COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR AN ADJUSTMENT OF ITS ELECTRIC AND GAS BASE RATES	))))	CASE NO. 2009-00549

RESPONSE OF KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
TO FIRST DATA REQUEST OF
COMMISSION STAFF

1. Refer to the Direct Testimony of Lane Kollen ("Kollen Testimony"), page 6, at which Mr. Kollen states that KIUC opposed the unbilled revenue adjustment in a previous Louisville Gas and Electric Company ("LG&E") rate case, Case No. 2003-00433.[1] State whether KIUC opposed the unbilled revenue adjustment in LG&E's subsequent rate case, Case No. 2008-00252.[2] If no, explain why it was not opposed.

Response:

No. KIUC does not identify or address all potential issues in rate cases. Mr. Kollen does not recall whether he identified the unbilled revenue adjustment as a potential issue, and if he did, why he did not oppose it. Regardless, the case was settled and there was no Commission adjudication of the issue.

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[1] Case No. 2003-00433, An Adjustment of the Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company (Ky. PSC Jun. 30, 2004).

[2] Case No. 2008-00252, Application of Louisville Gas and Electric Company for an Adjustment of Electric and Gas Base Rates (Ky. PSC Feb. 5, 2009).

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2. Refer to page 13 of the Kollen Testimony, specifically, lines 8 through 15, where Mr. Kollen discusses the harm to ratepayers until base rates are reset in the next base rate case if off-system sales ("OSS") margins are not normalized and states that "[i]t is vitally important that base rates reflect a normal amount of OSS margins..." (Emphasis added).
   a. Confirm whether it is Mr. Kollen's understanding that historically, in LG&E rate cases, the Commission has not adjusted or normalized OSS margins.
   b. Confirm that, by a "normal" amount of OSS margins, Mr. Kollen means an average of historical annual OSS margins.
   c. If the Commission were to adopt Mr. Kollen's recommendation in this case, when OSS margins are below "normal" and the normalization adjustment increases them and lowers the revenue requirement, does KIUC commit to supporting adjustments to normalize OSS margins in future LG&E cases irrespective of the test year level and the adjustment's impact on the revenue requirement? If no, explain why.

Response:

a. Mr. Kollen is not aware that parties have proposed or that the Commission has adopted a normalization adjustment to OSS margins based on average historic margins. But past Commission inaction on an issue does not preclude a change in practice if it is justified on the merits. Normalization adjustments are standard ratemaking practice.

b. Yes, as described in his testimony.

c. Mr. Kollen agrees that would be appropriate, all else equal.

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3. Refer to page 14 of the Kollen Testimony where he cites LG&E's proposal to normalize revenues based on normal weather and its proposed normalizations of storm damage expense and injuries and damages expense. Mr. Kollen points out that LG&E's temperature normalization of revenues is based on normal temperatures over 30 years and that its storm damage expense and injuries and damages expense normalizations are based on 10-year averages. Given the use of these time periods in the adjustments proposed by LG&E, explain why Mr. Kollen opted to use only five years to develop an average to normalize OSS margins.

Response:

OSS margins are directly affected by a utility's energy available for sale. The Companies have added significant peaking capacity in recent years and will add significant base load capacity this year, thus increasing the energy available for sale. OSS margins also are affected by market pricing, which in turn reflects the market's supply of and demand for energy, natural gas prices, and other factors, all of which may exhibit shorter trend patterns than those used to determine normal temperatures or injuries and damages expense and storm damage expense. Also, the wholesale market for electricity has changed greatly over the last 10-30 years and using those time periods to normalize OSS margins would not be representative of expected going-forward levels.

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4. Refer to pages 12-13 of the Kollen Testimony, specifically lines 11-17 on page 12 and the chart on page 13.
   a. LG&E's OSS margins always exceeded 15 percent of related fuel costs, and averaged more than 25 percent, for the years 2005-2008. For the test year, they were 11 percent of related fuel costs. In nominal dollars, they averaged more than $18 million annually for 2005-2008. For the test year, they were $4.5 million. What part of the data on pages 12-13 leads Mr. Kollen to believe that OSS margins will increase in the near-term future to the "normal" amount he has calculated?
   b. Mr. Kollen has referred to ratepayers being harmed if base rates reflect too low a level of OSS margins. Explain whether he agrees that shareholders may be harmed if the level of OSS is set too high.

Response:

a. There are at least three factors. The first is the growing economic recovery, which will increase demand and drive up market prices, all else equal. The historic test year in this case was during a period of severe economic recession. The PJM forward price curves cited in my testimony suggest that the market believes that pricing will rebound in the near future. The second is that there will be significantly more energy available for sale once TC 2 enters commercial operation. Finally, the data cited by Staff in this question on the relationship between fuel costs and OSS margins indicate that the test year level of OSS margins was abnormally low.

b. Yes, all else equal. That is why a tracker, like the one Kentucky Power utilizes, provides a reasonable balance.

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5. Refer to the Direct Testimony of Dennis W. Goins ("Goins Testimony"), page 21, where he states that "not all customers may be able to curtail load with only 10-minutes notice." Explain whether this applies to KIUC customers. Are they unable to curtail with only 10-minutes' notice? Provide a description for each affected customer.

