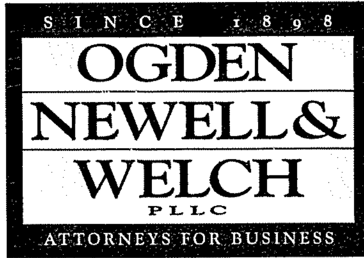


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RECEIVED

APR 29 2005

PUBLIC SERVICE COMMISSION

April 29, 2005

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

Case No. 2005-00180

**RE:** ***In the Matter of: Application of Louisville Gas and Electric Company for an Order Approving the Accounting Treatment Relating to Income Tax Expense for 2005 and Subsequent Years***

Dear Ms. O'Donnell:

Enclosed please find and accept for filing the original and ten copies of Louisville Gas and Electric Company's Application in the above-referenced matter. Please confirm your receipt of this filing 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. Louisville Gas and Electric Company respectfully requests the Commission enter an order granting the relief requested in its Application by June 30, 2005, so that the Company may reflect the Commission's decision in the next Securities and Exchange Commission's quarterly reporting period.

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

Very truly yours,

Kendrick R. Riggs

KRR/ec
Enclosures
cc: Elizabeth E. Blackford, Esq. (Office of the Attorney General, Office of Rate Intervention)
Michael L. Kurtz, Esq. (Kentucky Industrial Utility Customers, Inc.)

327593.1

**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

RECEIVED
APR 29 2005
PUBLIC SERVICE COMMISSION

**In the Matter of:**

| | | |
|---|---|---|
| **APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR AN ORDER APPROVING THE ACCOUNTING TREATMENT RELATING TO INCOME TAX EXPENSE FOR 2005 AND SUBSEQUENT YEARS** | ) | **CASE NO: 2005-**00180 |

**APPLICATION OF**
**LOUISVILLE GAS AND ELECTRIC COMPANY**

Louisville Gas and Electric Company ("LG&E" or "Applicant"), by counsel, hereby petitions the Kentucky Public Service Commission ("Commission") for an order approving the accounting treatment for use in the calculation of its annual net operating income for 2005 and subsequent years.

In support of this Application, LG&E states as follows:

1. LG&E is a Kentucky corporation organized pursuant to Kentucky law. LG&E's post office address is P. O. Box 32030, Louisville, Kentucky 40232-2030. LG&E is a utility as defined by KRS 278.010(3) (a) and (b), provides retail electric service to approximately 400,000 customers and retail gas service to approximately 300,000 customers in 17 counties in Kentucky, and is subject to this Commission's jurisdiction as to its retail rates and service. A certified copy of the Applicant's Articles of Incorporation was filed with the Commission in Case No. 2003-00433 (An Adjustment of the Electric Rates, Terms and Conditions of Louisville Gas and

Electric Company) and is incorporated by reference herein pursuant to 807 KAR 5:001, Section 8(3).

2. This Application is filed pursuant to KRS 278.220, which authorizes the Commission to prescribe the accounting to be used by any public utility subject to its jurisdiction.

3. Communications regarding this Application should be addressed to:

Kendrick R. Riggs
Timothy J. Eifler
OGDEN NEWELL & WELCH PLLC
1700 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202
Telephone: (502) 582-1601

Gregory J. Meiman
Senior Counsel Specialist
LG&E ENERGY SERVICES INC.
220 West Main Street
Louisville, Kentucky 40202

Counsel for Louisville Gas and Electric Company

**Uniform System of Accounts, General Instruction 18, and Federal and Kentucky Income Tax Law**

4. The Federal Energy Regulatory Commission (the "FERC"), in General Instruction 18 to the Uniform System of Accounts (18 C.F.R. 101), requires utility companies under FERC jurisdiction to follow comprehensive interperiod tax allocation (i.e., normalization or normalized accounting) using the deferred tax method where there are timing differences between the periods in which transactions affect taxable income and the periods in which they enter into the determination of pretax regulated accounting income. The Commission pursuant to its authority under KRS 278.220 similarly requires utility companies under Commission jurisdiction to use normalized accounting.

5. The Internal Revenue Code ("Code") similarly requires normalization of such timing differences for regulated accounting purposes as a precondition to the use of accelerated depreciation methods in calculating federal taxable income. Sections 168(f)(2) and (i)(9) of the Code require regulatory commissions to normalize, for ratemaking purposes, the income tax effects of differences between book and tax depreciation arising from use of accelerated depreciation for federal income tax but not book purposes.

