LG&E

Louisville Gas and Electric Company
220 West Main Street (40202)
P.O. Box 32010
Louisville, Kentucky 40232

March 15, 2005

Elizabeth O'Donnell, Executive Director
Public Service Commission
211 Sower Boulevard
P. O. Box 615
Frankfort, Kentucky 40602

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MAR 15 2005
PUBLIC SERVICE COMMISSION

RE: Modifications to Louisville Gas and Electric Company's Gas Supply Clause to Incorporate an Experimental Performance-Based Ratemaking Mechanism - Case No. 2005-00031

Dear Ms. O'Donnell:

Please find enclosed an original and eight copies of the Response of Louisville Gas and Electric Company to the Second Data Request of Commission Staff dated March 3, 2005, in the above-referenced case.

Also accompanying this filing is a Petition for Confidentiality for certain information contained in the responses to Questions 3(b), 6(a), and 7(a).

Please contact me if you have any questions regarding this filing.

Sincerely,

Robert M. Conroy
Manager, Rates

Enclosures

cc: Honorable Elizabeth E. Blackford

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

RECEIVED

MAR 15 2005

PUBLIC SERVICE COMMISSION

In the Matter of:

MODIFICATION TO LOUISVILLE GAS AND ELECTRIC COMPANY'S GAS SUPPLY CLAUSE TO INCORPORATE AN EXPERIMENTAL PERFORMANCE-BASED RATEMAKING MECHANISM	)))))	**CASE NO. 2005-00031**

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PETITION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR CONFIDENTIAL TREATMENT OF CERTAIN INFORMATION CONTAINED IN RESPONSES TO DATA REQUESTS

Louisville Gas and Electric Company ("LG&E"), pursuant to 807 KAR 5:001, Section 7, petitions the Commission to classify and protect as confidential certain information that is contained in its Responses to the Second Data Request of the Commission Staff herein it has filed contemporaneously herewith. In support thereof, LG&E states:

1. LG&E has filed today its responses to the data requests propounded to it by the Commission Staff on March 3, 2005. Included in certain of these responses is information the public disclosure of which would damage LG&E's competitive position and business interests. As required by 807 KAR 5:001, Section 7(2)(b), LG&E is providing one copy of these responses under seal with the confidential information highlighted. An original and ten copies of this Petition are being filed with the redacted pages of the responses containing the confidential information attached.

2. The Kentucky Open Records Act exempts from disclosure certain commercial information. KRS 61.878 (1)(c). To qualify for this exemption and, therefore, maintain the

confidentiality of the information, a party must establish that disclosure of the commercial information would permit an unfair advantage to competitors of that party.

3. The Responses to the Data Requests listed below contain sensitive commercial information, the disclosure of which would injure LG&E's ability to negotiate future gas supply, transportation and off-system sales contracts at advantageous prices and, thereby, minimize the price of natural gas to its customers, and would unfairly advantage LG&E's competitors for gas supplies, transportation services, off-system sales and retail gas load. Any impairment of its ability to obtain the most advantageous price possible from natural gas producers and marketers will necessarily erode LG&E's competitive position vis-à-vis other energy suppliers that compete in LG&E's service territory, as well as other LDCs with whom LG&E competes for new and relocating industrial customers. The specific Data Requests which require LG&E to provide commercially sensitive information for which confidential protection is requested are as follows:

Question No. 3(b) of the Second Commission Staff Data Request – The percentage of purchases that use first-of-month indices, mid-month price indices, and any other types of contracts used by LG&E.

Question No. 6(a) of the Second Commission Staff Data Request– The number of times that a supplier has interrupted gas sold to LG&E and the circumstances of the recall.

Question No. 7(a) of the Second Commission Staff Data Request – The percentage of LG&E's portfolio that includes constrained point purchase contracts.

4. Public disclosure of these responses will damage LG&E's competitive position and business interests in various ways that are detailed below.

Question No. 3(b) of the Second Commission Staff Data Request – Public disclosure of this information will allow both competitors with LG&E and sellers to LG&E to know important information about its gas purchasing practices. Disclosure would enable sellers of gas to LG&E to determine an important element of LG&E's purchasing practices and, thus, place them in a position to negotiate with a serious advantage over LG&E. Disclosure will allow competitors to know an important component of how LG&E manages its cost of gas and thus better compete with LG&E for customers. In addition, it will give competitors for gas supply as well as gas suppliers important information regarding LG&E's gas requirements, which would disadvantage LG&E in its gas procurement.

Question No. 6(a) of the Second Commission Staff Data Request – This information is very similar to the information supplied in response to Question No. 3(b) of the Second Commission Staff Data Request and the disclosure of it would damage LG&E in the same way as the disclosure of the information provided in response to Question No. 3(b) of the Second Commission Staff Data Request.

Question No. 7(a) of the Second Commission Staff Data Request – This information is very similar to the information supplied in response to Question No. 3(b) of the Second Commission Staff Data Request and the disclosure of it would damage LG&E in the same way as the disclosure of the information provided in response to Question No. 3(b) of the Second Commission Staff Data Request.

5. The information for which LG&E is seeking confidential treatment is not known outside of LG&E and it is not disseminated within LG&E except to those employees with a legitimate business need to know and act upon the information.

6. The public interest will be served by granting this Petition, in that competition among LG&E's prospective gas suppliers and other business partners will be fostered and the

cost of gas to LG&E's customers will thereby be minimized. In addition, the public interest will be served by fostering full and fair competition between LG&E and other energy service providers within LG&E's gas service territory.

WHEREFORE, Louisville Gas and Electric Company respectfully requests that the Commission classify and protect as confidential the specific information contained in the responses to data requests more specifically described herein above.

