

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 LOUISVILLE GAS)	
AND ELECTRIC COMPANY FOR THE SIX-MONTH)	CASE NO.
BILLING PERIODS ENDING OCTOBER 31, 2003,)	2006-00130
APRIL 30, 2004, OCTOBER 31, 2004,)	
OCTOBER 31, 2005, AND APRIL 30, 2006, AND)	
FOR THE TWO-YEAR BILLING PERIOD ENDING)	
APRIL 30, 2005)	

O R D E R

On April 6, 1995, the Commission approved Louisville Gas and Electric Company's ("LG&E") environmental surcharge application and established a surcharge mechanism.¹ Pursuant to KRS 278.183(3), at 6-month intervals, the Commission must review the past operations of the environmental surcharge. After hearing, the Commission may, by temporary adjustment in the surcharge, disallow any surcharge amounts found not to be just and reasonable and reconcile past surcharges with actual costs recoverable pursuant to KRS 278.183(1). At 2-year intervals, the Commission must review and evaluate the past operations of the environmental surcharge. After hearing, the Commission must disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

¹ Case No. 1994-00332, The Application of Louisville Gas and Electric Company for Approval of Compliance Plan and to Assess a Surcharge Pursuant to KRS 278.183 to Recover Costs of Compliance with Environmental Requirements for Coal Combustion Wastes and By-Products, final Order dated April 6, 1995.

The Commission has determined that it will be administratively efficient and reasonable to review the pending 6-month periods and the 2-year period in the same case. Therefore, the Commission hereby initiates the 6-month reviews of the surcharge as billed from May 1, 2003 to October 31, 2003, from November 1, 2003 to April 30, 2004, from May 1, 2004 to October 31, 2004, from May 1, 2005 to October 31, 2005, and from November 1, 2005 to April 30, 2006 and the 2-year review of the surcharge as billed from May 1, 2003 to April 30, 2005.²

To facilitate this review, a procedural schedule is set forth in Appendix A, attached hereto and incorporated herein. In accordance with that schedule, LG&E is to file prepared direct testimony: (a) in support of the reasonableness of the application of its environmental surcharge mechanism during the time periods under review; and (b) on a proposal to roll-in its environmental surcharge into existing base rates. In addition, LG&E is to file its response to the information requested in Appendix B, attached hereto and incorporated herein. Since each of the periods under review in this proceeding may have resulted in over- or under-recoveries, the Commission will entertain proposals to adopt one adjustment factor to net all over- or under-recoveries.

² Since LG&E's surcharge is billed on a two-month lag, the amounts billed from May 2003 through October 2003 are based on costs incurred from March 2003 through August 2003; amounts billed from November 2003 through April 2004 are based on costs incurred from September 2003 through February 2004; amounts billed from May 2004 through October 2004 are based on costs incurred from March 2004 through August 2004; amounts billed from May 2005 through October 2005 are based on costs incurred from March 2005 through August 2005; amounts billed from November 2005 through April 2006 are based on costs incurred from September 2005 through February 2006; and amounts billed from May 2003 through April 2005 are based on costs incurred from March 2003 through February 2005.

Since the approval of its original environmental compliance plan and surcharge mechanism, LG&E has sought and been granted three amendments to its original environmental compliance plan and surcharge mechanism.³ In Case No. 2002-00193,⁴ LG&E's surcharge mechanism was changed from the incremental approach to the base-current approach and a portion of the environmental surcharge was incorporated, or "rolled-in," to existing base rates. In Case No. 2003-00433,⁵ the capital expenditures and operating expenses associated with the original environmental compliance plan were rolled-in to LG&E's base rates. After this last roll-in, the environmental surcharge provides recovery of the costs associated with the three amended environmental compliance plans. When determining its over- or under-recovery of the surcharge in this proceeding, LG&E should reflect the impacts of these prior cases, as applicable.

³ See Case No. 2000-00386, The Application of Louisville Gas and Electric Company for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff, final Order dated April 18, 2001; Case No. 2002-00147, The Application of Louisville Gas and Electric Company for Approval of Its 2002 Compliance Plan for Recovery by Environmental Surcharge, final Order dated February 11, 2003; and Case No. 2004-00421, The Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge, final Order dated June 20, 2005.

⁴ Case No. 2002-00193, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Periods Ending April 30, 2000, October 31, 2000, October 31, 2001, and April 30, 2002 and for the Two-Year Billing Period Ending April 30, 2001, final Order dated October 22, 2002.

⁵ Case No. 2003-00433, An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company, final Order dated June 30, 2004.

IT IS THEREFORE ORDERED that:

1. The procedural schedule set forth in Appendix A, attached hereto and incorporated herein, shall be followed in this proceeding.

