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PUBLIC SERVICE
COMMISSION

Stephanie L. Stumbo
Executive Director
Kentucky Public Service Commission
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Frankfort, Kentucky 40602-0615

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March 20, 2008

**RE: AN INVESTIGATION OF THE ENERGY AND REGULATORY
ISSUES IN SECTION 50 OF KENTUCKY'S 2007 ENERGY ACT**
Adm Case 2007-00477

Dear Ms. Stumbo:

Enclosed please find an original and ten (10) copies of Kentucky Utilities Company (“KU”) and Louisville Gas and Electric Company (“LG&E”) Response to the First Data Request of Commission Staff to Louisville Gas and Electric Company and Kentucky Utilities Company dated March 11, 2008, in the above-referenced docket.

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

Sincerely,

Rick E. Lovekamp

cc: Parties of Record

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

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MAR 20 2008

**PUBLIC SERVICE
COMMISSION**

In the Matter of:

**AN INVESTIGATION OF THE)
ENERGY AND REGULATORY)
ISSUES IN SECTION 50 OF) CASE NO. 2007-00477
KENTUCKY'S 2007 ENERGY ACT)**

**LOUISVILLE GAS AND ELECTRIC COMPANY
AND
KENTUCKY UTILITIES COMPANY
RESPONSE TO FIRST DATA REQUEST
OF COMMISSION STAFF
DATED MARCH 11, 2008**

FILED: March 20, 2008

VERIFICATION

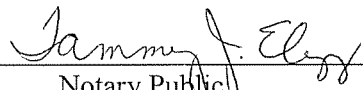
STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Lonnie E. Bellar**, being duly sworn, deposes and says that he is Vice President, State Regulation and Rates for E.ON U.S. Services Inc., that he has personal knowledge of the matters set forth in the responses (Question Nos. 1-6), and the answers contained therein are true and correct to the best of his information, knowledge and belief.



LONNIE E. BELLAR

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 20th day of March, 2008.

 (SEAL)

Notary Public

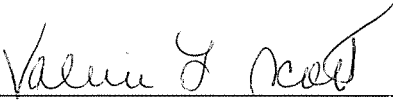
My Commission Expires:

November 9, 2010

VERIFICATION

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Valerie L. Scott**, being duly sworn, deposes and says that she is Controller for E.ON U.S. Services Inc., that she has personal knowledge of the matters set forth in the response (Question No. 6a), and the answers contained therein are true and correct to the best of her information, knowledge and belief.



VALERIE L. SCOTT

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 20th day of March, 2008.



Notary Public (SEAL)

My Commission Expires:
November 9, 2010

**LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY**

ADMINISTRATIVE CASE NO. 2007-00477

**Response to First Data Request of Commission Staff
Dated March 11, 2008**

Question No. 1

Responding Witness: Lonnie E. Bellar

- Q-1. Refer to pages 2-3 of the Direct Testimony of Lonnie E. Bellar (“Bellar Testimony”), specifically, the proposal for annual reviews of utility’s financial results. Provide a more detailed description of the manner in which these financial reviews would be conducted and processed by the Commission.
- a. Include in the description a discussion of the information upon which LG&E/KU believe the Commission’s decision would be based.
 - b. Would adjustments to the utility’s actual financial results be allowed or be required to reflect changes in items such as the number of customers served, annual degree days, and the level of economic activity in the service territory?
- A-1.
- a. Though the LG&E/KU (collectively, the “Companies”) do not have a specific proposal, the description of the information upon which the Companies believe the Commission’s decision may be based could be comparable to the annual revenue requirement filings used for the Earning Sharing Mechanism or the Annual Information Filing made by KU each year with the Virginia State Corporation Commission. Any such annual review would necessarily be less comprehensive and time-consuming than a general rate case, but the information reviewed would be sufficient to ensure that a utility’s revenues for the year were consistent with the rates established in the utility’s most recent general rate case.
 - b. Again the Companies do not have a specific proposal, however standard ratemaking adjustments approved in the Companies' most recent rate cases could be used.

**LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY**

ADMINISTRATIVE CASE NO. 2007-00477

**Response to First Data Request of Commission Staff
Dated March 11, 2008**

Question No. 2

Responding Witness: Lonnie E. Bellar

Q-2. Refer to the Bellar Testimony, page 2, lines 16-18. Is Mr. Bellar recommending annual rate adjustments to ensure that the utilities' revenues remain constant only to the extent that revenues have decreased as a direct result of implementing energy efficiency programs? If no, explain in detail the reasons why Mr. Bellar believes that Section 50 of the 2007 Energy Act encompasses rate adjustments to keep utilities' revenues constant between rate cases when the changes in the levels of revenues are unrelated to energy efficiency programs.

A-2. First, the annual rate adjustment proposal would ensure utilities' revenues remained consistent with their approved rate designs – not “constant” – and could do so even in situations in which utilities' revenues decreased for reasons other than energy efficiency programs.

Second, Section 50 of the 2007 Energy Act “direct[s] the Commission to examine its statutes and make recommendations on or before July 1, 2008 to the Legislative Research Commission (“LRC”) regarding four highly technical energy and regulatory issues.” Among those issues are energy efficiency and DSM programs and strategies. But nothing in Section 50 forbids the Commission from entertaining in this proceeding proposed solutions that address not only the issues explicitly raised in Section 50, but others as well. Therefore, the annual rate adjustment proposal is appropriate to discuss in this proceeding precisely because it addresses energy efficiency and DSM concerns; the fact that it addresses other situations as well does not make it less relevant to the issues at hand or otherwise inappropriate to discuss in this forum.

**LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY**

ADMINISTRATIVE CASE NO. 2007-00477

**Response to First Data Request of Commission Staff
Dated March 11, 2008**

Question No. 3

Responding Witness: Lonnie E. Bellar

- Q-3. Refer to the Bellar Testimony, page 4, lines 4-15. Explain in detail whether LG&E/KU believe that KRS 278.285 already authorizes the recovery of the two rate-making measures discussed by Mr. Bellar. If not, explain in detail the revisions that would be needed to KRS 278.285 to authorize such recovery.
- A3. Yes, please see the Bellar Testimony, page 2, lines 13-15.

**LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY**

ADMINISTRATIVE CASE NO. 2007-00477

**Response to First Data Request of Commission Staff
Dated March 11, 2008**

Question No. 4

Responding Witness: Lonnie E. Bellar

- Q-4. Refer to page 4 of the Bellar Testimony, specifically, the discussion of the proposed incentive return-on-equity adder ("ROE adder") for investments in energy efficiency programs. If a portion of the costs of energy efficiency programs are allowed to be capitalized (as also suggested on page 4 of the Bellar Testimony) and permitted to earn a return, explain why it is necessary to have an ROE adder compared to the return allowed on traditional investment in generation, transmission and distribution plant.
- A-4. The Companies did not mean to suggest that an ROE adder is "necessary". If it is a goal to increase the number, size, and scope of such programs, one way to encourage utilities to meet the goal is to create additional incentives for utilities to increase the number, size, and scope of the programs. One possible incentive would be an ROE adder for utilities' capital investments associated with such programs.

**LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY**

ADMINISTRATIVE CASE NO. 2007-00477

**Response to First Data Request of Commission Staff
Dated March 11, 2008**

Question No. 5

Responding Witness: Lonnie E. Bellar

- Q-5. Refer to page 5 of the Bellar Testimony concerning the proposal that utilities be permitted to capitalize the demand cost portion of any purchased power contracts into which they enter.
- a. Explain how not being permitted to capitalize any part of the cost of economic purchased power causes such purchases to be “less economically viable” alternatives to constructing new generation.
 - b. Mr. Bellar makes reference to the proposal being particularly relevant to renewable resource purchased power twice in the discussion on page 5, lines 1-10. However, the proposal will allow capitalization for all purchased power contracts. Explain why LG&E/KU believe that capitalizing the demand component of all purchased power within the scope of the issues set forth in Section 50 of the 2007 Energy Act and explain which issue(s) encompass this proposal.
 - c. Filings supporting LG&E/KU’s monthly fuel adjustment clause (“FAC”) reports, as well as similar supporting filings of other generating utilities reflect that the terms of power purchase transactions have evolved in recent years such that prices typically reflect an all-in energy price stated in dollars per megawatt-hour. Do LG&E/KU have reason to believe that this energy pricing structure will be changing within the industry or, alternatively, that they can negotiate to have both demand and energy pricing in their future purchased power contracts? Explain the response.
 - d. If LG&E/KU enter into a long-term purchase power contract and are allowed to capitalize the demand-related cost component, will this result in LG&E/KU recovering all of its expenses for purchasing that power plus recovering a return on capital that was never invested?
 - e. Does LG&E/KU believe that proper consideration would be given to purchase power alternatives, demand-side management programs, and energy efficiency programs if amendments were enacted to the integrated resource plan regulation, 807 KAR 5:058, and the certificate statute, KRS

278.020, to require a showing that such alternatives and programs were considered before a certificate to construct new generation could be issued?