Respectfully submitted,

Elizabeth L. Cocanougher
Senior Regulatory Counsel
Louisville Gas and Electric Company
220 West Main Street
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Louisville, Kentucky 40232
Telephone: (502) 627-4850

and

Robert M. Watt III
Stoll, Keenon & Park, LLP
300 West Vine Street, Suite 2100
Lexington, Kentucky 40507-1801
Telephone: (859) 231-3000

Counsel for Louisville Gas and Electric Company

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing pleading has been served by mailing a copy of same, postage prepaid, to the following person on this 14th day of March 2005:

Elizabeth E. Blackford, Esq.
Assistant Attorney General
Office of Rate Intervention
1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204

Elizabeth L. Cocanougher

Elizabeth L. Cocanougher
Senior Regulatory Counsel
Louisville Gas and Electric Company
220 West Main Street
Post Office Box 32010
Louisville, Kentucky 40232
Telephone: (502) 627-4850

Counsel for Louisville Gas and Electric Company explained how it responds to changes in price behavior in its response to Question Nos. 1 and 2 of the Commission Staff's First Data Request. LG&E discusses the successful and unsuccessful aspects of its strategy to include a variety of pricing mechanisms, and flexibility provisions in the contracts making up its gas supply portfolio in its response to Question No. 2 of the Commission Staff's Second Data Request.

CONFIDENTIAL INFORMATION REDACTED

		FOM INDICES	MID-MONTH INDICES	FIXED PRICES	TOTAL
2001	NOV	[redacted]	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	[redacted]	100.00%
2002	JAN	[redacted]	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	[redacted]	100.00%
2003	JAN	[redacted]	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	[redacted]	100.00%
2004	JAN	[redacted]	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	[redacted]	100.00%

CONFIDENTIAL INFORMATION REDACTED

[redacted]

[redacted]

[redacted]

CONFIDENTIAL INFORMATION REDACTED

[redacted]

b. If a supplier recalls gas purchased by LG&E, LG&E has several options. The first option is to replace the gas. However, inasmuch as the supplier typically will recall the gas when the price in the market at which it can resell the gas is higher than the price it is selling the gas to LG&E, LG&E will typically not attempt to purchase replacement supplies at the higher market price. Indeed, such an action could likely eliminate any benefits accruing to LG&E and its customers under the arrangement. Instead, LG&E will seek to use other available options. These other options include withdrawing gas from storage (either on-system storage or the storage component of its No-Notice Service with Texas Gas), suspending injections into storage for the duration and in the amount of the recall, or some combination thereof. LG&E structures the terms of the recall (e.g., frequency and volume) around its ability to exercise these options in the event of a recall.

CONFIDENTIAL INFORMATION REDACTED

		CONSTRAINED POINT PURCHASES	ALL OTHER PURCHASES	TOTAL
2001	NOV	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	100.00%
2002	JAN	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	100.00%
2003	JAN	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	100.00%
2004	JAN	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	100.00%

b. These supplies were purchased by LG&E at a discount to a first-of-the-month index.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

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PUBLIC SERVICE COMMISSION

In the Matter of:

MODIFICATION TO LOUISVILLE GAS AND ELECTRIC COMPANY'S GAS SUPPLY CLAUSE TO INCORPORATE AN EXPERIMENTAL PERFORMANCE-BASED RATEMAKING MECHANISM	)))))	CASE NO. 2005-00031

LOUISVILLE GAS AND ELECTRIC COMPANY'S
RESPONSE TO
SECOND DATA REQUEST OF COMMISSION STAFF
DATED
MARCH 3, 2005

FILED: MARCH 15, 2005

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2005-00031

Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 1

Responding Witness: Clay Murphy

Q-1 Provide a description and dollar amount of any additional expense, other than those included in the PBR mechanism itself, that LG&E has incurred during the experimental period covered by Case No. 2001-00017.

A-1. In Case No. 2001-00017, the Commission permitted LG&E and its customers to share any savings or expenses generated from the sale of off-system storage services through the OSSIF component of the PBR mechanism. In response thereto, LG&E requested and received a limited jurisdiction blanket certificate and authorization to charge market-based rates from the Federal Energy Regulatory Commission ("FERC") pursuant to its Order 63. That certificate permits LG&E to provide such interstate natural gas storage services in the interstate marketplace at market-based rates.

In addition to the costs described in LG&E's response to Question No. 2 of the Commission Staff's Second Data Request, LG&E has incurred out-of-pocket costs of $49,042, which includes $25,631 in legal costs and $23,411 in consulting fees. The legal costs and consulting fees associated with acquiring the FERC certificate described above were paid by shareholders, and not included in the PBR mechanism itself. Inasmuch as such costs cannot be shared as between company and customers under the PBR mechanism, LG&E has sought to minimize any incremental out-of-pocket costs.

See also LG&E's response to Attorney General Question No. 13.

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2005-00031

Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 2

Responding Witness: Clay Murphy

Q-2. Refer to Item 1, page 2, of LG&E's response to the Commission Staff's first data request.

a. LG&E provides a discussion of the management of its contracting, operational, credit and other risks incurred in pursuing additional savings under the PBR mechanism. Does LG&E incur any additional expenses in trying to manage its risks?

b. If yes, provide a description and amount of the additional expense.

c. LG&E states that some of its supply strategies and actions to achieve savings under the PBR mechanism have proven successful, some have not. Identify and describe all strategies and actions that were not successful.

