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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY, INC. FOR AN	)	CASE NO. 2008-00252
ADJUSTMENT OF ITS ELECTRIC AND GAS	)	C/W
BASE RATES	)	CASE NO. 2007-00564

ATTORNEY GENERAL'S RESPONSES TO DISCOVERY
REQUESTS OF COMMISSION STAFF

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 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 Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, it was served by mailing a true and correct copy of the same, first class postage prepaid, to:

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this 3rd day of December, 2008

Lawrence W. Cook

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WITNESS RESPONSIBLE:
Robert Henkes
PAGE 1 of 1

QUESTION No. 1. Refer to the Direct Testimony and Exhibits of Robert J. Henkes pertaining to the Electric Case ("the Henkes Electric Testimony"), page 14, concerning Mr. Henkes's second rate base adjustment. Provide citations to prior rate Orders which reflect the "[w]ell-established and long-standing Commission ratemaking policy" to which Mr. Henkes refers at the bottom of the page.

RESPONSE:

Examples of prior rate Orders in which the Commission reiterated its long-standing policy of excluding prepaid PSC fees from rate base include:

- Union Light, Heat & Power, pages 15 – 16, Case No. 2005 - 00042
- Delta National Gas Company, pages 3 – 5, Case No. 2004 – 00067
- Louisville Gas & Electric Company, pages 16 – 17, Case No. 2000 - 080 and Case No. 98 – 474.

It should also be noted that, in recognition of the fact that the Commission had excluded the prepaid PSC fees from rate base in LG&E's rate cases in Case Nos. 2000 – 080 and 98 - 474, both LG&E and KU excluded prepaid PSC fees from their respective filed rate bases in their prior rate cases, Case Nos. 2003 – 434 and 2003 – 433. Furthermore, the Companies' intent in the current case was to exclude prepaid PSC fees from their respective rate bases (see Rives Exhibit 4, page 1, footnote (c)), however, while KU indeed did remove the prepaid PSC fees, LG&E inadvertently failed to actually do so, as acknowledged in the Company's response to AG-1-13.

WITNESSES RESPONSIBLE:
Robert Henkes and
Glenn Watkins
PAGE 1 of 1

QUESTION No. 2. Refer to the Henkes Electric Testimony, page 19, and the Prepared Direct Testimony and Schedules of Glenn A. Watkins ("Watkins Testimony"), pages 3 and 10-13, regarding the electric weatherization adjustment proposed by Louisville Gas and Electric Company ("LG&E").

a. Mr. Henkes refers to the recommendations made by Mr. Watkins with regard to eliminating LG&E's proposed adjustment. Exactly where in the Watkins Testimony does Mr. Watkins make this recommendation?

b. Mr. Watkins refers to "[t]he vast majority of other states." Identify the states of which Mr Watkins is aware that accept, or have accepted in the past, some form of electric weather normalization adjustment.

c. On pages 10-13 of his testimony, Mr. Watkins discusses his disagreement with various aspects of LG&E's adjustment and his analysis of the test year sales and how they were impacted by temperatures. Mr. Watkins also computes a weather normalization adjustment, the details of which are shown on Schedule GAW-2. Explain whether Mr. Watkins is proposing that the Commission adopt his calculated weather normalization adjustment. If not, explain why he has included such an adjustment in his testimony.

RESPONSE:

a. See page 3, lines 9 – 15 of the Prepared Direct Testimony of Glenn A. Watkins. Based on discussions Mr. Henkes has had with Mr. Watkins regarding this issue, Mr. Henkes understands that the primary recommendation of Mr. Watkins is that the Commission reject LG&E's proposed electric temperature normalization adjustment.
b. Mr. Watkins is not aware of any states that utilize weather normalization for electric revenue requirement purposes. With this said, Mr. Watkins is aware that Pennsylvania uses a forecasted test year concept and several small utilities rely on budgeted amounts for forecasts. These budgets may or may not reflect "normal weather." Mr. Watkins is also aware of Mr. Seelye's testimony on page 49 in which he states that Connecticut, North Carolina, Washington, D.C., Indiana, Georgia, and Kansas have recognized electric temperature normalization adjustments.
c. Mr. Watkins' primary recommendation is to not recognize weather normalization for electric ratemaking. To the extent the Commission disagrees with this recommendation, an alternative to Mr. Seelye's weather normalization adjustment is presented.

