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VIA OVERNIGHT MAIL

December 7, 2005

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DEC 08 2005

PUBLIC SERVICE
COMMISSION

Beth A. O'Donnell, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: Case No. 2005-00351 and Case No. 2005-00352

Dear Ms. O'Donnell:

Please find enclosed the original and twelve (12) copies of Direct Testimony and Exhibits of Lane Kollen on behalf of the Kentucky Industrial Utility Customers, Inc. to be filed in the above-referenced matter.

By copy of this letter, all parties listed on the attached Certificate of Service been served. Please place this document of file.

Very Truly Yours,



David F. Boehm, Esq.
Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment

cc: Certificate of Service
A. W. Turner, Esq.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by overnight mail (unless otherwise noted) to all parties on the 7th day of December, 2005.

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COMMONWEALTH OF KENTUCKY

RECEIVED

BEFORE THE PUBLIC SERVICE COMMISSION

DEC 08 2005

IN THE MATTER OF:

**PUBLIC SERVICE
COMMISSION**

**THE PLAN OF KENTUCKY UTILITIES)
COMPANY FOR THE VALUE DELIVERY)
SURCREDIT MECHANISM)**

**CASE NO.
2005-00351**

IN THE MATTER OF:

**THE PLAN OF LOUISVILE GAS AND)
ELECTRIC COMPANY FOR THE VALUE)
DELIVERY SURCREDIT MECHANISM)**

**CASE NO.
2005-00352**

**DIRECT TESTIMONY
AND EXHIBITS
OF
LANE KOLLEN**

**ON BEHALF OF THE
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.**

**J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA**

DECEMBER 2005

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

**THE PLAN OF KENTUCKY UTILITIES)
COMPANY FOR THE VALUE DELIVERY) CASE NO.
SURCREDIT MECHANISM) 2005-00351**

IN THE MATTER OF:

**THE PLAN OF LOUISVILE GAS AND)
ELECTRIC COMPANY FOR THE VALUE) CASE NO.
DELIVERY SURCREDIT MECHANISM) 2005-00352**

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

THE PLAN OF KENTUCKY UTILITIES)	
COMPANY FOR THE VALUE DELIVERY)	CASE NO.
SURCREDIT MECHANISM)	2005-00351

IN THE MATTER OF:

THE PLAN OF LOUISVILE GAS AND)	
ELECTRIC COMPANY FOR THE VALUE)	CASE NO.
DELIVERY SURCREDIT MECHANISM)	2005-00352

DIRECT TESTIMONY OF LANE KOLLEN

I. QUALIFICATIONS AND SUMMARY

1

2 **Q. Please state your name and business address.**

3

4 A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc.
5 ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia
6 30075.

7

8 **Q. What is your occupation and by whom are you employed?**

9

1 A. I am a utility rate and planning consultant holding the position of Vice President and
2 Principal with the firm of Kennedy and Associates.

3

4 **Q. Please describe your education and professional experience.**

5

6 A. I earned a Bachelor of Business Administration in Accounting degree from the
7 University of Toledo. I also earned a Master of Business Administration degree from
8 the University of Toledo. I am a Certified Public Accountant, with a practice license,
9 and a Certified Management Accountant.

10

11 I have been an active participant in the utility industry for more than twenty-five years,
12 both as an employee and as a consultant. Since 1986, I have been a consultant with
13 Kennedy and Associates, providing services to state government agencies and large
14 consumers of utility services in the ratemaking, financial, tax, accounting, and
15 management areas. From 1983 to 1986, I was a consultant with Energy Management
16 Associates, providing services to investor and consumer owned utility companies. From
17 1976 to 1983, I was employed by The Toledo Edison Company in a series of positions
18 encompassing accounting, tax, financial, and planning functions.

19

1 I have appeared as an expert witness on accounting, finance, ratemaking, and planning
2 issues before regulatory commissions and courts at the federal and state levels on more
3 than one hundred occasions. I have developed and presented papers at industry
4 conferences on ratemaking, accounting, and tax issues.

5
6 I have testified before the Kentucky Public Service Commission on numerous occasions,
7 including the three most recent Louisville Gas and Electric Company (“LG&E” or
8 “Company”) base rate cases; the two most recent Kentucky Utilities Company (“KU” or
9 “Company”) base rate cases; the LG&E and KU merger proceeding, Case No. 97-300;
10 the LG&E and KU Earnings Sharing Mechanism (“ESM”) proceedings, Case Nos.
11 2003-00335 and 2003-00334; numerous LG&E and KU environmental cost recovery
12 (“ECR”) and fuel adjustment clause (“FAC”) proceedings, and proceedings involving
13 Kentucky Power Company (“KPC” or “Company”) and Big Rivers Electric Corporation.
14 My qualifications and regulatory appearances are further detailed in my Exhibit __ (LK-
15 1).