A-2. a. Yes. LG&E has incurred expenses to mitigate its risks under the PBR mechanism. The PBR mechanism does not allow LG&E to recover labor-related expenses or other expenses typically classified as operating and maintenance expenses through the mechanism. As such, LG&E seeks to minimize the out-of-pocket expenses that it incurs in its efforts to generate savings under the PBR mechanism.

b. As described in LG&E's response to Question No. 1 of the Commission Staff's Second Data Request, LG&E incurred out-of-pocket expenses of $49,042 to obtain a limited jurisdiction blanket certificate and authorization from FERC to sell natural gas storage services at market-based rates. LG&E obtained this certificate as a part of its strategy to sell natural gas storage services and generate savings under the OSSIF component of the PBR mechanism. The ability to generate savings by selling natural gas storage services was expected to decrease LG&E's risk of creating expenses under the mechanism. Therefore, obtaining this certificate is an action that was undertaken by LG&E and linked directly to activity under the PBR mechanism.

In addition to those out-of-pocket expenses described above, there are also other expenses associated with managing LG&E's risks under the PBR mechanism. Those expenses include labor-related expenses and other operating and maintenance expenses that are typically not considered to be out-of-pocket. While these expenses, which are discussed below, do not represent "short-term incremental" or "out-of-pocket" expenses, in the long-run, they would not likely be incurred by LG&E absent the gas supply cost PBR mechanism.

For example, LG&E's Gas Supply Department analyzes and develops strategies to generate savings under the PBR mechanism, evaluates risks related to potential strategies, and implements strategies and actions to manage risks, maximize savings, and mitigate expenses under the PBR mechanism. Other departments within LG&E also provide support in these processes. For example, the development and evaluation of strategies that rely upon LG&E's on-system storage capabilities also requires analytical support from LG&E's Gas Control Department. The management of credit risks related to strategies that involve off-system sales transactions requires input from LG&E's Credit Department. LG&E's regulatory counsel also assists LG&E in identifying various potential regulatory developments that may impact the pipeline services purchased by LG&E and its ability to achieve savings under the PBR mechanism.

The Gas Supply Department must also administer the PBR mechanism, which includes calculating benchmarks, tracking PBR mechanism results, and preparing regulatory and other reports related to the PBR mechanism. These administrative functions assist LG&E in determining the extent to which its risk of incurring expenses is increasing or decreasing as the PBR Year progresses.

It is not possible to quantify these expenses because LG&E does not track specific hours related to the development of strategies, the implementation of those strategies, or the administrative functions related to the PBR mechanism. However, absent the PBR mechanism, there would have been no need for LG&E to undertake these kinds of activities.

c. When LG&E implements a strategy to create savings under the PBR mechanism, there is no guarantee that the strategy will produce savings under the mechanism. Some of the strategies and associated actions that LG&E has undertaken to create savings under the PBR mechanism have not always proven successful. Some strategies have proven very successful during some months, but have not been successful in all the months in which the strategy was implemented. Other strategies are currently successful, but may not continue to be successful in the future. There is no single purchasing strategy that can be successful in any and all potential market scenarios. LG&E undertakes a variety of purchasing strategies which enable it to achieve savings for customers under a variety of market conditions because it does not know what market conditions will ultimately materialize and be used to measure its performance. Indeed, that is LG&E's overall strategy, and generally that strategy has proven successful.

An action taken by LG&E to create savings under the PBR mechanism that has not proven successful to date was the request and receipt by LG&E of an open-access certificate from FERC pursuant to FERC Order 63 that allows LG&E to sell natural gas storage services off-system at market-based rates. As discussed in LG&E's response to Attorney General Question No. 13 and Question No. 2 of the Commission Staff's Second Data Request, LG&E incurred $49,042 in out-of pocket costs on this action. In canvassing the marketplace, LG&E discovered that the type of storage services which LG&E is capable of offering (without diminishing reliability) are not valuable enough to overcome the costs and reliability considerations.

One strategy that LG&E uses to generate savings under the Gas Acquisition Index Factor ("GAIF") component of the PBR mechanism is to purchase natural gas from a supplier for a specified number of days while allowing that supplier to retain the right to recall the gas for a limited number of days. In exchange for the right to recall gas, the supplier sells the gas to LG&E at a discount to an index price. Whether or not this strategy will be successful in a given month of any PBR Year is dependent on the price that LG&E pays for the gas purchased using this strategy as compared to the benchmark calculated under the PBR mechanism. This strategy has been successful in two of the three PBR Years included in the review period. While this strategy can be successful for a particular PBR Year, there may be certain months during that same year when the strategy is not successful. For example, overall, this strategy was successful during the PBR Year ended October 31, 2002, but it was not successful during all of the months that it was implemented during that PBR Year. LG&E found this strategy to be successful during the months of May 2002, August 2002, and September 2002. This strategy was not successful during the months of June 2002 and July 2002.

Another strategy that LG&E uses to generate savings under the GAIF component of the PBR mechanism is to purchase natural gas from a supplier at a constrained receipt point at a discount to an index price. This strategy has been successful in all three of the PBR Years included in the review period. While this strategy can be successful for a PBR Year, there may be certain months during that same year when the strategy is not successful. For example, overall, this strategy was successful during the PBR Year ended October 31, 2002, but it was not successful during the months of November 2001, January 2002, June 2002, and July 2002. Whether or not this strategy will be successful in a given month of any PBR Year is dependent on the price that LG&E pays for the gas purchased using this strategy as compared to the benchmark calculated under the PBR mechanism. This illustrates the risk to which LG&E is exposed in attempting to achieve least cost acquisition as incented by the PBR mechanism.