- A-5.
- a. Allowing utilities to capitalize the demand component of purchased power, and therefore to earn a return on that portion of it, would provide an incentive to supply customers' needs with purchased power rather than self-built generation.
 - b. As the Companies stated in response to Q-2 above, Section 50 of the 2007 Energy Act "direct[s] the Commission to examine its statutes and make recommendations on or before July 1, 2008 to the Legislative Research Commission ("LRC") regarding four highly technical energy and regulatory issues." One of the issues Section 50 explicitly asks the Commission to address is "[e]ncouraging diversification of utility energy portfolios through the use of renewables . . .," which the Companies believe includes power purchases from renewable sources. But nothing in Section 50 forbids the Commission from entertaining in this proceeding proposed solutions that address not only the issues explicitly raised in Section 50, but others as well. Therefore, the proposal to allow utilities to capitalize the demand component of purchased power is appropriate to discuss in this proceeding precisely because it addresses the renewables issue; the fact that the proposal addresses other situations as well does not make it less relevant to the issues at hand or otherwise inappropriate to discuss in this forum.
 - c. There have been in the past, and likely will continue to be in the future, various purchase power products available depending upon the type of resource sought. Economy power purchases for short periods of time remain all-in, energy-priced products. However, longer term contracts for purchase power or call option products have in the past and likely will in the future contain demand and energy components. For example, the Companies recently executed a Purchase Power Agreement with Dynegy for unit firm power during the summer periods (June through September) of 2008 and 2009. This peaking power call option contains a demand price component as well as an energy price component.
 - d. Long-term purchase power agreements are significant financial commitments by the Companies that impair the Companies' ability to invest capital elsewhere. In that way, such commitments are like capital investments, therefore it may be appropriate for the Companies to earn a return thereon.
 - e. The Companies believe proper consideration is already given to purchase power alternatives, demand-side management programs, and energy efficiency programs in the current IRP and CPCN processes.

**LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY**

ADMINISTRATIVE CASE NO. 2007-00477

**Response to First Data Request of Commission Staff
Dated March 11, 2008**

Question No. 6

Responding Witness: Valerie L. Scott / Lonnie E. Bellar

- Q-6. Refer to the Bellar Testimony, page 5, lines 5-10.
- a. Is capitalization of the demand cost of a long-term purchase power contract required by generally accepted accounting principles or is the capitalization merely a means to establish a regulatory asset?
 - b. Provide a list of each U.S. regulatory commission that has adopted a policy of allowing a portion of purchased power costs to be capitalized with a return earned on the unamortized balance. For each such commission, provide the statute, regulation, order, etc., which authorizes such treatment of purchased power costs.
 - c. Considering that Kentucky jurisdictional local distribution gas companies do not earn a return on the demand costs incurred for the purchase of natural gas, explain why the power purchased by an electric utility should be treated differently.
- A-6. a. Generally accepted accounting principles could require a long-term purchase power contract to be capitalized depending on the contract terms. For instance, if a long-term purchase power contract meets the criteria of a capital lease, under Statement of Financial Accounting Standards (SFAS) No. 13, *Accounting for Leases*, an asset and associated debt could be recorded. Also, if a long-term purchase power contract was determined to be a derivative not subject to the normal purchases and sales exclusion under the requirements for SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the mark-to-market value of the contract could be recorded on the balance sheet. Regardless of the terms of the contract, with Commission approval, the demand cost of a long-term purchase power contract could be recorded as a regulatory asset under SFAS No. 71, *Accounting for Certain Types of Regulation*.

- b. The Companies are not aware of any U.S. regulatory commissions that have adopted a policy of allowing a portion of purchased power costs to be capitalized with a return earned on the unamortized balance.
- c. Please see response to Q-5 (d).