16

17 **Q. On whose behalf are you testifying?**

18

1 A. I am testifying on behalf of the Kentucky Industrial Utility Customers, Inc. (“KIUC”), a
2 group a large users taking electric and gas service on the LG&E system and electric
3 service on the KU system.

4
5 **Q. What is the purpose of your testimony?**

6
7 A. The purpose of my testimony is to address the continuation of the Companies’ VDT
8 surcredit riders after March 31, 2006 and to address the appropriate surcredit amounts
9 after that date if they are continued.

10
11 **Q. Please summarize your testimony.**

12
13 A. As of March 31, 2006 the Companies will have recovered from ratepayers the entirety of
14 the \$196.2 million in costs they incurred to achieve their Workforce Separation Program
15 (“WSP”). Therefore, beginning April 1, 2006, the net WSP savings will equal the gross
16 WSP savings. The currently effective VDT surcredit allocates 40% of the net savings to
17 ratepayers. None of the net savings are reflected in base rates. The Companies’ propose
18 to end the VDT surcredit precisely at the time ratepayers will have paid all of the costs
19 to achieve those savings. This is unreasonable.

20

1 I recommend that the Commission continue the Companies' VDT surcredit riders after
2 March 31, 2006 and that they remain in effect until the effective dates of Commission
3 Orders resetting the Companies' base rates to reflect fully the WSP savings. The VDT
4 surcredit riders were established on a stand-alone basis to allow the Companies to
5 recover the entirety of their costs associated with their WSP from ratepayers and to share
6 the savings in excess of the costs 60% to the Companies and 40% to ratepayers. The
7 VDT surcredit was designed so that no WSP costs or savings were reflected in base rates
8 and so that no other revenues or costs were used to increase or reduce the net savings.
9 The VDT surcredit riders were established pursuant to a Settlement Agreement among
10 the Companies, KIUC, and the AG.

11
12 I recommend that the Commission make no changes to the WSP net savings sharing
13 formula established in the Settlement Agreement. The sharing formula provides for a
14 sharing of the net savings, which are computed as the gross annual savings less the
15 amortization of the deferred WSP costs, with the net savings allocated 60% to the
16 Companies and 40% to ratepayers.

17
18 I recommend that the Commission update the VDT surcredit rider amounts effective
19 April 1, 2006 to reflect the fact that the amortization of the deferred costs of the WSP
20 will be completed on March 31, 2006. The gross and net savings will be equivalent

1 after March 31, 2006. In accordance with the sharing formula adopted by the
2 Commission, the Companies will continue to retain 60% of the net savings and
3 ratepayers will receive 40% of the net savings until the effective date of new base rates.
4 I recommend that the Commission reject the Companies' proposal to terminate the VDT
5 surcredit riders. The Companies' proposal is unreasonable because it would eliminate
6 all sharing to ratepayers of the net savings resulting from the WSP. None of the VDT
7 net savings are reflected in present base rates due to the stand-alone nature of the VDT
8 surcredit riders and the manner in which all VDT effects were eliminated from the base
9 revenue requirement in Docket Nos. 2003-00433 and 2003-00434. The Companies'
10 proposal would replace a reasonable and equitable sharing of 60% to the Companies and
11 40% to ratepayers with an unreasonable and inequitable allocation of 100% of the net
12 savings to the Companies. Ratepayers would get zero percent. The ratepayers will
13 receive none of the WSP savings because their 40% share was included solely in the
14 VDT surcredit riders and was not reflected in lower base rates.

15
16 Finally, I recommend that the Commission reject the Companies' attempt to justify their
17 proposal to terminate the VDT surcredit riders on the basis of alleged under-earnings.
18 The VDT surcredit riders were established as stand-alone ratemaking mechanisms
19 without the benefit of comprehensive base ratemaking proceedings, where normally the
20 net savings would have been allocated 100% to ratepayers. This proceeding is not a

1 base rate case. If the Companies indeed can justify base rate increases, then they should
2 file applications with the Commission in accordance with the statutory framework for
3 such base rate increases.

