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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY UTILITIES	)	
COMPANY FOR AN ADJUSTMENT OF	)	CASE NO. 2009-00548
BASE RATES	)	

ATTORNEY GENERAL'S RESPONSES TO DISCOVERY REQUESTS OF KENTUCKY PUBLIC SERVICE COMMISSION

Comes now the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and states as follows for his responses to the discovery requests of the Kentucky Public Service Commission staff.

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that the responses set forth herein are true and accurate to the best of his knowledge, information, and belief formed after a reasonable inquiry. Counsel further certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

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____
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Data Requests relating to the Testimony of Mr. Majoros:

WITNESS RESPONSIBLE:
Michael Majoros

QUESTION 1:
Refer to the testimony of Michael J. Majoros, Jr. ("Majoros Testimony") at pages 1-5. On page 1, Mr. Majoros states that his firm, Snavely King Majoros O'Connor & Bedell, Inc. ("Snavely King") has "participated in more than 1,000 proceedings before almost all of the state commissions." On page 2, he states that he and other members of his firm specialize in the field of "public utility depreciation." On pages 4 and 5, he states that it is appropriate to apply KU's 2008 and 2009 deferred storm damage costs of $2.195 million and $57.237 million, respectively, against the asset removal costs that have been recovered in prior years through depreciation rates.

(a) Provide all testimony prepared by a Snavely King member wherein a recommendation was made to apply deferred storm damage costs, or any other type of regulatory asset, to the asset removal costs accumulated by a utility through its depreciation rates (as suggested by Mr. Majoros in this case) in those cases in which the regulatory commission agreed to and accepted this position. In all such instances, provide the pertinent parts of the commission orders approving this rate treatment.

(b) Provide a reference to the International Financial Accounting Standards ("IFAS") upon which Mr. Majoros bases the statement shown on page 5 that "KU's Cost of Removal Regulatory Liability is likely to disappear when KU begins accounting under the new IFRS (sic). That is because, when KU adopts IFRS (sic), it will reduce the huge regulatory liability to its present value. It will transfer the entire excess to its equity account."

(1) Explain whether Mr. Majoros is aware that the regulatory liability to which he refers is recorded only for Generally Accepted Accounting Practices ("GAAP") and that for regulatory accounting purposes this amount is recorded as accumulated depreciation.
(2) If current IFAS replaces GAAP in the United States, explain whether Mr. Majoros agrees that asset removal costs will continue to be reported as a component of accumulated depreciation for regulatory purposes.

(3) Explain whether Mr. Majoros is aware that the International Accounting Standards Board ("IASB") issued an Exposure Draft in August 2009 seeking comment to its proposed IFAS standard defining regulatory assets and regulatory liabilities.

(4) If the IASB's Exposure Draft becomes a part of IFAS, would Mr. Majoros change his opinion regarding KU's restatement of its regulatory liability to a discounted present value amount and roll-in to equity? Explain.

(c) Would Mr. Majoros agree that the deferred storm restoration costs represent the cost, which would have otherwise been expensed, of repairing existing facilities and that the deferred amounts do not include the cost of removing or replacing assets that were destroyed beyond repair? If no, explain why. If yes, state why Mr. Majoros is of the opinion that it is appropriate to pay for these deferred repair costs with funds that have been collected to remove assets from service when necessary.

(d) Would Mr. Majoros agree that the rate treatment he suggests here would impact the depreciation rates of KU in a future depreciation study?

(1) If no, explain why.
(2) If yes, quantify this impact using KU's depreciation rates as approved by the Commission and attached to the Commission's final order in Case No. 2008-00251.[1]

RESPONSE:

(a) See attachment which contains the relevant portion of Majoros testimony Washington State Docket Nos. UE-072300 and UG-072301. The case was settled via black-box settlement.

(b) See discussion and schedules in attached CD.

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[1] Case No. 2008-00251, Application of Kentucky Utilities Company for an Adjustment of Electric Base Rates (Ky. PSC Feb. 5, 2009).

(1) Mr. Majoros does not agree with the premise of the question. The Company records the regulatory liability on its official books and reports it to its shareholders and the SEC and the world at large. Mr. Majoros is testifying as

an expert witness on behalf of the Attorney General and his constituent interests which presumably includes all Kentucky citizens. He is trying to protect this regulatory liability on behalf of ratepayers and to avoid unnecessary rate increases which amount to essentially a double recovery. Without such protection there is no way the regulatory system in Kentucky can guarantee that ratepayers will not lose their money.

(2) Mr. Majoros does not agree. Regulators cannot guarantee that outcome. Mr. Majoros believes that the utilities will receive a significant gain and ratepayers will suffer a significant loss, if the Commission makes that assumption.

(3) Yes.

