Kent W. Blake
Director
State Regulation and Rates

LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202
502-627-2573
502-217-2442 FAX
kent.blake@lgeenergy.com

September 30, 2005

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

RE: ***The Plan of Louisville Gas and Electric Company for the Value Delivery Surcredit Mechanisms***
Case No. 2005-00352

Dear Ms. O'Donnell:

Enclosed please find an original and ten (10) copies of Louisville Gas and Electric Company's ("LG&E") Application and Testimonies of Kent. W. Blake, Valerie L. Scott and S. Bradford Rives in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to contact me at (502) 627-2573.

Sincerely,

Kent W. Blake

Kent W. Blake

cc: Elizabeth E. Blackford
Michael L. Kurtz

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE VALUE DELIVERY SURCREDIT MECHANISMS	))))	**CASE NO. 2005-00352**

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY

Applicant, Louisville Gas and Electric Company ("LG&E"), pursuant to Chapter 278 of the Kentucky Revised Statutes and the Kentucky Public Service Commission ("Commission") Order and Settlement Agreement in Case No. 2001-00169[1], hereby applies to the Commission for authority to withdrawal from service its Value Delivery Surcredit Rider tariff for electric service and its Value Delivery Surcredit Rider tariff for gas service following the expiration of the sixty month period ending March 31, 2006, subject to any final balancing adjustment.

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

1. The full name and mailing address of the Applicant is: Louisville Gas and Electric Company, Post Office Box 32010, 220 West Main Street, Louisville, Kentucky 40232. LG&E is a Kentucky corporation authorized to do business in the Commonwealth of Kentucky.

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[1] In the Matter of: The Annual Earnings Sharing Mechanism Filing of Louisville Gas And Electric Company, Case No. 2001-00054 and The Annual Earnings Sharing Mechanism Filing of Kentucky Utilities Company, Case No. 2001-00055 and Application of Kentucky Utilities Company for an Order Approving Revised Depreciation Rates, Case No. 2001-00140 and Application of Louisville Gas and Electric Company for an Order Approving Revised Depreciation Rates, Case No. 2001-00141 and Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be included in Earnings Sharing Mechanism Calculations, Case No. 2001-00169, Order (December 3, 2001).

2. LG&E is a utility engaged in the electric and gas business. LG&E generates and purchases electricity, and distributes and sells electricity at retail in Jefferson County and portions of Bullitt, Hardin, Henry, Meade, Oldham, Shelby, Spencer and Trimble Counties. LG&E also purchases, stores and transports natural gas and distributes and sells natural gas at retail in Jefferson County and portions of Barren, Bullitt, Green, Hardin, Hart, Henry, Larue, Marion, Meade, Metcalfe, Nelson, Oldham, Shelby, Trimble and Washington Counties.

3. A certified copy of LG&E's Articles of Incorporation, as amended, are on file with the Commission in Case No. 2001-104, *In the Matter of: Joint Application of E.ON AG, Powergen plc, LG&E Energy Corp., Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of an Acquisition.*

4. Copies of all orders, pleadings and other communications related to this proceeding should be directed to:

Kent W. Blake
Director, State Regulation and Rates
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202

Elizabeth L. Cocanougher
Senior Corporate Attorney
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202

Kendrick R. Riggs
Ogden Newell & Welch PLLC
1700 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202

Value Delivery Team Initiative

5. In connection with their Value Delivery Team ("VDT") initiative, including the 2001 Workforce Separation Program ("Workforce Separation"), on June 1, 2001, LG&E and Kentucky Utilities Company ("KU") filed a joint Application with the Commission requesting an order approving certain accounting debits and declaring the amortization of the deferred debits to be included in the calculation of the existing Earnings Sharing Mechanism. In February 2001, LG&E recorded an estimated Workforce Reduction expense of $144,385,494 for their gas and electric operations. In the joint application LG&E proposed this expense entry would be reversed and the estimated amounts capitalized and recorded as a deferred debit.

2001 Settlement Agreement

6. The representatives of consumer interests, including the Attorney General, met with the Commission Staff, LG&E and KU at the Commission's office during the fall of 2001 and reached a unanimous Settlement Agreement ("2001 Settlement Agreement"). Under the terms of the 2001 Settlement Agreement, LG&E recorded an estimated deferred debit of $114,569,000 for electric operations and $29,816,000 for gas operations. These amounts were to be amortized over a sixty month period, beginning April 1, 2001 and terminating on March 31, 2006, in equal monthly amounts, except as adjusted for certain timing differences allocated during the nine months ending December 31, 2001. In the 2001 Settlement Agreement, the parties agreed to use a surcredit mechanism designated as the "Value Delivery Surcredit." Under the Value Delivery Surcredit mechanism, the estimated savings from the Value Delivery Team initiative were netted against the monthly amortization of the deferred debits. The resulting net savings were then to be shared 40 percent to ratepayers and 60 percent to the shareholder. The 2001 Settlement Agreement

further expressly provided that "[t]he surcredit mechanisms will terminate and be withdrawn from service following the expiration of the sixty month period ending March 31, 2006, subject to any final balancing adjustment." The Commission approved the 2001 Settlement Agreement in its Order dated December 3, 2001 in Case No. 2001-00169.

The Plan

7. In Case No. 2003-00433,[2] the Commission's June 30, 2004 Order approved the Partial Settlement Agreement, Stipulation and Recommendation. Under Section 3.5 of the Partial Settlement Agreement, Stipulation and Recommendation, LG&E is required to file a "plan for the future ratemaking treatment of the VDT surcredits, the shareholder savings, the amortization of VDT costs and all other VDT-related issues" ("the Plan").

8. This Application and supporting testimony constitutes LG&E's Plan under Section 3.5 of the Partial Settlement Agreement, Stipulation and Recommendation. Effective for service rendered on and after April 1, 2006, the Value Delivery Surcredits will be allowed to expire subject to the final balancing adjustment to be billed in May 2006.

9. LG&E supports its request for authority to withdraw the Value Delivery Surcredit Rider tariffs with the testimony of:

- Kent W. Blake, State Regulation and Rates for LG&E Energy Services Inc. – Mr. Blake will present LG&E's Plan for withdrawal of the Value Delivery Surcredit effective April 1, 2006. Mr. Blake's testimony will also present the supporting analysis which demonstrates why LG&E's Plan is reasonable and should be approved. In addition, his testimony will support certain pro forma adjustments to the Company's operating income for the twelve months ended

[2] In the Matter of: An Adjustment of the Gas and Electric Rates, Terms and Conditions of Louisville Gas and Electric Company, Case No. 2003-00433, Order (June 30, 2004).

June 30, 2005, demonstrate that those adjustments are known, measurable and reasonable, and affirm certain reference schedules supporting the Company's Plan.

- Valerie L. Scott, Controller – Ms. Scott will support certain pro forma adjustments to the Company's operating income for the twelve months ended June 30, 2005, demonstrate that those adjustments are known, measurable and reasonable, and affirm certain reference schedules supporting the Company's Plan; and
- S. Bradford Rives, Chief Financial Officer – Mr. Rives will describe the financial and operating condition of the Company and discuss the Company's capital structure and adjustments to the capital structure.

10. This Application constitutes notice to the Commission of the proposed termination and withdrawal from service of LG&E's Value Delivery Surcredit Rider tariff for electric service and LG&E's Value Delivery Surcredit Rider tariff for gas service by the expiration of the sixty month period ending March 31, 2006. Pursuant to the Value Delivery Surcredit Rider, the final balancing adjustment will be applied to customer billings in the second month following the fifth distribution year. The final balancing adjustment shall be performed no later than May 2006. The Value Delivery Surcredit Rider tariffs, presented in Exhibit 1 to this Application for reference, shall be withdrawn from service as of June 1, 2006.

11. Based on the twelve month period ending June 30, 2005, LG&E's earned return on gas operations, adjusted for accepted ratemaking adjustments and other known and measurable changes, is 3.99 percent and its earned return on electric operations, adjusted for

accepted ratemaking adjustments and other known and measurable changes is 7.36 percent. In LG&E's most recent rate case, Case No. 2003-00433, the Commission issued an order on June 30, 2004 authorizing a required return on equity for LG&E within a range of 10.00 to 11.00 percent with a midpoint of 10.50 percent. More recently, in connection with LG&E's 2004 Environmental Cost Recovery ("ECR") application, Case No. 2004-00421, the Commission issued an order on June 20, 2005, concluding that "a range of 10.0 to 11.0 percent, with a midpoint of 10.5 percent, continues to be a reasonable ROE for LG&E." Thus, LG&E's gas and electric operations have revenue deficiencies well below the authorized range of return on equity before the Value Delivery Surcredit expires.

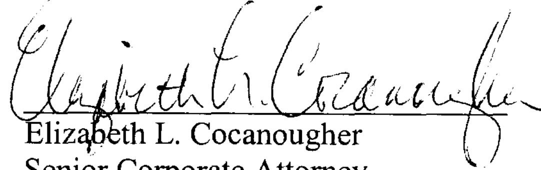
12. Expiration of the Value Delivery Surcredits does not cause the Company's financial returns to exceed the authorized range of return approved by the Commission. Moreover, the Company expects to sustain further attrition in earnings from significant capital investments in the Company's electric and gas infrastructure until its next base rate case. Rate stability and continuity support allowing the Value Delivery Surcredits to expire according to the terms of the 2001 Settlement Agreement. If the Plan is approved, the Commission will, of course, retain the authority to monitor the Company's financial performance and take any actions necessary in the future should economic circumstances and the Company's financial performance dictate such action.

WHEREFORE, Louisville Gas and Electric Company respectfully requests the Kentucky Public Service Commission to enter an order:

1. Approving the withdrawal from service of its Value Delivery Surcredit Rider tariff for electric service and its Value Delivery Surcredit Rider tariff for gas service as proposed herein; and

2. Granting all other relief to which Louisville Gas and Electric Company may be entitled.

Respectfully submitted,



Elizabeth L. Cocanougher
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220 West Main Street
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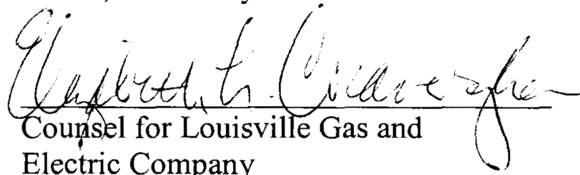
Kendrick R. Riggs
Ogden Newell & Welch PLLC
1700 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202
Telephone: (502) 582-1601

Counsel for Louisville Gas
and Electric Company

CERTIFICATE OF SERVICE

The undersigned hereby certifies that an original and ten copies of this Application was hand delivered to Elizabeth O'Donnell, Executive Director, Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601, and that a copy of the Application was mailed to Elizabeth E. Blackford, Assistant Attorney General, Office of Rate Intervention, 1024 Capital Center Drive, Frankfort, Kentucky 40601 on the 30th day of September 2005.



Counsel for Louisville Gas and
Electric Company

VDSR

Value Delivery Surcredit Rider

APPLICABLE
In all territory served.

AVAILABILITY OF SERVICE
To all electric rate schedules.

RATE
The monthly billing amount computed under each of the rate schedules to which this surcredit is applicable shall be adjusted by the Value Delivery Surcredit Factor, which shall be calculated in accordance with the following formula:

Value Delivery Surcredit Factor = VDS + BA

Where:

(VDS) is the Value Delivery Surcredit which is based on the total Company net savings that are to be distributed to the Company's customers in each 12-month period.

	Net Savings to be Distributed	Value Delivery Surcredit (VDS)
Year 1, Dec 1, 2001 to Dec 31, 2001	$1,080,000	2.82%
Year 2, Jan 1, 2002 to Dec 31, 2002	$1,120,000	0.20%
Year 3, Jan 1, 2003 to Dec 31, 2003	$4,640,000	0.77%
Year 4, Jan 1, 2004 to Dec 31, 2004	$5,640,000	0.90%
Year 5, Jan 1, 2005 to Dec 31, 2005	$6,680,000	1.04%
Year 6, Jan 1, 2006 to Mar 31, 2006	$1,760,000	1.23%

(BA) is the Balancing Adjustment for the second through the twelfth months of the current distribution year which reconciles any over- or under-distribution of the net savings from prior periods. The Balancing Adjustment will be determined by dividing the differences between amounts which were expected to be distributed and the amounts actually distributed from the application of the Value Delivery Surcredit Factor from the previous year by the expected retail electric revenues. The final Balancing Adjustment will be applied to customer billings in the second month following the fifth distribution year.

TERMS OF DISTRIBUTION
(1) The total distribution to Company's customers will, in no case, be less than the sum of the amounts shown above.

(2) In the event that the actual net savings to the customers differs from the values shown under "Net Savings to be Distributed" an adjustment shall be made to Year 6 via the Balancing Adjustment. The determination of any such adjustment shall be reported to the Commission when it becomes available.

Louisville Gas and Electric Company

Original Sheet No. 75.1
P.S.C. of Ky. Electric No. 6

VDSR

Value Delivery Surcredit Rider

(3) On or before the 21st of the first month of each distribution year following Year 1, the Company will file with the Commission a status report of the Surcredit. Such report shall include a statement showing the amounts which were expected to be distributed and the amounts actually distributed in previous periods, along with a calculation of the Balancing Adjustment (BA) which will be implemented with customer billings in the second month of that distribution year to reconcile any previous over-or under-distributions.

(4) The Value Delivery Surcredit shall be applied to the customer's bill following the rates and charges for electric service, but before application of the school tax, the franchise fee, sales tax or similar items.

(5) Unless the Public Service Commission has already modified or terminated the Value Delivery Team surcredits in a subsequent procedure the Company will file, six (6) months prior to the expiration of the sixty (60) month period in which the VDT surcredits are in operation, with the Commission a plan for the future ratemaking treatment of the VDT surcredits, the shareholder savings, the amortization of VDT costs, and all other VDT-related issues.

(6) The Value Delivery Surcredit shall remain in effect until the Public Service Commission enters an order on the ratemaking treatment of all VDT-related issues.

Date of Issue: July 20, 2004

Issued By

Michael S. Beer, Vice President
Louisville, Kentucky

Date Effective: May 1, 2003
Refiled; July 20, 2004

Issued By Authority of an Order of the KPSC in Case No. 2003-00433 dated June 30, 2004

Louisville Gas and Electric Company

Original Sheet No. 75
P.S.C. of Ky. Gas No. 6

STANDARD RIDER VDSR

Value Delivery Surcredit Rider

APPLICABLE
In all territory served. T

AVAILABILITY OF SERVICE
To all gas rate schedules.

RATE
The billing amount computed under each of the rate schedules to which this surcredit is applicable shall be adjusted by the Value Delivery Surcredit Factor, which shall be calculated in accordance with the following formula: T

Value Delivery Surcredit Factor = VDS + BA

Where:

(VDS) is the Value Delivery Surcredit which is based on the total Company net savings that are to be distributed to the Company's customers in each 12-month period.

	Net Savings to be Distributed	Value Delivery Surcredit (VDS)
Year 1, Dec 1, 2001 to Dec 31, 2001	$ 120,000	0.27%
Year 2, Jan 1, 2002 to Dec 31, 2002	$ 320,000	0.12%
Year 3, Jan 1, 2003 to Dec 31, 2003	$1,240,000	0.54%
Year 4, Jan 1, 2004 to Dec 31, 2004	$1,520,000	0.65%
Year 5, Jan 1, 2005 to Dec 31, 2005	$1,800,000	0.72%
Year 6, Jan 1, 2006 to Mar 31, 2006	$ 440,000	0.39%

(BA) is the Balancing Adjustment for the second through the twelfth months of the current distribution year which reconciles any over- or under-distribution of the net savings from prior periods. The Balancing Adjustment will be determined by dividing the differences between amounts which were expected to be distributed and the amounts actually distributed from the application of the Value Delivery Surcredit Factor from the previous year by the expected retail gas revenues. The final Balancing Adjustment will be applied to customer billings in the second month following the fifth distribution year.

TERMS OF DISTRIBUTION
(1) The total distribution to Company's customers will, in no case, be less than the sum of the amounts shown above.

(2) In the event that the actual net savings to the customers differs from the values shown under "Net Savings to be Distributed" an adjustment shall be made to Year 6 via the Balancing Adjustment. The determination of any such adjustment shall be reported to the Commission when it becomes available.

(3) On or before the 21st of the first month of each distribution year following Year 1, the Company will file with the Commission a status report of the Surcredit. Such report shall include a statement showing the amounts which were expected to be distributed and the

Date of Issue: July 20, 2004

Issued By

Michael S. Beer, Vice President
Louisville, Kentucky

Date Effective: With Bills Rendered On and After December 3, 2001
Refiled: July 20, 2004

Issued By Authority of an Order of the K.P.S.C. in Case No. 2003-00433 dated June 30, 2004

Louisville Gas and Electric Company

STANDARD RIDER VDSR

Value Delivery Surcredit Rider

amounts actually distributed in previous periods, along with a calculation of the Balancing Adjustment (BA) which will be implemented with customer billings in the second month of that distribution year to reconcile any previous over-or under-distributions.

(4) The Value Delivery Surcredit shall be applied to the customer's bill following the rates and charges for gas service, but before application of the school tax, the franchise fee, sales tax or similar items.

(5) The Value Delivery Surcredit shall be withdrawn with application of the final Balancing Adjustment following Year 6.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY FOR THE	)	CASE NO. 2005-00352
VALUE DELIVERY SURCREDIT	)	
MECHANISMS	)	

TESTIMONY OF
KENT W. BLAKE
DIRECTOR, STATE REGULATION AND RATES
LOUISVILLE GAS AND ELECTRIC COMPANY

Filed: September 30, 2005

1 **Q. Please state your name, position and business address.**

2 A. My name is Kent W. Blake. I am Director of State Regulation and Rates for LG&E
3 Energy Services Inc., which provides services to Louisville Gas and Electric
4 Company ("LG&E" or "the Company") and Kentucky Utilities Company ("KU")
5 (collectively "the Companies"). My business address is 220 West Main Street,
6 Louisville, Kentucky. A statement of my professional history and education is
7 attached as an appendix hereto.

8 **Q. Have you previously testified before this Commission?**

9 A. Yes. I have previously testified before this Commission in environmental surcharge,
10 certificate and other proceedings.

11 **Q. What is the purpose of your testimony?**

12 A. The purpose of my testimony is to discuss the Value Delivery Team ("VDT")
13 surcredit and to present LG&E's "plan for the future ratemaking treatment of the
14 VDT surcredits, the shareholder savings, the amortization of VDT costs and all other
15 VDT-related issues"[1] ("the Plan"). My testimony will also present the supporting
16 analysis which demonstrates why LG&E's Plan is reasonable and should be
17 approved. As part of LG&E's supporting analysis, my testimony will present certain
18 pro forma adjustments to the Company's operating income for the twelve months
19 ended June 30, 2005, demonstrate that those adjustments are known, measurable and
20 reasonable, and affirm certain reference schedules supporting that analysis.

21 **Q. Please describe the other witnesses offering direct testimony on behalf of the**
22 **Company in this proceeding.**

[1] Section 3.5 of the Partial Settlement Agreement, Stipulation and Recommendation approved by the Commission's June 30, 2004 orders in Case Nos. 2003-00433 and 2003-00434.

1 A. LG&E is offering direct testimony from the following witnesses:

2 • Valerie L. Scott, Controller – Ms. Scott will support certain pro forma
3 adjustments to the Company's operating income for the twelve months ended
4 June 30, 2005, demonstrate that those adjustments are known, measurable and
5 reasonable, and affirm certain reference schedules supporting the Company's
6 Plan; and

7 • S. Bradford Rives, Chief Financial Officer – Mr. Rives will describe the
8 financial and operating condition of the Company and discuss the Company's
9 capital structure and adjustments to the capital structure.

