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March 13, 2006

HAND DELIVERY

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

RE: ***Application of Louisville Gas and Electric Company for an Adjustment of its Gas and Electric Rates, Terms and Conditions***
Case No. 2003-00433

Application of Kentucky Utilities Company for an Adjustment of its Electric Rates, Terms and Conditions
Case No. 2003-00434

Dear Ms. O'Donnell:

Enclosed please accept for filing two originals and five copies each of Louisville Gas and Electric Company's and Kentucky Utilities Company's Reply Memorandum Opposing Use of Effective Tax Rates in the above-referenced matters. Please confirm your receipt of these filings by placing the stamp of your Office with the date received on the enclosed additional copies and return them to me in the enclosed self-addressed stamped envelope.

Should you have any questions or need any additional information, please contact me at your convenience.

Very truly yours,

W. Duncan Crosby III

W. Duncan Crosby III

WDC/ec
Enclosures
cc: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

In the Matter of:

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

LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY'S REPLY MEMORANDUM OPPOSING USE OF EFFECTIVE TAX RATES

In his Memorandum on Petition for Rehearing ("AG Memo"), the Attorney General ("AG") provides three supports for his argument that the Commission should employ the effective state tax rate, not the statutory rate, when evaluating the reasonableness of a proposed revenue requirement increase. None of these arguments suffices to provide a ground for the Commission to alter or amend the June 30, 2004 Orders, but because the AG's third argument moots his other arguments, the Companies address it first.

I. Because Use of an Effective Tax Rate Will Have No Impact on the Outcome of the Commission's Analysis, the Commission Should Not Alter Its June 30, 2004 Order.

The AG concedes that the revenue requirements the Companies offered to accept in the Partial Settlement Agreement, Stipulation and Recommendation ("Settlement Agreement"), which requirements the Commission approved, are less than the revenue requirements would be using an effective tax rate.[1] Indeed, the AG states: "This is true regardless of whether the

[1] AG Memo at 2.

income taxes paid in other states on out-of-state activities are included in the analysis."[2] The AG further concedes, "[T]he dollar changes represented by the utilization of the effective tax rate may not serve to change the Commission's ultimate finding that the electric revenue increase agreed to by the Companies in the [Settlement Agreement] is reasonable."[3]

The AG's concessions effectively moot his arguments for use of an effective tax rate in this case. Kentucky's highest court has defined a moot case as "one which seeks a judgment . . . upon some matter which, when rendered, for any reason, cannot have any practical effect upon a then existing controversy," and has stated that Kentucky courts "will not consume their time in deciding moot cases, and have no jurisdiction to do so," even when the question presented is one of public importance.[4] Thus, in Schamback v. Brumleve, Kentucky's highest court dismissed an appeal of an action to cancel certain taxi licenses because, by the time the court issued its decision, the licenses in question had expired.[5] Analogously, the AG here admits that use of an effective tax rate does not result in revenue requirements for the Companies lower than those the Companies agreed to accept and which the Commission approved, rendering moot the AG's arguments for use of an effective tax rate in this case.[6] Moreover, insofar as future rate proceedings are concerned, the June 30, 2004 Orders already state that the Companies should, in their next rate cases, "address in detail the use of the effective tax rate for rate-making purposes."[7] Because the issue of use of an effective tax rate in this case is moot, the Commission should now decline to modify or amend the June 30, 2004 Orders.

II. The Commission Should Continue to Use the Statutory Rate, Not the Effective Rate, Because It Is A More Known, Measurable, and Reliable Rate.

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[2] AG Memo at 2.
[3] Id.
[4] Louisville Transit Co. v. Dept. of Motor Transport., 286 S.W.2d 536, 538 (Ky. 1956).
[5] 201 S.W.2d 903, 903-04 (Ky. 1947).
[6] AG Memo at 2.
[7] Case No. 2003-00433, Order at 55; Case No. 2003-00434, Order at 46.

The AG argues that because the statutory rate is higher than the effective rate and because the statutory rate has changed, the Commission should apply the effective rate in this case.[8] There are two problems with the AG's position. First, by noting a change in the statutory rate since the close of evidence, the AG effectively encourages the Commission selectively to make a single and forward-looking adjustment well outside the test period; however, the Commission stated in one of the June 30, 2004 Orders: "The Commission generally has not recognized adjustments occurring that far [nine months] beyond the end of the test year."[9] Second, the AG concedes that the effective rate "lacks the named certainty of the statutory rate." It is precisely because the statutory rate is more known, measurable, and reliable that the Commission traditionally has used it. The Commission should continue to do so in this case.

III. The Union Light, Heat and Power Company and Kentucky-American Water Company Cases Are Distinguishable from these Rate Cases Because the Companies Have Not Volunteered to Use An Effective Tax Rate.

Finally, the AG asserts that the Commission should use an effective tax rate in these rate cases because, the AG claims, it would be consistent with the Commission's approach in the most recent rate cases for Union Light, Heat and Power Company and Kentucky-American Water Company.[10] The Commission previously addressed these other cases in its June 30, 2004 Order:

> The Commission is not persuaded by the AG's arguments. Case No. 2001-00092 was a gas operations only rate case, and there was no issue related to out-of-state taxation of off-system sales, and, of particular note, ULH&P expressly requested the use of the effective income tax rate. Here, LG&E expressly opposes using the effective tax rate.[11]

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[8] AG Memo at 1.
[9] Case No. 2003-00434, Order at 39.
[10] AG Memo at 1-2.
[11] Case No. 2003-00433, Order at 54; Case No. 2003-00434, Order at 46.

As the Commission has noted, the Companies oppose use of an effective tax rate,[12] which distinguishes these rate cases from those the AG cites. Because these rate cases are distinguishable, and because the AG's concessions moot his Petition for Rehearing and the arguments contained in the AG Memo, the Commission should not use an effective tax rate in these rate cases.

[12] Case No. 2003-00433, Order at 54; Case No. 2003-00434, Order at 46.

Conclusion

The Commission should issue orders in both proceedings affirming the June 30, 2004 Orders in all respects and denying the Attorney General's request for adopting the effective corporate state income tax rates as the appropriate measure for calculating tax expense for the electric operations of LG&E and KU.

Dated: March 13, 2006

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Reply Memorandum was served on the following persons on the 13th day of March 2006, U.S. mail, postage prepaid:

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