LG&E's strategies to sell natural gas off-system have generally been successful in generating savings. However, LG&E made an off-system sale in April 2002, which resulted in expenses, not savings, under the PBR mechanism. LG&E sold 25,404 MMBtu per day of natural gas for five days at a price that was indexed to a daily price posting. At the time that LG&E entered into this sales transaction, market trends indicated that the price that the counter-party would pay was likely to remain above the price that LG&E was paying for the gas it was selling to the customer. Instead, the daily price posting fell to a level that resulted in the customer paying a price to LG&E that was lower than LG&E's gas cost on three weekend days of the five total days that the gas was sold. This transaction resulted in expenses of $4,065 under the OSSIF component of the PBR mechanism for April 2002.

LG&E's strategy to purchase natural gas for the winter season under longer-term, flexible contracts that require the payment of a reservation fee has generally not been successful in terms of generating savings under the Historical Reservation Fee ("HRF") portion of the GAIF benchmark. Expenses, not savings, of $1,289,242 and $2,737,394 were generated under the HRF during the PBR Years ended October 31, 2002, and October 31, 2004, respectively. LG&E generated savings of $43,552 under the HRF for the PBR year ended October 31, 2003. LG&E absorbed its portion of the expenses as provided for in the PBR mechanism.

LG&E has undertaken various strategies to reduce these supply reservation fees. (See LG&E's response to Question No. 2 of the Commission Staff's First Data Request). These strategies have helped LG&E to mitigate the expenses calculated under the HRF but they have not been successful in preventing expenses from occurring in most PBR Years. A potential strategy to prevent expenses under the HRF that LG&E has not implemented is "de-contracting" because of the reliability and flexibility they provide in responding to changes in load conditions and the market price of gas.

Although many of the strategies discussed in this response have been successful during certain months or years, there is no guarantee that they will continue to be successful or unsuccessful. LG&E continues to evaluate and modify its purchasing and sales strategies within the context of market and regulatory trends to determine which strategies are the most likely to be successful going forward.

See LG&E's response to Question Nos. 1 and 3 of Commission Staff's First Data Request and Question Nos. 4 and 7 of the Commission Staff's Second Data Request, for a discussion of strategies or activities (for example, capacity release, pipeline discounting, or constrained point purchases) that, because of changing market conditions or regulatory circumstances, may be less successful in the future.

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2005-00031

Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 3

Responding Witness: Clay Murphy

Q-3. Refer to Item 1, page 3, of LG&E's response to the Commission Staff's first data request, which includes a discussion of LG&E's contracting risks.

a. Does LG&E use fixed price contracts?

b. Provide the percentage of purchases that use first-of-month indices, mid-month price indices, and any other types of contracts used by LG&E.

A-3. a. LG&E does not purchase gas at fixed prices for terms longer than one month. For terms of one month or less, LG&E may purchase gas at a fixed price. In the overall context of LG&E's supply purchasing strategies, a purchase at a fixed price is just another means of purchasing gas at a mid-month price. LG&E does not purchase any natural gas supplies using forward pricing techniques or related financial instruments.

b. Included in this response is a spreadsheet (filed with a Motion for Confidential Treatment) showing the percentages of purchases by month as among first-of-month indices, mid-month price indices, and any other types of contracts (i.e., fixed-priced supplies for terms of one month or less) used by LG&E.

Typically, when prices during a month increase above the first-of-month ("FOM") price, LG&E maximizes its purchases under those contracts priced at a FOM price to the extent practicable. Conversely, when prices during a month fall below the first-of-month ("FOM") price, LG&E minimizes its purchases under those contracts priced at a FOM price to the extent practicable. This behavior is consistent with least cost acquisition strategies incented through the construction of the gas supply cost PBR mechanism. (In most cases, purchases of natural gas supplies at fixed prices are made in the mid-month market and not during the FOM market.)

Therefore, the percentage breakdown in the following table illustrates LG&E's strategy to optimize (in the context of prevailing market prices) the use of its gas supply portfolio and contracting options in order to achieve least cost acquisition as incented by the PBR mechanism. LG&E has also explained how it responds to changes in price behavior in its response to Question Nos. 1 and 2 of the Commission Staff's First Data Request. LG&E discusses the successful and unsuccessful aspects of its strategy to include a variety of pricing mechanisms, and flexibility provisions in the contracts making up its gas supply portfolio in its response to Question No. 2 of the Commission Staff's Second Data Request.

CONFIDENTIAL INFORMATION REDACTED

		FOM INDICES	MID-MONTH INDICES	FIXED PRICES	TOTAL
2001	NOV	[redacted]	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	[redacted]	100.00%
2002	JAN	[redacted]	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	[redacted]	100.00%
2003	JAN	[redacted]	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	[redacted]	100.00%
2004	JAN	[redacted]	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	[redacted]	100.00%

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2005-00031

Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 4

Responding Witness: Clay Murphy

Q-4. Refer to Item 1, page 4, of LG&E's response to the Commission Staff's first data request.

a. LG&E states that it assumes contracting risk through the negotiation of discounts with interstate pipeline transportation providers. Explain how negotiating a discount for interstate pipeline transportation puts LG&E at risk.

b. LG&E states that it faces the threat of a pipeline bypassing it to directly serve a customer in order to recoup some of the discounts awarded to LG&E. Provide the number of times that LG&E has experienced this type of bypass.

c. When a pipeline has bypassed LG&E in this manner, was the bypass initiated by the pipeline or the customer?

A-4. a. Negotiating a discount for interstate pipeline transportation puts LG&E at risk for several reasons. These forms of risk include both increased exposure to potential bypass and the limitation of potential revenues otherwise achievable through capacity release. Furthermore, savings achieved under the TIF component of the PBR mechanism through exploiting LG&E's competitive situation and securing pipeline discounts could be diminished by a change in FERC policy as related to the recovery of discounted revenues.