10 **Value Delivery Surcredit Mechanism**

11 **Q. Please describe the history of the Value Delivery rate mechanism.**

12 A. In connection with their Value Delivery Team initiative, including the 2001
13 Workforce Separation Program ("Workforce Separation"), on June 1, 2001, LG&E
14 and KU filed a joint Application requesting an order approving certain accounting
15 debits and declaring the amortization of the deferred debits to be included in the
16 calculation of the existing Earnings Sharing Mechanism. In February 2001, LG&E
17 recorded an estimated Workforce Reduction expense of $144,385,494 for its gas and
18 electric operations. In the joint application LG&E proposed this expense entry would
19 be reversed and the estimated amounts capitalized and recorded as a deferred debit.

20 The representatives of consumer interests, including the Attorney General,
21 met with the Commission Staff, LG&E and KU at the Commission's office during the

1 fall of 2001 and reached a unanimous Settlement Agreement ("2001 Settlement

2 Agreement")[2].

3 Under the terms of the 2001 Settlement Agreement, LG&E recorded an

4 estimated deferred debit of $114,569,000 for electric operations and $29,816,000 for

5 gas operations. These amounts were to be amortized over a sixty month period,

6 beginning April 1, 2001 and terminating on March 31, 2006, in equal monthly

7 amounts, except as adjusted for certain timing differences allocated during the nine

8 months ending December 31, 2001.

9 In the 2001 Settlement Agreement, the parties agreed to use a surcredit

10 mechanism designated as the "Value Delivery Surcredit." Under the Value Delivery

11 Surcredit mechanism, the estimated savings from the Value Delivery Team initiative

12 were netted against the monthly amortization of the deferred debits. The resulting net

13 savings were then to be shared 40 percent to ratepayers and 60 percent to the

14 shareholder.

15 The 2001 Settlement Agreement further expressly provided, on page 6, that

16 "[t]he surcredit mechanisms will terminate and be withdrawn from service following

17 the expiration of the sixty month period ending March 31, 2006, subject to any final

18 balancing adjustment."

[2] In the Matter of: Annual Earnings Sharing Mechanism Filing of Louisville Gas and Electric Company, Case No. 2001-054, Annual Earnings Sharing Mechanism Filing of Kentucky Utilities Company, Case No. 2001-055, Application of Kentucky Utilities Company For An Order Approving Revised Depreciation Rates, Case No. 2001-140, Application of Louisville Gas and Electric Company For An Order Approving Revised Depreciation Rates, Case No. 2001-141, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company For An Order Approving Proposed Deferred Debits and Declaring the Amortization Of The Deferred Debits To Be Included In Earnings Sharing Mechanism, Case No. 2001-169, Commission's Order dated December 3, 2001

1 The Commission approved the 2001 Settlement Agreement in its Order dated

2 December 3, 2001 in Case No. 2001-00169.

3 Q. **Please describe the ratemaking treatment associated with the Value Delivery**

4 **Surcredit in LG&E's last base rate case.**

5 A. The shareholder's portion of the net savings allocated to electric operations was

6 included as an adjustment to operating expenses in the calculation of the Earnings

7 Sharing Mechanism filings for 2001, 2002 and 2003. With the termination of the

8 Earnings Sharing Mechanism in Case No. 2003-00433, the shareholder adjustment

9 was similarly included in the calculation of the revenue requirement for LG&E's base

10 electric and gas rates by separate adjustments to operating expenses. The rate case

11 test year used to calculate the gas and electric revenue requirements also included 12

12 months amortization of the costs to achieve and the Value Delivery Surcredit for gas

13 operations and electric operations.

14 The table below is used to clarify how base rates in Case No. 2003-00433

15 were impacted by the 2001 Settlement Agreement.

Test Year Ended September 30, 2003	$ millions	
	Electric	Gas
Gross Savings from VDT initiative	$ 33.3	$ 8.6
Less: Amortization of Costs to Achieve	(29.9)	(6.1)
Net VDT Savings	**9.4**	**2.5**
Less: Revenue Reduction for Value Delivery Surcredit (customer's 40% share of net savings)	(3.8)	(1.0)
Impact on Net Operating Income	**5.6**	**1.5**
Less: Pro-forma Adjustment for Shareholder Savings (made in order for LG&E to retain its 60% share of net savings)	(5.6)	(1.5)
Net Impact on Base Rates	**0**	**0**
Customers' 40% share of Net Savings provided via Value Delivery Surcredit	**$ 3.8**	**$ 1.0**

16

1 **Q. Has the Value Delivery Surcredit mechanisms been successful?**

2 A. Yes. The Value Delivery Surcredit mechanisms are providing LG&E's electric and
3 gas customers with the approved $20.9 million and $5.4 million of net savings,
4 respectively, over the sixty month period in which the mechanisms are intended to be
5 in effect.

6 **Plan for Value Delivery Surcredits**

7 **Q. Please describe the Plan for the Value Delivery Surcredits.**

8 A. LG&E is proposing to allow the Value Delivery Surcredit Rider to expire and
9 withdraw the tariffs from electric and gas service effective March 31, 2006 subject to
10 final balancing adjustments in May 2006.

11 **Q. Why should the Value Delivery Surcredits be allowed to expire at this time?**

12 A. Under the express terms of the 2001 Settlement Agreement, the Value Delivery
13 Surcredit is to "terminate and be withdrawn from service following the expiration of
14 the sixty month period ending March 31, 2006, subject to any final balancing
15 adjustment." The cost to achieve the 2001 Workforce Separation has been recovered
16 and there is no longer any need to continue the mechanisms.

17 **Q. Please describe how LG&E's proposed Plan will be implemented.**

18 A. Effective for service rendered on and after April 1, 2006, the Value Delivery
19 Surcredits will be allowed to expire subject to the final balancing adjustment to be
20 billed in May 2006.

21 From that point forward, in future base rate cases, LG&E will not make a pro-
22 forma adjustment to retain its 60% share of the net savings from the VDT initiative.
23 Of course, LG&E's net operating income in any future test year will also not include
24 the costs to achieve these savings since the amortization period will have expired.

1 Similarly, revenues will not be reduced by the Value Delivery Surcredit in any future
2 test year upon expiration of the Value Delivery Surcredit Rider tariff.

3 These future impacts are applied to the twelve months ended June 30, 2005,
4 on lines 32 through 35 in Blake Exhibit 1. These adjustments demonstrate the effect
5 of the Value Delivery Surcredit expiration.

6 **Q. Please explain the purpose of Blake Exhibit 1.**

7 A. LG&E believed that the Commission and other parties to the case would want to
8 know the Company's current financial returns from base rates prior to reaching
9 conclusions on the reasonableness of the Company's Plan to allow the Value Delivery
10 Surcredits to expire.

11 Blake Exhibits 1-4 provide a traditional revenue requirements calculation for
12 the twelve months ended June 30, 2005. It should be noted that this period represents
13 the first full year under LG&E's current base rates and is the most recent quarter
14 ended prior to the date of this filing. Blake Exhibit 5 shows the return on equity both
15 under the existence of the Value Delivery Surcredit and upon expiration of the Value
16 Delivery Surcredit for the twelve months ended June 30, 2005.

17 Blake Exhibit 1 begins by showing both electric and gas operating revenues
18 and expenses, and net operating income per books for electric and gas jurisdictional
19 operations for the twelve months ended June 30, 2005. The terms of this schedule are
20 presented in detail later in my testimony.

21 Blake Exhibit 1, line 31, shows the net operating income per books for
22 LG&E's respective electric and gas operations for the twelve months ended June 30,
23 2005, with pro-forma adjustments based on the established methodology approved by

1 this Commission to eliminate other rate mechanisms, eliminate revenue and expense
2 items as previously ordered by this Commission in prior rate cases, normalize
3 significant variable activity during a twelve month period, annualize significant
4 changes during a twelve month period and remove non-recurring items. These
5 adjustments include an adjustment for LG&E's share of the net VDT savings
6 consistent with the method used in Case No. 2003-00433.

7 Blake Exhibit 1, line 38, shows the impact on net operating income of the
8 expiration of the Value Delivery Surcredits. First, the adjusted net operating income
9 per books for LG&E's electric and gas operations for the twelve months ended June
10 30, 2005 from line 31 are adjusted by $9,240,000 for electric operations and
11 $2,490,000 for gas operations to remove the net savings to the shareholder by a
12 decrease in expenses. Secondly, revenues for electric and gas operations are adjusted
13 by increasing revenue by $6,113,935 and $1,691,828 respectively to reflect the
14 withdrawal of the Value Delivery Surcredits. Finally, expenses for electric and gas
15 operations are adjusted by $23,806,460 and $6,328,300 respectively to remove the
16 cost of the amortized amounts to achieve the savings. The tax effect of these
17 adjustments is also shown on Blake Exhibit 1, line 36.

18 The resulting pro-forma net operating income from line 31 (prior to VDT
19 expiration) and line 38 (after VDT expiration) are both carried forward to Blake
20 Exhibit 4 to calculate the resulting revenue deficiency, and to Blake Exhibit 5 to
21 calculate the earned return on equity for LG&E's electric and gas operations both
22 prior to VDT expiration and after VDT expiration.

23 **Q. Please identify and explain what is contained in Blake Exhibit 2.**

1 A. Blake Exhibit 2 calculates adjusted capitalization as of June 30, 2005, as well as the
2 weighted average cost of capital to apply to the adjusted capitalization. The details of
3 the calculations of the adjusted capitalization and LG&E's capital structure are
4 addressed in the direct testimony of Mr. Rives.

5 **Q. Please identify and explain what is contained in Blake Exhibit 3.**

6 A. Blake Exhibit 3 computes LG&E's net original cost rate base as of June 30, 2005, and
7 the related rate base percentage used to allocate LG&E's total capitalization between
8 electric and gas operations on Blake Exhibit 2.

9 **Q. Is there reason to expect any significant change in the revenue requirement for**
10 **LG&E's electric and gas operations in the near term?**

11 A. Yes. LG&E is in the process of making significant capital investments in electric
12 generation, transmission and distribution facilities in order to continue to provide safe
13 and reliable service for its electric customers. LG&E is also making significant
14 capital investments in gas distribution facilities in order to continue to provide safe
15 and reliable service for its gas customers. Some of the more significant capital
16 projects are the subject of certificate of convenience and necessity cases before this
17 Commission. These investments in the service facilities are necessary for the public
18 convenience and necessity.

19 The construction of these projects however will also cause LG&E to sustain
20 further attrition in its earnings from the level that is presently required for the
21 Company to maintain its financial strength and favorable financial ratings for
22 borrowing money and otherwise raise capital.

1 **Q. Has the Commission recently approved an authorized required return on equity**
2 **for LG&E?**
3 A. Yes. In LG&E's most recent rate case, Case No. 2003-00433, the Commission issued
4 an order on June 30, 2004 authorizing a required return on equity for LG&E within a
5 range of 10.00 to 11.00 percent with a midpoint of 10.50 percent. More recently, in
6 connection with LG&E's 2004 ECR application, Case No. 2004-00421, the
7 Commission issued an order on June 20, 2005, concluding that "a range of 10.0 to
8 11.0 percent, with a midpoint of 10.5 percent, continues to be a reasonable ROE for
9 LG&E."
10 **Q. What do Blake Exhibits 4 and 5 show for the return on equity earned by**
11 **LG&E's gas and electric operations?**
12 A. Blake Exhibit 4 demonstrates that LG&E's gas operations has a revenue deficiency
13 clearly below the authorized range of return on equity before the Value Delivery
14 Surcredit expires and shows LG&E can continue to reasonably expect, to a lesser
15 extent, to continue to have a revenue deficiency after the Value Delivery Surcredit
16 expires. Blake Exhibit 5 shows the return on equity for the gas operations to be
17 3.99% with the Value Delivery Surcredit effective and 7.51% after the pro-forma
18 adjustments are made to reflect the expiration of the Value Delivery Surcredit as
19 proposed in this Plan. Blake Exhibit 4 demonstrates that LG&E's electric operations
20 has a revenue deficiency clearly below the authorized range of return before the
21 Value Delivery Surcredit expires and shows LG&E could reasonably expect to have
22 sufficient revenues, with the earned return on equity within the authorized range of
23 return on equity after the Value Delivery Surcredit expires. Blake Exhibit 5 shows

1 the return on equity for the electric operations to be 7.36% with the Value Delivery
2 Surcredit effective and 10.28% after the pro-forma adjustments are made to reflect
3 the expiration of the Value Delivery Surcredit as proposed in this Plan.

4 **Q. Given the results shown on Blake Exhibit 4, is LG&E planning to file for a gas**
5 **base rate increase?**

6 A. Not at this time. With regard to the gas operations, LG&E must consider the fact that
7 the last base rate increase occurred just more than a year ago. We understand the
8 customers' need for rate stability. In addition, the gas utility is currently making
9 significant capital investments in its infrastructure, such as gas main replacements,
10 which could dictate the timing and nature of future rate cases. We are, however,
11 concerned about the financial results for our gas utility and will continue to monitor
12 those results. We cannot forgo filing a gas base rate case indefinitely and if the return
13 does not improve, but continues to decline over time LG&E, if necessary, would file
14 a separate gas base rate case.

15 **Q. Given the results shown on Blake Exhibit 4, is LG&E planning to file for an**
16 **electric base rate increase?**

17 Not at this time. With regard to the electric operations, upon the expiration of the
18 Value Delivery Surcredit and the full amortization of related costs, Exhibits 4 and 5
19 show that LG&E's return on equity is expected to be within the range of return
20 authorized by the Commission. Future base rate cases are likely to be dependent
21 upon the timing and nature of capital expenditures required to support the Company's
22 infrastructure. Extending the Value Delivery Surcredit after March 31, 2006 however
23 could cause LG&E to file a base rate case sooner and for a greater amount than

1 otherwise would be necessary due to the cumulative impact of the planned
2 construction expenditures and the extension of the Value Delivery Surcredit.

3 **Q. Should the Commission consider the potential impact of filing new base rate**
4 **cases in connection with determining whether to extend the Value Delivery**
5 **Surcredit mechanisms in this case?**

6 A. Yes. Rate stability and continuity are important ratemaking considerations. It is
7 important that the Commission consider the potential impact of extending the Value
8 Delivery Surcredits beyond their scheduled expiration on the timing and magnitude of
9 upcoming base rate cases given the planned construction schedule of transmission
10 and generation projects.

11 As Blake Exhibits 4 and 5 show, with the Value Delivery Surcredits in place,
12 LG&E's electric and gas operations are presently earning a return below the currently
13 authorized range of return. If the Value Delivery Surcredits are extended, the benefit
14 to customers of extending these rate mechanisms would likely be very short-lived and
15 would cause LG&E to file base rate cases sooner and for a greater amount than if the
16 mechanisms expire according to the terms in the 2001 Settlement Agreement. By
17 allowing the Value Delivery Surcredits to expire under the terms in the 2001
18 Settlement Agreement, the Commission can advance the important goals of rate
19 stability and continuity for customers.

20 **Q. What consideration should the Commission give to this analysis on Blake**
21 **Exhibits 1-5 in making its decision on the resolution of the Value Delivery**
22 **Surcredits?**

1 A. The Company's pro-forma analysis is a sound indication of what the Company's
2 financial returns are reasonably expected to be following the expiration of the Value
3 Delivery Surcredits. The Company believes it is a reasonable effort, consistent with
4 the Commission's prior orders and policies, to estimate the impact of this decision on
5 the Company's financial returns. Actual Company returns will, of course, be
6 dependent upon any number of factors including, but not limited to, capital
7 investments, market interest rates, the economy, the weather and market prices for
8 power, natural gas and fuel. Should the Commission agree with the Company's Plan
9 to allow the Value Delivery Surcredits to expire as originally intended, the
10 Commission will, of course, retain the authority to monitor the Company's financial
11 performance and take any action necessary in the future should economic
12 circumstances and the Company's financial performance dictate such action.

13 **Analysis of Net Operating Income**

14 **Q. Please further describe Blake Exhibit 1 and its purpose.**

15 A. Blake Exhibit 1 shows electric and gas operating revenues, electric and gas operating
16 expenses and net operating income per books separately for the twelve months ended
17 June 30, 2005. Because a historical year is used instead of a forecasted year, it is
18 necessary that the historical year be adjusted to reflect changes in revenues and
19 expenses that can be expected to occur during the period after the discontinuation of
20 the Value Delivery Surcredits. This Exhibit sets forth adjustments for the known and
21 measurable changes and eliminates unrepresentative conditions in order to "pro form"
22 or make the year suitable for use in determining the deficiency/sufficiency of current
23 electric and gas revenues upon the expiration of the Value Delivery Surcredits. A

1 further description of, and support for, each adjustment is contained in supporting
2 Reference Schedules 1.10 through 1.74 of this Exhibit.

3 **Electric Operations**

4 **Q. Briefly describe the nature of the pro forma adjustments you have made to**
5 **LG&E's electric operations for the twelve months ended June 30, 2005 shown on**
6 **Blake Exhibit 1.**

7 A. The adjustments are consistent with previous adjustments approved by the
8 Commission in LG&E's last electric base rate case or the Commission's policy with
9 respect to known and measurable adjustments.

10 For the electric operations as reflected in the twelve month period ended June
11 30, 2005, LG&E has made adjustments which:

12 a) Remove the impact of items included in other rate mechanisms
13 (Reference Schedules 1.11 - 1.16),

14 b) Eliminate certain revenue and expense items as previously ordered by
15 this Commission (Reference Schedules 1.20 – 1.23),

16 c) Normalize certain revenues and expenses (Reference Schedules 1.30 -
17 1.32),

18 d) Annualize year end facts and circumstances (Reference Schedules 1.40
19 - 1.45),

20 e) Adjust for non-recurring items in the period (Reference Schedule
21 1.50),

22 f) Adjust for VDT-related items (Reference Schedules 1.60 – 1.61), and

23 g) Adjust for Federal and state income tax expenses for these pro-forma
24 adjustments (Reference Schedules 1.70 -1.74).

1 **Q. Please explain the adjustment to operating revenues and expenses shown in**
2 **Reference Schedule 1.11 of Blake Exhibit 1.**
3 A. This adjustment removes environmental cost recovery ("ECR") revenues and
4 expenses from net operating income because those revenues and expenses are
5 addressed by a separate rate mechanism. Consistent with the Commission's practice
6 of eliminating the revenues and expenses associated with full-recovery cost trackers,
7 an adjustment was made to eliminate $5,546,197 of ECR revenues and $6,870,960 in
8 ECR costs. The adjustment is calculated in accordance with the Commission's
9 determination in its Order of June 30, 2004 in Case No. 2003-00433. The ECR
10 surcharge provides for full recovery of environmental costs that qualify for the
11 surcharge and contains a mechanism to true up actual ECR revenues to allowed ECR
12 revenues under the surcharge. The adjustment to revenues includes all ECR billings
13 during the twelve months ended June 30, 2005. The adjustment to expenses includes
14 operating expenses recovered under the ECR during the twelve months ended June
15 30, 2005 for compliance costs that will continue to be recovered through the
16 surcharge (i.e., operating expenses relating to the post-1995 ECR Plan). LG&E's
17 capitalization includes an adjustment to eliminate the ECR rate base for the post-1995
18 ECR Plan (see Blake Exhibit 2).
19 **Q. Please explain the adjustment to operating revenues and expenses shown in**
20 **Reference Schedule 1.12 of Blake Exhibit 1.**
21 A. This adjustment has been made to remove the impact of the revenues and expenses
22 associated with LG&E's demand-side management mechanism from the twelve
23 months ended June 30, 2005 revenues and expenses. The impact of rate mechanisms,

like the demand-side management mechanism, should be removed from the twelve months ended June 30, 2005 revenues when assessing the adequacy of base rates. Consistent with the Commission's practice of eliminating the revenues and expenses associated with full-recovery cost trackers, an adjustment was made to eliminate $3,870,433 of revenue recovered through the Demand-Side Management Cost Recovery Mechanism ("DSMRM") and the corresponding $3,790,679 of demand-side management expenses recorded during the twelve months ended June 30, 2005. The DSMRM includes a balance adjustment that automatically adjusts unit charges under the mechanism to account for differences between revenues collected and demand-side management program costs incurred during the applicable period. The adjustment is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00433.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.13 of Blake Exhibit 1.