WITNESS RESPONSIBLE:
Glenn Watkins
PAGE 1 of 1

QUESTION No. 3. Refer to the discussion at the top of page 10 of the Watkins Testimony.

a. Mr. Watkins states that because daily usage varies significantly between weekdays and weekends and holidays, he has reflected this in his analysis of daily observations. Explain in detail how Mr. Watkins reflected the variation in daily observations in his analysis.

b. Mr. Watkins states that he expressed daily kWh usage on a per customer basis for the residential class in order to prevent any skewness in the regression model but used a total class basis for the commercial and industrial classes. Provide a detailed discussion of how using daily kWh usage per customer prevents skewness in the regression model.

RESPONSE:

a. Mr. Watkins utilized a binary or "dummy" variable for weekend days (Saturday and Sunday) and holidays (July 4th and Labor Day). Please see Attorney General's Response to LG&E's Request No. 11 for each classes' "dummy" variable coefficient.

b. This is due to customer growth during the period of evaluation as well as other differences in number of billed customers. In other words, if total class KWH were used a dependent variable, and the number of customers vary from the forecast period, a skewness (inaccuracy) will result.

WITNESS RESPONSIBLE:
Robert Henkes
PAGE 1 of 1

QUESTION No. 4. Refer to the Henkes Electric Testimony, pages 23-24, regarding the proposed rate-making treatment of LG&E's net MISO costs.

a. Explain in detail why Mr. Henkes believes that LG&E's post-test year net MISO costs should not be deferred until LG&E's next base rate case.

b. Explain why Mr. Henkes favors rate-making recognition of amounts based on various estimates which, to some extent, depend on activity in the MISO market through the year 2014, and which will result in MISO exit fee credits in the first quarter of the year 2015, or 8 years beyond the end of the test year in this case.

RESPONSE:

Upon further reflection on this issue, Mr. Henkes believes that it would be more appropriate to defer the customer refunds for the post-test year MISO Exit Fee credits and MISO Schedule 10 rate collections until LG&E's next base rate case. Mr. Henkes therefore agrees that his proposed MISO cost adjustment on his Schedule RJH-11 should be withdrawn. This would decrease the AG's recommended pro forma test year after-tax operating income by approximately $496,000 and would reduce the AG's recommended rate decrease by approximately $798,000. See the attached revised Schedules RJH-1, RJH-4, and RJH-11.

WITNESS RESPONSIBLE:
Robert Henkes

QUESTION No.5. Refer to the Henkes Electric Testimony, pages 27-29, regarding the Kentucky Coal Tax Credit. LG&E has qualified for the credit for the past 6 years. The amount of its credit for the 3 most recent years has been much greater than in prior years. Explain why Mr. Henkes proposes to normalize LG&E's coal tax credits based on the most recent 5-year period.

RESPONSE:

With regard to this issue, Mr. Henkes chose to take a conservative approach by normalizing the tax credit based on a 5-year historic average and by assuming that 100% of the tax credit would be booked as a property tax credit. Mr. Henkes agrees with the PSC that the tax credits for LG&E of $1.712 million (2005), $1,136 (2006) and $1,666 (2007) in the most recent 3 years have been much greater than the tax credits of $0.719 million and $0.558 million booked in 2003 and 2004. Mr. Henkes therefore believes that it would also be appropriate for the Commission to reflect normalized coal tax credits for LG&E of $1.505 million based on the average for the most recent three years or $1.666 million based on the most recent actual 2007 tax credit experience.

Mr. Henkes chose to take the same conservative approach with regard to the KU coal tax credits by similarly normalizing the tax credit based on a 5-year historic average and by assuming that 100% of the tax credit would be booked as a property tax credit. The amounts of the tax credits of $0.508 million (2006) and $2.491 million (2007) booked by KU in the last 2 years have been much higher than in prior years. Mr. Henkes therefore believes that it would also be appropriate for the Commission to reflect normalized coal tax credits for KU of $1.059 million based on the average for the most recent three years or $2.491 million based on the most recent actual 2007 tax credit experience.

WITNESS RESPONSIBLE:
Robert Henkes

QUESTION No.6. Refer to the Henkes Electric Testimony, pages 29-32, regarding the Kentucky Recycle Tax Credit. Explain why Mr. Henkes recommends that the $4 million remainder of the recycle credit be amortized over 5 years for rate-making purposes.