6. Kentucky income tax law also requires normalization of such timing differences for regulated accounting purposes as a precondition to use of accelerated depreciation methods in calculating Kentucky taxable income. KRS 141.010(13) authorizes utilities to use the accelerated depreciation methods authorized in Section 168 of the Code for Kentucky income tax purposes. KRS 141.050(1) incorporates into Kentucky income tax law the accounting methods and procedures mandated by federal income tax law as follows:

> Except to the extent required by differences between this chapter and its application and the federal income tax law and its application, the administrative and judicial interpretations of the federal income tax law, computations of gross income and deductions therefrom, ***accounting methods***, and ***accounting procedures***, for purposes of this chapter shall be as early as practicable identical with those required for federal income tax purposes. (emphasis added)

7. A normalization method of accounting requires that the utility defer the difference between actual federal and Kentucky income tax liability and book-tax expense in the early years and permits ratepayers to pay a normalized level of income tax expense through rates. The normalized level of tax expense is based on the tax rate in effect at the time the deferral occurs. It assumes that the timing differences between book and tax depreciation giving rise to deferred taxes would reverse in future periods at that same tax rate. That assumption is no longer valid with respect to the Kentucky corporate income tax as a result of the enactment of House Bill 272

("HB 272") on March 18, 2005. HB 272, among other things, reduces the Kentucky income tax rates applicable to corporate taxable net income for taxable years beginning on or after January 1, 2005 as follows:

| Income Level | Current Rate | 2005-06 | 2007+ |
|---|---|---|---|
| $0.00 - $25,000 | 4% | Same | Same |
| $25,000.01 - $50,000 | 5% | 4% | " |
| $50,000.01 - $100,000 | 6% | 5% | " |
| $100,000.01 - $250,000 | 7% | 7% | 6% |
| > $250,000 | 8.25% | 7% | 6% |

**LG&E's Accounting for Deferred Tax Expense**

8. LG&E uses accelerated depreciation methods for federal and Kentucky income tax purposes. Consistent with General Instruction 18, Sections 168(f)(2) and (i)(9) of the Code, and KRS 141.010(13) and KRS 141.050(1), LG&E follows normalized accounting using the deferred tax method for book and ratemaking purposes.

9. HB 272's reduction in future Kentucky corporate income tax rates causes LG&E to have an excess or surplus deferred tax reserve for book purposes. Because state taxes are deducted against otherwise taxable federal income, HB 272's reduction in future Kentucky corporate income tax rates also affects LG&E's federal income tax liability for book purposes.

**Legislatively "Protected" and "Unprotected" Excess Deferred Taxes and Historical Commission Treatment**

10. The Tax Reform Act of 1986 ("TRA") reduced the federal corporate income tax rate from 46% to 34% and created an excess federal income tax deferral for LG&E and other Kentucky utilities. Section 203(e) of the TRA required that utilities flow back excess deferred taxes related to depreciation timing differences no faster than under the average-rate assumption

method (so-called legislatively "protected" excess deferred taxes). The average-rate assumption method for calculating the reversal of deferred taxes ensures the normalization of this excess in the utility's reserve for deferred taxes. The TRA did not, however, have specific provisions for excess deferred taxes unrelated to depreciation timing differences (so-called legislatively "unprotected" excess deferred taxes).

11. Consistent with the TRA, the Commission in a series of decisions required utilities to transfer protected excess deferred taxes (i.e., excess deferred taxes related to the life of a depreciable asset over the life of the asset) caused by the reduction in the federal income tax rate to a separate regulatory liability account and use the average-rate assumption method to flow back protected excess deferred taxes. *See, e.g. In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Louisville Gas and Electric Company*, KPSC Case No. 9781 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Kentucky Utilities Company*, KPSC Case No. 9780 (June 11, 1987).[1]