A. This adjustment has been made to eliminate the impact of accrued revenues recorded in the twelve months ended June 30, 2005 associated with the Environmental Cost Recovery and Fuel Adjustment Clause from Accounts 440-445 and Rate Refund Account 449. The impact of rate mechanisms, such as these, should be removed from the twelve months ended June 30, 2005 revenues when assessing the adequacy of base rates. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.14 of Blake Exhibit 1.

1 A. This adjustment is made to reflect the current customers' and shareholder's portions
2 of the merger savings approved by the Commission in its October 16, 2003 Order in
3 Case No. 2002-00430. This adjustment was prepared by Ms. Scott and is discussed
4 in her testimony.

5 **Q. Please explain the adjustment to operating revenues and expenses shown in**
6 **Reference Schedule 1.15 of Blake Exhibit 1.**

7 A. This adjustment has been made to account for the timing mismatch in fuel cost
8 expenses and revenues under the Fuel Adjustment Clause ("FAC") for the twelve
9 months ended June 30, 2005. Consistent with past Commission practice, the
10 mismatch between fuel costs and fuel cost recovery through LG&E's FAC has been
11 eliminated. These over- or under-recoveries were taken directly from LG&E's
12 monthly FAC filings. The adjustment is calculated in accordance with the
13 Commission's determination in its Order of June 30, 2004 in Case No. 2003-00433.

14 **Q. Please explain the adjustment to operating revenues shown in Reference**
15 **Schedule 1.16 of Blake Exhibit 1.**

16 A. This adjustment includes the environmental compliance costs associated with off-
17 system sales revenues. This adjustment is made in accordance with the methodology
18 approved by the Commission in its June 1, 2000 Order in Case No. 98-426 and
19 applied in Case No. 2003-00433. It is also consistent with the Commission's
20 determination in Case No. 94-332 that eligible environmental compliance costs
21 attributable to off-system sales are not otherwise eligible for environmental surcharge
22 recovery. In the determination of the ECR surcharge, a portion of LG&E's
23 environmental compliance costs eligible for recovery through the surcharge are

1 allocated to off-system sales. Since jurisdictional customers receive the benefit of
2 off-system sales margins in all revenue requirements calculations, the Commission
3 has previously determined that reducing off-system sales margins to reflect
4 environmental costs incurred but not recovered through the surcharge is a correct
5 adjustment to operating results for the twelve month period. Therefore, consistent
6 with the methodology prescribed in the Commission's Order on rehearing in Case
7 No. 98-426 dated June 1, 2000, an adjustment of $1,100,531 was made to reduce
8 revenues to reflect the environmental surcharge calculations recognized in the
9 determination of off-system sales.

10 **Q. Please explain the adjustment to operating revenues shown in Reference**
11 **Schedule 1.20 of Blake Exhibit 1.**

12 A. This adjustment has been made to eliminate the effect of unbilled revenues.
13 Consistent with prior rate cases, unbilled revenues were removed from twelve months
14 ended June 30, 2005 operating revenues. For LG&E's electric operations, $9,922,000
15 of unbilled revenues were removed from operating results for this period. An
16 adjustment to remove unbilled revenues was accepted by the Commission in LG&E's
17 last three base rate cases, Case No. 2003-00433, Case No. 2000-080 (gas only) and
18 Case No. 90-158. LG&E had not recorded unbilled revenues prior to Case No. 90-
19 158.

20 **Q. Please explain the adjustment to operating revenues and expenses shown in**
21 **Reference Schedule 1.21 of Blake Exhibit 1.**

1 A. This adjustment has been made to eliminate electric brokered sales revenues and
2 expenses as directed by the Commission in Case No. 98-426. This adjustment was
3 prepared by Ms. Scott and is discussed in her testimony.

4 **Q. Please explain the adjustment to operating expenses shown in Reference**
5 **Schedule 1.22 of Blake Exhibit 1.**

6 A. This adjustment eliminates advertising expenses, was prepared by Ms. Scott and is
7 discussed in her testimony.

8 **Q. Please explain the adjustment to operating revenues shown in Reference**
9 **Schedule 1.23 of Blake Exhibit 1.**

10 A. This adjustment is made to reflect the rate schedule switch of two electric customers.
11 General Electric switched from a special contract rate to Rate LP-TOD in September
12 2004 resulting in a decrease in revenue of $459,195. UPS switched from a special
13 contract rate to Rate LP-TOD in April 2005 resulting in a decrease in revenue of
14 $150,553.

15 **Q. Please explain the adjustment to operating expenses shown in Reference**
16 **Schedule 1.30 of Blake Exhibit 1.**

17 A. This adjustment has been made to reflect a normalized level of storm damage
18 expenses. This adjustment was prepared by Ms. Scott and is discussed in her
19 testimony.

20 **Q. Please explain the adjustment to operating expenses shown in Reference**
21 **Schedule 1.31 of Blake Exhibit 1.**

1 A. This adjustment is made to normalize the expense levels in Account 925 "Injuries and
2 Damages." This adjustment was prepared by Ms. Scott and is discussed in her
3 testimony.

4 **Q. Please explain the adjustment to operating revenues shown in Reference**
5 **Schedule 1.32 of Blake Exhibit 1.**

6 A. This adjustment is made to normalize the Off-System Sales Margins to a five-year
7 level. The level of off-system sales during the twelve months ended June 30, 2005 is
8 not representative of a sustainable level due to market and operating conditions
9 unique to that specific time period. The twelve months ended June 30, 2005,
10 included unusually high plant availability and wholesale power prices. The
11 Equivalent Forced Outage Rate ("EFOR") for the combined LG&E and KU system
12 was below 3.0% for the calendar year 2004 (a record low rate) and continued to be
13 below historical levels during the twelve months ended June 30, 2005 at 3.6%.
14 Electricity prices in the wholesale market have increased over historical levels due
15 primarily to increased fuel prices. As such the level of off-system sales margins in
16 the twelve month period ending June 30, 2005 is not indicative of the amount that can
17 be expected going forward and an adjustment of $7,573,222 was made to reduce
18 revenues to reflect a level of off-system sales margins consistent with a five-year
19 average.

20 **Q. Please explain the adjustment to operating revenues and expenses shown in**
21 **Reference Schedule 1.40 of Blake Exhibit 1.**

22 A. This adjustment has been made to annualize revenues based on actual customers at
23 June 30, 2005 and is calculated in accordance with the Commission's determination

1 in its Order of June 30, 2004 in Case No. 2003-00433. The numbers of customers
2 served at the end of the twelve months ended June 30, 2005 for the rate classes were
3 higher than the 13-month average number of customers. The differences between the
4 number of customers served at year-end and the 13-month average number for each
5 rate class was multiplied by the average annual kWh usage per customer. The
6 average usage for each rate class was then multiplied by the average revenue per kWh
7 (including customer charges, energy charges, demand charges and minimum bills),
8 resulting in an upward adjustment to electric operating revenue of $2,882,415.
9 The additional operating expenses associated with serving the higher number
10 of customers and volumes were calculated by applying an operating ratio to the
11 revenue adjustment. Consistent with the Commission's practice, the operating ratio
12 of 48.95 percent was determined by dividing operation and maintenance expenses,
13 exclusive of wages and salaries, pensions and benefits, and regulatory commission
14 expenses, by base rate revenues calculated at the currently effective rates. When
15 applied to the year-end revenue adjustment, the application of the operating ratio
16 resulted in an upward adjustment to expenses of $1,410,942.
17 **Q. Please explain the adjustment to operating expenses shown in Reference**
18 **Schedule 1.41 of Blake Exhibit 1.**
19 A. This adjustment has been made to reflect annualized depreciation expenses under the
20 existing rates applied to plant-in-service as of June 30, 2005. The calculation of the
21 adjustment was prepared by Ms. Scott and is discussed in her testimony.
22 **Q. Please explain the adjustment to operating expenses shown in Reference**
23 **Schedule 1.42 of Blake Exhibit 1.**

A. This adjustment has been made to reflect increases in labor and labor-related costs as applied to the twelve months ended June 30, 2005, and includes specific adjustments for wages, payroll taxes and LG&E's 401(k) match. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.43 of Blake Exhibit 1.

A. This adjustment has been made to reflect an annual level of Midwest Independent Transmission System Operator, Inc. ("MISO") administrative expenses associated with the operation of the "Day 2" markets. More specifically the administrative expenses are those contained in Schedules 16 and 17 of the MISO Energy Markets Tariff filed with and approved by the Federal Energy Regulatory Commission ("FERC"). The MISO Day 2 market began April 1, 2005; therefore, only three months of expenses were contained in the twelve months ended June 30, 2005[3]. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.44 of Blake Exhibit 1.

A. This adjustment has been made to reflect an annual level of the MISO Revenue Neutrality Uplift charges associated with the operation of the Day 2 market. The MISO Day 2 market began April 1, 2005; therefore, only three months of these revenues and expenses were contained in the twelve months ended June 30, 2005. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

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[3] In the Matter of: Investigation into the Membership of Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission Operator, Inc., Case No. 2003-00266.

1 **Q. Please explain the adjustment to operating revenues and expenses shown in**
2 **Reference Schedule 1.45 of Blake Exhibit 1.**
3 A. This adjustment has been made to reflect an annual level of the MISO Revenue
4 Sufficiency Guarantee ("RSG") make-whole Payments (net of production expenses
5 associated with units receiving RSG make-whole Payments), and the MISO RSG
6 Distribution Amount charges associated with the operation of the Day 2 market. The
7 MISO Day 2 market began April 1, 2005; therefore, only three months of these
8 revenues and expenses were contained in the twelve months ended June 30, 2005.
9 This adjustment was prepared by Ms. Scott and is discussed in her testimony.
10 **Q. Please explain the adjustment to operating revenues shown in Reference**
11 **Schedule 1.50 of Blake Exhibit 1.**
12 A. This adjustment is to remove a non-recurring item related to the reclassification of
13 RSG revenues for the twelve months ended June 30, 2005. This adjustment was
14 prepared by Ms. Scott and is discussed in her testimony.
15 **Q. Please explain the adjustment to operating expenses shown in Reference**
16 **Schedule 1.60 of Blake Exhibit 1.**
17 A. This adjustment is to recognize the Value Delivery Team net savings to the
18 shareholder recognized by the Commission in its Order of December 3, 2001 in Case
19 No. 2001-169. This adjustment was prepared by Ms. Scott and is discussed in her
20 testimony.
21 **Q. Please explain the adjustment to operating revenues and expenses shown in**
22 **Reference Schedule 1.61 of Blake Exhibit 1.**

1 A. This adjustment has been made to remove the amount of the Value Delivery Surcredit
2 contained in revenues for the twelve months ended June 30, 2005 and to remove from
3 expenses the amount of the Value Delivery Cost Amortization included in base rates
4 that will not exist after expiration of the Value Delivery Surcredit on March 31, 2006.
5 This adjustment was prepared by Ms. Scott and is discussed in her testimony.

6 Q. **Please explain the adjustment to operating expenses shown in Reference**
7 **Schedule 1.70 of Blake Exhibit 1.**

8 A. This adjustment is for federal and state income taxes corresponding to the base
9 revenues and expense adjustments discussed above. Reference Schedule 1.70 shows
10 the calculation of a composite federal and state income tax rate. This adjustment was
11 prepared by Ms. Scott and is discussed in her testimony.

12 Q. **Please explain the adjustment to operating expenses shown in Reference**
13 **Schedule 1.71 of Blake Exhibit 1.**

14 A. This adjustment is for federal and state income taxes corresponding to the
15 annualization and adjustment of year-end interest expense. This adjustment was
16 prepared by Ms. Scott and is discussed in her testimony.

17 Q. **Please explain the adjustment to operating expenses shown in Reference**
18 **Schedule 1.72 of Blake Exhibit 1.**

19 A. This adjustment is for income tax true-ups and adjustments made during the twelve
20 months ended June 30, 2005 that relate to prior periods. This adjustment was
21 prepared by Ms. Scott and is discussed in her testimony.

22 Q. **Please explain the adjustment to operating expenses shown in Reference**
23 **Schedule 1.73 of Blake Exhibit 1.**

1 A. This adjustment is for the tax adjustment for manufacturing activities and was
2 prepared by Ms. Scott and is discussed in her testimony.

3 **Q. Please explain Reference Schedule 1.74 of Blake Exhibit 1.**

4 A. This schedule calculates the revenue gross up factor, was prepared by Ms. Scott and
5 is discussed in her testimony.

6 <u>**Gas Operations**</u>

7 **Q. Briefly describe the nature of the pro forma adjustments you have made to**
8 **LG&E's gas operations for the twelve months ended June 30, 2005 shown on**
9 **Blake Exhibit 1.**

10 A. The adjustments are consistent with previous adjustments approved by the
11 Commission in LG&E's last gas base rate case or the Commission's policy with
12 respect to known and reasonable adjustments.

13 For the gas operations as reflected in the twelve month period ended June 30,
14 2005, LG&E has made adjustments which:

15 a) Remove the impact of items included in other rate mechanisms
16 (Reference Schedules 1.10 and 1.12),

17 b) Includes standard adjustments made in the Company's last rate case
18 (Reference Schedules 1.20 and 1.22),

19 c) Normalize certain revenues and expenses (Reference Schedule 1.31),

20 d) Annualize year end facts and circumstances (Reference Schedules 1.40
21 - 1.42),

22 e) Adjust for VDT-related items (Reference Schedules 1.60 and 1.61),
23 and

1 f) Adjust for Federal and state income tax expenses for these pro-forma
2 adjustments (Reference Schedules 1.70 -1.74).

3 Q. **Please explain the adjustment to operating revenues and expenses shown in**
4 **Reference Schedule 1.10 of Blake Exhibit 1.**

5 A. This adjustment has been made to eliminate the effect of gas supply cost recoveries
6 and gas supply expenses for the twelve months ended June 30, 2005. Consistent with
7 past Commission practice, Gas Supply Clause ("GSC") revenues and corresponding
8 gas supply expenses have been removed from this period's operating results.
9 Because gas supply costs are recovered through a stand-alone cost-recovery
10 mechanism, the Commission requires that the distributor remove these costs from
11 revenues in order to establish the base revenues that relate to the delivery of gas. This
12 adjustment eliminates the possibility of over- or under-recoveries resulting from
13 timing differences from the collection of revenues under the GSC and the actual
14 incurrence of the cost and thus ensures that base rates recover only the utility's
15 distribution-related costs. The adjustment is calculated in accordance with the
16 Commission's determination in its Order of June 30, 2004 in Case No. 2003-00433.

17 Q. **Please explain the adjustment to operating revenues and expenses shown in**
18 **Reference Schedule 1.12 of Blake Exhibit 1.**

19 A. This adjustment has been made to remove the impact of the revenues and expenses
20 associated with LG&E's demand-side management mechanism from the twelve
21 months ended June 30, 2005 revenues and expenses. The impact of rate mechanisms,
22 like the demand-side management mechanism, should be removed from the twelve
23 months ended June 30, 2005 revenues when assessing the adequacy of base rates.

1 Consistent with the Commission's practice of eliminating the revenues and expenses
2 associated with full-recovery cost trackers, an adjustment was made to eliminate
3 $706,959 of revenue recovered through the DSMRM and the corresponding $679,147
4 of demand-side management expenses recorded during the twelve months ended June
5 30, 2005. The DSMRM includes a balance adjustment that automatically adjusts unit
6 charges under the mechanism to account for differences between revenues collected
7 and demand-side management program costs incurred during the applicable period.
8 The adjustment is calculated in accordance with the Commission's determination in
9 its Order of June 30, 2004 in Case No. 2003-00433.

10 **Q. Please explain the adjustment to operating revenues shown in Reference**
11 **Schedule 1.20 of Blake Exhibit 1.**

12 A. This adjustment has been made to eliminate the effect of unbilled revenues.
13 Consistent with prior rate cases, unbilled revenues were removed from twelve months
14 ended June 30, 2005 operating revenues. For LG&E's gas operations, $143,000 of
15 unbilled revenues were removed from twelve months ended June 30, 2005 operating
16 results. An adjustment to remove unbilled revenues was accepted by the Commission
17 in LG&E's last three base rate cases, Case No. 2003-00433, Case No. 2000-080 (gas
18 only) and Case No. 90-158. LG&E had not recorded unbilled revenues prior to Case
19 No. 90-158.

20 **Q. Please explain the adjustment to operating expenses shown in Reference**
21 **Schedule 1.22 of Blake Exhibit 1.**

22 A. This adjustment eliminates advertising expenses, was prepared by Ms. Scott and is
23 discussed in her testimony.

1 **Q. Please explain the adjustment to operating expenses shown in Reference**
2 **Schedule 1.31 of Blake Exhibit 1.**
3 A. This adjustment is made to normalize the expense levels in Account 925 "Injuries and
4 Damages." This adjustment was prepared by Ms. Scott and is discussed in her
5 testimony.
6 **Q. Please explain the adjustment to operating revenues and expenses shown in**
7 **Reference Schedule 1.40 of Blake Exhibit 1.**
8 A. This adjustment has been made to annualize revenues based on actual customers at
9 June 30, 2005 and is calculated in accordance with the Commission's determination
10 in its Order of June 30, 2004 in Case No. 2003-00433. The numbers of customers
11 served at the end of the twelve months ended June 30, 2005 for the rate classes were
12 different from the 13-month average number of customers. The purpose of this
13 adjustment is to reflect the deliveries and revenue assuming that the year-end number
14 of customers had been served for the entire 12-month period. The differences
15 between the number of customers served at year-end and the 13-month average
16 number for each rate class was multiplied by the average annual consumption per
17 customer in order to determine the deliveries expected. The volumetric adjustment
18 for each rate class was then multiplied by the average rate per Mcf (including
19 customer charges, distribution charges and minimum bills), resulting in an upward
20 adjustment to gas operating revenue of $454,500.
21 The additional operating expenses associated with serving the higher number
22 of customers and volumes were calculated by applying an operating ratio to the
23 revenue adjustment. Consistent with the Commission's Order in LG&E last gas base

1 rate proceeding, Case No. 2003-00433, the operating ratio of 57.42 percent was
2 determined by dividing operation and maintenance expenses, exclusive of gas supply
3 costs, wages and salaries, pensions and benefits, and regulatory commission
4 expenses, by base rate revenues calculated at the currently effective rates. When
5 applied to the year-end revenue adjustment, the application of the operating ratio
6 resulted in an upward adjustment to expenses of $260,994.

7 Q. **Please explain the adjustment to operating expenses shown in Reference**
8 **Schedule 1.41 of Blake Exhibit 1.**

9 A. This adjustment has been made to reflect annualized depreciation expenses under the
10 existing rates applied to plant-in-service as of June 30, 2005. The calculation of the
11 adjustment was prepared by Ms. Scott and is discussed in her testimony.

12 Q. **Please explain the adjustment to operating expenses shown in Reference**
13 **Schedule 1.42 of Blake Exhibit 1.**

14 A. This adjustment has been made to reflect increases in labor and labor-related costs as
15 applied to the twelve months ended June 30, 2005, and includes specific adjustments
16 for wages, payroll taxes and LG&E's 401(k) match. This adjustment was prepared
17 by Ms. Scott and is discussed in her testimony.

