 40% net VDT savings portion.

c. For the reasons discussed in my response to part b. above, the Companies' response to KPSC-2-7 does not change Mr. Henkes' recommendation to continue the VDT surcredit mechanism of KU and LG&E.