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[1] *See also In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Kentucky Power Company*, KPSC Case No. 9779 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Louisville Gas and Electric Company*, KPSC Case No. 9781 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Union Light, Heat and Power Company*, KPSC Case Nos. 9788 and 9782 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Delta Natural Gas Company, Inc.*, KPSC Case No. 9785 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Western Kentucky Gas Company*, KPSC Case No. 9789 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Alltel Kentucky, Inc.*, KPSC Case No. 9796 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Brandenburg Telephone Company, Inc.*, KPSC Case No. 9797 (June 11, 1987); *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of South Central Bell Telephone Company*, KPSC Case No. 9803 (June 11, 1987); and *In re the Effects of the Federal Tax Reform Act of 1986 on the Rates of Kentucky-American Water Company*, KPSC Case No. 9815 (June 11, 1987). The foregoing authorities are cited for the regulatory accounting treatment approved therein and not for the ratemaking procedure used therein. The KPSC subsequently has recognized that single-issue ratemaking is appropriate only where specifically authorized by statute or the result of a unanimous agreement by all parties with approval by the KPSC. *In re Big Rivers Electric Corporation*, KPSC Case No. 94-543 (February 21, 1997); *see also The Application of Louisville Gas and Electric Company for Approval of New Rate Tariffs Containing a Mechanism for the Pass-Through of MISO-Related Revenues and Costs not Already Included in Existing Base Rates*, KPSC Case No. 2004-00459 (Dec. 22, 2004).

12. Exhibit No. 1 to this Petition shows an example of the depreciation-related mismatch between LG&E's current and deferred tax expense for tax and book purposes created by the enactment of HB 272 for illustrative purposes. It assumes that LG&E purchased and placed in service in 2002 a piece of equipment costing $10,000 when the Kentucky corporate income tax rate was 8.25%. For tax purposes, the equipment is classified as five-year MACRS[2] property. For book purposes, LG&E uses the straight-line method over a ten-year useful life. Because of the enactment of HB 272, LG&E in 2005 and 2006 is subject to a Kentucky corporate income tax rate of 7%, and in 2007 and subsequent years the applicable Kentucky corporate income tax rate is 6%. As shown in the first table, additions to LG&E's deferred tax reserve in years 2002 through 2006 are computed based on the effective tax rates for those years (i.e., 8.25% in 2002 through 2004 and 7% in 2005 and 2006). The reversals from LG&E's deferred tax reserve in years 2007 through 2011 are computed based on the effective tax rates for those years -- 6%. Absent an adjustment to LG&E's normalization method of accounting for these timing differences, LG&E will have a $68 remaining tax deferral reserve which balance is the excess tax deferral.

13. Exhibit No. 1 to this Petition also illustrates the normalization of LG&E's excess deferred state taxes using the average-rate assumption method. As shown in the second table, additions to LG&E's deferred state tax reserve in years 2002 through 2006 are computed based on the effective Kentucky tax rates for those years (i.e., 8.25% in 2002 through 2004 and 7% in 2005 and 2006). The reversals from LG&E's deferred tax reserve in years 2007 through 2011 are adjusted for book purposes as requested by this Application, using the weighted average of the effective Kentucky tax rates for the years 2002 through 2006 (7.7% in this example). At the

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[2] Modified Accelerated Cost Recovery System.

end of 2011, LG&E's deferred state tax reserve has been reduced to zero, and there is no remaining balance.

**LG&E's Proposed Treatment of Excess Deferred Taxes**

14. LG&E has established a regulatory liability for its excess deferred taxes caused by the reduction in the Kentucky corporate income tax rate. This regulatory liability is separated into two components: (i) protected excess deferred taxes (i.e., deferred taxes associated with depreciation related timing differences), and (ii) unprotected excess deferred taxes (i.e., deferred taxes not associated with depreciation related timing differences).

15. For the quarter ending March 31, 2005, LG&E will record as a regulatory liability excess deferred state taxes of $16,381,000 ($16,340,000 protected; $41,000 unprotected). The journal entries to establish this regulatory liability are shown on Exhibit No. 2 attached to this Application. The current estimate of the Kentucky-related excess deferred income taxes is shown on Exhibit No. 3, including a breakdown between protected and unprotected excess deferred taxes.

