COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	**)**	
COMMISSION OF THE ENVIRONMENTAL	**)**	
SURCHARGE MECHANISM OF KENTUCKY	**)**	**CASE NO.**
UTILITIES COMPANY FOR THE SIX-MONTH	**)**	**2015-00020**
BILLING PERIODS ENDING APRIL 30, 2014	**)**	
AND OCTOBER 31, 2014	**)**	

DIRECT TESTIMONY OF

ROBERT M. CONROY
DIRECTOR - RATES
LG&E AND KU SERVICES COMPANY

Filed: February 16, 2015

Q. Please state your name, title, and business address.

A. My name is Robert M. Conroy. I am the Director – Rates for LG&E and KU Services Company, which provides services to Kentucky Utilities Company ("KU" or "Company") and Louisville Gas and Electric Company ("LG&E") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky, 40202. A complete statement of my education and work experience is attached to this testimony as Appendix A.

Q. Have you previously testified before this Commission?

A. Yes. I have previously testified before this Commission in proceedings concerning the Companies' most recent rate cases, fuel adjustment clauses, and environmental cost recovery ("ECR") surcharge mechanisms.

Q. What is the purpose of this proceeding?

A. The purpose of this proceeding is to review the past operation of KU's environmental surcharge during the six-month billing periods ending April 30, 2014 (expense months of September 2013 through February 2014) and October 31, 2014 (expense months of March 2014 through August 2014) and to determine whether the surcharge amounts collected during the periods are just and reasonable.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to summarize the operation of KU's environmental surcharge during the billing periods under review, demonstrate that the amount collected during the periods was just and reasonable, present and discuss KU's proposed adjustment to the Environmental Surcharge Revenue Requirement based on the operation of the surcharge during the periods and explain how the environmental surcharge factors were calculated during the periods under review.

Q. Please summarize the operation of the environmental surcharge for the billing periods included in this review.

A. KU billed an environmental surcharge to its customers from November 1, 2013 through October 31, 2014. For purposes of the Commission's examination in this case, the monthly KU environmental surcharges are considered as of the six-month billing periods ending April 30, 2014 and October 31, 2014. In each month of the six-month periods under review in this proceeding, KU calculated the environmental surcharge factors in accordance with its ECR Tariff and the requirements of the Commission's previous orders concerning KU's environmental surcharge. The calculations were made in accordance with the Commission-approved monthly forms and filed with the Commission ten days before the new monthly charge was billed by the Company.

Q. What costs were included in the calculation of the environmental surcharge factors for the billing periods under review?

A. The capital and operating costs included in the calculation of the environmental surcharge factors for the six-month billing periods under review were the costs incurred each month by KU from September 2013 through August 2014, as detailed in the attachment in response to Question No. 2 of the Commission Staff's Request for Information, incorporating all required revisions.

The monthly environmental surcharge factors applied during the billing periods under review were calculated consistent with the Commission's Orders in

KU's previous applications to assess or amend its environmental surcharge mechanism and plan, as well as Orders issued in previous review cases. The monthly environmental surcharge reports filed with the Commission during this time reflect the various changes to the reporting forms ordered by the Commission from time to time.

Q. Please describe the most recently approved changes to KU's ECR Compliance Plan.

A. In Case No. 2011-00161, the Commission approved KU's 2011 ECR Compliance Plan that included two new projects and associated operation and maintenance costs, amended Project 29 (2009 Plan) to convert the Brown Main Ash Pond to a Landfill, and approved the reporting of operation and maintenance costs associated with sorbent injection approved with the 2006 Plan for Ghent Units 1, 3, and 4 as part of the 2011 Plan. Pursuant to the Commission's December 15, 2011 Order approving the Settlement Agreement in Case No 2011-0161, KU began including the approved projects in the monthly filing for the December 2011 expense month that was billed in February 2012 with separate authorized rates of return for the Pre-2011 and 2011 ECR Plans. In addition, the Commission approved the use of net (non-fuel) revenues to calculate the jurisdictional revenue requirement for non-residential customers defined as Group 2 in the ECR Tariff. The use of net revenues for Group 2 customers was implemented in Case No. 2011-00231 as discussed below.

In Case No. 2012-00221, KU's most recently approved rate case, the Commission approved the elimination of KU's 2005 and 2006 ECR Compliance Plans (with the exception of Project 22 related to Emission Allowances) from the monthly environmental surcharge filings and reset the return on equity to be used in the monthly environmental surcharge filings. Pursuant to the Commission's December 20, 2012 Order in that case, the changes were implemented with the January 2013 expense month. The approved return on equity is used in this proceeding to establish the overall rate of return on capital to be used to calculate the environmental surcharge as discussed later in this testimony.