18 Q. **Please explain the adjustment to operating expenses shown in Reference**
19 **Schedule 1.60 of Blake Exhibit 1.**

20 A. This adjustment is to recognize the Value Delivery Team net savings to the
21 shareholder recognized by the Commission in its Order of December 3, 2001 in Case
22 No. 2001-169. This adjustment was prepared by Ms. Scott and is discussed in her
23 testimony.

1 **Q. Please explain the adjustment to operating revenues and expenses shown in**
2 **Reference Schedule 1.61 of Blake Exhibit 1.**
3 A. This adjustment has been made to remove the amount of the Value Delivery Surcredit
4 contained in revenues for the twelve months ended June 30, 2005 and to remove from
5 expenses the amount of the Value Delivery Cost Amortization included in base rates
6 that will not exist after expiration of the Value Delivery Surcredit on March 31, 2006.
7 This adjustment was prepared by Ms. Scott and is discussed in her testimony.
8 **Q. Please explain the adjustment to operating expenses shown in Reference**
9 **Schedule 1.70 of Blake Exhibit 1.**
10 A. This adjustment is for federal and state income taxes corresponding to the base
11 revenues and expense adjustments discussed above. Reference Schedule 1.70 shows
12 the calculation of a composite federal and state income tax rate. This adjustment was
13 prepared by Ms. Scott and is discussed in her testimony.
14 **Q. Please explain the adjustment to operating expenses shown in Reference**
15 **Schedule 1.71 of Blake Exhibit 1.**
16 A. This adjustment is for federal and state income taxes corresponding to the
17 annualization and adjustment of year-end interest expense. This adjustment was
18 prepared by Ms. Scott and is discussed in her testimony.
19 **Q. Please explain the adjustment to operating expenses shown in Reference**
20 **Schedule 1.72 of Blake Exhibit 1.**
21 A. This adjustment is for income tax true-ups and adjustments made during the twelve
22 months ended June 30, 2005 that relate to prior periods. This adjustment was
23 prepared by Ms. Scott and is discussed in her testimony.

1 **Q. Please explain Reference Schedule 1.74 of Blake Exhibit 1.**

2 A. This schedule calculates the revenue gross up factor, was prepared by Ms. Scott and
3 is discussed in her testimony.

4 **Conclusion**

5 **Q. What is LG&E's recommendation for the Commission in this proceeding?**

6 A. The Commission should approve LG&E's Plan and issue an order permitting the
7 withdrawal of the Value Delivery Surcredits from gas and electric service rendered on
8 and after April 1, 2006, subject to a final balancing adjustment in the May 2006
9 billing.

10 **Q. Does this conclude your testimony?**

11 A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Kent W. Blake**, being duly sworn, deposes and says he is the Director of State Regulation and Rates for LG&E Energy Services Inc., that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Kent W. Blake

KENT W. BLAKE

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 30th day of September 2005.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

APPENDIX A

Kent W. Blake

Director, State Regulation and Rates
LG&E Energy Services Inc.
220 West Main Street
P. O. Box 32010
Louisville, Kentucky 40202
(502) 627-2573

Education

University of Kentucky, B.S. in Accounting, May 1988
Certified Public Accountant, Kentucky, January 1991

Previous Positions

LG&E Energy LLC, Louisville, Kentucky
- 2003 (Sept) – 2004 (Oct) – Director, Regulatory Initiatives
- 2003 (Feb) – 2003 (Sept) – Director, Business Development
- 2002 (Aug) – 2003 (Feb) – Director, Finance and Business Analysis

Mirant Corporation (f.k.a. Southern Company Energy Marketing)
- 2002 (Feb-Aug) – Senior Director, Applications Development
- 2000-2002 – Director, Systems Integration
- 1998-2000 – Trading Controller

LG&E Energy Corp.
- 1997-1998 – Director, Corporate Accounting and Trading Controls

Arthur Andersen LLP
- 1992-1997 – Manager, Audit and Business Advisory Services
- 1990-1992 – Senior Auditor
- 1988-1990 – Audit Staff

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustments to Electric and Gas Operating Revenues, Operating Expenses and Net Operating Income
For the Twelve Months Ended June 30, 2005

		Electric Department			Gas Department		
	Reference Schedule (1)	Operating Revenues (2)	Operating Expenses (3)	Net Operating Income (4)	Operating Revenues (5)	Operating Expenses (6)	Net Operating Income (7)
1. Amount per books		882,059,250	748,207,845	$133,851,405	374,848,119	357,219,364	$17,628,755
2. Adjustments for known changes and to eliminate unrepresentative conditions:							
3. Adjustment to revenues and expenses to eliminate gas supply cost recoveries and gas supply expenses	1.10	-	-	-	(280,583,021)	(278,335,277)	(2,247,744)
4. Adjustment to eliminate environmental surcharge revenues and expenses	1.11	(5,546,197)	(6,870,960)	1,324,763	-	-	-
5. Eliminate DSM revenue and expenses	1.12	(3,870,433)	(3,790,679)	(79,754)	(706,959)	(679,147)	(27,812)
6. To eliminate ECR and FAC accruals	1.13	(6,364,332)	-	(6,364,332)	-	-	-
7. Adjustment for merger savings	1.14	1,335,639	19,427,401	(18,091,762)	-	-	-
8. To adjust mismatch in fuel cost recovery	1.15	(1,401,767)	(3,783,772)	2,382,005	-	-	-
9. Off-system sales revenue adjustment for the ECR calculation	1.16	(1,100,531)	-	(1,100,531)	-	-	-
10. Adjustment to eliminate unbilled revenues	1.20	(9,922,000)	-	(9,922,000)	(143,000)	-	(143,000)
11. To eliminate electric brokered sales revenues and expenses	1.21	308,077	(77,758)	385,835	-	-	-
12. Adjustment to eliminate advertising expenses pursuant to Commission Rule 807 KAR 5:016	1.22	-	(97,555)	97,555	-	(34,176)	34,176
13. Adjustment to reflect customer rate switching	1.23	(609,748)	-	(609,748)	-	-	-
14. Adjustment to reflect normalized storm damage expense	1.30	-	(2,656,827)	2,656,827	-	-	-
15. Adjustment for injuries and damages FERC account 925	1.31	-	(252,587)	252,587	-	252,153	(252,153)
16. To reflect representative level of off-system sales margins	1.32	(7,573,222)	-	(7,573,222)	-	-	-
17. Adjustment to annualize year-end customers	1.40	2,882,415	1,410,942	1,471,473	454,500	260,994	193,506

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustments to Electric and Gas Operating Revenues, Operating Expenses and Net Operating Income
For the Twelve Months Ended June 30, 2005

		Reference Schedule (1)	Electric Department Operating Revenues (2)	Electric Department Operating Expenses (3)	Electric Department Net Operating Income (4)	Gas Department Operating Revenues (5)	Gas Department Operating Expenses (6)	Gas Department Net Operating Income (7)
18. Adjustment to reflect annualized depreciation expenses under current rates		1.41	-	553,054	(553,054)	-	823,816	(823,816)
19. Adjustment to reflect increases in labor and labor related costs		1.42	-	2,336,390	(2,336,390)	-	658,983	(658,983)
20. Adjustment to annualize MISO schedules 16 and 17		1.43	-	2,583,796	(2,583,796)	-	-	-
21. Adjustment to annualize MISO revenue neutrality uplift		1.44	-	12,776,646	(12,776,646)	-	-	-
22. Adjustment to annualize RSG revenues and expenses		1.45	17,126,108	21,334,998	(4,208,890)	-	-	-
23. Adjustment for reclassification of RSG		1.50	(6,727,960)	-	(6,727,960)	-	-	-
24. Adjustment to reflect VDT net shareholder savings		1.60	-	9,240,000	(9,240,000)	-	2,490,000	(2,490,000)
25. Total of above adjustments prior to Value Delivery Surcredit expiration			(21,463,951)	52,133,089	$ (73,597,040)	(280,978,480)	(274,562,654)	$ (6,415,826)
26. Federal and state income taxes corresponding to base revenue and expense adjustments and above adjustments -	39.5500 %	1.70		(29,107,629)	29,107,629		(2,537,459)	2,537,459
27. Federal and state income taxes corresponding to annualization and adjustment of year-end interest expense		1.71		(31,970)	31,970		(182,733)	182,733
28. Prior income tax true-ups and adjustments		1.72		685,806	(685,806)		(28,867)	28,867
29. Tax deduction for manufacturing activities (TDMA) adjustment		1.73		(791,000)	791,000		-	-
30. Total adjustments prior to Value Delivery Surcredit expiration			(21,463,951)	22,888,296	$ (44,352,247)	(280,978,480)	(277,311,713)	$ (3,666,767)
31. Adjusted Net Operating Income prior to Value Delivery Surcredit expiration			860,595,299	771,096,141	$ 89,499,158	93,869,639	79,907,651	$ 13,961,988

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustments to Electric and Gas Operating Revenues, Operating Expenses and Net Operating Income
For the Twelve Months Ended June 30, 2005

	Reference Schedule (1)	Electric Department Operating Revenues (2)	Electric Department Operating Expenses (3)	Electric Department Net Operating Income (4)	Gas Department Operating Revenues (5)	Gas Department Operating Expenses (6)	Gas Department Net Operating Income (7)
32. Adjustments for expiration of Value Delivery Surcredit:							
33. Adjustment to remove VDT net shareholder savings	1.60	-	(9,240,000)	9,240,000	-	(2,490,000)	2,490,000
34. Adjustment to remove Value Delivery Surcredit and cost amortization	1.61	6,113,935	(23,806,460)	29,920,395	1,691,828	(6,328,300)	8,020,128
35. Total of above adjustments for expiration of Value Delivery Surcredit		6,113,935	(33,046,460)	$ 39,160,395	1,691,828	(8,818,300)	$ 10,510,128
36. Federal and state income taxes corresponding to base revenue and expense adjustments and above adjustments - 39.5500 %	1.70		15,487,936	(15,487,936)		4,156,756	(4,156,756)
37. Total adjustments for expiration of Value Delivery Surcredit		6,113,935	(17,558,524)	$ 23,672,459	1,691,828	(4,661,544)	$ 6,353,372
38. Adjusted Net Operating Income for expiration of Value Delivery Surcredit		866,709,234	753,537,617	$ 113,171,617	95,561,467	75,246,107	$ 20,315,360

Blake Exhibit 1
Reference Schedule 1.10
Sponsoring Witness: Kent Blake

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Revenues and Expenses to Eliminate Gas Supply Cost Recoveries and Gas Supply Expenses During the Twelve Months Ended June 30, 2005

		Gas
1. Cost recoveries in revenue for the 12 months ended June 30, 2005	$	(280,583,021)
2. Gas supply expenses for the 12 months ended June 30, 2005		(278,335,277)
3. Net adjustment	$	(2,247,744)

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Eliminate Environmental Surcharge Revenues and Expenses
For the Twelve Months Ended June 30, 2005

Expense Month	ECR Electric Revenues	Electric Expenses Post '95 Plan	Electric Expenses Roll-In	ECR Catch-Up Depreciation (1)	Net Electric
Jul-04	$ 1,538,553	$ 293,810	$ (55,984)	$ -	$ 1,300,727
Aug-04	532,694	313,825	(55,984)	0	274,853
Sep-04	(329,093)	325,515	(55,984)	0	(598,624)
Oct-04	237,910	260,730	(55,984)	0	33,164
Nov-04	326,125	244,646	(55,984)	0	137,463
Dec-04	369,741	584,359	(55,984)	2,404,608	(2,563,242)
Jan-05	498,138	567,824	(55,984)	0	(13,702)
Feb-05	507,787	559,453	(55,984)	0	4,318
Mar-05	256,953	569,854	(55,984)	0	(256,917)
Apr-05	296,537	598,222	(55,984)	0	(245,701)
May-05	402,786	(107,258)	(55,984)	0	566,028
Jun-05	908,066	927,180	(55,984)	0	36,870
Total	$ 5,546,197	$ 5,138,160	$ (671,808)	$ 2,404,608	$ (1,324,763)
Adjustment	$ (5,546,197)	$ (5,138,160)	$ 671,808	$ (2,404,608)	$ 1,324,763

(1) Represents catch-up depreciation posted to General Ledger in December 2004 related to ECR NOx Project - 3rd Unitization.

Blake Exhibit 1
Reference Schedule 1.12
Sponsoring Witness: Kent Blake

LOUISVILLE GAS AND ELECTRIC COMPANY

Eliminate DSM Revenues and Expenses
For the Twelve Months Ended June 30, 2005

	Electric	Gas
1. DSM revenue adjustment	$ (3,870,433)	$ (706,959)
2. DSM expense adjustment	(3,790,679)	(679,147)
3. Total	$ (79,754)	$ (27,812)

Blake Exhibit 1
Reference Schedule 1.13
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

To Eliminate ECR and FAC Accruals
For the Twelve Months Ended June 30, 2005

	Electric
1. ECR Accrued Revenue in Account 449	$ (2,183,451)
2. FAC Accrued Revenue in Account 449	(268,850)
3. ECR Accrued Revenue in Accounts 440-445	6,127,942
4. FAC Accrued Revenue in Accounts 440-445	2,688,691
5. Total Accrued Revenues	$ 6,364,332
6. Adjustment	$ (6,364,332)

Blake Exhibit 1
Reference Schedule 1.14
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment for Merger Savings
For the Twelve Months Ended June 30, 2005

	Electric
1. Customer portion of merger surcredit per agreement	$ 19,427,401
2. Revenue returned to customers through the merger surcredit and amortization of amounts previously returned to customers for 12 months ended June 30, 2005	20,763,040
3. Adjustment to savings due customers	$ 1,335,639
4. Shareholder's portion of merger surcredit per agreement	$ 19,427,401

NOTE: Merger surcredit per Commission's order dated October 16, 2003 in Case No. 2002-00430.

LOUISVILLE GAS AND ELECTRIC COMPANY

To Adjust Mismatch in Fuel Cost Recovery
For the Twelve Months Ended June 30, 2005

Expense Month	Electric Revenue Form A Page 4 of 5 Line 3	Electric Expense Form A* Page 4 of 5 Line 8
Jul-04	$ 589,666	$ (165,449)
Aug-04	240,285	(114,868)
Sep-04	(156,110)	(41,762)
Oct-04	(90,991)	(272,896)
Nov-04	(34,168)	710,228
Dec-04	(282,013)	446,603
Jan-05	836,076	(269,645)
Feb-05	418,136	(970,653)
Mar-05	(251,102)	27,642
Apr-05	(968,929)	880,051
May-05	24,907	740,293
Jun-05	1,076,010	2,814,228
Total	$ 1,401,767	$ 3,783,772
Adjustment	$ (1,401,767)	$ (3,783,772)

* NOTE : Expenses are recovered in the second succeeding month. For example, January 2005 would be reflected in March 2005.

Blake Exhibit 1
Reference Schedule 1.16
Sponsoring Witness: Kent Blake

LOUISVILLE GAS AND ELECTRIC COMPANY

Off-System Sales Revenue Adjustment for the ECR Calculation
For the Twelve Months Ended June 30, 2005

	Electric					
	(1)	(2)	(3)	(4)	(5)	(6)
	LG&E Off-System Sales Revenue	LG&E Off-System Sales Intercompany Revenue	LG&E Off-System Sales Revenue Less Intercompany (Col. 1 - 2)	Monthly Environmental Surcharge Factor	Average Environmental Surcharge Factor	Off-System Sales Environmental Cost (Col. 3 * 5)
Jul-04	$ 12,002,534	$ 3,446,382	$ 8,556,152	-0.51%	0.76%	$ 65,027
Aug-04	10,600,562	3,764,807	6,835,755	0.49%	0.76%	51,952
Sep-04	13,774,699	3,967,693	9,807,006	0.71%	0.76%	74,533
Oct-04	17,668,044	5,240,161	12,427,883	0.76%	0.76%	94,452
Nov-04	16,618,844	6,757,824	9,861,020	0.90%	0.76%	74,944
Dec-04	20,712,671	7,212,699	13,499,972	1.01%	0.76%	102,600
Jan-05	28,271,309	9,029,778	19,241,531	0.53%	0.76%	146,236
Feb-05	27,110,770	9,151,877	17,958,893	0.67%	0.76%	136,488
Mar-05	25,259,670	7,883,065	17,376,605	0.87%	0.76%	132,062
Apr-05	14,425,518	5,762,344	8,663,174	1.47%	0.76%	65,840
May-05	19,501,205	7,627,774	11,873,431	0.36%	0.76%	90,238
Jun-05	16,273,168	7,568,079	8,705,089	1.80%	0.76%	66,159
Total	$ 222,218,994	$ 77,412,483	$ 144,806,511			$ 1,100,531
Average				0.76%		
Adjustment						$ (1,100,531)

Blake Exhibit 1
Reference Schedule 1.20
Sponsoring Witness: Kent Blake

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Eliminate Unbilled Revenues

	Electric	Gas
1. Unbilled revenues at June 30, 2004	$ 30,221,000	$ 4,344,000
2. Unbilled revenues at June 30, 2005	(40,143,000)	(4,487,000)
3. Increase in book revenues due to unbilled revenues	$ (9,922,000)	$ (143,000)

Blake Exhibit 1
Reference Schedule 1.21
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

To Eliminate Electric Brokered Sales Revenues and Expenses
For the Twelve Months Ended June 30, 2005

	Electric
1. Brokered Sales	$ 11,024,420
2. Brokered Expense recorded in revenues	11,332,497
3. Net Brokered Sales Revenue	$ (308,077)
4. Net Brokered Sales Revenue adjustment	$ 308,077
5. Operating Expense related to Brokered Sales	$ 77,758 *
6. Brokered Sales Operating Expense adjustment	$ (77,758)
7. Total adjustment (Line 4 - Line 6)	$ 385,835

*NOTE: Reflects 5.9% of total labor and labor related costs from off-system sales activities.

Blake Exhibit 1
Reference Schedule 1.22
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Eliminate Advertising Expenses
Pursuant to Commission Rule 807 KAR 5:016
For the Twelve Months Ended June 30, 2005

	Electric	Gas
1. Uniform System of Accounts - Account No. 930.1 General Advertising Expenses	$ 95,834	$ 32,335
2. Account No. 913 Advertising Expenses	1,721	1,841
3. Total	$ 97,555	$ 34,176
4. Adjustment	$ (97,555)	$ (34,176)

Blake Exhibit 1
Reference Schedule 1.23
Sponsoring Witness: Kent Blake

LOUISVILLE GAS AND ELECTRIC COMPANY

To Adjust for Customer Rate Switching
As Applied to the Twelve Months Ended June 30, 2005

	Electric	Gas
1. Rate switch - General Electric to LP-TOD Transmission	$ (459,195)	
2. Rate switch - UPS to LP-TOD Primary	(150,553)	
3. Adjustment	$ (609,748)	$ -

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Reflect Normalized Storm Damage Expense
For the Twelve Months Ended June 30, 2005

	Electric
1. Storm damage provision based upon ten year average	$ 4,281,173
2. Storm damage expenses incurred during the 12 months ended June 30, 2005	6,938,000
3. Adjustment	$ (2,656,827)

Year	Expense *	CPI-All Urban Consumers	Amount
2005	$ 6,938,000	1.0000	$ 6,938,000
2004	13,867,000	1.0296	14,277,463
2003	2,350,000	1.0571	2,484,185
2002	2,465,175	1.0812	2,665,347
2001	2,329,376	1.0982	2,558,121
2000	2,167,000	1.1295	2,447,627
1999	1,152,000	1.1675	1,344,960
1998	3,108,339	1.1933	3,709,181
1997	1,708,339	1.2118	2,070,165
1996	3,482,316	1.2396	4,316,679
Total			$ 42,811,728
Ten Year Average			$ 4,281,173

* NOTE: 2005 expenses are for the 12 months ended June 30, 2005.
All other years expenses are for the calendar year.

