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PUBLIC SERVICE
COMMISSION

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

RE: The Plan of Kentucky Utilities Company for the Value Delivery Surcredit Mechanism
Case No. 2005-00351

Dear Ms. O'Donnell:

Enclosed please find an original and seven (7) copies of Kentucky Utilities Company's ("KU") response to the Commission Staff's Third Data Request dated January 25, 2006, in the above-referenced case.

Should you have any questions concerning the enclosed, please do not hesitate to contact me.

Sincerely,

Kent W. Blake

cc: Elizabeth E. Blackford
Michael L. Kurtz
David F. Boehm

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

RESPONSE OF
KENTUCKY UTILITIES COMPANY
TO THE
COMMISSION STAFF'S THIRD DATA REQUEST
DATED JANUARY 25, 2006

FILED: FEBRUARY 6, 2006

KENTUCKY UTILITIES COMPANY

CASE NO. 2005-00351

Response to the Commission Staff's Third Data Request Dated January 25, 2006

Question No. 1

Responding Witness: Kent W. Blake

- Q-1. Refer to page 2 of the Rebuttal Testimony of Kent W. Blake ("Blake Testimony") and Item 7(c) of KU's response to the Commission Staff's Supplemental Data Request ("Staff's Supplemental Request") of November 14, 2005. The sentence at lines 5-7 of the Blake Testimony reads, "The Companies have taken the position that the VDT Surcredit mechanism has served its purpose during its term and should now be allowed to expire." The sentence at lines 10-12 reads, "In their plans filed with the Commission in these proceedings, the Companies have proposed detailed steps for customers to receive 100 percent of the savings from the VDT initiative after expiration of the existing VDT Surcredit mechanism." The data response reads, "The savings associated with the WSP and related value delivery initiatives were reflected in the Company's net operating income for the test year ended September 30, 2003, which was used in determining the revenue requirement in the Company's last general rate case. The test year also reflected the amortization of the costs to achieve those savings and the sharing of those savings between customers and the shareholder."
- a. How has the explanation included in the response to Item 7(c) of the Staff's Supplement Request been incorporated into KU's decision to request that the VDT surcredit mechanism be terminated?
- b. Describe the extent to which the treatment of items related to the Workforce Separation Program in KU's last general rate case supports its contention that the "VDT Surcredit mechanism has served its purpose" and that it has proposed "detailed steps for customers to receive 100 percent of the savings from the VDT initiative after expiration of the existing VDT Surcredit mechanism."
- A-1. The Company has combined its responses to questions (a) and (b) below. The responses to both questions relate directly to the Company's position in this proceeding and were combined to provide the appropriate context.

a. and b.

As indicated in the response to Item 7(c) of KU's response to the Commission Staff's Supplemental Data Request of November 14, 2005, and the table on page 5 of the direct testimony of Kent Blake filed with KU's application in this proceeding on September 30, 2005, the Company recognizes that, to the extent actual savings from the VDT initiative were exactly equal to the estimated savings included in the October 31, 2001 written and unanimous Settlement Agreement in Case No. 2001-169¹ ("2001 Settlement Agreement"), the initiative did not impact base rates. To the extent actual savings exceeded those estimates, they were reflected in base rates in the Company's last rate case.

At the request of the KIUC and AG, the 2001 Settlement Agreement provided that the customers' share of the estimated net savings would be provided via the surcredit mechanism over a 60-month period in order to guarantee that customers would receive net savings from the initiative during the amortization period of related costs regardless of whether the initiative actually provided such net savings.

The surcredit mechanism has thus served its purpose by providing these guaranteed net savings to customers while the related costs were being amortized over that 60-month period and should now be allowed to expire as originally provided for in the 2001 Settlement Agreement. Following the expiration of the surcredit mechanism and the cost amortization period, the savings associated with the VDT initiative will be treated like other operational savings the Company is able to realize. That is, they will be considered as part of the overall financial returns of the Company in any revenue requirements analysis to determine whether base rates are fair, just and reasonable.

The Company has presented evidence in this proceeding that demonstrates the Company's rates will remain fair, just and reasonable after the expiration of the VDT Surcredit mechanism. Following the expiration of the surcredit mechanism and the completion of the cost amortization, customers will begin to effectively receive 100% of the gross savings from the VDT initiative effective April 1, 2006 because the savings to customers would offset other increases in the cost of providing service such that base rates remain constant.

¹ *In the Matter of: Annual Earnings Sharing Mechanism Filing of Louisville Gas and Electric Company, Case No. 2001-054; Annual Earnings Sharing Mechanism Filing of Kentucky Utilities Company, Case No. 2001-055; Application of Kentucky Utilities Company for an Order Approving Revised Depreciation Rates, Case No. 2001-140; Application of Louisville Gas and Electric Company for an Order Approving Revised Depreciation Rates, Case No. 2001-141; Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be Included in Earnings Sharing Mechanism, Case No. 2001-169, Commission's Order dated December 3, 2001.*

The Company goes on to stipulate on page 6 of Mr. Blake's direct testimony that in subsequent base rate cases the Company's net operating income will not reflect the VDT cost amortization or surcredits nor will the Company include a pro-forma adjustment to retain the shareholders' portion of these savings. Just as the Company's pro-forma analysis filed in this proceeding shows that base rates will be at such a level upon expiration of the VDT surcredit mechanism that effectively provides 100% of the gross VDT savings to customers, the Company's next base rate case after that date will directly reflect this in the calculation of the Company's revenue requirement.