

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LOUISVILLE GAS AND)	
ELECTRIC COMPANY FOR APPROVAL OF ITS)	CASE NO.
2006 COMPLIANCE PLAN FOR RECOVERY BY)	2006-00208
ENVIRONMENTAL SURCHARGE)	

O R D E R

On June 23, 2006, Louisville Gas and Electric Company (“LG&E”) filed, pursuant to KRS 278.020(1) and 278.183, an application requesting: (1) approval of an amended compliance plan for purposes of recovering the costs of new and additional pollution control facilities; and (2) an amended Environmental Cost Recovery Surcharge tariff (“ECR Tariff”). LG&E maintains that it will need these facilities and will incur the related compliance costs to comply with the requirements of the Clean Air Act Amendments of 1990 (“CAA”),¹ the Clean Air Interstate Rule, the Clean Air Mercury Rule, the Clean Air Visibility Rule, and other federal, state, or local environmental requirements applicable to combustion waste and by-products from facilities used for the generation of energy from coal. LG&E proposed that its amended ECR tariff become effective for bills rendered on and after February 1, 2007.

The following parties requested and were granted full intervention: the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“AG”), and Kentucky Industrial Utility Customers, Inc. (“KIUC”). A

¹ As amended, 42 U.S.C.A. § 7401 *et seq.*

consolidated hearing was held on November 8, 2006 for this case and Case No. 2006-00206,² the companion case for Kentucky Utilities Company (“KU”). All information requested at the public hearing has been filed and LG&E submitted a brief.³ Neither the AG nor KIUC filed a brief or expressed any objection to LG&E’s application for approval of the 2006 Compliance Plan and surcharge.

BACKGROUND

LG&E is a privately owned electric and gas utility that generates, transmits, distributes, and sells electricity to approximately 393,000 consumers in Jefferson County and in portions of 8 other counties.⁴ LG&E is a wholly owned subsidiary of E.ON U.S. LLC, a non-utility holding company.⁵

KRS 278.183 provides that a utility is entitled to the current recovery of its costs of complying with the CAA as amended and those federal, state, or local environmental requirements that apply to combustion wastes and by-products from facilities utilized for the production of energy from coal. Pursuant to KRS 278.183(2), a utility seeking to recover its environmental compliance costs through an environmental surcharge must

² Case No. 2006-00206, The Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct a Selective Catalytic Reduction System and Approval of Its 2006 Compliance Plan for Recovery by Environmental Surcharge.

³ LG&E filed with KU a Joint Brief on December 5, 2006.

⁴ The 8 counties are Bullitt, Hardin, Henry, Meade, Oldham, Shelby, Spencer, and Trimble. LG&E also distributes and sells natural gas to approximately 316,000 consumers in Jefferson County and in portions of Barren, Bullitt, Green, Hardin, Hart, Henry, Larue, Marion, Meade, Metcalfe, Nelson, Oldham, Shelby, Trimble, and Washington counties.

⁵ E.ON U.S. LLC is a Kentucky limited liability company and is an indirect subsidiary of E.ON AG, a German multi-national energy corporation.

first submit to the Commission a plan that addresses compliance with the applicable environmental requirements. The plan must also include the utility's testimony concerning a reasonable return on compliance-related capital expenditures and a tariff addition containing the terms and conditions of the proposed surcharge applied to individual rate classes. Within 6 months of submission, the Commission must conduct a hearing to:

- (a) Consider and approve the compliance plan and rate surcharge if the plan and rate surcharge are found reasonable and cost-effective for compliance with the applicable environmental requirements;
- (b) Establish a reasonable return on compliance-related capital expenditures; and
- (c) Approve the application of the surcharge.

LG&E's original compliance plan and environmental surcharge were approved by the Commission in 1995 ("1995 Plan") in Case No. 1994-00332.⁶ The 1995 Plan was comprised of capital projects involving sulfur dioxide ("SO₂") removal systems, low nitrogen oxide ("NOx") burners, and other pollution control equipment required by federal, state, or local environmental regulations applicable to coal combustion and by-products. The ECR tariff for the 1995 Plan provided for a formula to calculate the retail monthly environmental surcharge gross revenue requirement ("ES revenue requirement") and applicable monthly surcharge factor. The rate of return authorized for

⁶ 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 of Coal Combustion Wastes and By-Products, final Order dated April 6, 1995.

the 1995 Plan environmental capital expenditures was based on the actual cost of LG&E's October 1993 pollution control bond issue.⁷

LG&E added new pollution control facilities to its compliance plan and environmental surcharge through amendments that were approved by the Commission in 2001 ("2001 Plan") in Case No. 2000-00386.⁸ The 2001 Plan contained a capital project involving selective catalytic reduction ("SCR") NOx reduction technology facilities and other pollution control equipment required by the emission limits mandated by the Environmental Protection Agency ("EPA") and the CAA. The ECR tariff for the 2001 Plan amended the ECR tariff for the 1995 Plan and provided for a formula to calculate the ES revenue requirement and applicable monthly surcharge factor.