Blake Exhibit 1
Reference Schedule 1.31
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment for Injuries and Damages FERC Account 925
For the Twelve Months Ended June 30, 2005

	Electric	Gas
1. Injury/Damage provision based upon ten year average	$ 1,549,512	$ 659,362
2. Injury/Damage expenses incurred during the 12 months ended June 30, 2005	1,802,099	407,209
3. Adjustment	$ (252,587)	$ 252,153

Year	Electric *	Gas *	CPI-All Urban Consumers	Adjusted Electric	Adjusted Gas
2005	$ 1,802,099	$ 407,209	1.0000	$ 1,802,099	$ 407,209
2004	1,326,433	384,722	1.0296	1,365,695	396,110
2003	1,303,019	349,057	1.0571	1,377,421	368,988
2002	3,369,044	354,333	1.0812	3,642,610	383,105
2001	726,180	323,911	1.0982	797,491	355,719
2000	1,750,482	770,436	1.1295	1,977,169	870,207
1999	1,912,057	1,048,283	1.1675	2,232,327	1,223,870
1998	1,666,969	757,523	1.1933	1,989,194	903,952
1997	1,286,765	607,735	1.2118	1,559,302	736,453
1996	(1,006,929)	764,769	1.2396	(1,248,189)	948,008
Total				$15,495,119	$ 6,593,621
Ten Year Average				$ 1,549,512	$ 659,362

* NOTE: 2005 expenses are for the 12 months ended June 30, 2005.
All other years expenses are for the calendar year.

Blake Exhibit 1
Reference Schedule 1.32
Sponsoring Witness: Kent Blake

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Reflect Representative Level of Off-System Sales Margins
For the Twelve Months Ended June 30, 2005

1. Off-System Sales margin based upon five year average	$ 40,490,496
2. Off-System Sales margin incurred during the 12 months ended June 30, 2005	48,063,718
3. Adjustment	(7,573,222)

	OSS Revenue	OSS Expenses	MISO Net RSG Margin	OSS Margin
2005	231,541,747	182,335,370	1,142,659	48,063,718
2004	191,572,314	147,801,959		43,770,355
2003	175,861,484	132,790,860		43,070,624
2002	118,082,196	91,457,223		26,624,973
2001	120,585,650	79,662,841		40,922,809
Total				$ 202,452,479
Five Year Average				$ 40,490,496

NOTE: 2005 values are for the 12 months ended June 30, 2005.
All other years values are for the calendar year.

Blake Exhibit 1
Reference Schedule 1.40
Sponsoring Witness: Kent Blake

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Annualize Year-End Customers
At June 30, 2005

	Electric	Gas
1. Revenue adjustment	$ 2,882,415	$ 454,500
2. Expense adjustment	1,410,942	260,994
3. Net adjustment	$ 1,471,473	$ 193,506

Blake Exhibit 1
Reference Schedule 1.41
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment To Reflect Annualized Depreciation Expenses Under Current Rates
At June 30, 2005

	Electric	Gas
1. Depreciation expense per books excluding ARO and post-1995 ECR	$ 98,245,097	$ 17,195,518
2. Annualized depreciation expense with current rates	98,798,151	18,019,334
3. Total Adjustment to reflect annualized depreciation expense	$ 553,054	$ 823,816

NOTE: Common depreciation was allocated 74% to electric and 26% to gas pursuant to common utility plant study.

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Reflect Increases in Labor and Labor-Related Costs
As Applied to the Twelve Months Ended June 30, 2005

	Electric (1)	Gas (2)	Total (3)
1. Wages (Page 2)	$ 2,134,922	$ 602,158	$ 2,737,080
2. Payroll Taxes (Page 3)	160,264	45,203	205,467
3. 401(k) (Page 4)	41,204	11,622	52,826
4. Total	$ 2,336,390	$ 658,983	$ 2,995,373

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Reflect Increases in Labor and Labor-Related Costs
As Applied to the Twelve Months Ended June 30, 2005

		Operating	Construction/ Other	Total
1.	Labor for 12 months ended June 30, 2005:			
2.	Base	$ 39,269,158	$ 8,808,930	$ 48,078,088
3.	Overtime and Premium	8,359,559	$ 1,905,162	10,264,721
4.	TIA	4,089,240	813,818	4,903,058
5.	Total Labor	$ 51,717,957	$ 11,527,910	$ 63,245,867
6.	Total Operating and Construction/Other %	81.8%	18.2%	100.0%

			Employees	
7.	Annualized base labor at June 30, 2005:			
8.	Union		623	$ 32,467,552
9.	Exempt		192	14,630,900
10.	Non-Exempt		74	2,955,614
11.	Total Annualized Labor		889	50,054,066
12.	Union Wage Increase Effective November 10, 2005 (Line 8 x 3%)			974,027
13.	Union Overtime/Premiums (a)			9,957,125
14.	Union wage increase applied to union overtime/premiums (Line 13 x 3%)			298,714
15.	Non-Exempt overtime (a)			307,596
16.	TIA - Exempt/Non-Exempt/Union (a)			4,903,058
17.	Union wage increase applied to union TIA (Sum of Lines 12 and 14 x 6%)			76,364
18.	Total Annualized Labor			$ 66,570,950
19.	Operating Labor for 12 months ended June 30, 2005			$ 51,717,957
20.	Operating Labor based on annualized labor $ 66,570,950 x	81.8%		54,455,037
21.	Labor Adjustment Total			$ 2,737,080
22.	Electric Department (a)	78%		$ 2,134,922
23.	Gas Department (a)	22%		602,158
24.	Total			$ 2,737,080

(a) Represents actual numbers taken from the Company's financial records for the 12 months ended June 30, 2005.

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustments to Reflect Increases in Payroll Taxes
As Applied to the Twelve Months Ended June 30, 2005

1. Operating Labor increase (Page 2 Line 24)		$	2,737,080
2. Percentage of wages that do not exceed Social Security (OASDI) limit			97.69%
3. Operating Labor increase subject to Social Security tax		$	2,673,853
4. Medicare Tax (Line 1 x 1.45%)		$	39,688
5. Social Security Tax (Line 3 x 6.2%)			165,779
6. Payroll Tax adjustment		$	205,467
7. Electric Department	78%	$	160,264
8. Gas Department	22%		45,203
9. Total		$	205,467

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Reflect Increases in Company Match of 401(k)
As Applied to the Twelve Months Ended June 30, 2005

Line	Description	%	Amount
1.	Direct total payroll for 12 months ended 06/30/05 (Page 2 Line 5)		$ 63,245,867
2.	Total 401(k) Company Match for 12 months ended 06/30/05		$ 1,223,355
3.	401(k) Company Match as a percent of payroll		1.93%
4.	Operating Labor increase (Page 2 Line 24)		2,737,080
5.	401(k) Company Match operating increase (Line 3 x Line 4)		$ 52,826
6.	Electric Department	78%	$ 41,204
7.	Gas Department	22%	11,622
8.	Total		$ 52,826

Blake Exhibit 1
Reference Schedule 1.43
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Annualize MISO Schedules 16 and 17
For the Twelve Months Ended June 30, 2005

	Electric
1. Actual MISO Schedules 16 and 17 incurred in the 12 months ended June 30, 2005 (April, May, and June 2005)	$ 731,924
2. Actual MISO Schedules 16 and 17 incurred in July and August 2005	649,624
3. Average MISO Schedules 16 and 17 monthly amount [(Line 1 + Line 2) / 5)	276,310
4. MISO Schedules 16 and 17 annual amount (Line 3 x 12)	3,315,720
5. MISO Schedules 16 and 17 incurred during 12 months ended June 30, 2005	731,924
6. MISO Schedules 16 and 17 annualization adjustment (Line 4 - Line 5)	$ 2,583,796

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Annualize MISO Revenue Neutrality Uplift
For the Twelve Months Ended June 30, 2005

1.	Actual MISO Revenue Neutrality Uplift incurred in the 12 months ended June 30, 2005 (April, May, and June 2005)	$ 2,760,186
2.	Actual MISO Revenue Neutrality Uplift incurred in July and August 2005	3,713,494
3.	Average MISO Revenue Neutrality Uplift monthly amount [(Line 1 + Line 2)/ 5]	1,294,736
4.	MISO Revenue Neutrality Uplift annual amount (Line 3 x 12)	15,536,832
5.	MISO Revenue Neutrality Uplift incurred during 12 months ended June 30, 2005	2,760,186
6.	MISO Revenue Neutrality Uplift annualization adjustment (Line 4 - Line 5)	$ 12,776,646

Blake Exhibit 1
Reference Schedule 1.45
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Annualize MISO Revenue Sufficiency Guarantee
For the Twelve Months Ended June 30, 2005

Revenue	April-June 2005	July-August 2005	
1. RSG Make Whole Payments	$ 5,817,280	$ 3,742,464	$ 9,559,744
2. RSG Make Whole Payment monthly amount (Line 1 / 5)			1,911,949
3. RSG Make Whole Payment annual amount (Line 2 x 12)			22,943,388
4. RSG Make Whole Payments earned during 12 months ended June 30, 2005 (Line 1 for April-June 2005)			5,817,280
5. Annualized Revenue Adjustment (Line 3 - Line 4)			$ 17,126,108
Expenses			
6. Production cost for RSG Payments	4,674,621	2,498,517	$ 7,173,138
7. RSG Distribution Amount	1,838,937	2,591,492	4,430,429
8. Monthly Expense amount [(Line 6 + Line 7) / 5]			2,320,713
9. Annual Expense Amount (Line 8 x 12)			27,848,556
10. MISO RSG Expenses incurred during 12 months ended June 30, 2005 (Line 6 + Line 7 for April-June 2005)			6,513,558
11. Annualized Expense Adjustment (Line 9 - Line 10)			$ 21,334,998
12. Net Adjustment (Line 5 - Line 11)			$ (4,208,890)

Blake Exhibit 1
Reference Schedule 1.50
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment for Reclassification of MISO Revenue Sufficiency Guarantee
For the Twelve Months Ended June 30, 2005

	(1) RSG based on Generating Unit Ownership	(2) RSG based on Off-System Sales	(3) Adjustment (Col 1 - Col 2)
1. April 2005	$ 183,445	$ 1,245,040	$ (1,061,595)
2. May 2005	1,359,466	2,716,931	(1,357,465)
3. June 2005	4,274,369	8,583,269	(4,308,900)
4. Total	$ 5,817,280	$ 12,545,240	$ (6,727,960)

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment for VDT Net Savings to Shareholder
For the Twelve Months Ended June 30, 2005

	Electric	Gas
1. Adjustment to reflect VDT Net Shareholder Savings	$ 9,240,000	$ 2,490,000
2. Adjustment to remove VDT Net Shareholder Savings	$(9,240,000)	$(2,490,000)

Electric:		
2004 Shareholder's portion of VDT Savings	$ 8,460,000	
July - December 2004 (50%)	4,230,000	$ 4,230,000
2005 Shareholder's portion of VDT Savings	10,020,000	
January - June 2005 (50%)	5,010,000	5,010,000
		$ 9,240,000

Gas:		
2004 Shareholder's portion of VDT Savings	$ 2,280,000	
July - December 2004 (50%)	1,140,000	$ 1,140,000
2005 Shareholder's portion of VDT Savings	2,700,000	
January - June 2005 (50%)	1,350,000	1,350,000
		$ 2,490,000

Blake Exhibit 1
Reference Schedule 1.61
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment to Remove VDT Surcredit and Cost Amortization
For the Twelve Months Ended June 30, 2005

	Electric	Gas
1. Actual Value Delivery Surcredit refunded	$ (6,113,935)	$ (1,691,828)
2. Value Delivery Surcredit revenue adjustment	$ 6,113,935	$ 1,691,828
3. VDT cost amortization	$ 23,806,460	$ 6,328,300
4. VDT cost adjustment	$ (23,806,460)	$ (6,328,300)
5. Total adjustment	$ 29,920,395	$ 8,020,128

Blake Exhibit 1
Reference Schedule 1.70
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Calculation of Composite Federal and Kentucky Income Tax Rate (Based on Law in Effect June 30, 2005)

1. Assume pre-tax income of		$ 100.0000
2. State income tax at 7.00%		7.0000
3. Taxable income for Federal income tax		93.0000
4. Federal income tax at 35% (Line 3 x 35%)		32.5500
5. Total State and Federal income taxes (Line 2 + Line 4)		$ 39.5500
6. Therefore, the composite rate is:		
7. Federal	32.5500%	
8. State	7.0000%	
9. Total	39.5500%	

Blake Exhibit 1
Reference Schedule 1.71
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Calculation of Current Tax Adjustment Resulting From "Interest Synchronization"

	Electric	Gas
1. Adjusted Capitalization - Exhibit 2	$ 1,544,192,592	$ 345,230,511
2. Weighted Cost of Debt	1.79%	1.79%
3. "Interest Synchronization"	27,641,047	6,179,626
4. Interest per books (excluding other interest)	27,560,212	5,717,595
5. "Interest Synchronization" adjustment	$ (80,835)	$ (462,031)
6. Composite Federal and State tax rate	39.5500%	39.5500%
7. Current tax adjustment from "Interest Synchronization"	$ (31,970)	$ (182,733)

Blake Exhibit 1
Reference Schedule 1.72
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment for Prior Period Income Tax True-Ups and Adjustments
For the Twelve Months Ended June 30, 2005

	Electric	Gas
1. 2003 Income Tax True-up:		
2. Federal Tax (benefit)	$ (21,541)	$ 24,737
3. State Tax (benefit)	(339,793)	(87,732)
4. Total 2003 Income Tax True-up	$ (361,334)	$ (62,995)
5. 2004 and 2005 Other Tax adjustments:		
6. Kentucky Coal Credit	$ (167,051)	$ -
7. Misc. operating tax adjustments	(34,421)	(6,138)
8. KY Tax Rate Decrease	(123,000)	98,000
9. Total 2004 and 2005 Other Tax adjustments	$ (324,472)	$ 91,862
10. Total adjustments (Line 4 + Line 9)	$ (685,806)	$ 28,867
11. Adjustment	$ 685,806	$ (28,867)

Blake Exhibit 1
Reference Schedule 1.73
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Adjustment for Tax Deduction for Manufacturing Activities (TDMA)
For the Twelve Months Ended June 30, 2005

1. TDMA Annual Amount for 2005	$ 4,000,000
2. TDMA included in 12 months ended June 30, 2005	2,000,000
3. TDMA Adjustment Amount (Line 1 - Line 2)	$ 2,000,000
4. TDMA Adjustment	$ (2,000,000)
5. Composite Federal and State tax rate	39.5500%
6. TDMA Income Tax Adjustment	$ (791,000)

Blake Exhibit 1
Reference Schedule 1.74
Sponsoring Witness: Valerie Scott

LOUISVILLE GAS AND ELECTRIC COMPANY

Calculation of Revenue Gross Up Factor
(Based on Law in Effect June 30, 2005)

1. Assume pre-tax income of	$	100.000000
2. Bad Debt at .27%		0.270000
3. PSC Assessment at .167%		0.167000
4. Taxable income for State income tax		99.563000
5. State income tax at 7.00%		6.969410
6. Taxable income for Federal income tax		92.593590
7. Federal income tax at 35%		32.407757
8. Total Bad Debt, PSC Assessment, State and Federal income taxes (Line 2 + Line 3 + Line 5 + Line 7)		39.814167
9. Assume pre-tax income of	$	100.000000
10. Gross Up Revenue Factor		60.185833

NOTE: Bad debt percent is percent of net charge-offs to revenue for the 12 months ended June 30, 2005.

LOUISVILLE GAS AND ELECTRIC COMPANY

Capitalization at June 30, 2005

	Per Books 6-30-05 (1)	Capital Structure (2)	Rate Base Percentage (Exhibit 3 Line 24) (3)	Capitalization (Col 1 x Col 3) (4)	Adjustments to Capitalization (Col 7, Pg 2) (5)	Adjusted Capitalization (6)	Adjusted Capital Structure (7)	Annual Cost Rate (8)	Cost of Capital (Col 8 x Col 7) (9)
ELECTRIC									
1. Short Term Debt	$ 20,755,000	1.08%	82.06%	$ 17,031,553	$ (299,536)	$ 16,732,017	1.08%	3.060%	0.03%
2. Long Term Debt	821,804,000	42.90%	82.06%	674,372,362	(11,898,219)	662,474,143	42.90%	4.102%	1.76%
3. Preferred Stock	70,424,594	3.68%	82.06%	57,790,422	(1,020,640)	56,769,782	3.68%	4.296%	0.16%
4. Common Equity	1,002,599,354	52.34%	82.06%	822,733,030	(14,516,380)	808,216,650	52.34%	10.000% - 10.500% - 11.000%	5.23% - 5.50% - 5.76%
5. Total Capitalization	$1,915,582,948	100.00%		$1,571,927,367	$ (27,734,775)	$1,544,192,592	100.00%		7.18% - 7.45% - 7.71%
GAS									
1. Short Term Debt	$ 20,755,000	1.08%	17.94%	$ 3,723,447	$ 17,009	$ 3,740,456	1.08%	3.060%	0.03%
2. Long Term Debt	821,804,000	42.90%	17.94%	147,431,638	675,645	148,107,283	42.90%	4.102%	1.76%
3. Preferred Stock	70,424,594	3.68%	17.94%	12,634,172	57,957	12,692,129	3.68%	4.296%	0.16%
4. Common Equity	1,002,599,354	52.34%	17.94%	179,866,324	824,319	180,690,643	52.34%	10.000% - 10.500% - 11.000%	5.23% - 5.50% - 5.76%
5. Total Capitalization	$1,915,582,948	100.00%		$ 343,655,581	$ 1,574,930	$ 345,230,511	100.00%		7.18% - 7.45% - 7.71%

LOUISVILLE GAS AND ELECTRIC COMPANY

Capitalization at June 30, 2005

	Capitalization (Col 4, Pg 1) (1)	Capital Structure (2)	Trimble County Inventories (a) (Col 2 x Col 3 Line 5) (3)	Investments in OVEC (Col 2 x Col 4 Line 5) (4)	JDIC (Col 2 x Col 5 Line 5) (5)	Environmental Surcharge Post '95 Plan (Col 2 x Col 6 Line 5) (6)	Total Adjustments To Capital (7)
ELECTRIC							
1. Short Term Debt	$ 17,031,553	1.08%	$ (23,870)	$ (6,418)	$ 459,523	$ (728,771)	$ (299,536)
2. Long Term Debt	674,372,362	42.90%	(948,172)	(254,949)	18,253,286	(28,948,384)	(11,898,219)
3. Preferred Stock	57,790,422	3.68%	(81,335)	(21,870)	1,565,783	(2,483,218)	(1,020,640)
4. Common Equity	822,733,030	52.34%	(1,156,814)	(311,049)	22,269,860	(35,318,377)	(14,516,380)
5. Total Capitalization	$1,571,927,367	100.00%	$ (2,210,191)	$ (594,286)	$ 42,548,452	$ (67,478,750)	$ (27,734,775)
GAS							
1. Short Term Debt	$ 3,723,447	1.08%	$ -	$ -	$ 17,009	$ -	$ 17,009
2. Long Term Debt	147,431,638	42.90%	-	-	$ 675,645	-	$ 675,645
3. Preferred Stock	12,634,172	3.68%	-	-	$ 57,957	-	$ 57,957
4. Common Equity	179,866,324	52.34%	-	-	$ 824,319	-	$ 824,319
5. Total Capitalization	$ 343,655,581	100.00%	$ -	$ -	$ 1,574,930	$ -	$ 1,574,930

(a) Trimble County Inventories @ 6/30/05

Stores	$ 3,697,411
Stores Expense	611,056
Coal	4,247,845
Limestone	126,240
Fuel Oil	153,671
Emission Allowances	4,542
Total Trimble County Inventories	$ 8,840,765
Multiplied by Disallowed Portion	25.00%
Trimble County Inv. Disallowed	$ 2,210,191

LOUISVILLE GAS AND ELECTRIC COMPANY

Net Original Cost Rate Base as of June 30, 2005

	Electric (1)	Gas (2)	Total (3)
1. Utility Plant at Original Cost (a)	$ 3,391,366,190	$ 575,408,231	$ 3,966,774,421
2. Deduct:			
3. Reserve for Depreciation (a)	1,471,390,161	204,214,632	1,675,604,793
4. Net Utility Plant	1,919,976,029	371,193,599	2,291,169,628
5. Deduct:			
6. Customer Advances for Construction	540,939	9,139,440	9,680,379
7. Accumulated Deferred Income Taxes (a)(b)	295,232,860	45,611,075	340,843,935
8. FAS 109 Deferred Income Taxes	49,355,423	4,884,411	54,239,834
9. Asset Retirement Obligation-Net Assets	3,269,908	-	3,269,908
10. Asset Retirement Obligation-Liabilities	(10,616,823)	-	(10,616,823)
11. Asset Retirement Obligation-Regulatory Assets	7,286,460	-	7,286,460
12. Asset Retirement Obligation-Regulatory Liabilities	(155,364)	-	(155,364)
13. Reclassification of Accumulated Depreciation associated with Cost of Removal for underlying ARO Assets	553,644	-	553,644
14. Investment Tax Credit (prior law)	2,103	-	2,103
15. Total Deductions	345,469,150	59,634,926	405,104,076
16. Net Plant Deductions	1,574,506,879	311,558,673	1,886,065,552
17. Add:			
18. Materials and Supplies (c)(e)(f)	46,358,782	47,526	46,406,308
19. Gas Stored Underground (c)	-	48,887,093	48,887,093
20. Prepayments (c)(d)	2,083,402	304,235	2,387,637
21. Cash Working Capital (page 2)	57,211,316	6,593,668	63,804,984
22. Total Additions	105,653,500	55,832,522	161,486,022
23. Total Net Original Cost Rate Base	$ 1,680,160,379	$ 367,391,195	$ 2,047,551,574
24. Electric and Gas Net Original Cost Rate Base Percentage	82.06%	17.94%	100.00%

(a) Common utility plant and the reserve for depreciation are allocated 74% to the Electric Department and 26% to the Gas Department based on December 31, 2004 study.