Response:

Two KIUC members are currently served by LG&E under curtailable service Rider CSR1, and a third member is served by KU under curtailable service Rider CSR3. Both CSR1 and CSR3 have a 20-minutes curtailment notice. One of the Rider CSR1 customers and the Rider CSR3 customer have the technical and operational capability to interrupt on 10-minutes notice, and may opt for Rider CSR10 as proposed by KIUC witness Dennis Goins if the Commission approves that rider. However, the third KIUC member, which is served under Rider CSR1, has operational safety issues that require at least 20-minutes notice to interrupt operations safely. More specifically, safety regulations mandated by the Mine, Safety, and Health Administration of the Department of Labor require steps that take up to 20 minutes for this KIUC member to shut down applicable operations safely. Nonetheless, this KIUC member has been able to comply with the 20-minutes curtailment notice requirements of Rider CSR1.

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6. Refer to page 26 of the Goins Testimony. Provide the basis for the proposed SCR10 credits of $5.40 and $5.50 per kW-month and for the proposed CSR30 credits of $5.20 and $5.30 per kW-month.

Response:

The testimony and exhibits of KIUC witness Dennis Goins demonstrate that the value of interruptible load is significantly greater than the credits he has proposed in Riders CSR10 and CSR30. The proposed credits in Riders CSR10 and CSR 30 are well below the credits justified by the long-run avoided cost of peaking capacity. (*See* Goins Testimony at 10-14, especially Table 1.) However, the justification for setting the CSR10 and CSR30 credits at the proposed levels is explained in the Goins Testimony at 29:4-18. Although LG&E has understated the value of interruptible load in its proposed CSR credits, the KIUC proposed CSR10 and CSR30 credits were set only slightly above the credits in LG&E's proposed Rider CSR for three reasons. First, the initial CSR10 and CSR30 credits represent an interim step in moving credits closer to the economic value of interruptible load represented by the long-run avoided cost of peaking capacity. Second, Riders CSR10 and CSR30 allow fewer buy-through hours (250 hours versus 400 hours in Rider CSR). Third, Rider CSR30 has a longer notice (30 minutes versus 10 minutes for Rider CSR). Concerning the relatively small initial credit differentials for CSR10 and CSR30, we should expect that future credit adjustments will increase the differentials to reflect the higher value of CSR10's shorter curtailment notice.

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7. Refer to the Direct Testimony of Stephen J. Baron ("Baron Testimony"), page 10, line 7. Explain whether Mr. Baron meant to state that winter peak period costs are assigned based on winter coincident peak rather than summer coincident peak.

Response:

Yes. The winter peak period costs are allocated to rate classes based on rate class winter coincident peak demands.

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8. Refer to the Baron Testimony, Exhibit SJB-3. Provide this exhibit in electronic format with the formulas intact.

Response:

See attached excel file.

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9. Refer to page 5 of the Direct Testimony of Richard A. Baudino ("Baudino Testimony"). Provide a copy of the entire article referenced in footnote 1.

Response:

Please refer to the attached page from the SBBI Yearbook.

apter 1
ghlights of the 2008 Markets d the Past Decade

Events of 2008

In one of the worst years since the Great Depression,the stock market declined significantly in 2008 Both large company stocks and small company stocks declined approximately 37% and experienced remarkable volatility

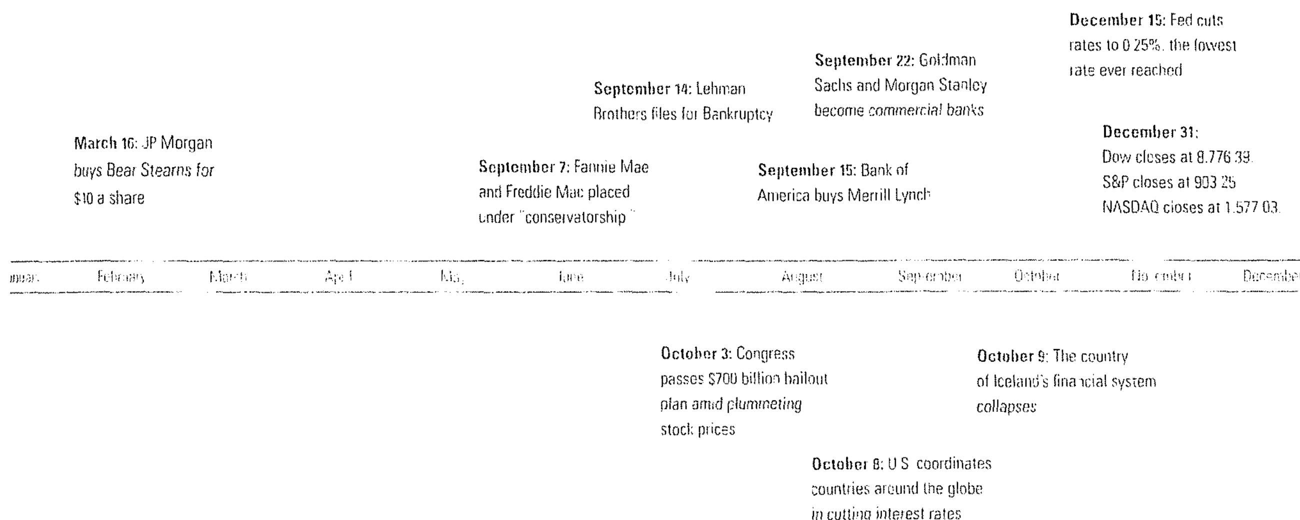
The bond market was characterized by a flight to safety, as investors pulled money out of corporate bonds and purchased U S Treasuries On a month-end basis, long-term government bond yields fell to levels not seen since June 1956, and intermediate-term government bond yields fell to levels not seen since December 1949 The Consumer Price Index (a measure of inflation) increased 4.18 percent in the first half of 2008, but declined 3 92 percent in the second half, the largest June to December decrease since 1930