1 **II. VDT SURCREDIT RIDERS WERE ESTABLISHED AS STAND-ALONE**
2 **RATEMAKING MECHANISMS**
3

4 **Q. Please describe the origination of the VDT surcredit riders.**

5
6 A. The VDT surcredit riders were established by the Commission outside the base
7 ratemaking process to provide the Companies recovery of their WSP costs in
8 conjunction with a Settlement Agreement among the Companies, KIUC and the AG in
9 Docket Nos. 2001-0054, 2001-055, 2001-140, 2001-141, and 2001-169. The
10 Companies initially requested deferral of the WSP costs and recovery of the
11 amortization expense through their annual Earnings Sharing Mechanism (“ESM”)
12 filings. The Companies proposed no sharing of the net savings other than through the
13 operation of the ESM mechanism. KIUC initially opposed the Companies’ request.

14
15 The parties settled this issue, along with other issues, by agreeing to allow the
16 Companies cost recovery through the VDT surcredit riders in exchange for a sharing of
17 the savings and to remove the effects of the cost recovery and savings from the annual
18 ESM revenue requirements. The agreement on these issues was detailed in Sections 2.4
19 and 2.5 of the Settlement Agreement. Section 2.4 describes the VDT surcredit riders
20 and their single issue nature as follows::

21 **LG&E and KU will file with the Commission surcredit rate mechanism**
22 **tariffs as part of this Settlement Agreement for the purpose of recovering**

1 **the cost of the deferred debits through rates and sharing with their**
2 **Kentucky retail customers forty percent of the estimated net savings.**
3

4 Section 2.5 of the Settlement Agreement details the manner in which the annual ESM
5 filings would be adjusted to remove the effects of the VDT surcredit riders from the
6 ESM revenue requirement as follows:

7
8 **The amounts shown on Exhibit B to this Settlement Agreement as the “Net**
9 **Savings to Shareholders” on line 6 and 22 shall be included as an**
10 **adjustment to the calculation of the Earnings Sharing Mechanism Annual**
11 **filings for LG&E and KU in 2001 and 2002.**
12

13 **Q. Did the Commission explicitly recognize the fact that the effects of the VDT**
14 **surcredit riders were to be removed from the ESM revenue requirement when it**
15 **approved the Settlement Agreement including Sections 2.4 and 2.5?**

16
17 **A. Yes. The Commission recognized that the VDT surcredit riders represented single issue**
18 **ratemaking recovery and that the effects should not be commingled with other revenues**
19 **and costs included in the base revenue requirement. In its Order approving the**
20 **Settlement Agreement, the Commission stated the following (at 9):**

21
22 **When the ESM calculations are performed for electric operations, the**
23 **effects of the Value Delivery Surcredit will be removed from the**
24 **calculations, just as the Merger Surcredit has been.**
25

1 **Q. Were the effects of the VDT surcredit actually removed from the Companies'**
2 **annual ESM filings and from the base revenue requirement in their most recent**
3 **base rate proceedings?**

4
5 A. Yes. The effects were removed from the annual ESM filings and the base rate filings in
6 Docket Nos. 2003-0433 and 2003-0434. Mechanically, the filings did not incorporate
7 specific proforma adjustments to remove the amortization expense or to eliminate the
8 savings equivalent to the amortization expense. However, these amounts netted to zero
9 and thus had no effect on the present base rates. In the ESM filings and the base rate
10 filings in Docket Nos. 2003-0433 and 2003-0434, the Companies' share of the projected
11 savings, based on Exhibit B to the Settlement Agreement, was added to the test year
12 expense and the ratepayers' share of the projected savings was eliminated from
13 revenues.

14
15 In this manner, the ratepayers received no share of net savings through the ESM or the
16 base rates established in Docket Nos. 2003-0433 and 2003-0434. However, in those
17 proceedings, the Companies' base revenue requirement was increased to reflect their
18 share of the net savings in excess of the WSP amortization expense. Mr. Blake
19 confirmed in his testimony (at page 5) in this proceeding that the net impact of the VDT
20 surcredit riders on base rates in the cited base rate proceedings was \$0.

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14

Q. What is the significance of the fact that the VDT surcredit riders were established as a stand-alone ratemaking mechanism with no effect on base rates?