(b) Excludes supplemental retirement-related deferred taxes.

(c) Average for 13 months.

(d) Excludes PSC fees.

(e) Excludes 25% of Trimble County inventories.

(f) Includes emission allowances.

LOUISVILLE GAS AND ELECTRIC COMPANY

Calculation of Cash Working Capital
As of June 30, 2005

	Electric (1)	Gas (2)	Total (3)
1. Operating and maintenance expense for the 12 months ended June 30, 2005	$ 570,707,319	$ 328,063,360	$ 898,770,679
2. Deduct:			
3. Electric Power Purchased	113,016,792		113,016,792
4. Gas Supply Expenses		275,314,019	275,314,019
5. Total Deductions	$ 113,016,792	$ 275,314,019	$ 388,330,811
6. Remainder (Line 1 - Line 5)	$ 457,690,527	$ 52,749,341	$ 510,439,868
7. Cash Working Capital (12 1/2% of Line 6)	$ 57,211,316	$ 6,593,668	$ 63,804,984

LOUISVILLE GAS AND ELECTRIC COMPANY

Calculation of Overall Revenue Deficiency/(Sufficiency) at June 30, 2005

	ELECTRIC (1)				
			ROE RANGE		
SECTION I - VALUE DELIVERY SURCREDIT EFFECTIVE	10.00%	-	10.50%	-	11.00%
1. Adjusted Electric Capitalization (Exhibit 2, Col 6)	$1,544,192,592		$1,544,192,592		$1,544,192,592
2. Total Cost of Capital (Exhibit 2, Col 9)	7.18%	-	7.45%	-	7.71%
3. Net Operating Income Found Reasonable (Line 1 x Line 2)	$ 110,873,028	-	$ 115,042,348	-	$ 119,057,249
4. Pro-forma Net Operating Income prior to Value Delivery Surcredit expiration	89,499,158		89,499,158		89,499,158
5. Net Operating Income Deficiency/(Sufficiency) prior to Value Delivery Surcredit expiration	$ 21,373,870	-	$ 25,543,190	-	$ 29,558,091
6. Gross Up Revenue Factor - Blake Exhibit 1, Reference Schedule 1.74	0.60185833		0.60185833		0.60185833
7. Overall Revenue Deficiency/(Sufficiency) prior to Value Delivery Surcredit expiration	$ 35,513,125	-	$ 42,440,536	-	$ 49,111,376
SECTION II - VALUE DELIVERY SURCREDIT EXPIRED					
1. Adjusted Electric Capitalization (Exhibit 2, Col 6)	$1,544,192,592		$1,544,192,592		$1,544,192,592
2. Total Cost of Capital (Exhibit 2, Col 9)	7.18%	-	7.45%	-	7.71%
3. Net Operating Income Found Reasonable (Line 1 x Line 2)	$ 110,873,028	-	$ 115,042,348	-	$ 119,057,249
4. Pro-forma Net Operating Income for expiration of Value Delivery Surcredit	113,171,617		113,171,617		113,171,617
5. Net Operating Income Deficiency/(Sufficiency) for expiration of Value Delivery Surcredit	$ (2,298,589)	-	$ 1,870,731	-	$ 5,885,632
6. Gross Up Revenue Factor - Blake Exhibit 1, Reference Schedule 1.74	0.60185833		0.60185833		0.60185833
7. Overall Revenue Deficiency/(Sufficiency) for expiration of Value Delivery Surcredit	$ (3,819,153)	-	$ 3,108,258	-	$ 9,779,099

LOUISVILLE GAS AND ELECTRIC COMPANY

Calculation of Overall Revenue Deficiency/(Sufficiency) at June 30, 2005

	GAS (1)				
			ROE RANGE		
SECTION I - VALUE DELIVERY SURCREDIT EFFECTIVE	10.00%	-	10.50%	-	11.00%
1. Adjusted Gas Capitalization (Exhibit 2, Col 6)	$ 345,230,511		$ 345,230,511		$ 345,230,511
2. Total Cost of Capital (Exhibit 2, Col 9)	7.18%	-	7.45%	-	7.71%
3. Net Operating Income Found Reasonable (Line 1 x Line 2)	$ 24,787,551	-	$ 25,719,673	-	$ 26,617,272
4. Pro-forma Net Operating Income prior to Value Delivery Surcredit expiration	13,961,988		13,961,988		13,961,988
5. Net Operating Income Deficiency/(Sufficiency) prior to Value Delivery Surcredit expiration	$ 10,825,563	-	$ 11,757,685	-	$ 12,655,284
6. Gross Up Revenue Factor - Blake Exhibit 1, Reference Schedule 1.74	0.60185833		0.60185833		0.60185833
7. Overall Revenue Deficiency/(Sufficiency) prior to Value Delivery Surcredit expiration	$ 17,986,895	-	$ 19,535,636	-	$ 21,027,015
SECTION II - VALUE DELIVERY SURCREDIT EXPIRED					
1. Adjusted Gas Capitalization (Exhibit 2, Col 6)	$ 345,230,511		$ 345,230,511		$ 345,230,511
2. Total Cost of Capital (Exhibit 2, Col 9)	7.18%	-	7.45%	-	7.71%
3. Net Operating Income Found Reasonable (Line 1 x Line 2)	$ 24,787,551	-	$ 25,719,673	-	$ 26,617,272
4. Pro-forma Net Operating Income for expiration of Value Delivery Surcredit	20,315,360		20,315,360		20,315,360
5. Net Operating Income Deficiency/(Sufficiency) for expiration of Value Delivery Surcredit	$ 4,472,191	-	$ 5,404,313	-	$ 6,301,912
6. Gross Up Revenue Factor - Blake Exhibit 1, Reference Schedule 1.74	0.60185833		0.60185833		0.60185833
7. Overall Revenue Deficiency/(Sufficiency) for expiration of Value Delivery Surcredit	$ 7,430,637	-	$ 8,979,377	-	$ 10,470,756

LOUISVILLE GAS AND ELECTRIC COMPANY

Electric Rate of Return on Common Equity
For the Twelve Months Ended June 30, 2005

Section I - Value Delivery Surcredit Effective

	Adjusted Electric Capitalization (Exhibit 2 Col 6) (1)	Percent of Total (2)	Annual Cost Rate (Exhibit 2 Col 8) (3)	Weighted Cost of Capital (Col 2 x Col 3) (4)
1. Short Term Debt	$16,732,017	1.08%	3.06%	0.03%
2. Long Term Debt	$662,474,143	42.90%	4.10%	1.76%
3. Preferred Stock	$56,769,782	3.68%	4.30%	0.16%
4. Common Equity	$808,216,650	52.34%	7.36% (a)	3.85% (b)
5.	$1,544,192,592	100.00%		5.80%

6. Pro-forma Net Operating Income prior to Value Delivery Surcredit expiration	$89,499,158	(c)
7. Net Operating Income / Total Capitalization	5.80%	(e)

Section II - Value Delivery Surcredit Expired

	Adjusted Electric Capitalization (Exhibit 2 Col 6) (1)	Percent of Total (2)	Annual Cost Rate (Exhibit 2 Col 8) (3)	Weighted Cost of Capital (Col 2 x Col 3) (4)
1. Short Term Debt	$16,732,017	1.08%	3.06%	0.03%
2. Long Term Debt	$662,474,143	42.90%	4.10%	1.76%
3. Preferred Stock	$56,769,782	3.68%	4.30%	0.16%
4. Common Equity	$808,216,650	52.34%	10.28% (a)	5.38% (b)
5.	$1,544,192,592	100.00%		7.33%

6. Pro-forma Net Operating Income for expiration of Value Delivery Surcredit	$113,171,617	(d)
7. Net Operating Income / Total Capitalization	7.33%	(e)

Notes: (a) - Column 4, Line 4 / Column 2, Line 4
(b) - Column 4, Line 5 - Line 1 - Line 2 - Line 3
(c) - Exhibit 1, Line 31, Column 4
(d) - Exhibit 1, Line 38, Column 4
(e) - Column 4, Line 6 divided by Column 1, Line 5

LOUISVILLE GAS AND ELECTRIC COMPANY

Gas Rate of Return on Common Equity
For the Twelve Months Ended June 30, 2005

Section I - Value Delivery Surcredit Effective

	Adjusted Gas Capitalization (Exhibit 2 Col 6) (1)	Percent of Total (2)	Annual Cost Rate (Exhibit 2 Col 8) (3)		Weighted Cost of Capital (Col 2 x Col 3) (4)	
1. Short Term Debt	$3,740,456	1.08%	3.06%		0.03%	
2. Long Term Debt	$148,107,283	42.90%	4.10%		1.76%	
3. Preferred Stock	$12,692,129	3.68%	4.30%		0.16%	
4. Common Equity	$180,690,643	52.34%	3.99%	(a)	2.09%	(b)
5.	$345,230,511	100.00%			4.04%	

6. Pro-forma Net Operating Income prior to Value Delivery Surcredit expiration	$13,961,988	(c)
7. Net Operating Income / Total Capitalization	4.04%	(e)

Section II - Value Delivery Surcredit Expired

	Adjusted Gas Capitalization (Exhibit 2 Col 6) (1)	Percent of Total (2)	Annual Cost Rate (Exhibit 2 Col 8) (3)		Weighted Cost of Capital (Col 2 x Col 3) (4)	
1. Short Term Debt	$3,740,456	1.08%	3.06%		0.03%	
2. Long Term Debt	$148,107,283	42.90%	4.10%		1.76%	
3. Preferred Stock	$12,692,129	3.68%	4.30%		0.16%	
4. Common Equity	$180,690,643	52.34%	7.51%	(a)	3.93%	(b)
5.	$345,230,511	100.00%			5.88%	

6. Pro-forma Net Operating Income for expiration of Value Delivery Surcredit	$20,315,360	(d)
7. Net Operating Income / Total Capitalization	5.88%	(e)

Notes: (a) - Column 4, Line 4 / Column 2, Line 4
(b) - Column 4, Line 5 - Line 1 - Line 2 - Line 3
(c) - Exhibit 1, Line 31, Column 7
(d) - Exhibit 1, Line 38, Column 7
(e) - Column 4, Line 6 divided by Column 1, Line 5

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY FOR THE	)	**CASE NO. 2005-00352**
VALUE DELIVERY SURCREDIT	)	
MECHANISMS	)	

TESTIMONY OF
VALERIE L. SCOTT
CONTROLLER
LOUISVILLE GAS AND ELECTRIC COMPANY

Filed: September 30, 2005

1 **Q. Please state your name, position and business address.**

2 A. My name is Valerie L. Scott. I am the Controller for LG&E Energy LLC and
3 Louisville Gas and Electric Company ("LG&E" or "the Company"). I am employed
4 by LG&E Energy Services Inc. which provides services to LG&E. My business
5 address is 220 West Main Street, Louisville, Kentucky. A statement of my
6 professional history and education is attached as an appendix hereto.

7 **Q. Have you previously testified before this Commission?**

8 A. Yes. I have previously testified before this Commission in rate and environmental
9 surcharge proceedings.

10 **Q. What is the purpose of your testimony?**

11 A. The purpose of my testimony is to review LG&E's accounting records and support
12 certain pro forma adjustments to LG&E's net operating income for the twelve months
13 ended June 30, 2005. The pro forma adjustments are described on the Reference
14 Schedules attached to Blake Exhibit 1. My testimony demonstrates that these
15 adjustments are known and measurable and, therefore, reasonable.

16 **Accounting Records**

17 **Q. Are the accounting records of LG&E kept in accordance with the Uniform**
18 **System of Accounts prescribed by the Federal Energy Regulatory Commission**
19 **and adopted by the Kentucky Public Service Commission?**

20 A. Yes. The records are kept in accordance with the Uniform System of Accounts
21 prescribed for electric and gas public utilities.

22 **Q. Does LG&E file monthly and annual operating reports presenting financial**
23 **results with the Kentucky Public Service Commission?**

1 A. Yes.

2 **Q. Is an audit of the financial statements of LG&E performed annually by**
3 **independent public accountants?**

4 A. Yes. PricewaterhouseCoopers audits LG&E's financial statements annually.

5 <u>**Electric Net Operating Income**</u>

6 **Q. Please explain the adjustment to operating revenues shown in Reference**
7 **Schedule 1.13 of Blake Exhibit 1.**

8 A. This adjustment has been made to eliminate the impact of the revenues accrued, but
9 unbilled, in the twelve months ended June 30, 2005, associated with the
10 Environmental Cost Recovery and Fuel Adjustment Clause. These amounts were
11 accrued in Rate Refund Account 449 during the six months ended December 31,
12 2004, and in Accounts 440 through 445, based on the customer class, during the six
13 months ended June 30, 2005. LG&E has recorded accruals for Fuel Adjustment
14 Clause revenues in the financial statements to better match revenues and expenses in
15 the month they occur, eliminating the two month lag in billing or refunding
16 customers for actual fuel clause expenses. The Environmental Cost Recovery accrual
17 records additional amounts to be billed or refunded to customers due to differences in
18 actual cost of capital versus authorized cost of capital and differences in actual non-
19 Environmental Cost Recovery revenue and the twelve month average of non-
20 Environmental Cost Recovery revenue. These differences in cost of capital and
21 revenue have historically been adjusted in the six month Environmental Cost
22 Recovery review proceedings held by the Commission. The impact of rate
23 mechanisms, such as these, should be removed from the revenues for the twelve

1 months ended June 30, 2005, when assessing the adequacy of base rates. The
2 adjustment is calculated in accordance with the Commission's determination in its
3 Order of June 30, 2004 in Case No. 2003-00433.

4 **Q. Please explain the adjustment to operating revenues and expenses shown in**
5 **Reference Schedule 1.14 of Blake Exhibit 1.**

6 A. This adjustment is made to reflect the customers' and shareholder's portions of the
7 merger savings in accordance with the Settlement Agreement approved by the
8 Commission's October 16, 2003 Order in Case No. 2002-00430 and in accordance
9 with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-
10 00433. The customers' portion of the savings is adjusted to equal the amount
11 attributed to the shareholder to reflect the 50/50 saving split per the Settlement
12 Agreement. The shareholder's portion is adjusted by adding the settlement agreed
13 upon amount to operating expenses in the twelve months ended June 30, 2005.
14 Absent this adjustment, the shareholder would lose its share of such savings that were
15 approved by the Commission in its Orders.

16 **Q. Please explain the adjustment to operating revenues and expenses shown in**
17 **Reference Schedule 1.21 of Blake Exhibit 1.**

18 A. This adjustment has been made to eliminate brokered electric sales revenues and
19 expenses as directed by the Commission in Case No. 98-426. Brokered transactions
20 do not utilize company generation or transmission assets; accordingly, the related
21 revenues and expenses are eliminated in determining base rates. The adjustment is
22 calculated in accordance with the Commission's determination in its Order of June
23 30, 2004 in Case No. 2003-00433.

1 **Q. Please explain the adjustment to operating expenses shown in Reference**
2 **Schedule 1.22 of Blake Exhibit 1.**
3 A. This adjustment eliminates advertising expenses. Commission regulation 807 KAR
4 5:016, Section 2(1) provides that a utility will be allowed to recover, for ratemaking
5 purposes, only those advertising expenses which produce a "material benefit" to its
6 ratepayers. The advertising expenses eliminated by this adjustment are primarily
7 institutional and promotional in nature. The adjustment is calculated in accordance
8 with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-
9 00433.
10 **Q. Please explain the adjustment to operating expenses shown in Reference**
11 **Schedule 1.30 of Blake Exhibit 1.**
12 A. This adjustment has been made to reflect a normalized level of storm damage
13 expenses based upon a ten-year average adjusted for inflation. This adjustment is
14 calculated in accordance with the methodology approved by the Commission in its
15 Order of June 30, 2004 in Case No. 2003-00433.
16 **Q. Please explain the adjustment to operating expenses shown in Reference**
17 **Schedule 1.31 of Blake Exhibit 1.**
18 A. This adjustment has been made to normalize the expense levels in Account 925
19 "Injuries and Damages" based upon a ten-year average adjusted for inflation. The
20 adjustment is calculated in accordance with the methodology approved by the
21 Commission in its Order of June 30, 2004 in Case No. 2003-00433.
22 **Q. Please explain the adjustment to operating expenses shown in Reference**
23 **Schedule 1.41 of Blake Exhibit 1.**

1 A. This adjustment has been made to reflect annualized depreciation expenses. This
2 adjustment calculates annual depreciation expense by multiplying the plant in service
3 at June 30, 2005 (exclusive of Asset Retirement Obligations and post-1995
4 Environmental Cost Recovery assets) by the depreciation rates currently in effect.
5 LG&E's current depreciation rates were approved in Case No. 2001-00141 based on
6 a settlement, and the depreciation study filed in that case was based on plant in
7 service as of December 31, 1999. The adjustment is calculated in accordance with the
8 methodology approved by the Commission in its Order of June 30, 2004 in Case No.
9 2003-00433.

10 **Q. Please explain the adjustment to operating expenses shown in Reference**
11 **Schedule 1.42 of Blake Exhibit 1.**

12 A. This adjustment has been made to reflect increases in labor and labor-related costs as
13 applied to the twelve months ended June 30, 2005, and includes specific adjustments
14 for wages, payroll taxes and LG&E 401(k) match. Page 1 of 4 presents an overview
15 of the adjustment.