Q. Please describe the most recently approved changes to the environmental surcharge mechanism and the monthly ES forms.

A. In Case No. 2011-00231, KU's previous ECR two-year review, the Commission implemented the use of net revenues to calculate the jurisdictional revenue requirement for non-residential customers defined as Group 2 in the ECR Tariff in conjunction with the ECR Roll-in and revisions to the monthly reporting forms to reflect the implementation of Group 1 and Group 2 billing factors. Pursuant to the Commission's January 31, 2012 Order in that case, the changes were implemented with the January 2012 expense month that was billed in March 2012.

In Case No. 2013-00242, KU's most recent ECR two-year review, the Commission approved the ECR Roll-in, revisions to the monthly ES forms to reflect the elimination of KU's 2005 and 2006 ECR Compliance Plans and the use of an overall authorized rate of return for all ECR Plans. Pursuant to the Commission's November 14, 2013 Order in that case, the changes were implemented with the November 2013 expense month that was billed in January 2014.

Q. Are there any changes or adjustments in Rate Base from the originally filed expense months?

A. No**.** During the periods under review, there were no changes to Rate Base from the originally filed billing months as summarized in KU's response to the Commission Staff's Request for Information, Question No. 1. In addition, there were no changes identified as a result of preparing responses to the requests for information in this review.

Q. Are there any changes necessary to the jurisdictional revenue requirement (E(m))?

A. Yes. Adjustments to E(m) are necessary for compliance with the Commission's Order in Case No. 2000-00439 to reflect the actual changes in the overall rate of return on capitalization that is used in the determination of the return on environmental rate base for each of the six-month periods under review. Pursuant to the terms of the Settlement Agreement approving the 2011 ECR Plan, KU calculated the short- and long-term debt rate using average daily balances and daily interest rates in the calculation of the overall rate of return true-up adjustment for the six-month expense periods ending February 28, 2014 and August 31, 2014. For the expense months of September through December 2013, the weighted average cost of capital was based on the balances as of December 31, 2013 and the 2013 gross-up revenue factor. For the expense months of January and February 2014, the weighted average cost of capital was based on the balances as of February 28, 2014 (the last expense month of the first six-month period under review) and the 2014 gross-up revenue factor. For the 6-month expense period ending August 31, 2014, the weighted average cost of capital was based on the balances as of August 31, 2014 (the last expense month of the second six-month period under review) and the 2014 gross-up revenue factor. The details of and support for this calculation are shown in KU's response to Question No. 1 of the Commission Staff's Request for Information.

Q. Please explain why KU is using different gross-up revenue factors for the expense months in 2013 and 2014.

A. As discussed in the testimony of Mr. Garrett, KU has elected to take the bonus tax depreciation deduction for 2014. As a result of the bonus tax depreciation deduction, KU will incur a tax loss in 2014 and will be unable to take the Internal Revenue Code §199 manufacturing tax deduction. Because the §199 manufacturing tax deduction is a component of the gross-up revenue factor calculation, it is necessary to recognize the impact of this difference for the expense months in calendar year 2014. This is consistent with the Commission's past practices of recognizing changes to the gross-up revenue factor calculations due to changes in the tax laws.

Q. Are there corrections to information provided in the monthly filings during the billing periods under review?

A. No.

Q. As a result of the operation of the environmental surcharge during the billing periods under review, is an adjustment to the revenue requirement necessary?

A. Yes. For the expense periods ending February 28, 2014 and August 31, 2014, KU experienced a net over-recovery of $1,478,110. KU's response to Question No. 2 of the Commission Staff's Request for Information shows the calculation of the over-recovery as of the end of each six-month expense period, representing a change from previous review cases where the adjustment to the revenue requirement was calculated as of the end of each billing period. This change is necessary to provide the calculations requested in Question Nos. 1 and 2 of the Commission Staff's Request for Information. An adjustment to the revenue requirement is necessary to reconcile the collection of past surcharge revenues with the actual costs for the billing periods under review.

Q. Has KU identified the causes of the over-recovery during the billing periods under review?

A. Yes. KU has identified the components that make up the over-recovery during the billing periods under review. The components are (1) changes in overall rate of return, including the change to the gross-up revenue factor as previously discussed, and (2) the use of 12-month average revenues to determine the billing factor. The details and support of the components that make up the over-recovery during the billing periods under review are shown in KU's response to Question No. 2 of the Commission Staff's Request for Information.

Q. Please explain how the function of the ECR mechanism contributes to the over-recovery in the billing periods under review.

A. The use of 12-month average revenues to calculate the monthly billing factors and then applying those same billing factors to the actual monthly revenues will result in an over- or under-collection of ECR revenues. The table below shows a comparison of the 12-month average revenues used in the monthly filings to determine the ECR billing factors and the actual revenues to which the ECR billing factors were applied in the billing month.