In Case No. 2000-00386 the rates of return on the 1995 and 2001 Plan environmental capital expenditures were separated. For the 1995 Plan, the rate of return was based on the weighted average cost of LG&E's pollution control debt as of December 31, 2000;⁹ but the rate of return on the 2001 Plan environmental capital expenditures was based on LG&E's overall rate of return on capital, reflecting LG&E's electric capital structure and corresponding debt and preferred stock cost rates as of

⁷ Id. at 24.

⁸ 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.

⁹ Id. at 19.

December 31, 2000.¹⁰ For both the 1995 and 2001 Plans, the cost of debt and preferred stock were to be reviewed and re-established during the 6-month surcharge review cases. In addition, at the 6-month surcharge reviews, a “true-up” calculation would reflect changes during the review period in the cost of debt.

As part of Case No. 2002-00193,¹¹ LG&E’s surcharge mechanism was modified to utilize the base-current methodology. Prior to the modification, LG&E’s surcharge mechanism was based on the incremental approach. Under the base-current methodology, all retirements and replacements recognized as offsets in the monthly surcharge filings through April 30, 2001 were incorporated in the base period surcharge factor. Only retirements or replacements of pollution control plant in service occurring since April 30, 2001 are reflected in the monthly surcharge filings as part of the current period surcharge factor. The determination of the ES revenue requirements for the 1995 and 2001 Plans were otherwise not changed by the adoption of the base-current methodology.

¹⁰ Id. at 24-27. During rehearing the Commission included short-term debt and accounts receivable financing in LG&E’s electric capital structure along with the corresponding cost rates as of December 31, 2000. See Orders on Rehearing dated May 14, 2001 and August 30, 2001.

¹¹ 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.

LG&E's second amendment to its environmental compliance plan and surcharge mechanism was in Case No. 2002-00147.¹² The approved amendment to the compliance plan approved by the Commission in 2003 ("2003 Plan") consisted of capital projects that included the conversion and additions to existing flue gas desulfurization systems ("scrubber"), the upgrade of existing electrostatic precipitators, and the restoration of a water system. The separation of the 1995 Plan and the 2001 Plan ES revenue requirements was maintained, and no changes were made to the surcharge mechanism or calculation of the ES revenue requirements and monthly surcharge factor for the 1995 Plan and the 2001 Plan. For the 2003 Plan, the surcharge mechanism, calculation of the ES revenue requirement, and the calculation of the monthly surcharge factor were similar to that used for the 1995 and 2001 Plans. In Case No. 2002-00147, the rate of return applied to the 1995 Plan and 2001 Plan environmental capital expenditures remained the same as approved in Case No. 2000-00386. For the 2003 Plan environmental capital expenditures, the overall rate of return on capital was approved, consistent with the approach outlined for the 2001 Plan in Case No. 2000-00386.

In Case No. 2003-00433,¹³ the capital expenditures and operating expenses associated with the 1995 Plan were included for recovery through LG&E's base rates. These costs were removed from LG&E's environmental surcharge, with the

¹² 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 rehearing Order dated September 4, 2003.

¹³ 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.

environmental surcharge providing recovery of the costs associated with the 2001 and 2003 Plans.

LG&E's third amendment to its environmental surcharge compliance plan and surcharge mechanism was in Case No. 2004-00421.¹⁴ The amendment to the compliance plan, approved by the Commission in 2005 ("2005 Plan"), consisted of capital projects that involved the handling of ash at the Mill Creek and Cane Run generating stations, refurbishment and modification of existing scrubbers at the Trimble and Cane Run generating stations, and the purchase of emission allowances. No changes were made to the surcharge mechanism or calculation of the ES revenue requirements and monthly surcharge factor for the 2001 Plan and the 2003 Plan. For the 2005 Plan, the surcharge mechanism, the calculation of the ES revenue requirement, and the calculation of the monthly surcharge factor were similar to that used for the 2001 and 2003 Plans. The overall rate of return on capital was used as the rate of return, and the same rate of return was applied to the 2001, 2003, and 2005 Plan environmental surcharge expenditures.