A. The history of the VDT surcredit riders demonstrates that there simply is no doubt that from the date of the Settlement Agreement, through the ESM filings, and in the Companies' present base rates, there are no WSP savings reflected. The only manner in which the WSP savings were and will continue to be provided to ratepayers is through a continuation of the VDT surcredit riders. If the VDT surcredit riders are terminated after March 31, 2006, the ratepayers' share of the net WSP savings will be eliminated. Ratepayers will get zero and the Companies would get 100%. There is no other means by which the ratepayers will receive their share of the net savings unless and until the effective dates of new base rates determined in some future base rate proceeding

1 **III. THE SHARING FORMULA SHOULD BE MAINTAINED**
2

3 **Q. Please describe the VDT surcredit sharing formula.**

4
5 A. The Settlement Agreement established a sharing formula, which was detailed in Exhibit
6 B to the Settlement Agreement. The net savings were quantified as projected gross
7 savings less the amortization expense. The net savings then were allocated 60% to the
8 Companies and 40% to the ratepayers. The final amounts after the true-up to actual
9 costs are reflected in the tariffs on file with the Commission and which the Companies
10 included as Exhibit 1 to their Applications in this proceeding.

11
12 **Q. Why were the 60% and 40% sharing allocations chosen?**

13
14 A. The 60% and 40% sharing allocations were consistent with the 60% and 40% sharing
15 allocations adopted in the ESMs. Normally, such savings would be allocated 100% to
16 ratepayers, but the 60% and 40% sharing allocations were adopted to ensure a measure
17 of consistency in conjunction with separating the WSP rate recovery from other base
18 ratemaking recovery and establishing the VDT surcredit riders.

19
20 **Q. If the VDT surcredit riders are continued, should the Commission maintain the**
21 **60% and 40% sharing allocations?**

1

2 A. Yes, but only in the interest of maintaining the status quo. As I noted previously, the
3 ratepayers are entitled to 100% of the net savings given the general ratemaking principle
4 that the revenue requirement should be set to provide the utility the opportunity to
5 recover its costs, no more and no less. There currently are no ratepayers savings
6 reflected in base rates. The only way in which the ratepayers will continue to receive
7 even the 40% allocation of the net savings is to continue the VDT surcredit riders.

8

9 **Q. If the VDT surcredit riders are continued, should the Commission maintain the**
10 **computation of the net savings that are allocated between the Companies and their**
11 **ratepayers?**

12

13 A. Yes. However, after March 31, 2006, the amortization expense will be \$0. On March
14 31, 2006, the Companies will have fully amortized their deferred WSP costs and
15 recovered the entirety of those costs from their ratepayers. Thus, the gross savings and
16 net savings will be the same amount.

17

18 **Q. Should the amount of the VDT surcredit riders after March 31, 2006 reflect the**
19 **fact that the deferred WSP costs have been fully recovered from ratepayers?**

1

2 A. Yes. The amount of the VDT surcredit riders should increase on April 1, 2006 to reflect
3 the fact that the deferred WSP costs have been fully recovered from the ratepayers and
4 that there no longer is any amortization expense.

5

6 **Q. Have you quantified the amount of the VDT surcredit riders that should be**
7 **effective on April 1, 2006?**

8

9 A. Yes. The net savings should be the January – March 2006 gross savings on an
10 annualized basis projected by the Companies and reflected in Exhibit B to the
11 Settlement Agreement. These are the same amounts that would be computed by using
12 the net savings for January – March 2006 from the Companies' tariff and adding back
13 the amortization expense. Thus, the annualized gross savings and net savings amounts
14 for each Company on and after April 1, 2006 are as follows:

15

16	LG&E Electric	\$10.5 million times 4 = \$42.0 million
17	LG&E Gas	\$ 2.7 million times 4 = \$10.8 million
18	KU Electric	\$ 5.1 million times 4 = \$20.4 million

19

20 The net savings amounts that should be allocated to the ratepayers of each Company on
21 and after April 1, 2006 on an annual basis are as follows:

22

23	LG&E Electric	\$42.0 million times 40% = \$16.8 million
----	---------------	---

1 LG&E Gas \$10.8 million times 40% = \$ 4.3 million
2 KU Electric \$20.4 million times 40% = \$ 8.2 million¹
3
4
5

¹ I have attached a copy of Exhibit B to the Settlement Agreement as my Exhibit__(LK-2). The WSP amortization expense for each Company, as adjusted by the Companies for actual WSP costs and reflected in the Companies' tariffs, was provided by the Companies in response to the Third Data Request of the Staff, Question 15 in Docket No. 2003-00433 and Question 17(b) in Docket No. 2003-00434. I have attached the relevant portions of these responses as my Exhibit__(LK-3).

