COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE GAS AND ELECTRIC RATES, TERMS, AND CONDITIONS OF LOUISVILLE GAS AND ELECTRIC COMPANY	)))	CASE NO. 2003-00433

AND

AN ADJUSTMENT OF THE ELECTRIC RATES, TERMS, AND CONDITIONS OF KENTUCKY UTILITIES COMPANY	)))	CASE NO. 2003-00434

O R D E R

The Commission's June 30, 2004 Orders in the cases referenced included the requirement that Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") file with the Commission a plan developed and implemented that would eliminate the underfunding of the respective pension and post-retirement plans. In addition, LG&E and KU were required to file progress reports every 2 years on the progress to eliminate the underfunding, with the first report due to be filed by March 31, 2007.[1]

LG&E and KU filed the required plans with the Commission on June 30, 2005. On March 29, 2007, LG&E and KU submitted the first progress report, as required by the June 30, 2004 Order. Based on information contained in the first progress report, LG&E and KU also submitted a motion requesting that the periodic reporting

[1] June 30, 2004 Orders, ordering paragraph 6.

requirement imposed by the June 30, 2004 Orders concerning the funding of the pension and post-retirement plans be eliminated.

The LG&E and KU pension plans are defined benefit plans that are subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended, and the oversight of the Pension Benefit Guaranty Corporation ("PBGC"). The funding and accounting for pensions were affected by the passage of the Pension Protection Act of 2006 ("PPA") and the Financial Accounting Standards Board ("FASB") adoption of Statement of Financial Accounting Standards ("SFAS") No. 158.

The ERISA rules governing the funding for defined benefit plans were modified by the PPA. The PPA requires employers to fund liabilities in a manner so that the plans reach 100 percent "funded status" within 7 years. The PPA also modified the calculation of the "funded status" by using a method similar to the FASB concept of the Accumulated Benefit Obligation ("ABO"). Defined benefit plans that do not meet the new funding standards pay a 0.9 percent PBGC premium for unfunded vested benefits. The PPA changes are effective for plan years beginning in 2008.

SFAS No. 158 requires employers to recognize the overfunded or underfunded status of defined benefit and post-retirement plans as an asset or liability in the balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The liability used to calculate the entries is the Protected Benefit Obligation ("PBO"), which equals the present value of all future anticipated pension payments including future pay increases based on service to date. Employers are required to measure the funded status of a plan as of the date of its year-end balance sheet.

The strategy employed by LG&E and KU is to fund the defined pension plans to the full funding limitation as defined by ERISA, thus the goal is to fully fund the ABO while not exceeding the PBO. The primary objective of the funding strategy is to avoid higher cost variable rate PBGC premiums by meeting the full funding limitation as defined by ERISA. E.ON U.S. LLC ("E.ON") made a $107.9 million contribution to its pension plans in January 2007, which includes the plans for LG&E and KU. LG&E and KU submitted an analysis of the pension plans which shows a fully funded status for the plans.[2]

LG&E and KU report that the implementation of SFAS No. 158 impacted the accounting for Other Post-Retirement Benefits ("OPEB"), requiring that the full liability be disclosed on the balance sheet. Unlike the pension plans, there have been no legal changes to the required funding for OPEB. The current funding strategy is to fund post-retirement benefits for current active and retired participants under a 401(h) account, to the extent allowable, and the remainder funded on a pay-as-you-go basis through the Voluntary Employee Benefit Account ("VEBA") trusts.

Assets for the 401(h) are held for future obligations. The 401(h) contributions are made in accordance with the maximum funding limitation governed by tax laws. E.ON funded the 401(h) account in the amount of $5.1 million in 2006. All current benefits are paid from VEBA trusts, with employee and retiree contributions immediately directed to the VEBA trusts and employer contributions made as needed. E.ON paid an additional $15.2 million directly into the VEBA trusts to fund current benefit payments. LG&E and KU state that most employers fund their OPEB liability on a pay-as-you-go basis due to

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[2] The analysis also shows the PBO is at a 92 percent funded status.

the lack of a statutory funding requirement, the limitations on tax-deductible funding, and the fact that employers generally reserve the right to modify or terminate retiree medical benefits.

In support of the request to eliminate the periodic reporting requirement for the pension and post-retirement plans, LG&E and KU cite the changes in statute and accounting standards, contributions made by E.ON, and the fully funded status of the pension plans. In addition, LG&E and KU state that they will continue to monitor the components and developments that affect pension and post-retirement plan costs and respond accordingly.

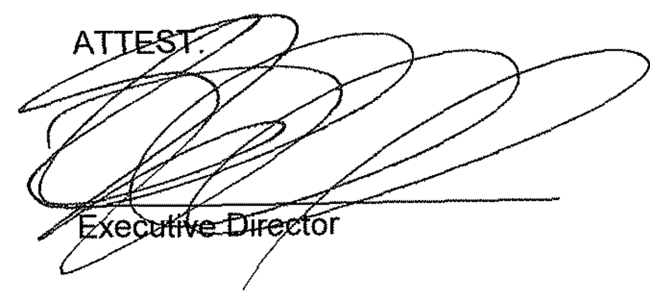
Based upon the information supplied by LG&E and KU, the Commission finds the request to eliminate the periodic reporting is reasonable and should be granted. The Commission believes LG&E and KU have adequately addressed the concerns that were expressed in the June 30, 2004 Orders. The Commission expects LG&E and KU to continue the monitoring of the funding status of the pension and post-retirement plans. In addition, when LG&E and KU file their next general rate case applications, the funding status of the pension and post-retirement plans should be addressed as part of the application.

IT IS THEREFORE ORDERED that the request by LG&E and KU to eliminate the periodic reporting requirement established in the June 30, 2004 Orders concerning the funding of the pension and post-retirement plans is granted.

Done at Frankfort, Kentucky, this 1st day of May, 2007.

By the Commission

ATTEST:



Executive Director

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