16. In accordance with KRS 141.010(13) and 141.050(1) and the KPSC's historical treatment, LG&E proposes for accounting purposes to flow back protected excess deferred state taxes in accordance with the average-rate assumption method. Under this method a weighted average tax rate is calculated and, as timing differences reverse, the accumulated deferred state taxes are credited to income at the weighted average rate, reducing the excess deferred state taxes to zero over the remaining life of the property. The weighted average rate is an historical composite tax rate used to provide deferred Kentucky income tax. It is the ratio of the cumulative deferred taxes (i.e., the balance in the deferred tax reserve immediately before the turnaround period) over the total remaining timing differences for which the deferred taxes were

provided. This method produces fair, just and reasonable results because: (i) it matches the deferred taxes with the depreciation of the asset over the life of the applicable asset and equitably benefits both current and future customers and (ii) the ratepayer will obtain the benefit of the reversal of deferred taxes at the original rate at which the taxes were established. Furthermore, this method is consistent with Commission precedent and applicable U.S. Treasury guidelines.

17. While LG&E supports the Commission's historical treatment of unprotected excess deferred taxes,[3] LG&E proposes to flow back the entire unprotected excess deferred state taxes in 2005. LG&E proposes this adjustment rather than the use of an amortization period because LG&E's unprotected excess deferred state taxes of $25,000 are *de minimis* and it is administratively prudent to do so.

18. A table summarizing the flow back of protected and unprotected excess deferred taxes consistent with the methodologies implicit in this Application is shown on Exhibit No. 4 attached to this Application. LG&E will continue to make monthly journal entries subsequent to the initial journal entries until the entire net excess deferred taxes has been flowed back into regulated accounting income. The accounts impacted each month by the amortization of the excess deferred taxes are shown on Exhibit No. 4.

19. Unfortunately, the enactment of HB 272 on March 18, 2005 placed LG&E in a position that did not allow for advance approval from the Commission. LG&E acknowledges that prior approval by the Commission is required to establish regulatory assets or liabilities and hereby advises the Commission that it has recorded on its books for March 2005 journal entries reflecting a regulatory liability for its excess deferred taxes as described in this Application and

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[3] The Commission required utilities to transfer unprotected excess deferred taxes (i.e., those unrelated to depreciation and the life of an asset) caused by the reduction in the federal income tax rate to a separate regulatory liability account and amortize them over five years for ratemaking purposes. *See, e.g., In re Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company*, Case No. 10064 (July 1, 1988).

also will record three months of amortization of this regulatory liability using the applicable methods described in this Application. These accounting entries are the direct result of HB 272 taking effect on March 18, 2005. LG&E must file shortly its first quarter 2005 financial statement with the Securities and Exchange Commission and will reflect in that financial statement that it is seeking, but has not yet obtained, Commission approval of the accounting entries relating to the excess deferred taxes. Accordingly, LG&E respectfully requests that the Commission issue its order approving this Application.

**WHEREFORE,** Louisville Gas and Electric Company requests that the Commission enter an order no later than June 30, 2005, authorizing for accounting and reporting purposes the establishment of separate regulatory liabilities, including the related deferred tax gross-up, of $16,340,000 and $41,000 for the excess deferred taxes resulting from the enactment of House Bill 272, to flow back through net income tax expense $9,984,000 in protected deferred taxes using the average-rate assumption method, and to immediately reduce income tax expense by $25,000 related to unprotected deferred taxes.

April 29, 2005

Respectfully submitted,

By: ______________________

Kendrick R. Riggs
Timothy J. Eifler
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Telephone: (502) 582-1601

Gregory J. Meiman
Senior Counsel Specialist
LG&E ENERGY SERVICES INC.
220 West Main Street
Louisville, Kentucky 40202

Counsel for Louisville Gas and Electric Company

**VERIFICATION**

**COMMONWEALTH OF KENTUCKY** )
) **SS:**
**COUNTY OF JEFFERSON** )

The undersigned, Valerie L. Scott, being duly sworn, deposes and says she is Controller, Louisville Gas and Electric Company, and in this position has personal knowledge of the matters set forth in the foregoing Joint Application, and the contents therein are true and correct to the best of her information, knowledge and belief.

______________________
**Valerie L. Scott**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 29th day of April, 2005.

Dawn M. Lyons (SEAL)
Notary Public

My Commission Expires:

April 10, 2008

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing Application was served by mailing a true and correct copy, via regular U.S. mail, to the following persons on the 29th day of April, 2005.

