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MAY 20 2010

PUBLIC SERVICE
COMMISSION

Via Overnight Mail

May 19, 2010

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: Case No. 2009-00548 and 2009-00549

Dear Mr. Derouen:

Please find enclosed the original and twelve (12) copies each of: 1) RESPONSE OF KIUC TO FIRST DATA REQUEST OF COMMISSION STAFF; and 2) FIRST DATA REQUEST OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY to be filed in the above-referenced dockets.

By copy of this letter, all parties listed on the Certificate of Service have been served. Please place these documents of file.

Very Truly Yours,

Michael L. Kurtz, Esq.
Kurt J. Boehm, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment
cc: Certificate of Service

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy via electronic mail (when available) and by first-class postage prepaid mail, to all parties on the 19th day of May, 2010.

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED
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PUBLIC SERVICE COMMISSION

In the Matter of:

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

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 Kentucky Utilities Company ("KU") rate case, Case No. 2003-00434.[1] State whether KIUC opposed the unbilled revenue adjustment in KU's subsequent rate case, Case No. 2008-00251.[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.

[1] Case No. 2003-00434, An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company (Ky. PSC Mar. 31, 2006).

[2] Case No. 2008-00251, Application of Kentucky Utilities Company for an Adjustment of Electric 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 KU 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 KU 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 KU'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 KU'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 KU, 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. KU'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 Kollen Testimony, pages 17 and 18. Mr. Kollen states that the Commission historically removed KU's share of Electric Energy, Inc. ("EEI") earnings and KU's investment in EEI from the determination of KU's revenue requirement to avoid a double recovery which would have otherwise occurred as a result of the commission's allowing KU a return of and on its rate base investment in EEI through the purchased power expense recovered through base rates. Cite any specific Orders, including page number, in which the Commission states this as a reason for its rate-making treatment of KU's EEI earning and investment.

Response:

Mr. Kollen is not aware of any Commission orders that adjudicated any controversy over the ratemaking treatment of KU's EEI earnings and investment; consequently, there was no need for the Commission to state its rationale. In fact, Mr. Kollen is unaware of any controversy over the Commission's ratemaking treatment until the circumstances changed in 2006. In his testimony, Mr. Kollen explained why the Commission's historic ratemaking treatment was rational prior to 2006 and why that ratemaking treatment no longer is rational now that the circumstances changed.

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6. Refer to the Kollen Testimony, page 21, where Mr. Kollen states that KU's investment in EEI is a "utility" investment, not a "non-utility" investment. Explain the basis for Mr. Kollen's position and provide citations to any parts of the Uniform System of Accounts which support Mr. Kollen's position.

Response:

KU owns the 20% share in EEI, not some subsidiary or other affiliate, and this investment is included in KU's per books capitalization. The Commission determines the return on component for KU based on capitalization, not on rate base. Thus, the capitalization used for this purpose should be the per books capitalization of KU and there should not be an adjustment unless the investment is in "non-utility" plant or some other "non-utility" investment account. Mr. Kollen believes that the adjustment to capitalization was made historically to avoid double counting the return on investment. Mr. Kollen is unaware that the Commission has ever adjudicated this investment as a non-utility investment, and believes that the presumption is that it is a utility investment unless there is some valid demonstration otherwise.

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7. Refer to the Direct Testimony of Stephen J. Baron ("Baron Testimony"), page 10, line 7. Did Mr. Baron intend 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 the Testimony of Richard A. Baudino ("Baudino Testimony"), page 5. 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

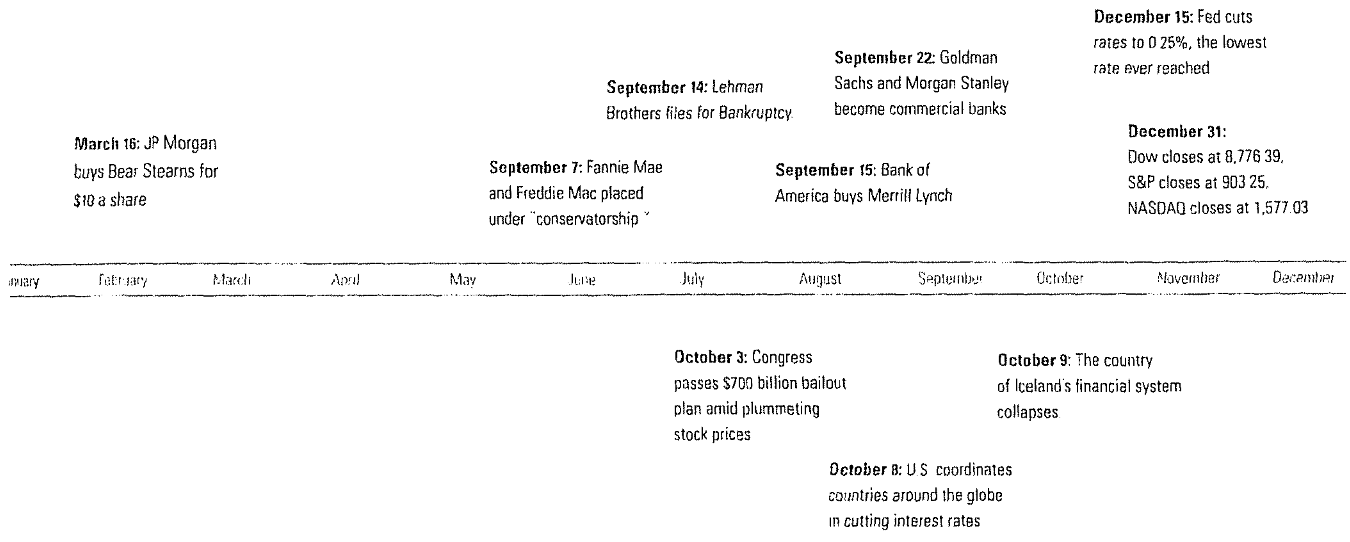
2008 was a very volatile year in securities markets and a very tumultuous year for business in general. Figure 1.1 displays a timeline of the major events of the year. The purchase of Bear Stearns by JP Morgan made many aware of the tremendous pressure the investment banking industry was facing; however, 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 plummetting 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 the Baudino Testimony, page 8. 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 the Baudino Testimony, pages 16-17.
    a. Explain why using 50 percent of revenues derived from electric operations is an appropriate screen for the proxy companies.
    b. For the electric companies not selected for the proxy group, provide the reason each did not pass the screening process.

Response:

a. 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.

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b. 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 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.