<u>Limitation of Capacity Release</u>: LG&E assumes risk in securing discounts because the terms of the discount require that LG&E give up the opportunity to release capacity at points on the pipeline's system (other than LG&E's city gate), as a condition of retaining the discounted rate. Therefore, LG&E gives up the ability to achieve savings through capacity release activities in exchange for discounted pipeline transportation costs. One form of risk inherent in negotiating discounts with interstate pipelines is that the discount amount may or may not be less than the amount which could have been achieved by LG&E through capacity release.

As explained by LG&E in its response to Question No. 3 of the Commission Staff's First Data Request, to the extent that LG&E releases its discounted firm transportation capacity to a replacement shipper, that replacement shipper must deliver gas to LG&E's city gate or LG&E will lose its discount for that portion of its capacity for the duration of the release. The discount agreements which LG&E is able to negotiate with Texas Gas Transmission LLC ("Texas Gas") and Tennessee Gas Pipeline Company ("Tennessee") provide for discounted rates at LG&E's city gate (the primary delivery point). However, if LG&E's capacity is used to deliver gas to a point other than its city gate (a secondary delivery point), LG&E must pay the maximum tariffed rate for the portion of the capacity used at that other point. This potential loss of the discounted rate requires LG&E to release capacity with the restriction that such capacity can only be used to deliver gas to LG&E's city gate, which means the gas has to be delivered to LG&E's system. Releasing capacity with this restriction greatly limits LG&E's ability to both release the capacity and to achieve potentially higher rates for the released capacity. LG&E assumes the risk under the PBR mechanism that the value of the transportation discounts that it has negotiated will outweigh the lost opportunity to release capacity and secure capacity release revenues.

FERC has recently affirmed this discount policy by reinstating its policy of permitting interstate natural gas pipeline companies to limit the selective discounts they offer to shippers to the primary receipt and delivery points contained in their contracts. FERC's decision responds to a remand by the U.S. Court of Appeals for the D.C. Circuit in a case brought by Williston Basin Interstate Pipeline ("Williston") challenging FERC's orders in Docket No. RP00-463. Williston challenged a FERC order that required Williston to modify its tariffs to implement a FERC policy that would permit a shipper with a discounted rate to retain its discount when using a secondary point or segmenting its capacity, if a similarly situated shipper is receiving a discount at that point. On remand, FERC concluded that it cannot justify such a policy. FERC's new order allows Williston and other pipelines (presumably including Texas Gas and Tennessee) to remove tariff provisions that permit shippers to retain discounts at secondary receipt and delivery points.

Heightened Exposure to Bypass: Another factor that LG&E considers when pursuing transportation discounts is the ability and likelihood that the pipeline from whom the discounts are being sought may seek to recapture some of those discounts by bypassing LG&E and serving LG&E's customers directly. LG&E must consider the risk of a "retribution" bypass when leveraging its competitive position to pursue transportation discounts.

Changes in FERC Discount Policy: On a going-forward basis, LG&E assumes certain transportation contracting and management risks arising out of potential changes in regulation by FERC. For example, a risk to which LG&E may be exposed is the potential change in regulation associated with pipeline discounting practices. On November 22, 2004, FERC issued a Notice of Inquiry ("NOI") addressing the issue of pipeline ratemaking policy as related to transportation discounts offered by interstate pipelines to shippers due to gas-on-gas competition from other interstate pipelines. The NOI was precipitated by a court order on judicial review on behalf of local distribution companies ("LDCs") which are captive to a single pipeline. They object to FERC's ratemaking adjustments that allocate to the pipeline's other customers the revenues lost by a pipeline in granting a discount in response to gas-on-gas competition.

In the NOI, FERC is focused on how the revenue shortfall from discounts will be handled, not whether pipelines should be allowed to agree to rate discounts. However, if pipelines cannot recover the costs of discounts from other ratepayers through the rate making process, pipelines will be less likely to offer discounts in response to gas-on-gas competition. Because LG&E is served by two interstate pipelines, it has been able to negotiate discounted rates with both pipelines. If FERC changes its discounting policy, the savings which LG&E has been able to achieve under the TIF component of the PBR mechanism could be eliminated, thereby increasing LG&E's risk under the PBR mechanism. LG&E's opportunities to generate savings under the TIF component would be decreased, thereby reducing significantly LG&E's opportunity to offset expenses that may occur under other components of the PBR mechanism.

b. LG&E has not experienced a physical bypass of its gas distribution system. However, the potential for such a physical bypass is real. The gas pipeline system of Texas Gas passes directly through the service area of LG&E, and in several instances near major natural gas consuming customers of LG&E. In addition to supply alternatives provided by Texas Gas, LG&E believes that there are also other opportunities for certain customers to physically bypass LG&E's gas distribution system. Because Texas Gas currently provides a significant portion of LG&E's transportation services, further shifting transportation services from Texas Gas may provide increased inducement for Texas Gas to recapture lost market share by seeking to directly serve large customers located along its system, thus physically bypassing LG&E.

c. Not applicable.

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2005-00031

Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 5

Responding Witness: Clay Murphy

Q-5. Refer to Item 1, page 5, of LG&E's response to the Commission Staff's first data request.

a. LG&E states that the elimination of discounts may increase its risk under the PBR mechanism, depending on a pipeline's ability to recover the cost of those discounts from other customers.

(1) Would LG&E ever pay more than the maximum rate for pipeline service approved by the Federal Energy Regulatory Commission ("FERC")?
(2) If yes, under what circumstances?
(3) If no, explain any risks LG&E may incur.

b. Under the heading "Storage Management Risks," LG&E discusses the limits it faces in operating its storage capabilities. Are these limits a result of timing issues? For example, does LG&E have to inject a certain volume each day or month to meet the needs of its system?