2006 COMPLIANCE PLAN

LG&E is adding new pollution control facilities to its previously approved compliance plans to reflect its continuing efforts to reduce SO₂ emissions, reduce NO_x emissions, mitigate sulfur trioxide ("SO₃"), reduce mercury, and control particulate matter. The fourth amendment to the compliance plan ("2006 Plan") proposed by LG&E calls for four projects that include the following facilities:

¹⁴ 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.

- (1) LG&E's share of the Air Quality Control System ("AQCS") to be installed at Trimble Unit 2,¹⁵ except for operating expenses, discussed below.
- (2) Installation of sorbent injection equipment to mitigate SO₃ emissions at Mill Creek Units 3 and 4 and Trimble Unit 1.
- (3) Installation of mercury monitors at all LG&E generating plants.
- (4) Installation of new particulate monitors at the Mill Creek plant.

The 2006 Plan has a total estimated capital expenditure of \$65.79 million, with the AQCS representing \$43.46 million of the investment.

In support of the 2006 Plan, LG&E presented testimony, the 2006 SO₃ Mitigation Study performed by Sargent and Lundy dated March 29, 2006, and the E.ON U.S. Generation Services 2006 SO₃ Mitigation Strategy for LG&E and KU dated April 2006 in support of its proposed SO₃ projects.

The appropriateness of LG&E's inclusion of projects dealing with the mitigation of SO₃ emissions was raised as an issue. In Case No. 2005-00068,¹⁶ the Commission had rejected the inclusion of SO₃ mitigation projects in Kentucky Power Company's

¹⁵ LG&E and KU are building Trimble Unit 2 in partnership with the Indiana Municipal Power Agency and the Illinois Municipal Electric Agency. LG&E and KU will own 75 percent of the capacity of Trimble Unit 2. LG&E will own 19 percent and KU will own 81 percent of their collective 75 percent share of Trimble Unit 2. The AQCS includes the installation of an SCR, dry and wet electrostatic precipitators, a wet process scrubber, and SO₃ mitigation equipment. A CPCN for these facilities was granted in Case No. 2004-00507, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity, and a Site Compatibility Certificate, for the Expansion of the Trimble County Generating Station, final Order dated November 1, 2005.

¹⁶ Case No. 2005-00068, Application of Kentucky Power Company for Approval of an Amended Compliance Plan for Purposes of Recovering Additional Costs of Pollution Control Facilities and to Amend Its Environmental Cost Recovery Surcharge Tariff.

proposed amendment to its environmental compliance plan. In its September 7, 2005 Order in that case, the Commission stated,

The CIs [Capital Improvement Requests] submitted by Kentucky Power clearly state that there are no regulations that limit SO₃ emissions, no regulatory issues associated with SO₃ mitigation, and no regulations specific to SO₃ emission levels. Although Kentucky Power claims that SO₃ must be controlled to avoid violating opacity limits, it has provided no evidence of what those opacity limits are or how SO₃ controls will enable the affected units to be in compliance with opacity limits.¹⁷

While LG&E acknowledged that state and federal environmental authorities have not promulgated specific SO₃ and sulfuric acid¹⁸ emission limits, LG&E argued that these authorities have expressed a clear requirement that these emissions must be controlled. LG&E noted that the studies it had provided in this proceeding indicated that SO₃ and sulfuric acid formation significantly increases when an SCR is utilized to control NO_x emissions. LG&E quoted a statement from the EPA where it assumed that utilities planning to install an SCR and/or a wet process scrubber would incur increased costs for SO₃ and sulfuric acid mitigation.¹⁹ LG&E argued that the existence of SO₃ and sulfuric acid in the plume from the stacks did impact the opacity of the plume, and cited reports for LG&E and KU generating units from the Kentucky Division of Air Quality (“KDAQ”) noting a connection between the concentrations of SO₃ and the opacity of the

¹⁷ Case No. 2005-00068, September 7, 2005 Order at 12.

¹⁸ Sulfuric acid forms when SO₃ in the flue gas cools and combines with flue gas moisture.

¹⁹ Response to the Commission Staff’s Second Data Request dated August 21, 2006, Item 2(a).

plume.²⁰ LG&E noted that its air permits from KDAQ state specific opacity limits and that LG&E's failure to mitigate SO₃ and sulfuric acid could result in violations of those permits.²¹

The Commission has reviewed the studies and information provided by LG&E concerning the need to mitigate SO₃ and sulfuric acid. The Commission finds that LG&E has sufficiently established that it needs to mitigate SO₃ and sulfuric acid in response to requirements from federal, state, and local environmental authorities, even though specific emission limits have not been established for those emissions. LG&E has provided sufficient information to show there is a link between the existence of SO₃ and sulfuric acid in the flue gas and the opacity of the stack plume.