2. LG&E shall appear at the Commission's offices on the date set forth in Appendix A, to submit itself to examination on the application of its environmental surcharge as billed to consumers from (a) May 1, 2003 through October 31, 2003; (b) November 1, 2003 through April 30, 2004; (c) May 1, 2004 through October 31, 2004; (d) May 1, 2005 through October 31, 2005; (e) November 1, 2005 through April 30, 2006; and, (f) May 1, 2003 through April 30, 2005. At the public hearing there shall be no opening statements or summaries of testimony.

3. LG&E shall give notice of the hearing in accordance with the provisions of 807 KAR 5:011, Section 8(5). At the time publication is requested, LG&E shall forward a duplicate of the notice and request to the Commission.

4. LG&E shall, by the date set forth in Appendix A, file the information requested in Appendix B, attached hereto and incorporated herein, along with its prepared direct testimony in support of the reasonableness of the application of its environmental surcharge mechanism during the six periods under review.

5. Any party filing testimony shall file an original and 9 copies.

6. All requests for information and responses thereto shall be appropriately indexed, and an original and 6 copies shall be filed with the Commission, with copies to all parties of record. Any request for information from the Commission Staff shall be responded to as if set forth in a Commission order. All responses shall include the

name of the witness who will be responsible for responding to questions related to the information provided.

7. Within 7 days of the Commission granting intervention to a party, LG&E shall provide the party with a copy of its monthly environmental surcharge reports as filed with the Commission for each review period.

8. LG&E's monthly environmental surcharge reports and supporting data for the review periods shall be incorporated by reference into the record of this case.

9. The case records of Case Nos. 1994-00332, 2000-00386, 2002-00147, 2002-00193, 2003-00433, and 2004-00421 shall be incorporated by reference into the record of this case.

10. Any objections or motions relating to discovery or procedural dates shall be filed upon 4 business days' notice or shall include an explanation why such notice was not possible.

Done at Frankfort, Kentucky, this 25th day of April, 2006.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and flourishes, positioned above a horizontal line.

Executive Director

Case No. 2006-00130

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2006-00130 DATED April 25, 2006

- LG&E shall file its prepared direct testimony and responses to the information requested in Appendix B no later than 06/05/06
- An informal technical conference is to begin at 1:30 p.m., Eastern Daylight Time, in Conference Room No. 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky for the discussion of issues 06/13/06
- All additional requests for information to LG&E shall be filed no later than..... 06/27/06
- LG&E shall file responses to additional requests for information no later than..... 07/12/06
- Intervenor testimony, if any, in verified prepared form shall be filed no later than 07/21/06
- All requests for information to Intervenors shall be filed no later than..... 08/04/06
- Intervenors shall file responses to requests for information no later than..... 08/18/06
- Last day for LG&E to publish notice of hearing date To be scheduled
- Public Hearing is to begin at 9:00 a.m., Eastern Daylight Time, in Hearing Room 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky, for the purpose of cross-examination of witnesses of LG&E and Intervenors..... To be scheduled
- Briefs, if any, shall be filed by To be scheduled

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00130 DATED April 25, 2006

FIRST DATA REQUEST OF COMMISSION STAFF TO LOUISVILLE GAS AND ELECTRIC COMPANY

For Each of the Six Periods Under Review

1. Concerning the rate of return on the original environmental compliance plan ("1995 Plan") and the three amendments to the environmental compliance plan ("Post-1995 Plans"), provide the following information for each of the billing periods under review:

a. For the 1995 Plan, calculate any true-up adjustment needed to recognize changes in the weighted average cost of LG&E's pollution control debt during the applicable months of each review period. Include all assumptions and other supporting documentation used to make this calculation. Any true-up adjustment is to be included in the determination of the over- or under-recovery of the surcharge for the corresponding billing period under review.

b. For the Post-1995 Plans, calculate any true-up adjustment needed to recognize changes in LG&E's cost of debt, preferred stock, accounts receivable financing (if applicable), or changes in LG&E's electric capital structure. Include all assumptions and other supporting documentation used to make this calculation. Any true-up adjustment is to be included in the determination of the over- or under-recovery of the surcharge for the corresponding billing period under review.

2. Prepare a summary schedule showing the calculation of Total E(m), Net Retail E(m), and the surcharge factor for the expense months covered by the applicable billing period. Include the expense months for the two expense months subsequent to the billing period in order to show the over- and under-recovery adjustments for the months included for the billing period under review. The summary schedule is to incorporate all corrections and revisions to the monthly surcharge filings LG&E has submitted during the billing periods under review. Include a calculation of any additional over- or under-recovery amount LG&E believes needs to be recognized for each 6-month review or the 2-year review. Include all supporting calculations and documentation for any such additional over- or under-recovery.