A-5. a. (1) LG&E does not anticipate that, under current circumstances, it would be willing to pay more than the maximum rate approved by FERC for pipeline services. In negotiating with its pipeline transporters, LG&E starts from the recourse (tariffed) rates and negotiates with the pipeline(s) to secure a discount. If LG&E was unable, or the pipeline was unwilling, to negotiate a discount, LG&E would contract for services from the pipeline with the lowest tariffed rates to the extent that system operational criteria allowed.

(2) See LG&E's response to Question No. 10 of the Commission Staff's Second Data Request which discusses circumstances under which a customer may pay more than the maximum rate for pipeline service approved by FERC.

(3) If FERC were to change its policies such that pipelines could no longer offer discounts to customers that have transportation alternatives, LG&E could be forced to contract for service at maximum rates on Tennessee

and/or Texas Gas. (LG&E would, of course, favor the pipeline with the lower maximum rates). However, a change in FERC policy affecting either pipeline's ability to offer discounts would also affect other transportation customers that Texas Gas and Tennessee have been able to attract or retain through discounting. The lack of available discounts (and the consequent loss of business by the pipeline) could potentially increase the affected pipelines' recourse (tariffed) rates.

Other risks to which LG&E may be exposed in connection with securing discounted transportation rates are included in LG&E's response to Question No. 4 of the Commission Staff's Second Data Request.

b. Storage limits are driven by a number of factors which can affect both the ability to withdraw gas from and inject gas into LG&E's on-system storage facilities.

LG&E's ability to inject gas into storage is limited by the pipeline capacity and gas supplies available to it, by maintenance work being conducted on the fields, by maintenance of LG&E's transmission facilities delivering gas from the interstate pipeline to the field, by inventory verification tests, by the total working gas capacity of the field, by the demand for gas to be injected into other fields, by retail system loads, by the need to mitigate storage field losses, by the geo-physical characteristics of the fields, and by the overall need to maintain the operational integrity of the field. All of these factors go into establishing a storage injection plan in order to ensure that none of the criteria are violated. These criteria result in daily, monthly and seasonal volumetric limitations in terms of amounts to be injected into storage.

LG&E's ability to withdrawal gas from storage is limited by the pipeline capacity and gas supplies available to it, by the physical limitations of compression and purification facilities, by LG&E's transmission facilities delivering gas from the field to load centers on LG&E's system, by inventory verification tests, by the total working gas capacity of the field, by the need to withdrawal gas from other fields, by retail system loads, by the need to mitigate storage field losses, by the geo-physical characteristics of the fields, and by the overall need to maintain the operational integrity of the field. All of these factors go into establishing a storage withdrawal plan in order to ensure that none of the criteria are violated. These criteria result in daily, monthly and seasonal volumetric limitations in terms of amounts to be withdrawn from storage.

The limitations surrounding overall storage withdrawal and injection abilities affect the quantities which LG&E may be able to purchase on a given day. For example, LG&E maintains certain storage inventory levels during the season. These inventory levels help LG&E to ensure that it can meet system requirements during design weather since inventory levels are one of the key components affecting withdrawal capabilities. In order for LG&E to maintain its storage schedule (thus ensuring that all withdrawals are completed by the end of the season prior to inventory verification and maintenance work), LG&E may not be able to inject quantities into storage or suspend withdrawals of gas from storage even if the price of gas is very low. Conversely, in order for LG&E to maintain its storage schedule, LG&E may not be able to withdraw extra quantities of gas from storage when the price of gas is high. In the case of summer storage injections, LG&E may not be able to inject extra quantities of gas when prices fall, or suspend injection of gas when prices rise, if the storage injection criteria are to be observed. Nevertheless, LG&E may have limited flexibility which it is able to use in order to shift withdrawal or injection quantities, or to handle potential gas recalls. LG&E is able to use this limited flexibility as a part of its overall strategy to lower gas costs and achieve savings under the PBR mechanism.

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CASE NO. 2005-00031

Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 6

Responding Witness: Clay Murphy

Q-6. Refer to Item 1, page 6, of LG&E's response to the Commission Staff's first data request. LG&E discusses the possibility that a supplier may interrupt the gas supply if it was purchased as recallable gas.

a. Provide the number of times that a supplier has interrupted gas sold to LG&E and explain the circumstances of the recall.

b. Explain LG&E's options if a supplier recalls gas purchased by LG&E. For example, does LG&E purchase the gas needed from another source.

A-6. a. Included in this response is a spreadsheet (filed with a Motion for Confidential Treatment) detailing the number of times that a supplier has recalled gas sold to LG&E and the circumstances of the recall. LG&E structures the terms of the recall around LG&E's ability to manage the recall within the terms of its pipeline services, on-system storage capabilities, and retail loads.

A portion of the gas LG&E purchases may include provisions allowing the supplier to recall (interrupt) a specified volume of gas for a pre-determined number of days during the period of the transaction. Such gas is priced in reference to a first-of-month ("FOM") index. Suppliers are typically able to offer discounts to the index price based upon their ability to recall the gas they are selling to LG&E. A supplier may recall the gas for any reason, and that reason is not provided to LG&E. A supplier may choose to exercise its option for several reasons: (i) because the price at which the supplier is selling the gas to LG&E is less than the current market price, (ii) because the supplier may desire to sell the gas to another party, (iii) because of a supply problem on the part of the supplier, or (iv) because of any other reason. However, the supplier must exercise its option within the limitations (notice period, number of days, frequency, etc.) specified in the transaction between LG&E and the supplier. As indicated in the table, LG&E entered into a number of transactions that incorporated recallable features. In certain instances, the supplier may not have exercised some or all of its recall rights.