The Sargent and Lundy 2006 SO₃ Mitigation Study, the 2006 SO₃ Mitigation Strategy for LG&E and KU, and LG&E's testimony shows that the projects in the 2006 Plan are related to compliance with the CAA as amended and other governmental regulations pertaining to combustion wastes and by-products resulting from the production of electricity from coal. This evidence also shows that LG&E sufficiently analyzed the available options and selected the option that is most cost-effective. Based on a review of the record, the Commission finds that LG&E's 2006 Plan is reasonable, cost-effective, and should be approved.

²⁰ Joint Response to Post-Hearing Data Request, filed November 21, 2006, Item 3.

²¹ Joint Post-Hearing Brief of KU and LG&E at 38.

SURCHARGE MECHANISM AND CALCULATION

LG&E proposed no changes in the surcharge mechanism or calculation of the ES revenue requirements and monthly surcharge factor for the 2001, 2003, and 2005 Plans and proposes that for the 2006 Plan the same approaches be used. The ES revenue requirement, determined for the current expense month, is comprised of a return on the 2006 Plan Environmental Compliance Rate Base ("Rate Base") plus specified environmental compliance operating expenses.²² The addition of the 2006 Plan will require a revision to the monthly surcharge reporting formats. LG&E provided sample monthly reporting formats that reflected the revisions required by the 2006 Plan.²³

Rate Base

LG&E's proposed 2006 Plan Rate Base used in the environmental surcharge mechanism includes the following components: eligible pollution control plant in service ("PC plant"); accumulated depreciation associated with the PC plant; eligible pollution control construction work in progress ("PC CWIP"); deferred income taxes; cash working capital allowance; and emission allowance inventories. The Rate Base would be adjusted for eligible PC plant, accumulated depreciation, and deferred taxes relating to replacements and retirements of PC plant that are already included in existing rates.

In conjunction with the installation of new particulate monitors at the Mill Creek plant, LG&E replaced stack opacity monitors ("stack monitors") and plenum opacity

²² Conroy Direct Testimony, Exhibit RMC-4 at 3 of 13.

²³ Id. at 1-13 of 13.

monitors (“plenum monitors”).²⁴ LG&E returned the stack monitors to inventory for future use at other facilities on an as needed basis and returned the plenum monitors to inventory for use in the mobile continuous emissions monitoring testing unit. LG&E stated that the stack monitors were on its books as of September 30, 2003 but the plenum monitors were not.²⁵ LG&E contended that there was no need to adjust the 2006 Plan Rate Base for the replacement of the stack and plenum monitors. LG&E noted that the plenum monitors were not on the books as of September 30, 2003 and the costs of the plenum monitors was not included in LG&E’s base rates as determined in its last rate case. As for the stack monitors, LG&E argued that these monitors remained part of the cost of service used to determine base rates and would be available for use at other facilities as needed due to the difficulty in obtaining replacement parts.²⁶

In previous environmental surcharge cases, the installation of new equipment that replaces existing equipment has resulted in the retirement of equipment. If the costs associated with the retired equipment are reflected in existing base rates, the Commission has required reductions to the Rate Base and operating expenses, to the extent appropriate, to eliminate a double recovery by the utility. In this instance, the

²⁴ The stack monitors were installed in 1984 and the plenum monitors were installed in 2004.

²⁵ Response to the Commission Staff’s First Data Request dated July 24, 2006, Item 10. The test year in LG&E’s last electric base rate case was the 12 months ending September 30, 2003.

²⁶ Response to the Commission Staff’s Second Data Request dated August 21, 2006, Item 5.

replaced equipment was not retired but moved to inventory for future use, either as replacement monitors or a source of replacement parts.

The Commission finds that since the plenum monitors were not on LG&E's books at the time of its last electric base rate case, no adjustment to the 2006 Plan Rate Base or associated operating expenses is necessary. Concerning the stack monitors, the Commission finds that LG&E's reclassification of this equipment to inventory is reasonable and no adjustment to the 2006 Plan Rate Base or associated operating expenses is necessary, at this time. However, if the stack monitors are subsequently retired from its inventory, LG&E will be required to recognize adjustments to its 2006 Plan Rate Base and operating expenses consistent with the Commission's previous decisions concerning the retirement of replaced equipment. In the event LG&E either sells or transfers the stack monitors to KU or another utility, LG&E will be required to recognize adjustments to its 2006 Plan Rate Base and operating expenses as if the stack monitors had been retired.