3. Provide the calculations, assumptions, workpapers, and other supporting documents used to determine the amounts LG&E has reported during each billing period under review for Pollution Control Deferred Income Taxes.

4. Provide the percentage of LG&E's long-term debt that has a variable interest rate as of the last expense month in the applicable billing period under review.

Billing Period from May 1, 2003 through October 31, 2003

5. Refer to ES Form 2.30, Inventory of Emission Allowances, for the May 2003 expense month. Explain why the dollar value of the current vintage year significantly increased over the dollar value reported in the April 2003 expense month. Include workpapers and calculations showing the determination of the dollar value of the current vintage year reported for the May 2003 expense month.

6. Refer to ES Form 2.40, O&M Expenses and Determination of Cash Working Capital Allowance, for the June through August 2003 expense months.

Explain why the “Current Month” operation and maintenance (“O&M”) expenses reported in these months were higher than the levels reported in the remaining 3 months in this billing period. The level of detail for this response should go to the expense account number.

Billing Period from November 1, 2003 through April 30, 2004

7. Refer to ES Form 2.40, O&M Expenses and Determination of Cash Working Capital Allowance, for the September and October 2003 and February 2004 expense months.

a. Explain why the “Current Month” O&M expenses reported in September and October 2003 were higher than the levels reported in the remaining 4 months in this billing period. The level of detail for this response should go to the expense account number.

b. Explain why the “Current Month” O&M expenses reported in February 2004 were negative. The level of detail for this response should go to the expense account number.

Billing Period from May 1, 2004 through October 31, 2004

8. Refer to ES Form 2.40, O&M Expenses and Determination of Cash Working Capital Allowance, for the May through August 2004 expense months. Explain why the “Current Month” O&M expenses reported for May through August 2004 were higher than the levels reported in the remaining 2 months in this billing period. The level of detail for this response should go to the expense account number.

Billing Period from November 1, 2003 through April 30, 2005

9. Refer to ES Form 2.40, O&M Expenses and Determination of Cash Working Capital Allowance, for the September and December 2004 expense months. Explain why the “Current Month” O&M expenses reported for September and December 2004 were higher than the levels reported in the remaining 4 months in this billing period. The level of detail for this response should go to the expense account number.

10. In Case No. 2000-00386, the Commission ordered that LG&E’s rate of return on common equity for the Post-1995 Plan projects included in its environmental surcharge would be the same rate of return on common equity incorporated in LG&E’s Earnings Sharing Mechanism (“ESM”). The Commission further ordered that this rate of return on common equity would remain unchanged unless the rate in the ESM was changed or discontinued. In Case No. 2003-00433, LG&E’s ESM was discontinued and the rate of return on common equity for environmental surcharge purposes was set at 11.00 percent. In Case No. 2004-00421, the Commission established the rate of return on common equity for the environmental surcharge at 10.5 percent.

a. Does LG&E believe that the 10.5 percent rate of return on common equity for the environmental surcharge is reasonable? Explain the response, and include any analyses or evaluations supporting its conclusions.

b. If no to part (a), what rate of return on common equity does LG&E propose for its environmental surcharge? Provide a detailed analysis and testimony supporting LG&E’s position.

11. KRS 278.183(3) provides that during the 2-year review, the Commission shall, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

a. Provide the surcharge amount that LG&E believes should be incorporated into its existing base rates. Include all supporting calculations, workpapers, and assumptions.

b. The surcharge factor reflects a percentage of revenue approach, rather than a per kWh approach. Taking this into consideration, explain how the surcharge amount should be incorporated into LG&E's base rates. Include any analysis that LG&E believes supports its position.

c. Provide the Base Period Jurisdictional Environmental Surcharge Factor ("BESF") that reflects all environmental surcharge amounts previously incorporated into existing base rates and the amount determined in part (a). Include all supporting calculations, workpapers, and assumptions.

d. Does LG&E believe that there will need to be modifications to either the surcharge mechanism or the monthly surcharge reports, other than a revision to BESF, as a result of incorporating additional environmental surcharge amounts into LG&E's existing base rates? If yes, provide a detailed explanation of the modifications and provide updated monthly surcharge reports.