RESPONSE:

Mr. Henkes' rationale for this proposed adjustment is explained in detail on pages 29 – 32 of his testimony. As explained in that testimony, this tax credit should not be disregarded in this case based on the fact that the tax credit was generated in 1999, as the Company argues. Because of the carry-forward provision of this 1999 tax credit generation, LG&E has been able to reduce its annual income taxes on its consolidated Kentucky income tax returns in 1999, 2000, 2005 and 2007. At the end of the test year, the unused (unamortized) portion of this tax credit still amounted to $4,037,437 and would be available to reduce LG&E's income taxes on a going forward basis. There is no difference between (1) recognizing a pro forma annual use (amortization) of this unused tax credit balance at the end of the test year for ratemaking purposes in this case; and (2) recognizing the continued annual amortization expenses associated with prior period deferred cost balances. While these deferred cost balances were also generated prior to the test year, the Company has proposed to reflect the annual amortizations of these prior period deferred costs as long as these prior period deferrals still had unamortized balances at the end of the test year.

Mr. Henkes has reflected a pro forma Kentucky income tax credit of approximately $0.8 million based on a 5-year amortization of the 4/30/08 end-of-test year tax credit balance of $4.037 million. This is essentially equivalent to assuming that the unused test year-end tax credit balance of $4.037 million would continue to generate pro forma annual Kentucky income tax credits of approximately $0.8 million such as LG&E actually experienced in the most recent available year, 2007.

While it is true that in the post-test period month of September 2008 LG&E received the entire $4.037 million from its parent E.ON U.S. LLC, this does not change the fact that the $4.037 million was available at the end of the test year, belongs to the ratepayers, and should flow back to the ratepayers as it otherwise would have in the form of future Kentucky income tax credits. Mr. Henkes' recommended 5-year amortization of the $4.037 million balance properly accomplishes this.

WITNESS RESPONSIBLE:
Robert Henkes

QUESTION No. 7. Refer to the Henkes Electric Testimony, pages 33-34, regarding his proposed adjustment to remove a portion of LG&E's annual dues to the Edison Electric Institute ("EEI"). Mr. Henkes discusses the adjustment made in LG&E's last rate case in which 45.35 percent of LG&E's dues was removed based on that percentage of EEI's activities being related to various types of lobbying activities. The information provided in this case, which is not prepared in the same manner as in previous years, indicates that 16.15 percent of LG&E's 2007 EEI dues was spent on lobbying activities. With this background, explain Mr. Henkes's reasoning for basing his proposed adjustment on the percentage used 5 years ago in LG&E's previous rate case.

RESPONSE:

In the prior rate case, the Commission ruled that the EEI dues dedicated to the NARUC functional expense categories of Legislative Advocacy, Regulatory Advocacy and Public Relations should be excluded for ratemaking purposes. These disallowed functional categories amounted to 45.35% of the total EEI dues. In the current case, the Company has indicated that EEI no longer presents its activities in accordance with these same NARUC functional expense categories, but that EEI has determined that 16.15% of EEI dues are spent on lobbying activities. On page 33 of his testimony, Mr. Henkes states in this regard:

> "It is not known whether EEI's determination of what represents lobbying activities is as inclusive as, and exactly similar to, NARUC's classification of EEI's legislative and regulatory advocacy and public relations activities. I have therefore relied on the same 43.35% EEI lobbying expense ratio as established by the Commission in the prior case in my determination of the EEI dues to be excluded for ratemaking purposes in the current case."

WITNESS RESPONSIBLE:
Robert Henkes
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QUESTION No.8. Refer to the Direct Testimony and Exhibits of Robert J. Henkes Pertaining to the Gas Case ("the Henkes Gas Testimony"), pages 10-11, concerning Mr. Henkes's second rate base adjustment. Provide citations to prior rate Orders which reflect the "[w]ell-established and long-standing Commission ratemaking policy" to which Mr. Henkes refers on page 11.

RESPONSE:

See Mr. Henkes' response to Question No. 1.

WITNESS RESPONSIBLE:
Robert Henkes
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QUESTION No.9. Refer to the Henkes Gas Testimony, page 20, regarding his proposed adjustment to remove a portion of LG&E's annual dues to the American Gas Association ("AGA). Mr. Henkes discusses the adjustment made in LG&E's last rate case in which 22.59 percent of LG&E's dues was removed based on that percentage of AGA's activities being related to lobbying activities. The information provided in this case indicates that 27.93 percent of LG&E's AGA dues was spent on lobbying activities. With that background, explain Mr. Henkes's reasoning for basing his proposed adjustment on the percentage used 5 years ago in the previous rate case.