The Commission finds that LG&E's proposed 2006 Plan Rate Base is reasonable and should be approved. This approval includes the requirement to properly recognize within 90 days the impact of any retirement or replacement of PC plant that is already included in existing rates resulting from the 2006 Plan.

Operating Expenses

LG&E anticipates additional incremental operating and maintenance expenses in conjunction with the 2006 Plan. LG&E plans to identify and track these incremental expenses associated with the 2006 Plan by utilizing various subaccounts of Account

Nos. 506 and 512.²⁷ In addition to these expenses, LG&E proposed that the monthly environmental compliance operating expenses for the 2006 Plan should include: depreciation expense, property taxes, and insurance expense. The depreciation expense, property taxes, and insurance expense are functions of the value of the PC plant and the monthly expense amounts would reflect that calculation.

In its application, LG&E specifically stated that it was not seeking to include operating expenses associated with the Trimble Unit 2 AQCS.²⁸ LG&E explained that it had not included the operating expenses associated with the AQCS because operating expenses would not be incurred until Trimble Unit 2 was placed into service in 2010. LG&E stated it expected the AQCS operating expenses would be considered in a future environmental surcharge or base rate case proceeding.²⁹ However, in a data response LG&E changed its position and requested the Commission to now consider including the operating expenses associated with the AQCS with the decision in this case, provided this did not impact the Commission's ability to issue an Order in this case by December 22, 2006. LG&E stated that if the Commission did not consider including the AQCS operating expenses in this case, LG&E reserved the right to seek recovery of these expenses in a subsequent environmental surcharge or base rate case filing.³⁰

²⁷ Conroy Direct Testimony, Exhibit RMC-4 at 11 of 13.

²⁸ Charnas Direct Testimony at 3.

²⁹ Response to the Commission Staff's First Data Request dated July 24, 2006, Item 9.

³⁰ Id.

The Commission finds that LG&E's proposal in its application to track the additional incremental expenses associated with the 2006 Plan by utilizing subaccounts of Account Nos. 506 and 512 and report those expenses in the same manner as currently used is reasonable and should be approved. The Commission further finds LG&E's proposal concerning the recovery of depreciation expense, property taxes, and insurance expense associated with the 2006 Plan to be reasonable, and it should be approved.

However, concerning the inclusion of operating expenses associated with the Trimble Unit 2 AQCS, the Commission finds that LG&E's use of a data response to expand the scope of this proceeding is not reasonable and should be rejected. LG&E established the range of operating expenses recoverable under its surcharge mechanism when it filed its application on June 23, 2006. Furthermore, LG&E offered no reason why these additional operating expenses need to be included at this time. As LG&E correctly notes, it will not incur any operating expenses for the Trimble Unit 2 AQCS until that plant is in service, currently expected in 2010. LG&E will not be financially harmed by today's decision, and it will be able to request the recovery of these operating expenses in a future environmental surcharge or base rate case proceeding.

The Commission anticipates that LG&E will not incur the approved operating expenses until the 2006 Plan facilities have gone into service. If a monthly surcharge factor includes these expenses prior to the 2006 Plan facilities going into service, LG&E should submit as part of the monthly surcharge filing a written explanation documenting

why the expense has been incurred. The inclusion of that expense would be subject to review during the appropriate 6-month surcharge review.

Surcharge Formula

LG&E proposed no changes to the surcharge formula utilized to calculate the monthly ES revenue requirement. LG&E does propose a modification to the jurisdictional $R(m)$ ³¹ component used in the determination of the surcharge factor. Currently jurisdictional $R(m)$ reflects the base rate revenues,³² the fuel adjustment clause revenues, the demand-side management revenues, the small time-of-day program cost recovery factor, the merger surcredit, and the value delivery (“VDT”) surcredit. However, the environmental surcharge factor is not applied to the merger surcredit and the VDT surcredit. LG&E proposes that the merger surcredit and VDT surcredit be removed from the determination of jurisdictional $R(m)$. LG&E contends this change will more closely align the revenues used to determine the environmental surcharge factor and the revenues to which the factor is applied.

The Commission agrees with LG&E that no changes are needed to the surcharge formula. The Commission has reviewed LG&E’s proposal concerning the revenues reported as jurisdictional $R(m)$ and finds the proposal is reasonable and should be approved.