1 **IV. THE COMMISSION SHOULD REJECT THE COMPANIES' PROPOSAL TO**
2 **TERMINATE VDT SURCREDIT RIDERS**
3

4 **Q. Please describe the Companies' proposal to address the VDT savings and the**
5 **allocation of those savings to ratepayers.**

6
7 A. The Companies propose to eliminate all VDT savings to ratepayers through the
8 withdrawal of the VDT surcredit rider tariffs. The Companies' proposal is the
9 functional equivalent of continuing the VDT surcredit riders, but changing the sharing
10 formula to allocate 100% of the net savings to the Companies and 0% to their
11 ratepayers. This occurs because the base rates established in Case Nos. 2003-00433 and
12 2003-00434 reflect no WSP savings as a reduction to the revenue requirement. If the
13 VDT surcredit riders are eliminated, then the 40% allocation of net savings to ratepayers
14 also is eliminated.

15
16 **Q. Is the Companies' proposal reasonable?**

17
18 A. No. It is extremely unreasonable and should be rejected. The Companies' proposal is
19 the exact opposite of the normal ratemaking process whereby 100% of such savings are
20 flowed through to the ratepayers. Given that their ratepayers have now paid 100% of the
21 costs, they should receive 100% of the savings resulting from the incurrence of the costs.

1 **Q. Please respond to the Companies’ attempts to justify the reallocation of the savings**
2 **on the basis of alleged under-earnings.**

3

4 A. The Commission should reject this attempt. First, the VDT surcredit riders have been
5 and should continue to be treated as a stand-alone ratemaking mechanism in the same
6 manner that the Fuel Adjustment Clause and Environmental Cost Recovery mechanisms
7 are stand-alone ratemaking mechanisms.

8

9 Second, the Commission previously rejected this very approach in the Companies’
10 merger proceeding, Case No. 97-300, in which the parties other than the Companies
11 proposed the use of over-earnings to justify an increased sharing allocation to ratepayers.

12 In the same manner, the Commission should reject the Companies’ approach of using
13 alleged under-earnings to justify a greater savings allocation to the Companies. In Case
14 No. 97-300, the Companies strenuously argued against the other parties’ proposal to use
15 overearnings to justify a greater savings allocation to ratepayers than had been proposed
16 by the Companies. Abandoning the position they took in the merger proceeding, the
17 Companies now strenuously argue the opposite position in this proceeding in their
18 attempt to use alleged under-earnings to justify a greater savings allocation to
19 themselves.

20

1 In Case No. 97-300, the Commission decided against KIUC and the AG and it should
2 decide against the Companies in this proceeding for the same reasons. The following
3 excerpts from the Commission's Order in Case No. 97-300 describe the KIUC proposal
4 and the Commission's decision to exclude any effects of "current earnings" on the
5 allocation of savings to ratepayers due to the Companies' merger.

6
7 **The Intervenors proposed that the identifiable merger savings be shared on**
8 **a basis that would give a larger portion of the savings to ratepayers. KIUC**
9 **proposed a 60/40 sharing, while the Attorney General proposed a 75/25**
10 **sharing. They argue that a larger portion of the savings should be shared**
11 **with the ratepayers due to the Applicants' current earnings. The**
12 **Applicants, however, claim that their earnings should not be investigated in**
13 **a merger case.**

14
15 *****

16
17 **The Commission notes that prior to the Applicants filing this merger case,**
18 **none of the parties had filed a complaint setting forth a prima facie case**
19 **that either LG&E's or KU's rates were unreasonable, and the Commission**
20 **had made no decision to do so on its own motion.**

21
22 *****

23
24
25 **Thus, the Commission is not persuaded to adjust the Applicants' proposed**
26 **ratio for sharing merger benefits. Nor do we believe that a reduction in**
27 **base rates, rather than a billing credit, is necessary or appropriate to ensure**
28 **an uninterrupted sharing of merger savings with ratepayers. Further, the**
29 **Commission finds that it is not appropriate in this instance to establish an**
30 **earnings review as a precondition to the merger. The Applicants' proposed**
31 **rate credits will provide significant future benefits to ratepayers, and the**
32 **parties as well as the Commission retain the ability under KRS 278.260 to**
33 **review the utilities' earnings.**

1

2 Third, to my knowledge, the Commission never has considered base rate earnings when
3 it rolls-in to base rates the effects of the FAC or the ECR outside of a comprehensive
4 base rate proceeding. It should not do so now in conjunction with the proposed
5 termination of the VDT surcredit riders.

6

7 Fourth, the Companies are not prohibited from seeking base rate increases if they
8 believe they are under-earning. This stand-alone proceeding should not be used as a
9 “back-door” base rate case proceeding.

10

11 **Q. Does this complete your testimony?**

12

13 **A. Yes.**

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LANE KOLLEN

ON BEHALF OF THE
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

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DECEMBER 2005