LG&E discusses the successful and unsuccessful aspects of this purchasing strategy in its response to Question No. 2 of the Commission Staff's Second Data Request.

CONFIDENTIAL INFORMATION REDACTED

[redacted]

CONFIDENTIAL INFORMATION REDACTED

[redacted]

b. If a supplier recalls gas purchased by LG&E, LG&E has several options. The first option is to replace the gas. However, inasmuch as the supplier typically will recall the gas when the price in the market at which it can resell the gas is higher than the price it is selling the gas to LG&E, LG&E will typically not attempt to purchase replacement supplies at the higher market price. Indeed, such an action could likely eliminate any benefits accruing to LG&E and its customers under the arrangement. Instead, LG&E will seek to use other available options. These other options include withdrawing gas from storage (either on-system storage or the storage component of its No-Notice Service with Texas Gas), suspending injections into storage for the duration and in the amount of the recall, or some combination thereof. LG&E structures the terms of the recall (e.g., frequency and volume) around its ability to exercise these options in the event of a recall.

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Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 7

Responding Witness: Clay Murphy

Q-7. Refer to Item 1, page 7, of LG&E's response to the Commission Staff's first data request. LG&E discusses its purchases of gas at constrained points, allowing it to purchase gas at below-market prices.

a. Provide the percentage of LG&E's portfolio that includes these types of contracts.

b. Are these contracts fixed priced or indexed priced?

A-7. a. Included in this response is a spreadsheet (filed with a Motion for Confidential Treatment) setting forth the percentage by month of LG&E's purchases that were made at constrained points during the review period.

As explained in LG&E's response to Question No. 1 of the Commission Staff's First Data Request, LG&E's purchases at constrained points can typically be made at a discount to the market price. However, LG&E wishes to clarify four factors related to these purchases. Firstly, the discount is to a first-of-month ("FOM") index price. Secondly, the discount is measured in a few cents per MMBtu, not dollars per MMBtu. Thirdly, the level of the discount from the FOM index changes with market conditions. Fourthly, LG&E has limited pipeline capacity at these constrained points and, incremental capacity is not available to LG&E. That portion of Texas Gas's system operates at or near capacity, meaning that the pipeline's facilities taking gas away from these points are typically full.

Also, as explained in LG&E's response to Question No. 1 of the Commission's Staff First Data Request and Question No. 2 of the Commission Staff's Second Data Request, sometimes LG&E's strategy with regard to purchases at constrained points is successful, and sometimes it is not. As LG&E has clarified above, the price typically obtainable is less than the FOM price, which may not be less than mid-month prices. Therefore, if prices drop during the month, the price that LG&E is paying for the purchases at the constrained point may be higher than the prevailing prices in the mid-month marketplace. If prices increase above the FOM price, the price that LG&E is paying for the purchases at the constrained point will be lower than the prevailing prices in the mid-month market making the strategy a successful one.

These purchases, because they are made at a price fixed during the course of the month, can expose LG&E to risk under the PBR mechanism. As LG&E discussed in its response to Question No. 1 of the Commission Staff's First Data Request (p. 7 of 10), LG&E assumes the risk that it will be able to manage its system in such a way that it can accept the fixed quantities it purchases. LG&E also gives up the ability to purchase alternate quantities of gas should the price of gas fall below the price for gas purchased at the constrained point. Even if gas prices fall to a level below the price applicable to purchases at the constrained point, LG&E still must take the gas.

As LG&E discussed in its response to Question No. 1 of the Commission Staff's First Data Request (p. 7 of 10), expansion of the facilities used to transport this constrained supply is currently being contemplated by Texas Gas. Such expansion may reduce LG&E's ability to purchase these supplies at a discount on a going-forward basis. Texas Gas is currently conducting a non-binding pipeline open season for capacity on its North Louisiana system where a major constrained point is located. More gas supply exists behind constrained points than is currently able to move to market through the existing pipeline facilities. Texas Gas has very limited ability to receive incremental gas supply for redelivery to its markets or mainline system in Louisiana because the system is fully subscribed. An expansion of its North Louisiana system will provide access to additional North Louisiana production that currently is unable to move on the Texas Gas system due to capacity constraints. This means that the ability to purchase these supplies at less than a market price will be decreased along with any price advantage that may currently exist. Therefore, this is a strategy that may no longer be appropriate or successful on a going-forward basis. According to Texas Gas, the proposed in-service date for this additional firm pipeline capacity could be as early at November 1, 2005, depending on the outcome of its open-season.

CONFIDENTIAL INFORMATION REDACTED

		CONSTRAINED POINT PURCHASES	ALL OTHER PURCHASES	TOTAL
2001	NOV	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	100.00%
2002	JAN	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	100.00%
2003	JAN	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	100.00%
	NOV	[redacted]	[redacted]	100.00%
	DEC	[redacted]	[redacted]	100.00%
2004	JAN	[redacted]	[redacted]	100.00%
	FEB	[redacted]	[redacted]	100.00%
	MAR	[redacted]	[redacted]	100.00%
	APR	[redacted]	[redacted]	100.00%
	MAY	[redacted]	[redacted]	100.00%
	JUN	[redacted]	[redacted]	100.00%
	JUL	[redacted]	[redacted]	100.00%
	AUG	[redacted]	[redacted]	100.00%
	SEP	[redacted]	[redacted]	100.00%
	OCT	[redacted]	[redacted]	100.00%

b. These supplies were purchased by LG&E at a discount to a first-of-the-month index.

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Question No. 8

Responding Witness: Clay Murphy

Q-8. Refer to Item 1, pages 8-9, of LG&E's response to the Commission Staff's first data request in which LG&E discusses its credit risks. Provide the number of times, during the PBR trial period, that LG&E experienced a counter party's default.