Michael L. Kurtz
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 2110
Cincinnati, Ohio 45202

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

Counsel for Louisville Gas and Electric Company



326735.9

**Exhibit No. 1**

# LOUISVILLE GAS AND ELECTRIC COMPANY

## House Bill 272

**Basic Illustration of Protected Excess Tax Deferral Created by HB 272**

| | Depreciation | | | | | Deferred Tax | |
|---|---|---|---|---|---|---|---|
| Year | Tax | Book | Annual Difference | Cumulative Difference | KY Tax Rate | Expense | Reserve Balance |
| 2002 | $1,500 | $1,000 | $500 | $500 | 8.25% | $41.25 | $41.25 |
| 2003 | 2,200 | 1,000 | 1,200 | 1,700 | 8.25% | 99.00 | 140.25 |
| 2004 | 2,100 | 1,000 | 1,100 | 2,800 | 8.25% | 90.75 | 231.00 |
| 2005 | 2,100 | 1,000 | 1,100 | 3,900 | 7.00% | 77.00 | 308.00 |
| 2006 | 2,100 | 1,000 | 1,100 | 5,000 | 7.00% | 77.00 | 385.00 |
| 2007 | 0 | 1,000 | (1,000) | 4,000 | 6.00% | (77.00) | 308.00 |
| 2008 | 0 | 1,000 | (1,000) | 3,000 | 6.00% | (60.00) | 248.00 |
| 2009 | 0 | 1,000 | (1,000) | 2,000 | 6.00% | (60.00) | 188.00 |
| 2010 | 0 | 1,000 | (1,000) | 1,000 | 6.00% | (60.00) | 128.00 |
| 2011 | 0 | 1,000 | (1,000) | 0 | 6.00% | (60.00) | 68.00 |
| | $10,000 | $10,000 | $0 | | | | |
| | | | | **Protected Excess Tax Deferral:** | | **$68.00** | |

Using the average-rate assumption method, the accumulated deferred state taxes are credited to income at a weighted average rate as timing differences reverse, reducing the excess deferred state taxes to zero over the remaining life of the property.

**Basic Illustration of Averate-Rate Assumption Method**

| | Depreciation | | | | | Deferred Tax | |
|---|---|---|---|---|---|---|---|
| Year | Tax | Book | Annual Difference | Cumulative Difference | KY Tax Rate | Expense | Reserve Balance |
| 2002 | $1,500 | $1,000 | $500 | $500 | 8.25% | $41.25 | $41.25 |
| 2003 | 2,200 | 1,000 | 1,200 | 1,700 | 8.25% | 99.00 | 140.25 |
| 2004 | 2,100 | 1,000 | 1,100 | 2,800 | 8.25% | 90.75 | 231.00 |
| 2005 | 2,100 | 1,000 | 1,100 | 3,900 | 7.00% | 77.00 | 308.00 |
| 2006 | 2,100 | 1,000 | 1,100 | 5,000 | 7.00% | 77.00 | 385.00 |
| 2007 | 0 | 1,000 | (1,000) | 4,000 | 7.70%* | (77.00) | 308.00 |
| 2008 | 0 | 1,000 | (1,000) | 3,000 | 7.70% | (77.00) | 231.00 |
| 2009 | 0 | 1,000 | (1,000) | 2,000 | 7.70% | (77.00) | 154.00 |
| 2010 | 0 | 1,000 | (1,000) | 1,000 | 7.70% | (77.00) | 77.00 |
| 2011 | 0 | 1,000 | (1,000) | 0 | 7.70% | (77.00) | 0.00 |
| | $10,000 | $10,000 | $0 | | | $0 | |

* Deferred tax reserve balance of $385 divided by the associated cumulative difference of $5,000.

**Exhibit No. 2**

**LOUISVILLE GAS & ELECTRIC COMPANY**

**House Bill 272**

**Kentucky Corporate Income Tax Rate Reduction**

**Protected & Unprotected Deferred Taxes**

Journal Entries to record the Regulatory Liability as a result of Kentucky Corporate Income Tax rate decrease.