(4) Mr. Majoros would not change his opinion based on his thirty years of regulatory accounting and ratemaking experience and training as a CPA. There is no question in Mr. Majoros's mind as to the company's intent to record that money in its income account.

(c) Mr. Majoros did not participate in the proceeding in which the Commission decided to allow the Company to calculate and record such costs. So he does not know what went into the figures. However, Mr. Majoros does not believe that the words surrounding the deferred costs and the premise of the question are relevant. He is accepting the ratepayers' responsibility for the costs, and recommending a reduction of the company's debt to ratepayers' as compensation to the company.

(d) No. If Mr. Majoros were to recommend depreciation rates, they would be whole-life rates which do not take the depreciation reserve into consideration. He would recommend that any significant reserve imbalance be considered for amortization separately.

WITNESS RESPONSIBLE:
Michael Majoros
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QUESTION 2:

Refer to page 6 of the Majoros Testimony where he recommends, with no explanation, that KU's regulatory assets for its investments in the Kentucky Consortium for Carbon Storage and the Carbon Management Resources Group be applied to KU's Cost of Removal Regulatory Liability. Given that these two regulatory assets have no relation to the removal of assets or amounts collected through depreciation expense to cover the cost of asset removal, explain Mr. Majoros's recommendation.

RESPONSE:
See response to 1.c. above.

Attorney General's Responses to Data Requests
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Data Requests relating to the Testimony of Mr. Watkins:

WITNESS RESPONSIBLE:
Glenn Watkins
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QUESTION 3:

Refer to page 40 of the Prepared Direct Testimony and Schedules of Glenn A. Watkins ("Watkins Testimony"). Explain why the customer charge calculated by Mr. Watkins is considerably lower than the customer charges authorized by the Commission for other utilities in recent years. Include in the explanation whether Mr. Watkins believes there are specific reasons for KU that would cause the customer charge to be lower than those of other utilities.

RESPONSE:
Mr. Watkins has been involved in several electric and natural gas LDC rate cases in Kentucky during the last few years. Every case that Mr. Watkins has been involved in has resulted in a settlement that reflected compromises of the positions of all parties. Mr. Watkins explains in detail on pages 31 through 40 of his direct testimony why Residential customer changes should remain at their current level.

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WITNESS RESPONSIBLE:
Glenn Watkins
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QUESTION 4:
Refer to pages 15–20 of the Watkins Testimony. Is Mr. Watkins aware that the modified Base Intermediate Peak methodology employed by KU in this case has been utilized in prior KU rate cases? If yes, explain whether there are differences in the proposed methodology in this case and the methodology used in the prior cases.

RESPONSE:
It is Mr. Watkins understanding that KU has proposed a cost of service method similar, if not identical to, the approach it is proposing in this case for the last several rate cases. It is also Mr. Watkins understanding that KU's proposed CCOSS method has been rigorously criticized and opposed in prior rate cases. Mr. Watkins has not conducted an investigation or analyses of any differences that may or may not exist between KU's proposed CCOSS in this case and those proposed in prior cases.

WITNESS RESPONSIBLE:
Glenn Watkins
Page 1 of 1

QUESTION 5:
Explain whether Mr. Watkins supports KU's proposed revision to its large commercial and industrial rate design that converts it to a kVa billing demand basis rather than a kW billing demand basis.

RESPONSE:
Mr. Watkins has not investigated KU's proposed revision to its large Commercial and Industrial rate design that converts it to a kVa billing demand. As such, Mr. Watkins has no opinion on this issue.

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WITNESS RESPONSIBLE:
Glenn Watkins
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QUESTION 6:

Explain whether Mr. Watkins agrees with Kentucky Industrial Utility Customer witness Stephen J. Baron's recommendation for a 25 percent subsidy reduction for KU's large industrial rates.

RESPONSE:
It is incorrect to characterize any classes' current rates and/or revenue as providing any "subsidy" to any other class or group of customers. Mr. Watkins also disagrees with Mr. Baron's proposed class revenue allocation.

Data Requests relating to the Testimony of Dr. Woolridge:

WITNESS RESPONSIBLE:
Dr. Woolridge
Page 1 of 1

QUESTION 7:
Refer to the Direct Testimony of Dr. J. Randall Woolridge ("Woolridge Testimony"), page 12 and Exhibit JRW-4. Provide a copy of the most recent published company analysis from Value Line for each of the companies in the electric proxy group.

RESPONSE:

The requested documents are provided on the CD in the V-Lines folder.

WITNESS RESPONSIBLE:
Dr. Woolridge
Page 1 of 1

QUESTION 8:
Several of the companies in the proxy group shown in Exhibit JRW-10 page 3 have negative growth rates. Explain why it is valid to have these companies included in the analysis.