16 Page 2 of 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the
17 adjustment for wage expenses. The adjustment reflects the annualized base labor of
18 all LG&E employees as of June 30, 2005, and it includes new union contract rates
19 expected to be effective November 10, 2005. The current union contract expires
20 November 10, 2005 and LG&E expects the replacement contract to include increases
21 consistent with the current contract terms.

22 Under the terms of the current contract, beginning November 10, 2004, union
23 employees received a three percent wage increase, which results in three percent

1 increases in overtime wages and in the Team Incentive Award ("TIA"). These same
2 increases are expected as of November 10, 2005. An adjustment has been made to
3 increase union wages, overtime and TIA for the twelve months ended June 30, 2005,
4 to recognize the impact of the expected November 10, 2005, contract increase. In
5 Case No. 2003-00433 LG&E had reduced the labor adjustment to remove the amount
6 of TIA guaranteed by E.ON to the extent that it exceeded what employees would
7 have been paid, without the guarantee. No adjustment is necessary in the current
8 labor adjustment because there was no E.ON TIA guarantee payment in the twelve
9 months ended June 30, 2005.

10 Page 3 of 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the
11 calculation of the component of the labor adjustment to reflect the increases in the
12 Federal Insurance Contributions Act ("FICA") employer payroll taxes due to the
13 increase in wages. The payroll tax increase reflects the methodology ordered by the
14 Commission in Case No. 2003-00433 in calculating the impact of the Social Security
15 wage limit.

16 Finally, page 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the
17 calculation of the component of the labor adjustment to reflect the resulting increases
18 in LG&E's match of 401(k) contributions as applied to the twelve months ended June
19 30, 2005, due to the adjustments to the increases in wages.

20 The labor adjustment follows the methodology approved by the Commission
21 in its Order of June 30, 2004 in Case No. 2003-00433.

22 **Q. Please explain the adjustment to operating expenses shown in Reference**
23 **Schedule 1.43 of Blake Exhibit 1.**

1 A. As a member of the Midwest Independent Transmission System Operator, Inc. ("MISO"), LG&E incurred charges, starting in April 2005, for Day 2 operations. Included as part of the Day 2 operations are Schedules 16 and 17 that are billed by MISO to LG&E to recover administrative costs for Financial Transmission Rights ("FTRs") and the day ahead and real time market. These charges are part of the MISO Energy Markets Tariff ("EMT") filed with and approved by the Federal Energy Regulatory Commission ("FERC"). Schedule 16 charges are based on the number of FTR megawatts times an administration rate per megawatt. Schedule 17 charges are based on the day ahead volumes bid into the market (generation, load and financial bi-lateral transactions) times an hourly energy market administration rate plus or minus the difference in volumes in the real time physical energy (generation, load and physical bi-lateral transactions) times the hourly energy market administration rate. The Schedule 16 and 17 charges began in April 2005 and are included in only three months of the twelve months ended June 30, 2005 (April – June 2005). This adjustment annualizes the twelve months ended June 30, 2005 for the Schedule 16 and 17 charges by multiplying the actual charges from MISO for the three months of April through June 2005 and for the months of July and August 2005, by twelve-fifths to arrive at a yearly charge and then subtracting the April through June 2005, amounts from the annualized yearly charge.

20 **Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1. 44 of Blake Exhibit 1.**

22 A. As a member of MISO, LG&E incurred uplift charges, starting in April 2005, for Day 2 operations pursuant to the MISO EMT filed with and approved by FERC.

1 Included as part of the uplift charges is the Revenue Neutrality Uplift charges that are
2 billed by MISO to LG&E. Because MISO is a non-profit corporation and has no
3 equity, it must collect from its members and other market participants an amount
4 equivalent to its costs. Revenue Neutrality Uplift is the amount MISO charges its
5 members for the difference between MISO's costs and its revenues. The Revenue
6 Neutrality Uplift is a balancing mechanism for charges and credits for which there
7 are no other methods of allocating to the asset owners. The charge or credit is
8 allocated to asset owners using a ratio of their share of the overall load. The Revenue
9 Neutrality Uplift charges began in April 2005, and are included in only three months
10 of the twelve months ended June 30, 2005 (April – June 2005). This adjustment
11 annualizes the twelve months ended June 30, 2005 for the Revenue Neutrality Uplift
12 charges by multiplying the actual charges from MISO for the three months of April
13 through June 2005 and for the months of July and August 2005, by twelve-fifths to
14 arrive at a yearly charge and then subtracting the April through June 2005, amount
15 from the annualized yearly charge.

16 **Q. Please explain the adjustment to operating revenues and expenses shown in**
17 **Reference Schedule 1.45 of Blake Exhibit 1.**

18 A. As a member of MISO, LG&E has received revenues for Revenue Sufficiency
19 Guarantee ("RSG") make-whole payments and incurred charges for RSG distribution
20 amounts, starting in April 2005, for Day 2 operations pursuant to the MISO EMT
21 filed with and approved by FERC. LG&E can receive RSG make-whole payments
22 only when MISO commits a unit to run when the Locational Marginal Pricing
23 ("LMP") is insufficient to cover the unit's offer price and meets eligibility

1 requirements. RSG distribution amounts are the amounts that MISO members pay to
2 compensate MISO for the RSG make-whole payments. MISO pays a generator an
3 RSG make-whole payment when it runs the generator notwithstanding that the LMP
4 at the generator is less than the generator's offer price. The RSG make-whole
5 payment amount is the difference between the offer price and the LMP (e.g., if MISO
6 runs a $100/MWh offer price generator at 100 MW for one hour while the LMP is
7 only $80/MWh, MISO will pay the generator a RSG make-whole payment of $2,000
8 [($100-$80) x 100 MW]). MISO collects the amount required to make all such RSG
9 make-whole payments from its members through RSG distribution charges.

10 The RSG make-whole payments and the RSG distribution charges began in
11 April 2005 and are included in only three months of the twelve months ended June
12 30, 2005 (April – June 2005). This adjustment annualizes the twelve months ended
13 June 30, 2005 for the RSG make-whole payments (net of production costs incurred)
14 and the RSG distribution charges by multiplying the actual amounts from MISO
15 (adjusted for the production costs incurred) for the three months of April through
16 June 2005 and for the months of July and August 2005, by twelve-fifths to arrive at a
17 yearly amount and then subtracting the April through June 2005 amounts from the
18 annualized yearly amount.

19 **Q. Please explain the adjustment to operating revenues shown in Reference**
20 **Schedule 1.50 of Blake Exhibit 1.**

21 A. This adjustment is to reclassify RSG make-whole payments to Kentucky Utilities
22 Company ("KU") for payments originally attributed to LG&E. At the start of MISO
23 Day 2 LG&E and KU ("the Companies") allocated RSG make-whole payments to the

1 company that was assigned the off-system sales. Since LG&E's generating units are
2 generally less expensive to run than KU's, LG&E's excess generation often is used to
3 serve KU's native load customers, rather than off-system sales. However, the sale of
4 KU's excess generation is then allocated to LG&E to replace power sold to KU for
5 its native load, resulting in LG&E having a higher percentage of off-system sales.

6 Upon further review of the allocation of RSG make-whole payments after the
7 start of the Day 2 market, the Companies determined in early July 2005 that a more
8 appropriate allocation would be one based on the ownership of the generating unit
9 resulting in the payment. Since the owner of the generating unit incurs the costs of
10 generation for which the RSG make-whole payments are paid, the owner of the unit
11 should receive the benefit of the RSG make-whole payment. The Companies
12 changed the method of allocating RSG make-whole payments in August 2005, and
13 made an adjustment on their books for April through July. This adjustment is to
14 change the allocation between the Companies for April through June in order to
15 correctly reflect the allocation during the twelve month period ended June 30, 2005.

16 **Q. Please explain the adjustment to operating expenses shown in Reference**
17 **Schedule 1.60 of Blake Exhibit 1.**

18 A. This adjustment is made to recognize the Value Delivery Team ("VDT") net savings
19 to the shareholder recognized by the Commission in its Order of December 3, 2001 in
20 Case No. 2001-169. In that case the Commission approved sharing of the net savings
21 from the VDT initiative 40 percent with the customers and 60 percent with the
22 shareholder. The customers' 40 percent share of the savings is distributed through
23 the Value Delivery Surcredit Rider. This adjustment is necessary to recognize the

1 shareholder's 60 percent portion of the net savings. This adjustment to expenses is
2 consistent with the ratemaking treatment of the shareholder's portion of the VDT
3 savings recognized by the Commission in its Order of June 30, 2004 in Case No.
4 2003-00433. If the Value Delivery Surcredit is allowed to expire at March 31, 2006,
5 this adjustment is not necessary; however, the adjustment shown in Reference
6 Schedule 1.61 of Blake Exhibit 1 must also be made.

7 **Q. Please explain the adjustment to operating revenues and expenses shown in**
8 **Reference Schedule 1.61 of Blake Exhibit 1.**

9 A. This adjustment is made if the Value Delivery Surcredit is allowed to expire as of
10 March 31, 2006. This adjustment removes the effect on revenues of the surcredit
11 provided to customers for their 40 percent share of the net VDT savings during the
12 twelve months ended June 30, 2005. This adjustment also removes the effect on
13 operating expenses of the amortization of expenses incurred to achieve the VDT
14 savings. These expenses were originally deferred and amortized over a five year
15 period ending March 31, 2006. This adjustment removes the amortization expense
16 recorded during the twelve months ended June 30, 2005.

17 **Q. Please explain the adjustment to operating expenses shown in Reference**
18 **Schedule 1.70 of Blake Exhibit 1.**

19 A. This adjustment is for federal and state income taxes corresponding to the base
20 revenue and expense adjustments discussed in Mr. Blake's and my testimony.
21 Reference Schedule 1.70 shows the calculation of a composite federal and state
22 income tax rate using a federal corporate income tax rate of 35%, and a Kentucky

1 corporate income tax rate of 7%. As shown on Reference Schedule 1.70, the
2 composite federal and state income tax rate is 39.55%.

3 **Q. Please explain the adjustment to operating expenses shown in Reference**
4 **Schedule 1.71 of Blake Exhibit 1.**

5 A. This adjustment is for federal and state income taxes corresponding to the
6 annualization and adjustment of year-end interest expense. The Commission has
7 traditionally recognized the income tax effects of adjustments to interest expense
8 through an interest synchronization adjustment. This adjustment is calculated
9 following the methodology used by the Commission in its Order in Case No. 2003-
10 00433. The total capitalization amount for LG&E is taken from Blake Exhibit 2 and
11 is multiplied by LG&E's weighted cost of debt, and that amount is then compared to
12 LG&E's interest expense per books (excluding other interest) to arrive at the interest
13 synchronization amount. The composite federal and state income tax rate has been
14 applied to the interest synchronization amount.

15 **Q. Please explain the adjustment to operating expenses shown in Reference**
16 **Schedule 1.72 of Blake Exhibit 1.**

17 A. This adjustment is for income tax true-ups and adjustments made during the twelve
18 months ended June 30, 2005, that relate to prior periods and is in accordance with the
19 Commission's approval of this type of adjustment in Case No. 2003-00433.

20 **Q. Please explain the adjustment to operating expense shown in Reference**
21 **Schedule 1.73 of Blake Exhibit 1.**

22 A. This adjustment is to recognize the estimated tax deduction for domestic
23 manufacturing activities as provided in the American Jobs Creation Act of 2004.

1 Section 102(a) of that Act added a new §199 to the Internal Revenue Code of 1986
2 entitled "Income Attributable to Domestic Production Activities". The §199
3 domestic manufacturing deduction is a deduction from taxable income that is equal to
4 three percent of the lesser of: (1) the taxpayer's qualified production activities income
5 ("QPAI") for the taxable year or (2) the taxpayer's taxable income for the taxable
6 year. To determine the amount of the adjustment for this case, LG&E annualized the
7 §199 tax deduction included in its 2005 tax provision at June 30, 2005. Preliminary
8 guidance provided by the Edison Electric Institute was used to develop an estimate of
9 the Company's QPAI. LG&E will not know the exact amount of the deduction until
10 it files its 2005 tax return later next year.

11 **Q. Please explain Reference Schedule 1.74 of Blake Exhibit 1.**

12 A. This schedule calculates the revenue gross up factor. The revenue gross up factor
13 recognizes the impact the overall revenue deficiency will have on the provision for
14 uncollectible accounts, the PSC Assessment, Kentucky income taxes, and federal
15 income taxes and is prepared in accordance with the Commission's Order in Case
16 No. 2003-00433.

17 **Gas Net Operating Income**

18 **Q. Please explain the adjustment to operating expenses shown in Reference**
19 **Schedule 1.22 of Blake Exhibit 1.**

20 A. This adjustment eliminates advertising expenses. Commission regulation 807 KAR
21 5:016, Section 2(1) provides that a utility will be allowed to recover, for ratemaking
22 purposes, only those advertising expenses which produce a "material benefit" to its
23 ratepayers. The advertising expenses eliminated by this adjustment are primarily

1 institutional and promotional in nature. The adjustment is calculated in accordance
2 with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-
3 00433.

4 **Q. Please explain the adjustment to operating expenses shown in Reference**
5 **Schedule 1.31 of Blake Exhibit 1.**

6 A. This adjustment has been made to normalize the expense levels in Account 925
7 "Injuries and Damages" based upon a ten-year average adjusted for inflation. The
8 adjustment is calculated in accordance with the methodology approved by the
9 Commission in its Order of June 30, 2004 in Case No. 2003-00433.

10 **Q. Please explain the adjustment to operating expenses shown in Reference**
11 **Schedule 1.41 of Blake Exhibit 1.**

12 A. This adjustment has been made to reflect annualized depreciation expenses. This
13 adjustment calculates annual depreciation expense by multiplying the plant in service
14 at June 30, 2005 by the depreciation rates currently in effect. LG&E's current
15 depreciation rates were approved in Case No. 2001-00141 based on a settlement, and
16 the depreciation study filed in that case was based on plant in service as of December
17 31, 1999. The adjustment is calculated in accordance with the methodology approved
18 by the Commission in its Order of June 30, 2004 in Case No. 2003-00433.

19 **Q. Please explain the adjustment to operating expenses shown in Reference**
20 **Schedule 1.42 of Blake Exhibit 1.**

21 A. This adjustment has been made to reflect increases in labor and labor-related costs as
22 applied to the twelve months ended June 30, 2005, and includes specific adjustments

1 for wages, payroll taxes and LG&E 401(k) match. Page 1 of 4 presents an overview
2 of the adjustment.
3 Page 2 of 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the
4 adjustment for wage expenses. The adjustment reflects the annualized base labor of
5 all LG&E employees as of June 30, 2005, and it includes new union contract rates
6 expected to be effective November 10, 2005. The current union contract expires
7 November 10, 2005 and LG&E expects the replacement contract to include increases
8 consistent with the current contract terms.
9 Under the terms of the current contract, beginning November 10, 2004, union
10 employees received a three percent wage increase, which resulted in three percent
11 increases in overtime wages and in the Team Incentive Award ("TIA"). These same
12 increases are expected as of November 10, 2005. An adjustment has been made to
13 increase union wages, overtime and TIA for the twelve months ended June 30, 2005,
14 to recognize the impact of the expected November 10, 2005, contract increase. In
15 Case No. 2003-00433 LG&E had reduced the labor adjustment to remove the amount
16 of TIA guaranteed by E.ON to the extent that it exceeded what employees would
17 have been paid, without the guarantee. No adjustment is necessary in the current
18 labor adjustment because there was no E.ON TIA guarantee payment in the twelve
19 months ended June 30, 2005.
20 Page 3 of 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the
21 calculation of the component of the labor adjustment to reflect the increases in the
22 Federal Insurance Contributions Act ("FICA") employer payroll taxes due to the
23 increase in wages. The payroll tax increase reflects the methodology ordered by the

1 Commission in Case No. 2003-00433 in calculating the impact of the Social Security
2 wage limit.
3 Finally, page 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the
4 calculation of the component of the labor adjustment to reflect the resulting increases
5 in LG&E's match of 401(k) contributions as applied to the twelve months ended June
6 30, 2005, due to the adjustments to the increases in wages.
7 The labor adjustment follows the methodology approved by the Commission
8 in its Order of June 30, 2004 in Case No. 2003-00433.

9 **Q. Please explain the adjustment to operating expenses shown in Reference**
10 **Schedule 1.60 of Blake Exhibit 1.**

11 A. This adjustment is made to recognize the VDT net savings to the shareholder
12 recognized by the Commission in its Order of December 3, 2001 in Case No. 2001-
13 169. In that case the Commission approved sharing of the net savings from the VDT
14 initiative 40 percent with the customers and 60 percent with the shareholder. The
15 customers' 40 percent share of the savings is distributed through the Value Delivery
16 Surcredit Rider. This adjustment is necessary to recognize the shareholder's 60
17 percent portion of the net savings. This adjustment to expenses is consistent with the
18 ratemaking treatment of the shareholder's portion of the VDT savings recognized by
19 the Commission in its Order of June 30, 2004 in Case No. 2003-00433. If the Value
20 Delivery Surcredit is allowed to expire at March 31, 2006, this adjustment is not
21 necessary; however, the adjustment shown in Reference Schedule 1.61 of Blake
22 Exhibit 1 must also be made.

1 **Q. Please explain the adjustment to operating revenues and expenses shown in**
2 **Reference Schedule 1.61 of Blake Exhibit 1.**

3 A. This adjustment is made if the Value Delivery Surcredit is allowed to expire as of
4 March 31, 2006. This adjustment removes the effect on revenues of the surcredit
5 provided to customers for their 40 percent share of the net VDT savings during the
6 twelve months ended June 30, 2005. This adjustment also removes the effect on
7 operating expenses of the amortization of expenses incurred to achieve the VDT
8 savings. These expenses were originally deferred and amortized over a five year
9 period ending March 31, 2006. This adjustment removes the amortization expense
10 recorded during the twelve months ended June 30, 2005.

11 **Q. Please explain the adjustment to operating expenses shown in Reference**
12 **Schedule 1.70 of Blake Exhibit 1.**

13 A. This adjustment is for federal and state income taxes corresponding to the base
14 revenue and expense adjustments discussed in Mr. Blake's and my testimony.
15 Reference Schedule 1.70 shows the calculation of a composite federal and state
16 income tax rate using a federal corporate income tax rate of 35%, and a Kentucky
17 corporate income tax rate of 7%. As shown on Reference Schedule 1.70, the
18 composite federal and state income tax rate is 39.55%.

19 **Q. Please explain the adjustment to operating expenses shown in Reference**
20 **Schedule 1.71 of Blake Exhibit 1.**

21 A. This adjustment is for federal and state income taxes corresponding to the
22 annualization and adjustment of year-end interest expense. The Commission has
23 traditionally recognized the income tax effects of adjustments to interest expense

1 through an interest synchronization adjustment. This adjustment is calculated
2 following the methodology used by the Commission in its Order in Case No. 2003-
3 00433. The total capitalization amount for LG&E is taken from Blake Exhibit 2 and
4 is multiplied by LG&E's weighted cost of debt, and that amount is then compared to
5 LG&E's interest expense per books (excluding other interest) to arrive at the interest
6 synchronization amount. The composite federal and state income tax rate has been
7 applied to the interest synchronization amount.

8 **Q. Please explain the adjustment to operating expenses shown in Reference**
9 **Schedule 1.72 of Blake Exhibit 1.**

10 A. This adjustment is for income tax true-ups and adjustments made during the twelve
11 months ended June 30, 2005, that relate to prior periods and is in accordance with the
12 Commission's approval of this type of adjustment in Case No. 2003-00433.

13 **Q. Please explain Reference Schedule 1.74 of Blake Exhibit 1.**

14 A. This schedule calculates the revenue gross up factor. The revenue gross up factor
15 recognizes the impact the overall revenue deficiency will have on the provision for
16 uncollectible accounts, the PSC Assessment, Kentucky income taxes, and federal
17 income taxes and is prepared in accordance with the Commission's Order in Case
18 No. 2003-00433.