RESPONSE:

The reason for this is explained on page 20 of Mr. Henkes' testimony. The information provided in the current case (response to AG-1-73) indicates that 27.93% of AGA dues is dedicated to the combination of Public Affairs and Communications activities. Based on the functional descriptions in the response to AG-1-73(c), Mr. Henkes has assumed that the Communications activities are non-lobbying related activities. Since it is not known what portion of the 27.93% is related to Public Affairs, Mr. Henkes relied on the 22.59% from the prior case, which percentage was specifically related to Public Affairs activities.

WITNESS RESPONSIBLE:
Dr. J. Randall Woolridge
PAGE 1 of 1

QUESTION No.10. Refer to the Direct Testimony of Dr. J. Randall Woolridge ("Woolridge Testimony") at pages 9-10 and Exhibit JRW-2. Provide a copy of the most recent published company analysis from Value Line for each of the companies in the electric and gas proxy groups.

RESPONSE:

The requested documents are attached in the files Elec V-Lines.zip and Gas V-Lines.zip files.

WITNESS RESPONSIBLE:
Dr. J. Randall Woolridge
PAGE 1 of 1

QUESTION No.11. Refer to the Woolridge Testimony at page 10 and Exhibit JRW-2, Panel B.

a. Show how LG&E's regulated revenues from its gas operations compare, in percentage terms, to each of the companies in the gas proxy group.
b. Explain whether the gas revenue percentages in Column 3 are only for regulated gas distribution operations. If not, provide a breakout of the regulated revenues between distribution activities and all other regulated operations activities.
c. New Jersey Resources Corp. receives only 33 percent of its revenues from regulated gas operations. Explain why this company is an acceptable candidate to include in the proxy group for LG&E's gas operations.
d. Atmos Energy Corporation dwarfs LG&E's gas operations. Explain why this company is an acceptable candidate to include in the proxy group for LG&Es gas operations.

RESPONSE:

a. The regulated gas revenues for the companies in the gas proxy group are provided in Panel B of Exhibit JRW-2. LG&E receives 70% of revenues from electric, and 30% from gas.

b. Yes.

c. While New Jersey Resources only receives 33% of its revenues from regulated gas operations, the company is still viewed primarily in the investment community as a gas distribution company.

d. Whereas Atmos is much larger than LG&E, its dominant risk factor is that the company is primarily involved in the gas distribution business.

WITNESS RESPONSIBLE:
Dr. J. Randall Woolridge

QUESTION No.12. Refer to the Woolridge Testimony, page 31, and Exhibit JRW-6, page 3 of 5.

a. Explain how taking the collective average of 5-year and 10-year historical growth rates for Earnings Per Share ("EPS"), Dividends Per Share ("DPS"), and Book Value Per Share ("BVPS") series' mean and median values provides a meaningful estimate of dividend growth as used in the Discounted Cash Flow ("DCF) model.

b. Describe the pros and cons of using each of the data series of EPS, DPS, and BVPS individually for calculating the dividend growth to be used in the DCF model.

c. Several of the electric companies in the proxy group have negative growth rates in the chart. Part of the rationale for including these companies in the proxy group was that each had paid dividends for the last 3 years.

(1) Explain why it is valid to have these companies included in this particular analysis.

(2) To the extent possible, provide LG&E's EPS, DPS, and BVPS 5-year and 10-year growth rates and describe how they compare to those of the companies listed in the proxy group.

RESPONSE:

a. Dr. Woolridge's objective is to find the central tendency for the figures shown. Means and medians are measures of central tendency for an array of numbers. Due to the presence of outliers, Dr. Woolridge is using both the means and medians. Growth over five- and ten- year periods are commonly provided to investors by Value Line and other investor information sources as indicators of historic growth.
b. According to the DCF model, DPS, EPS, and BVPS should all have the same rate of growth. Over short-term periods of time, these growth rates may differ. Dr. Woolridge is attempting to gauge an overall long-term rate of growth for all three. EPS is the most volatile, but it gets the most attention in the financial press. BVPS and DPS tend to be more stable over time.
c. (1) Investors have access to historic information and growth rates, and presumably take both positive and negative growth rates into consideration in forming expectations of the future.

   (2) Dr. Woolridge does not have that data. He relied on the data for the proxy group.

WITNESS RESPONSIBLE:
Dr. J. Randall Woolridge
PAGE 1 of 1

QUESTION No.13. Refer to the Woolridge Testimony, pages 31-32, and Exhibit JRW-6, page 4 of 5.

a. Explain why using internal growth, which also includes non-regulated revenue returns, as a proxy for dividend growth does not introduce a certain amount of circularity into the calculation and, therefore, should be unacceptable.

b. Explain why it is valid to use the calculated internal growth rate as a meaningful estimate of dividend growth as used in the DCF model.