Expense Month	12-Month Average Revenues	Billing Month	Actual Revenues Subject to ECR Billing Factors
September 2013	$ 83,203,261	November 2013	$ 71,417,634
October 2013	83,761,131	December 2013	93,504,316
November 2013	83,797,968	January 2014	113,700,126
December 2013	85,237,432	February 2014	117,870,227
January 2014	86,824,963	March 2014	104,429,278
February 2014	88,687,899	April 2014	81,944,350
March 2014	89,825,781	May 2014	78,083,473
April 2014	89,555,670	June 2014	88,727,995
May 2014	90,094,601	July 2014	96,798,276
June 2014	90,783,060	August 2014	86,057,969
July 2014	91,379,809	September 2014	93,048,074
August 2014	91,222,944	October 2014	77,759,785
*The 12-month average revenues and the Actual Revenues subject to ECR Billing Factors reflect net revenues for Group 2.			

Generally, an under-recovery will occur when actual revenues for the billing month are less than the 12-month average revenues used for the expense month. Likewise, an over-recovery will usually occur when actual revenues for the billing month are greater than the 12-month average revenues used for the expense month.

During the periods under review, KU's actual revenues for the billing months of January, February and March 2014 reflect weather that was more severe than typical, including the polar vortex. Absent the impact of the severe weather, KU's net recovery position resulting from the use of the 12-month average revenues would have been more balanced for the two six-month periods under review.

Q. What kind of adjustment is KU proposing in this case as a result of the operation of the environmental surcharge during the billing periods?

A. KU is proposing that the over-recovery be distributed over two months following the Commission's Order in this proceeding. Specifically, KU recommends that the

Commission approve a decrease to the Environmental Surcharge Revenue Requirement of $739,055 per month for two months, beginning in the second full billing month following the Commission's Order in this proceeding. This method is consistent with the method of implementing previous over- or under- recovery positions in prior ECR review cases.

Q. What is the bill impact on a residential customer for the proposed distribution of the over-recovery?

A. The inclusion of the distribution reflecting the over-recovery position in the determination of the ECR billing factor will decrease the billing factor by approximately 0.61%. For a residential customer using an average of 1,247 kWh per month, the impact of the adjusted ECR billing factor would be a decrease of approximately $0.65 per month for two months (using rates and adjustment clause factors in effect for the December 2014 billing month). The details of and support for this calculation are shown in KU's response to Question No. 6 of the Commission Staff's Request for Information.

Q. What rate of return is KU proposing to use for all ECR Plans upon the Commission's Order in this proceeding?

A. KU is recommending an overall rate of return on capital of 10.15%, including the currently approved 10.25% return on equity and adjusted capitalization, to be used to calculate the environmental surcharge. This is based on capitalization as of August 31, 2014, the Commission's Order of December 20, 2012 in Case No. 2012-00221 and use of the 2015 gross-up revenue factor that includes the §199 manufacturing tax deduction as discussed in Mr. Garrett's testimony. Please see the response and attachment to Commission Staff's Request for Information Question No. 5 following this testimony.

Q. What is your recommendation to the Commission in this case?

A. KU makes the following recommendations to the Commission in this case:

a) The Commission should approve the proposed decrease to the Environmental Surcharge Revenue Requirement of $739,055 per month for two months beginning in the second full billing month following the Commission's Order in this proceeding;

b) The Commission should determine the environmental surcharge amount for the six-month billing periods ending April 30, 2014 and October 31, 2014 to be just and reasonable;

c) The Commission should approve the use of an overall rate of return on capital of 10.15%, using a return on equity of 10.25%, beginning in the second full billing month following the Commission's Order in this proceeding;

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY	)	
	)	**SS:**
COUNTY OF JEFFERSON	)	

The undersigned, **Robert M. Conroy**, being duly sworn, deposes and says he is the Director – Rates for LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Robert M. Conroy

ROBERT M. CONROY

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 16th day of February 2015.

Tammy J. Elzy

(SEAL)
Notary Public

My Commission Expires:

November 9, 2018

APPENDIX A

Robert M. Conroy

Director – Rates
LG&E and KU Services Company
220 West Main Street
Louisville, Kentucky 40202
(502) 627-3324

Education

Masters of Business Administration,
Indiana University (Southeast campus), December 1998. GPA: 3.9.
Bachelor of Science in Electrical Engineering,
Rose Hulman Institute of Technology, May 1987. GPA: 3.3.

Essentials of Leadership, London Business School, 2004.

Center for Creative Leadership, Foundations in Leadership program, 1998.

Registered Professional Engineer in Kentucky, 1995.

Previous Positions

Manager, Rates	Apr. 2004 – Feb. 2008
Manager, Generation Systems Planning	Feb. 2001 – Apr. 2004
Group Leader, Generation Systems Planning	Feb. 2000 – Feb. 2001
Lead Planning Engineer	Oct. 1999 – Feb. 2000
Consulting System Planning Analyst	Apr. 1996 – Oct. 1999
System Planning Analyst III & IV	Oct. 1992 – Apr. 1996
System Planning Analyst II	Jan. 1991 – Oct. 1992
Electrical Engineer II	Jun. 1990 – Jan. 1991
Electrical Engineer I	Jun. 1987 – Jun. 1990

Professional/Trade Memberships

Registered Professional Engineer in Kentucky, 1995.