RESPONSE:

The data in Exhibit JRW-3 are Value Line's historic five and ten year growth rates for EPS, DPS and BVPS. Historic growth rate figures are provided to investors by virtually all investor information services, and so investors presumably use these figures in forming expectations of the future. Negative growth rates have been experienced in the past, especially for corporate earnings, and they will no doubt be experienced in the future. Therefore, they are part of the distribution of possible outcomes that investors consider when developing expectations of the future.

WITNESS RESPONSIBLE:
Dr. Woolridge
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QUESTION 9:
To the extent possible, provide KU's Earnings Per Share ("EPS"), Dividends Per Share ("DPS"), and Book Value Per Share 5-year and 10-year growth rates and describe how they compare to those of the companies listed in the proxy group.

RESPONSE:
Dr. Woolridge does not have the requested data and did not use it in developing his testimony and exhibits.

WITNESS RESPONSIBLE:
Dr. Woolridge
Page 1 of 1

QUESTION 10:
Refer to the Woolridge Testimony at pages 28–29 and Exhibit JRW-10. Explain why using internal growth and return calculations, which are derived in part, through rates determined by returns of equity ("ROE") awarded in other jurisdictions, as a proxy for dividend growth does not introduce a degree of circularity into the calculation that could make it unacceptable.

RESPONSE:
First, prospective internal growth is only one the growth rate measures considered. Second, while these may be subject to a degree of circularity, the expected growth of earnings, dividends, and book values of all of these companies are all affected to some extent by the authorized ROEs from other jurisdictions. Therefore, there is no escaping the impact of awarded ROEs on the expected growth rates of these companies. Finally, the ROE's used are the ROE forecasts from *Value Line*. If investors rely on these forecasts, then they are a factor in gauging future growth rate expectations.

WITNESS RESPONSIBLE:
Dr. Woolridge
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QUESTION 11:
Refer to the Woolridge Testimony at page 40. Provide legible copies of the referenced Derrig and Orr (2003), Fernandez (2007) and Song (2007) articles.

RESPONSE:
The requested articles are provided on the CD in the Articles folder.

WITNESS RESPONSIBLE:
Dr. Woolridge

QUESTION 12:
Refer to the Woolridge Testimony at pages 40-49 and Exhibit JRW-11 page 6 of 11. It is not clear whether the underlying assumptions, definitions of risk and return, as well as the estimates, in each of the studies are consistent and the results are appropriate for use in determining an estimated ROE in a regulated utility rate case.

(a) Provide a copy of each article or report listed in the Exhibit on page 6 of 11.

(b) For each article listed in the chart for which a low and high range is provided, explain whether EPS or DPS measures serve as the basis for the listed equity risk premium.

(c) Explain why it is valid to use a geometric mean to calculate the equity risk premium and, if it is valid, why it is reasonable to average those projections with those calculated using an arithmetic mean.

(d) Some equity risk premium estimates appear low and, therefore, may not be valid for the stated purpose. Two studies have estimates below 3.0 percent and two additional studies have estimates below 4.0 percent. Explain why an investor would undertake investing in stocks with risk premiums this low.

RESPONSE:

a. The requested articles are provided on the CD in the Articles folder.

b. On page 6 of Exhibit JRW-11, no high and low range is provided in the studies and hence none is reported.

c. There is a debate about whether the geometric or the arithmetic mean is appropriate is gauging historic returns. Those who believe that stock returns are mean reverting believe that the geometric mean is the appropriate measure of central tendency. And those who do not believe that stock returns are mean reverting believe that the arithmetic mean is appropriate. The following discussion comes from an article by John Campbell entitles "Forecasting U. S. Equity Returns in the 21st Century," pages 3, and is included on the CD in the Articles folder and is listed as Campbell, Diamond and Shoven.pdf.

"When returns are negatively serially correlated, however, the arithmetic average is not necessarily superior as a forecast of long-term future returns. To understand this, consider an extreme example in which prices alternate deterministically between 100 and 150. The return is 50% when prices rise, and -33% when prices fall. Over any even number of periods, the geometric average return is zero, but the arithmetic average return is 8.5%. In this case the arithmetic average return is misleading because it fails to take account of the fact that high returns always multiply a low initial price of 100, while low returns always multiply a high initial price of 150. The geometric average is a better indication of long-term future prospects in this example. This point is not just a theoretical curiosity, because in the historical data summarized by Siegel, there is strong evidence that the stock market is mean-reverting. That is, periods of high returns tend to be followed by periods of lower returns. This suggests that the arithmetic average return probably overstates expected future returns over long periods."

d. Dr. Woolridge has used the results of all studies which he could find that provide an equity risk premium estimate. He has not excluded the results of any studies because the equity risk premium estimates were high or low compared to other studies.