RESPONSE:

a. To minimize the impact of unregulated revenues on growth and risk, Dr. Woolridge has used a screen that requires regulated revenue of at least 75%.

b. As stated in Dr. Woolridge's testimony, a very important factor in stock valuation is the growth associated with the reinvestment of earnings and the earned returns on these reinvested earnings since this provides the basis to increase dividends in the future.

WITNESS RESPONSIBLE:
Dr. J. Randall Woolridge

QUESTION No.14. Refer to the Woolridge Testimony, page 44. Provide legible copies of the referenced Derrig and Orr (2003), Fernandez (2007) and Song (2007) articles.

RESPONSE:

The referenced publications are attached.

QUESTION No.15. Refer to the Woolridge Testimony, pages 44-53, and Exhibit JRW-7, page 3 of 5.

a. 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.

b. Regarding the three survey articles, explain whether the assumptions and definitions of risk and return underlying the estimates in each of the studies are consistent, and whether there is any weighting of more recent periods or events relative to more distant events.

c. Explain which, if any, of the estimates are in real terms and which are in nominal terms.

d. 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.

e. Several of the equity risk premium estimates appear to be low and may not be valid for the purpose at hand. There are ten studies with estimates ranging from 1.96 percent to 3.5 percent. Explain why an investor would undertake the risk of investing in stocks with such low premiums.

RESPONSE:

a. The approach used in each study is provided in the column labeled 'Methodology.' If dividends and/or earnings are used in determining the risk premium, it is noted. The Residual Income approach is an earnings-based approach.

b. In the surveys, the CFOs and Financial Forecasters were simply asked for the expected stock return in excess of the return on bonds over the next ten years. The survey of academics asked the same question, except over thirty years. There was no weighting of returns by time period.

c. All are in nominal terms.

d. See discussion below:

> There is an upward bias to the arithmetic mean. Consider the following example. Assume that you have a stock (that pays no dividend) that is selling for $100 today, increases to $200 in one year, and then falls back to $100 in two years. The table below shows the prices and returns.

Time Period	Stock Price	Annual Return
0	$100	
1	$200	100%
2	$100	-50%

The arithmetic mean return is simply (100% + (-50%))/2 = 25% per year. The geometric mean return is $((2 * .50)^{(1/2)}) - 1 = 0\%$ per year. Therefore, the arithmetic mean return suggests that your stock has appreciated at an annual rate of 25%, while the geometric mean return indicates an annual return of 0%. Since after two years, your stock is still only worth $100, the geometric mean return is the appropriate return measure. For this reason, when stock returns and earnings growth rates are reported in the financial press, they are generally reported using the geometric mean. This is because of the upward bias of the arithmetic mean. As further evidence of the appropriate mean return measure, the U.S. Securities and Exchange Commission requires equity mutual funds to report historic return performance using geometric mean and not arithmetic mean returns.[1]

e. Some of the equity risk premium estimates are low, and some are high. Dr. Woolridge has used the results of all the studies that he can locate. The lower equity risk premiums simply reflect what many have argued for some time – the equity risk premium has declined.

[1] U.S. Securities and Exchange Commission, Form N-1A.

WITNESS RESPONSIBLE:
Dr. J. Randall Woolridge
PAGE 1 of 1

QUESTION No.16. Refer to the Woolridge Testimony, page 45 Provide a legible copy of the Ibbotson and Chen article cited in footnote 16.

RESPONSE:

The requested article is attached.

WITNESS RESPONSIBLE:
Glenn Watkins
PAGE 1 of 1

QUESTION No.17. Refer to the Watkins Testimony, Schedule GAW_4, pages 21-28, which list the cost-of-service study allocators. State where in the Watkins cost-of-service study these allocators are used.

RESPONSE:

The allocator "amounts" are contained on pages 21-24 of Schedule GAW-4. The class allocator percentages are provided on pages 25-28 of Schedule GAW-4. The allocators were then used to allocate individual rate base and expense amounts on pages 1-20 of Schedule GAW-4. The "Allocator" column was inadvertently not printed. Attached is a revised Schedule GAW-4 that includes an allocator identification.

WITNESS RESPONSIBLE:
Glenn Watkins
PAGE 1 of 1

QUESTION No.18. Provide an electronic version of the Watkins cost-of-service study with the formulas intact.

RESPONSE:

See Attorney General's response to LG&E's Request No. 11.