Protected

| Account | Debit | Credit |
|---|---|---|
| FERC Acct. No. 282 Deferred Income Tax Liability – State | $16,340,000 | |
| FERC Acct. No. 254 Regulatory Liability - State | | $16,340,000 |

Determined as follows:
State excess deferred tax of $15,360,000 less federal effect of $5,376,000 plus tax gross-up of $6,356,000. [(15,360,000 – (35% X 15,360,000)) / (1 – 38.9%) = 16,340,000]

Unprotected

| Account | Debit | Credit |
|---|---|---|
| FERC Acct. No. 190/283 Deferred Income Tax Asset/Liability – State | $41,000 | |
| FERC Acct. No. 254 Regulatory Liability - State | | $41,000 |

Determined as follows:
State excess deferred tax of $39,000 less federal effect of $14,000 plus tax gross-up of $16,000. [(39,000 – (35% X 39,000)) / (1 – 38.9%) = 41,000]

**Exhibit No. 3**

**LOUISVILLE GAS & ELECTRIC COMPANY**

**House Bill 272**

**Kentucky Corporate Income Tax Rate Reduction**

**Protected & Unprotected Deferred Taxes**

Current estimate of Kentucky related excess deferred income taxes between unprotected and protected and the related changes to the regulatory liability.

| | State Adjustment 12/31/04 | Federal Effect | Net Adjustment | Tax Gross-up | Regulatory Liability |
|---|---|---|---|---|---|
| VDT Costs | $ 471,000 | | | | |
| Pensions & FAS 106 | (524,000) | | | | |
| Other | 92,000 | | | | |
| Total Non-depreciation Related Excess (Unprotected) | $ 39,000 | ($ 14,000) | $ 25,000 | $ 16,000 | $ 41,000 |
| Total Depreciation Related Excess (Protected) | 15,360,000 | (5,376,000) | 9,984,000 | 6,356,000 | 16,340,000 |
| **Grand Total** | **$15,399,000** | **($5,390,000)** | **$10,009,000** | **$6,372,000** | **$16,381,000** |

**Exhibit No. 4**

**LOUISVILLE GAS & ELECTRIC COMPANY**

**House Bill 272**

**Kentucky Corporate Income Tax Rate Reduction**

**Protected & Unprotected Deferred Taxes**

The following Table summarizes the projected amortization of Kentucky excess deferred income taxes and the related changes to the regulatory liability.

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010+ | Total |
|---|---|---|---|---|---|---|---|
| Unprotected | | | | | | | |
| Amortization of Non-Depreciation Related Deferred Excess – State | $39,000 | | | | | | $39,000 |
| Federal Effect | (14,000) | | | | | | (14,000) |
| Total Amortization | $25,000 | | | | | | $25,000 |
| Tax Gross-up | 16,000 | | | | | | 16,000 |
| Total Regulatory Liability | $41,000 | | | | | | $41,000 |
| Protected | | | | | | | |
| Amortization of Depreciation Related Deferred Excess – State | $248,000 | $243,000 | $672,000 | $659,000 | $664,000 | $12,874,000 | $15,360,000 |
| Federal Effect | (87,000) | (85,000) | (235,000) | (231,000) | (233,000) | (4,505,000) | (5,376,000) |
| Total Amortization | $161,000 | $158,000 | $437,000 | $428,000 | $431,000 | $8,369,000 | $9,984,000 |
| Tax Gross-up | 103,000 | 101,000 | 278,000 | 272,000 | 274,000 | 5,328,000 | 6,356,000 |
| Total Regulatory Liability | $264,000 | $259,000 | $715,000 | $700,000 | $705,000 | $13,697,000 | $16,340,000 |

Amortization of the excess deferred taxes will be included as part of the Company's monthly tax provision entries. The amortization results from the reversal of deferred taxes associated with depreciation related temporary differences. The specific amount of the entries will differ period to period depending upon property additions, retirements, and other required adjustments occurring during the period. The following illustrates the debits and credits which will be made in connection with those adjustments:

<u>Protected</u>

| | | |
|---|---|---|
| FERC Acct. No. 282 Deferred Income Tax Liability – Federal & State | $XXX,XXX | |
| FERC Acct. No. 411 Deferred Tax Expense – Federal & State | | $XXX,XXX |
| FERC Acct. No. 254 Regulatory Liability – State | $XXX,XXX | |
| FERC Acct. No. 282 Deferred Income Tax Liability – State | | $XXX,XXX |

<u>Unprotected (2005 Only)</u>

| | | |
|---|---|---|
| FERC Acct. No. 190/283 Deferred Income Tax Asset/Liability – Federal & State | $XXX,XXX | |
| FERC Acct. No. 410/411 Deferred Tax Expense – Federal & State | | $XXX,XXX |
| FERC Acct. No. 254 Regulatory Liability – State | $XXX,XXX | |
| FERC Acct. No. 190/283 Deferred Income Tax Liability – State | | $XXX,XXX |