³¹ Jurisdictional $R(m)$ is the average monthly jurisdictional revenue for the 12 months ending with the current expense month and is the denominator in the calculation of the surcharge factor.

³² Base rate revenues are customer charges, energy charges, and demand charges.

Monthly Reporting Formats

The inclusion of the 2006 Plan into the existing surcharge mechanism and the change in jurisdictional R(m) will require modifications to the monthly environmental surcharge reporting formats. LG&E provided revised formats reflecting these changes, as well as proposing changes to separately report the SO₂ and NO_x emission allowance inventories.³³ LG&E submitted a revision to its proposed formats in conjunction with its request that the Commission consider including the operating expenses associated with the Trimble Unit 2 AQCS.³⁴ In response to a data request, LG&E agreed that the reporting format for PC Plant, PC CWIP, and depreciation expense could be consolidated into one multi-page format and provided a sample format reflecting that change.³⁵

The Commission finds that LG&E's revised monthly environmental surcharge reporting formats should be approved with the inclusion of the multi-page format for PC Plant, PC CWIP, and depreciation expense. Consistent with the Commission's finding that the Trimble Unit 2 AQCS operating expenses should not be included in the 2006 Plan, the Commission finds the revision to the proposed reporting formats to reflect this expense should be rejected.

³³ Conroy Direct Testimony, Exhibit RMC-4.

³⁴ Response to the Commission Staff's First Data Request dated July 24, 2006, Item 9, Attachment 2, page 2 of 2.

³⁵ Id., Item 12.

RATE OF RETURN

LG&E proposed that it be allowed to earn the overall rate of return on capital for the 2001, 2003, 2005, and 2006 Plan Rate Bases. LG&E further proposed that the overall rate of return on capital reflect a rate of return on equity ("ROE") of 10.50 percent, which the Commission approved in Case No. 2004-00421.

The Commission finds that LG&E's request to continue using an ROE of 10.50 percent is reasonable and should be approved. The Commission further finds that the overall rate of return on capital on the 2001, 2003, 2005, and 2006 Plan Rate Bases, after reflecting the gross up for income taxes, should continue to be 10.39 percent.³⁶

TARIFF EFFECTIVE DATE

LG&E proposed that its amended ECR Tariff should become effective for bills rendered on and after February 1, 2007. LG&E argued that changes to the surcharge billing factor cannot be implemented on a service rendered basis because its billing system applies the billing factors on a billing cycle basis. LG&E noted that if the Commission approves recovery of the 2006 Plan in December 2006, the impact of that decision will not be reflected on customer bills until February 2007, the second month following the month in which the authorizing Order was issued. LG&E stated that the surcharge billing factor will only be assessed on service rendered subsequent to the date of the Commission's Order in this proceeding.³⁷

³⁶ Case No. 2004-00421, June 20, 2005 Order at 23.

³⁷ Response to the Commission Staff's First Data Request dated July 24, 2006, Item 14.

Since LG&E has acknowledged that its new surcharge billing factor will only be applied to service rendered subsequent to the date of the Commission's Order in this proceeding, the Commission finds that the ECR Tariff should state that its effective date is for service rendered. Making the revised ECR Tariff effective for service rendered on and after the date of this Order will avoid the situation where customers would pay for increases in environmental costs prior to the approval of those increases. Therefore, the Commission finds that the amended ECR Tariff should become effective for service rendered on and after the date of the Commission's Order in this case.

IT IS THEREFORE ORDERED that:

1. LG&E's 2006 Plan consisting of four additional capital projects to meet federal, state, and local environmental regulations is approved.
2. LG&E's request to include Trimble Unit 2 AQCS operating expenses is denied without prejudice to seeking recovery of those expenses in a future environmental surcharge or base rate application.
3. LG&E's proposed ECR tariff is approved and shall be effective for service rendered on or after the date of this Order.
4. LG&E's rate of return on the 2001, 2003, 2005, and 2006 Plan capital expenditures, reflecting the gross up for income taxes, shall be 10.39 percent.
5. The monthly surcharge reporting formats proposed by LG&E, as discussed in this Order, are approved. Previous reporting formats shall no longer be submitted.
6. Within 10 days of the date of this Order, LG&E shall file with the Commission revised tariff sheets setting out the ECR tariff approved in this Order.

Done at Frankfort, Kentucky, this 21st day of December, 2006.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the end, positioned above a solid horizontal line.

Executive Director