2008 was a very volatile year in securities markets and a very tumultuous year for business in general Figure 1 1 displays a timeline of the major events of the year The purchase of Bear Stearns by JP Morgan made many aware of the tremendous pressure the investment banking industry was facing, however, it wasn't until Lehman Brothers collapsed later in the year that the true weakness of the sector became evident to all Perhaps even more emblematic was the passage of the $700 billion Emergency Economic Stimulus plan by Congress in the midst of a plummeting stock market Throughout the year, the government of the United States, as well as others around the globe, took unprecedented action to avoid a total breakdown of financial markets

Gross Domestic Product (GDP)

The United States Real Gross Domestic Product (GDP), a measure of the market value of all goods and services produced within the U S , grew at an estimated 1 3 percent in 2008, compared with 2 0 percent in 2007 The first half of 2008 was positive, the second half of 2008 was negative, with quarters one, two, three and four coming in at 0 9 percent, 2.8 percent, -0 5 percent, and an estimated -3 8 percent, respectively.

Since 1970, there have been seven occurrences of lower annual GDP since than what was experienced in 2008 2001 (0 8 percent), 1991 (-0.2 percent), 1982 (-1.9 percent), 1980 (-0 2 percent), 1975 (-0.2 percent), 1974 (-0.5 percent), and 1970 (0 2 percent) On a quarterly basis since 1970, there have been five occurrences of lower GDP than what was experienced in the fourth quarter of 2008, the most recent being the first quarter of 1982 (-6 4 percent) Overall, there have been 21 occurrences of negative GDP on a quarterly basis since 1970



ure 1-1: 2008 Financial Crisis Timeline

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10. Refer to page 8 of the Baudino Testimony. Provide a copy of the Standard and Poor's article referenced at lines 5 through 7.

Response:

The referenced article is protected by copyright. It is available for purchase from Standard and Poor's.

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11. Refer to pages 16-18 of the Baudino Testimony.
    a. Explain whether the ROE estimate is appropriate for LG&E on a basis of combined electric and gas operations.
    b. What is the percentage of LG&E's revenues obtained from electric operations?
    c. Explain why using 50 percent of revenues derived from electric operations is an appropriate screen for the proxy companies.
    d. For the electric companies not selected for the proxy group, provide the reason each did not pass the screening process.

Response:

a. Mr. Baudino estimated the ROE for LGE's electric operations and did not consider the investor required return for its gas operations.

b. Please refer to LGE's Financial Exhibit (807 KAR 5:001 Sec.6) attached to its Application, page 6 of 8, which shows the operating revenues for electric and gas operations for the twelve months ending October 31, 2009. According to this Exhibit, the percentage of LGE's total operating revenues from electric operations is 69.6%.

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c. This is an appropriate screen to use for developing a comparison group that has similar business risk to LGE and KU. Mr. Baudino used the 50% electric revenues screen to assist in the development of a large enough group of companies that derived a significant portion of their operations from regulated electric operations.

d. In addition to PPL Corporation, SCANA Energy, and SEMPRA Energy, Mr. Baudino eliminated the following:

AES Corporation – No dividends
CH Energy Group – no consensus analysts' forecasts
CMS Energy – only resumed dividend payments in 2007
DPL, Inc. – rated Aa3
Duke Energy – recent corporate restructuring
FPL Group – rated Aa2
Great Plains Energy – dividend cut in 2009
Northwestern Corp. – not followed by Value Line
NSTAR – rated AA-
Portland General Electric - only resumed dividends in 2006 after major corporate restructuring, too little historical dividend and earnings experience.

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12. Refer to page 28 of the Baudino Testimony and Exhibit RAB-5.
    a. Explain why it is appropriate to use five-year Treasury note yields in the Capital Asset Pricing Model ("CAPM") analysis.
    b. Explain why 30-year Treasury bond yields should not be considered in the CAPM analysis.

Response:

a. Mr. Baudino used the 5-year Treasury bond in order to more closely approximate a short-term risk-free rate of return.

b. The 30-year Treasury bond may also be used in the CAPM analysis. There is not a significant difference in the yields between the 20-year and 30-year Treasury bonds.