19 **Q. Does this conclude your testimony?**

20 A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

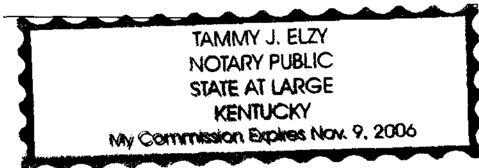
The undersigned, **Valerie L. Scott**, being duly sworn, deposes and says she is Controller for Louisville Gas and Electric Company, that she has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

Valerie L. Scott
VALERIE L. SCOTT

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 30th day of September 2005.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:


TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

APPENDIX A

Valerie L. Scott

Controller
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202
(502) 627-3660

Professional Memberships:

American Institute of Certified Public Accountants (AICPA)
Kentucky Society of Certified Public Accountants (KSCPA)

Education:

University of Louisville, Masters of Business Administration (with high distinction), 1994
University of Louisville, Bachelor of Science in Commerce with a major in Accounting (with honors), 1978

Previous Positions with LG&E Energy LLC:

- August 2002 – December 2004 – Director, Financial Planning and Accounting – Utility Operations
- February 1999 – August 2002 – Director, Trading Controls & Energy Marketing Accounting
- May 1998 – February 1999 – Manager, Trading Controls and Manager, Financial Planning, Reporting and Special Projects
- July 1993 – May 1998 – Manager, Corporate Internal Auditing
- October 1991 – July 1993 – Senior Staff Accountant

Previous Positions prior to LG&E Energy LLC:

- 1986 – 1990 Frankenthal Group, Controller
- 1978 – 1986 Arthur Young & Company (now Ernst & Young)
  1978 – 1979 Audit Staff
  1979 – 1983 Senior Auditor
  1983 – 1986 Audit Manager

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY FOR THE	)	**CASE NO. 2005-00352**
VALUE DELIVERY SURCREDIT	)	
MECHANISMS	)	

TESTIMONY OF
S. BRADFORD RIVES
CHIEF FINANCIAL OFFICER
LOUISVILLE GAS AND ELECTRIC COMPANY

Filed: September 30, 2005

1 **Q. Please state your name, position and business address.**

2 A. My name is S. Bradford Rives. I am the Chief Financial Officer for LG&E Energy
3 LLC and Louisville Gas and Electric Company ("LG&E" or "the Company"). I am
4 employed by LG&E Energy Services Inc. which provides services to LG&E. My
5 business address is 220 West Main Street, Louisville, Kentucky. A statement of my
6 professional history and education is attached as an appendix hereto.

7 **Q. Have you previously testified before this Commission?**

8 A. Yes. I have previously testified before this Commission in rate proceedings,
9 administrative investigations and environmental surcharge proceedings.

10 **Q. What is the purpose of your testimony?**

11 A. The purpose of my testimony is to describe why the financial conditions of LG&E
12 require the discontinuance of the Value Delivery Surcredits, and the maintenance of
13 base rates as ordered in Case No. 2003-00433. My testimony also supports the
14 analysis of capitalization contained in Blake Exhibit 2 as of June 30, 2005.

15 **LG&E's Current Financial and Operating Condition**

16 **Q. How would you describe LG&E's present financial circumstances?**

17 A. LG&E's operational performance remains strong, but its financial condition,
18 especially the gas operations, has deteriorated since Case No. 2003-00433. This is
19 primarily due to increased investment in plant and increases in cost of capital since
20 September 30, 2003. LG&E's electric operations financial results (with the Value
21 Delivery Surcredit effective) for the twelve months ended June 30, 2005, are below
22 the authorized level set in Case No. 2003-00433 and reaffirmed by the Commission
23 in Case No. 2004-00421. For LG&E's gas operations, the rate of return is well

1 below the return range authorized by the Commission in Case No. 2003-00433. The
2 gas decrease is primarily due to increased investment in the gas plant (see schedule
3 below) and increases in cost of capital.

4 It is essential that LG&E achieve and maintain a strong financial condition to
5 allow it to continue to provide safe, reliable service to its customers. The Value
6 Delivery Surcredits should be allowed to expire and the tariffs withdrawn with the
7 final balancing adjustment in May 2006 and base rates should remain at the level
8 authorized in Case No. 2003-00433.

9 **Q. Has LG&E's investment in electric utility plant increased since September 30,**
10 **2003, the test period used in Case No. 2003-00433?**

11 A. Yes. The following chart shows LG&E's investment in net electric utility plant
12 (excluding Asset Retirement Obligations ("ARO") and post-1995 Environmental
13 Cost Recovery ("ECR") assets) has increased by approximately $72.1 million since
14 September 30, 2003:

15 **Net Electric Utility Plant**

	June 30, 2005	**September 30, 2003**	**Increase**
Electric utility plant	$3,166,467,871	$2,945,460,295	$221,007,576
Accumulated depreciation	1,457,917,217	1,309,040,993	148,876,224
Net electric utility plant	$1,708,550,654	$1,636,419,302	$72,131,352

16

17 **Q. Has LG&E's investment in gas utility plant increased since September 30, 2003,**
18 **the test period used in Case No. 2003-00433?**

1 A. Yes. The following chart shows that investment in net gas utility plant has increased

2 by approximately $34.8 million since September 30, 2003:

3 **Net Gas Utility Plant**

	June 30, 2005	September 30, 2003	Increase
Gas utility plant	$575,408,231	$519,793,206	$55,615,025
Accumulated depreciation	204,214,632	183,372,937	20,841,695
Net gas utility plant	$371,193,599	$336,420,269	$34,773,330

4

5 **Q. Did LG&E earn its authorized return on equity for the twelve months ended**

6 **June 30, 2005?**

7 A. No. As shown in Blake Exhibit 5, for the twelve months ended June 30, 2005, the

8 return on equity is 7.36% and the return on capital is 5.80% for LG&E's electric

9 operations prior to the expiration of the Value Delivery Surcredit. The return on

10 equity is below the range established by the Commission in Case No. 2003-00433.

11 With the expiration of the VDT Surcredit the return on equity for electric operations

12 is 10.28% and the return on capital is 7.33% for the twelve months ended June 30,

13 2005, as also shown on Exhibit 5. With the expiration of the Value Delivery

14 Surcredit the return on equity is within the range established by the Commission in

15 Case No. 2003-00433. As recently as June 2005, in the Commission's order in Case

16 No. 2004-00421, the Commission found that a range of 10.0 to 11.0 percent, with a

17 midpoint of 10.5 percent, continues to be a reasonable return on equity for LG&E.

18 The gas operations for the twelve months ended June 30, 2005, earned a

19 3.99% return on equity and a return of 4.04% on total capitalization prior to the

1 expiration of the Value Delivery Surcredit. With the expiration of the Delivery
2 Surcredit the return on equity for gas operations is 7.51% and the return on capital is
3 5.88% for the twelve months ended June 30, 2005, as also shown on Exhibit 5. For
4 gas operations the return on equity with or without the expiration of the Value
5 Delivery Surcredit is well below the range established by the Commission in Case
6 No. 2003-00433.
7 **Q. Has the Company continued to provide high level customer service since its last**
8 **base rate case?**
9 A. Yes. LG&E Energy was rated #1 in the Midwest and #2 nationally among large
10 utilities in the most recent J.D. Power Residential Electric Customer Satisfaction
11 survey. Additionally, LG&E Energy was rated #1 in the Midwest in five of the six
12 categories in that survey.
13 The Companies' improved service and reliability was specifically recognized
14 in connection with the most recent J.D. Power Award. The Company remains
15 committed to providing low cost, high quality electric and gas service to its native
16 load customers.
17 **Q. Has the Company continued to meet or exceed customer expectations when**
18 **responding to customer inquires?**
19 A. Yes. The residential call center continues to meet or exceed customer expectations.
20 In the most recent survey, 88% of those surveyed rated the overall handling of their
21 call as "very good" or "outstanding" and 94% gave similar ratings for the courtesy
22 with which their call was handled.

1 **Q. Did the Companies' safety record continue to remain at a high level since the last**
2 **rate cases?**
3 A. Yes. In 2004, LG&E Energy Delivery employees had the lowest KOSHA recordable
4 safety injury rate since the merger of LG&E and Kentucky Utilities Company
5 ("KU"). The 2004 Energy Delivery year-end recordable rate was 1.47 compared to
6 the National Safety Council industry average of 5.0. Also, in 2004, LG&E Energy
7 Delivery had the lowest contractor recordable safety injury rate since the merger of
8 LG&E and KU. The 2004 year-end recordable injury rate for contractors was 3.16 in
9 comparison to the National Safety Council industry average of 7.6.
10 For 2005 to-date, the injury rate continues to trend downward; safety
11 performance for both Energy Delivery employees and contractors continue to
12 outperform the previous year's performance in 2004.
13 **Capitalization and Weighted Average Cost of Capital**
14 **Q. Please explain the capital structure strategy of LG&E.**
15 A. As I have expressed in previous testimony before the Commission, including most
16 recently in Case No. 2003-00433, LG&E is firmly committed to maintaining the
17 financial strength of the Company. The Company has a target capital structure of the
18 midpoint of the range for "A" rated utilities published by Standard and Poor's.
19 **Q. What is the current target capital structure?**
20 A. The midpoint of the total debt to total capital range for utilities with a business
21 position "5" (LG&E's current business position) is 46%. This midpoint was
22 established by Standard and Poor's. The range established by Standard and Poor's is

1 42% to 50%. This indicates an acceptable range for the equity component of capital
2 of 50% to 58%.
3 When rating agencies evaluate the Company's debt to capital ratio, the
4 agencies require purchased power agreements to be treated as fixed obligations
5 equivalent to debt. LG&E has a purchased power obligation in a contract with Ohio
6 Valley Electric Corporation. Although this contract is currently attractively priced,
7 the rating agencies consider a portion of the payments on this contract to be debt
8 equivalents in establishing the ratings. Standard and Poor's review of LG&E noted
9 that it has imputed $33 million of debt equivalent to LG&E for 2005. As indicated in
10 the tables below, if this adjustment is made to the electric capital structure shown in
11 Blake Exhibit 2, LG&E's electric debt to total capitalization ratio is 44.95% - within
12 the range published by Standard and Poor's. This indicates an equity component of
13 capital of 55.05% (common and preferred), approximately the midpoint of the
14 Standard and Poor's guideline range. If this adjustment is made to the gas capital
15 structure shown in Blake Exhibit 2, LG&E's gas debt to total capitalization ratio is
16 44.94% - within the range published by Standard and Poor's. This indicates an
17 equity component of capital of 55.06% (common and preferred), approximately the
18 midpoint of the Standard and Poor's guideline range. Disregarding the impact of the
19 purchased power agreement could limit the Company's future access to attractively
20 priced debt capital.

1

	Adjusted Electric Jurisdictional Capitalization (Exhibit 2, Col. 6)	Electric Jurisdictional Imputed Debt per S&P (82.06% X $33mill)	Imputed Electric Jurisdictional Capitalization (Col 1 + Col 2)	Imputed Electric Capital Structure
	(1)	(2)	(3)	(4)
Short Term Debt	$ 16,732,017		$ 16,732,017	1.07%
Long Term Debt	662,474,143		662,474,143	42.16%
Power Purchase Agreements		$ 27,079,800	27,079,800	1.72%
Preferred Stock	56,769,782		56,769,782	3.61%
Common Equity	808,216,650		808,216,650	51.44%
Total	$ 1,544,192,592	$ 27,079,800	$ 1,571,272,392	100.00%

2

	Adjusted Gas Jurisdictional Capitalization (Exhibit 2, Col. 6)	Gas Jurisdictional Imputed Debt per S&P (17.94% X $33mill)	Imputed Gas Jurisdictional Capitalization (Col 1 + Col 2)	Imputed Gas Capital Structure
	(1)	(2)	(3)	(4)
Short Term Debt	$ 3,740,456		$ 3,740,456	1.07%
Long Term Debt	148,107,283		148,107,283	42.18%
Power Purchase Agreements		$ 5,920,200	5,920,200	1.69%
Preferred Stock	12,692,129		12,692,129	3.61%
Common Equity	180,690,643		180,690,643	51.45%
Total	$ 345,230,511	$ 5,920,200	$ 351,150,711	100.00%

3

4 **Q. In light of the Companies' current proposed construction program, has LG&E**
5 **made efforts to lower debt and retain earnings?**
6 A. Since the last rate case, LG&E has refinanced $168 million of debt to lower interest
7 rates. In addition, the Company has retained earnings in anticipation of the
8 requirements of its construction program. The current common equity ratio of LG&E
9 is not only consistent with the Company's longstanding targeted debt-to-capital
10 structure, previously discussed, but is reasonable in light of the anticipated
11 construction program.

1 **Q. Can you explain what is contained in Blake Exhibit 2?**

2 A. Yes, Blake Exhibit 2 calculates adjusted capitalization as of June 30, 2005, as well as
3 the weighted average cost of capital to apply to the adjusted capitalization.

4 **Q. Please explain the calculation of the adjusted capitalization.**

5 A. Column 1, page 1 of Blake Exhibit 2 contains the components of capitalization as
6 recorded on the Company's books and records as of the end of the twelve months
7 ended June 30, 2005. Column 2, page 1 of Blake Exhibit 2 calculates the relative
8 capitalization percentages of each component of capitalization to the total
9 capitalization (e.g., line 1, column 1 divided by line 5, column 1 equals line 1,
10 column 2). Column 3 of page 1 contains the allocation factors to split total
11 capitalization between electric operations and gas operations. These factors were
12 calculated based on electric and gas net original cost rate base, excluding the net
13 ARO assets, as shown on Blake Exhibit 3. Column 4 calculates the relative electric
14 and gas capitalization components by multiplying column 1 by the factors in column
15 3.

16 **Q. Will you explain the adjustments to capitalization contained in column 5, page 1**
17 **of Blake Exhibit 2?**

18 A. Yes. The adjustments in column 5, page 1 of Blake Exhibit 2 are shown in detail in
19 columns 3 through 6 on page 2 of Blake Exhibit 2. The adjustments in columns 3
20 through 5 to remove the 25% portion of Trimble County Unit No. 1 inventories that
21 represent IMEA's and IMPA's portion of these assets, to remove LG&E's equity
22 investment in Ohio Valley Electric Corporation and to add the Job Development Tax
23 Credit are consistent with the adjustments approved by the Commission in Case No.

1 2003-00433. The remaining adjustment in column 6 is to remove LG&E's post-1995
2 environmental surcharge plan. Column 7, page 2 of Blake Exhibit 2 summarizes the
3 total capitalization adjustments by adding the separate adjustments listed in columns
4 3 through 6. This amount is then carried over to column 5, page 1. Finally, column
5 6, page 1 calculates adjusted capitalization by totaling the capitalization adjustments
6 in columns 4 and 5.

7 **Q. Please explain the adjustment shown in Column 6 of page 2 of 2 of Blake Exhibit**
8 **2 for the Environmental Surcharge Post-1995 Plan.**

9 A. LG&E removed the capitalization of its ECR rate base that is not recovered through
10 base rates. The adjustment removes the environmental surcharge rate base at June 30,
11 2005, as shown on June's expense month ECR filing, reduced by the environmental
12 surcharge rate base of the post-1995 ECR plan that was rolled into base rates in Case
13 No. 2003-236. Removing the environmental surcharge rate base from the capital
14 structure is necessary because LG&E is recovering its investment through the ECR
15 plan.

16 **Q. Please explain why a capitalization adjustment for ARO assets is not used in the**
17 **calculation of the weighted cost of capital in Blake Exhibit 2.**

18 A. In Case No. 2003-00433 the Commission made an adjustment to exclude ARO assets
19 from capitalization. The Commission found that the capitalization adjustment was
20 consistent with other Commission decisions when items are removed from
21 calculation of rate base. LG&E believes that an adjustment is not needed for
22 capitalization because the accounting for the AROs, consistent with the
23 Commission's December 23, 2003 Order in Case No. 2003-00426, effectively

1 removes all impacts of ARO accounting from the income statement and net assets in
2 the balance sheet, accordingly, there is no impact on common equity or other
3 capitalization accounts. The recorded regulatory assets, liabilities and credits offset
4 the effects of the ARO accounting. LG&E removed the AROs from rate base in
5 Blake Exhibit 3, in accordance with the December 23, 2003 Order.

6 **Q. Please explain how the weighted average cost of capital is calculated.**

7 A. Column 7, page 1 of Blake Exhibit 2 calculates the respective capitalization
8 percentages for the components of adjusted capitalization (e.g., line 1, column 6
9 divided by line 5, column 6 equals line 1, column 7). Column 8 includes the
10 embedded costs of the components of capital except the return on equity. The annual
11 rate used for Short Term Debt is the actual rate as of June 30, 2005. The annual cost
12 rate for Long Term Debt is the embedded cost of the first mortgage bonds and
13 intercompany loans outstanding as of June 30, 2005. The intercompany loans were
14 approved by the Commission in its April 30, 2003 Order in Case No. 2003-00058.
15 The annual cost rate for Preferred Stock is its embedded cost as of June 30, 2005. The
16 cost of equity is the range, including the mid- point, of the equity established by the
17 Commission in Case No. 2003-00433. Column 9 then calculates the weighted
18 average cost of capital by multiplying column 7 by column 8, resulting in 7.45% for
19 electric operations and 7.45% for gas operations using the 10.5 percent midpoint of
20 the return on equity range.

21 **Q. Does this conclude your testimony?**

22 A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **S. Bradford Rives**, being duly sworn, deposes and says he is the Chief Financial Officer for Louisville Gas and Electric Company, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

S. Bradford Rives
S. BRADFORD RIVES

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 30th day of September 2005.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

APPENDIX A

S. Bradford Rives

Chief Financial Officer
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202
(502) 627-3990

Civic Activities

University of Louisville, School of Business – Board of Advisors
Lincoln Heritage Council, Boy Scouts of America - Executive Board
Metro United Way of Louisville - Board of Directors
National Kidney Foundation of Kentucky –
  Board of Directors and Treasurer
  Chair of Cadillac Invitational Golf Tournament
St. Margaret Mary Parish Council

Professional/Trade Memberships

American Institute of Certified Public Accountants (AICPA)
Financial Executives Institute
Kentucky Bar Association
Kentucky Society of Certified Public Accountants
Louisville Bar Association

Education

University of Louisville School of Law, J.D. (cum laude) -- 1988
University of Kentucky, B.S. in Accounting -- 1980

Previous Positions

LG&E Energy LLC, Louisville, KY

- Dec 2000 – Sep 2003, Senior Vice President, Finance and Controller
- Feb 1999 – Dec 2000 – Senior Vice President, Finance and Business Development
- Mar 1996 – Feb 1999 – Vice President, Finance and Controller
- Jan 1996 – Mar 1996 – Vice President, Finance, Non Utility Business
- Mar 1995 – Dec 1995 – Vice President, Controller and Treasurer (LG&E Power)
- Jun 1994 – Mar 1995 – Vice President and Treasurer (LG&E Power)
- Jan 1994 – Jun 1994 – Associate General Counsel
- Jan 1993 – Dec 1993 – Director, Business Development
- Feb 1992 – Dec 1992 – Assistant Treasurer
- Oct 1991 – Feb 1992 – Director, Corporate Finance

Louisville Gas and Electric Company, Louisville, KY

- 1990-1991 – Director, Corporate Finance
- 1989-1990 – Director, Corporate Tax
- 1985-1989 – Manager, Tax Accounting
- 1983-1985 – Assistant Manager, Tax Accounting

Arthur Andersen and Company, Louisville, KY

- 1982-1983 – Audit Senior
- 1980-1982 – Audit Staff