Billing Period from May 1, 2005 through October 31, 2005

12. Refer to ES Form 2.00, Revenue Requirements of Environmental Compliance Costs and ES Form 2.31, Inventory of Emission Allowances – Current Vintage Year, for the June through August 2005 expense months. In Case No. 2004-

00421, the Commission determined that LG&E should include its sulfur dioxide (“SO₂”) emission allowance inventory balance in its environmental surcharge rate base and that SO₂ emission allowance expense should be included in the O&M expenses. While LG&E has reported a SO₂ emission allowance inventory balance and the use of SO₂ emission allowances on ES Form 2.31, it has not included either item in the environmental surcharge rate base or pollution control operating expenses reported on ES Form 2.00. Beginning with ES Form 2.31 for the July 2005 expense month filing, LG&E states that based upon its understanding of the Commission’s August 22, 1995 Order in Case No. 1995-00060,¹ it concluded that allowance inventory and expense resulting from the return of allowances in kind was not recoverable through the surcharge.

a. Considering the fact that the portion of the August 22, 1995 Order in Case No. 1995-00060 cited by LG&E deals with the revenues to be included in the surcharge factor calculations, explain how LG&E concluded that its SO₂ emission allowance inventory and emission allowance expense was not recoverable through the surcharge.

b. If returning emission allowances in kind does not constitute a purchase of the allowances by LG&E, explain why LG&E continues to value its emission allowance inventory reflecting the market value of the emission allowances returned in kind.

¹ Case No. 1995-00060, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company as Billed from August 1, 1994 to January 31, 1995, final Order dated August 22, 1995.

13. Refer to ES Form 2.40, O&M Expenses and Determination of Cash Working Capital Allowance, for the April through August 2005 expense months. Explain why the “Current Month” O&M expenses reported for April through August 2005 were higher than the level reported in the remaining month in this billing period. The level of detail for this response should go to the expense account number and by generating station.

Billing Period November 1, 2005 through April 30, 2006

14. Refer to ES Form 2.50, Pollution Control – Operations & Maintenance Expenses, for the September, October, and December 2005 and February 2006 expense months. Explain why the O&M expenses reported for these expense months were higher than the levels reported in the remaining 2 months in this billing period. The level of detail for this response should go to the expense account number and by generating station.

15. Refer to ES Form 2.11, Plant, CWIP & Depreciation Expense – Post-1195 Plan, and ES Form 2.12, Plant, CWIP & Depreciation Expense – 2005 Plan, for the February 2006 expense month. For each project shown on these schedules that is not considered completed, provide a description of the status of the project as of the end of the February 2006 expense month.

16. In Case No. 2000-00386, the Commission ordered that LG&E’s cost of debt and preferred stock would be reviewed and re-established during the 6-month review case. Provide the following information as of February 28, 2006:

a. The outstanding balances for long-term debt, short-term debt, preferred stock, and common equity. Provide this information on total company and electric operations bases.

b. The blended interest rates for long-term debt, short-term debt, and preferred stock. Include all supporting calculations showing how these blended interest rates were determined. If applicable, provide the blended interest rates on total company and electric operations bases.

c. LG&E's calculation of its weighted average cost of capital for environmental surcharge purposes.

17. Provide the following information concerning LG&E's SO₂ emission allowance inventory:

a. The number of emission allowances in the ending inventory balance as of December 31, 2005. The ending balance should reflect all available past vintage years of emission allowances through the 2005 vintage year. Also show the portion of the ending balance represented by allowances returned in kind by the Indiana Municipal Power Agency ("IMPA").

b. For each year in the period 2006 through 2016:

(1) Indicate the number of emission allowances allocated or expected to be allocated by the Environmental Protection Agency for LG&E's generating units.

(2) Indicate the number of emission allowances estimated to be returned in kind by IMPA.

(3) Indicate the number of emission allowances LG&E estimates it will utilize in conjunction with the operation of its generating units. Reflect the changes resulting from the adoption of the Clean Air Interstate Rule.

(4) If available, indicate any other estimated additions or withdrawals of emission allowances from LG&E's emission allowance inventory. Include a description of the type of addition or withdrawal.

18. Through the end of 2016, does LG&E plan on achieving SO₂ emission limit compliance for its generating units only through the operation of its currently in service emission control equipment, emission control equipment certificated and included in its environmental compliance plans, and the consumption of emission allowances? If no, describe LG&E's current plans for SO₂ emission limit compliance at its generating units through the end of 2016.

19. While reviewing the monthly surcharge filings corresponding to the billing periods included in the 6-month and 2-year reviews, it has been observed that LG&E has had to file several revisions or corrections to previously filed monthly surcharge reports. These revisions or corrections dealt with errors or inadvertent omissions LG&E discovered after the filing of the applicable monthly surcharge report.

a. Describe the processes employed by LG&E to collect and assemble the information submitted in the monthly surcharge filings.

b. Describe the internal controls employed by LG&E to ensure that the data provided in the processes described in part (a) are accurate and current.