A-8. LG&E has experienced no payment defaults by counterparties to whom LG&E has sold natural gas supplies pursuant to the OSSIF component of the gas supply cost PBR mechanism. No defaults have occurred largely because LG&E has successfully evaluated and monitored the financial credit-worthiness of potential counterparties, and mitigated its exposure to the risk of non-payment.

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Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 9

Responding Witness: Clay Murphy

Q-9. Refer to Item 2, pages 6-7, of LG&E's response to the Commission Staff's first data request. LG&E proposes two alternatives to encourage it to continue long-term contracts. The first is to benchmark reservation fees on a contemporaneous basis instead of a historical basis, and the second is to eliminate the use of historical reservation fees to benchmark supply reservation fees and benchmark these fees outside of the PBR mechanism.

a. Provide the contemporaneous level of reservation fees.

b. Explain how LG&E envisions that benchmarking reservation fees outside of the PBR mechanism would work.

A-9. a. The contemporaneous level of reservation fees are the actual reservation fees for the PBR Year. For example, reservation fees were $5,749,986 for the PBR Year ended October 31, 2002; $5,440,468 for the PBR Year ended October 31, 2003; and $8,332,624 for the PBR Year ended October 31, 2004. As with the GAIF component of the PBR mechanism, the benchmarking mechanism would rely upon a contemporaneous market price for the reservation fees. However, importantly, because there is no publicly available third-party data like the gas price postings used to benchmark gas commodity purchases in the GAIF component of the PBR mechanism, the level would be the costs actually paid by LG&E. Consequently, using a contemporaneous level of reservation fees would result in no expenses or savings being generated under the PBR mechanism as a result of supply reservation fees and would thus produce results similar to those discussed in (b) below.

An alternative to using the contemporaneous reservation fee methodology described above would be to modify the current HRF benchmark to reflect only the prior year's supply reservation fee levels, instead of the average of the prior two years. Under this methodology, the reservation fees benchmarked in 2003/2004 would be those paid in 2002/2003, and so on. This methodology would have resulted in reservation fee benchmarks of

$5,218,050 for the PBR Year ended October 31, 2002; $5,749,986 for the PBR Year ended October 31, 2003; and $5,440,468 for the PBR Year ended October 31, 2004. This methodology would have resulted in LG&E achieving expenses under the PBR mechanism of $531,936 for the PBR Year ended October 31, 2002; and $2,892,156 for the PBR Year ended October 31, 2004. This methodology would have resulted in savings of $309,518 for the PBR Year ended October 31, 2003. This methodology would have produced net expenses under the HRF of $3,114,574 for the review period as compared to $3,983,084 in net expenses calculated under the current HRF methodology.

However, modifying the HRF to include only one year of historical reservation fees would not substantially reduce LG&E's risks under the PBR mechanism as evidenced by the fact that this methodology would have only reduced the expenses calculated under the HRF by $868,509 ($3,983,084 - $3,114,574) over the three year review period. Therefore, this methodology may mitigate, but not eliminate, a potential "de-contracting" strategy such as that described in LG&E's response to Question No. 2 of the Commission Staff's First Data Request.

As compared to the current HRF methodology, it is likely that either alternative treatment of reservation fees described herein would more appropriately recognize the fact that LG&E has little control over the reservation fees available in the natural gas market. Each alternative would be less likely to encourage (although in varying degrees) a "de-contracting" strategy. Either methodology would rely upon, to a greater or lesser extent, a contemporaneous methodology, depending upon the alternative elected.

If reservation fees are to continue to be benchmarked, LG&E prefers that they be benchmarked in the context of the PBR mechanism as discussed above.

b. In benchmarking reservation fees outside of the PBR mechanism, one alternative would be to remove the HRF from the GAIF benchmark and to remove actual reservation fees from the calculation of Actual Gas Costs ("AGC"). However, LG&E believes that such a methodology may not be as appropriate as the contemporaneous methodology discussed above.

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Response to Second Data Request of Commission Staff dated March 3, 2005

Question No. 10

Responding Witness: Clay Murphy

Q-10. Refer to Item 5(b), page 1, of the response to the Attorney General's first set of data requests. LG&E states that pipelines and customers may enter into agreements that include negotiated rates higher than the otherwise applicable FERC-approved rates. Describe the type of situation that would result in a customer agreeing to pay more than the FERC-approved rate.

A-10. Under FERC's negotiated rate policies, a pipeline and its customer could agree to a negotiated rate that provides for a rate structure that differs from the structure used by the pipeline to establish its recourse (tariffed) rates.

For example, the pipeline and its customer could agree to a rate structure that is more heavily weighted toward the commodity charge (and away from the demand charge) than the typical two-part recourse (tariffed) rate under which FERC requires the pipeline to include all of its fixed costs in the demand charge, i.e., Straight-Fixed Variable rate design. 18 C.F.R. § 284.7(e).

Similarly, the pipeline and its customer could agree to a formula rate. Under a negotiated rate structure, the customer might pay more or less than it would pay under the pipeline's recourse (tariffed) rates depending on its level of consumption and/or the mechanics of the formula. For example, if a customer negotiated a commodity based rate, and consumed at a high load factor, it could pay more than it would pay under the recourse (tariffed) rates. Conversely, the customer would pay less than it would pay under the recourse (tariffed) rates if it consumed at a low load factor.

Some customers may find this alternate pricing to be attractive because it provides a more direct link between the amount paid for gas (based on actual usage) and their business activity that consumes gas; i.e., the customer pays more in a month of high business activity but pays less in a period of low business activity because it has negotiated a one-part commodity rate, for example, in lieu of a two-part demand/commodity rate.