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March 24, 2008

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MAR 24 2008

PUBLIC SERVICE
COMMISSION

HAND DELIVERED

Hon. Stephanie L. Stumbo
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40601

Re: Case No. 2007-00449
Louisville Gas and Electric Company
Kentucky Utilities Company

Dear Ms. Stumbo:

We enclose for filing an original and ten (10) copies of the Response of Louisville Gas and Electric Company and Kentucky Utilities Company to Questions Posed During Telephone Conference which was held last Thursday in the above-captioned case. Thank you for your assistance.

Sincerely,

Robert M. Watt, III

rmw:

Enclosures

cc: Allyson K. Sturgeon, Esq. (w/encl.)

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

MAR 24 2008

PUBLIC SERVICE
COMMISSION

In the Matter of:

JOINT FILING OF)
LOUISVILLE GAS AND)
ELECTRIC COMPANY AND)
KENTUCKY UTILITIES)
COMPANY OF A SPECIAL)
CONTRACT FOR FIRM GAS)
SALES AND FIRM)
TRANSPORTATION)
SERVICE)

CASE NO. 2007-00449

**RESPONSE OF LOUISVILLE GAS AND ELECTRIC
COMPANY AND KENTUCKY UTILITIES COMPANY
TO QUESTIONS POSED DURING TELEPHONE CONFERENCE**

Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (together the "Companies") respectfully submit the following responses to questions posed during a telephone conference on March 20, 2008, in this proceeding.

1. Do the rates in the Special Contract at issue in this proceeding comply with KRS 278.2207?

RESPONSE: Yes. Please refer to the study entitled "Derivation of Demand-Commodity Pricing for Natural Gas Services" prepared in June 2005 by The Prime Group for LG&E, which is attached hereto. Please note that on page 4 of the study, The Prime Group analyzed certain demand-related underground storage costs, but that the specific underground storage services associated with those rates were not ultimately incorporated in the Special Contract at issue here.

2. How do the Companies propose that they remain in compliance with the affiliate transaction rules in light of the automatic renewal provision in Section 3 of the Special Contract?

RESPONSE: The Companies intend to analyze the Special Contract to ensure that it complies with the prevailing affiliate transaction rules prior to the beginning of each Contract Year. The Companies also intend to comply with such rules during each Contract Year of the Special Contract. The pricing under the Special Contract will be reviewed and reset according to the affiliate transaction rules as a part of each gas rate case filing before the Commission.

Dated: March 24, 2008

Respectfully submitted,



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And

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Electric Company and Kentucky
Utilities Company

Louisville Gas and Electric Company

**Derivation of Demand-Commodity Pricing for
Natural Gas Services**

■ The Prime Group LLC ■

June 2005

Derivation of Demand-Commodity Pricing for Natural Gas Services

This report details the methodology used to derive the unit costs for (i) firm transportation services, (ii) firm bundled sales services, and (iii) firm unbundled storage services. These unit costs were derived (as described in further detail below) in order to ensure that they can be used as rates of general applicability, that is, they can be used for the purpose of providing service using cost-based rates to either potential special contract customers or to an affiliate at an internal transfer price in accordance with KRS 278.2207.

Unbundled Unit Cost Components

These unbundled unit costs were designed to reflect the cost elements associated with providing natural gas service in LG&E's cost-of-service study used in LG&E's most recent gas and electric rate application in Case No. 2003-00433. The cost elements are (1) customer-related costs, (2) demand-related distribution costs, (3) demand-related underground storage costs, and (4) variable commodity costs.

Customer-related costs are fixed costs that tend to vary according to the number of natural gas customers on the system. Conversely, customer-related costs are costs that do *not* vary with the demand placed on the system or the amount of natural gas throughput. Customer-related costs are costs such as operating and maintenance ("O&M"), depreciation, taxes, and return associated with investment in meters, company service lines, a portion of distribution mains¹, and pressure regulators. These costs also include meter reading and billing, and customer service expenses. Because customer-related costs are fixed, they should be recovered through a fixed monthly charge.

Demand-related distribution costs are costs associated with having adequate distribution main capacity available to meet maximum system demands. These costs include O&M, depreciation, taxes, and return associated primarily with the non-customer-related portion of distribution mains. In this cost-of-service study, distribution mains were broken down into two subcategories: high-pressure mains and low-pressure mains. This breakdown allows the rate design to more accurately reflect the facilities used by a given customer or customer group. Because this cost is a capacity-related cost, it should be recovered through a demand charge.

¹ The customer- and demand-related components of mains were determined based on the application of the zero-intercept methodology in LG&E's cost of service study, which has been found to be reasonable by the Kentucky Public Service Commission.

Demand-related underground storage costs are costs related to peak day deliveries required from storage to meet winter season customer demands. Because this cost component is a capacity-related cost, the appropriate means for recovering this cost is through a demand charge.

Variable commodity-related costs are costs that vary with amount of natural gas that flows through the system. This cost element is best recovered through a commodity charge.

Firm Transportation Service Unbundled Cost Components.

The unbundled cost components for firm transportation service consist of the following unit costs:

Monthly Customer Charge	\$686.00
Demand Charge Per Mcf	\$ 2.43
Commodity Charge Per Mcf	\$0.0487

The above unit costs were developed based on the Standard Rate Schedule FT costs contained in LG&E's gas cost-of-service study developed in connection with LG&E's rate application in Case No. 2003-00433. The return component included in these unit costs corresponds to the rate of return for Rate FT determined by updating test-year revenues in LG&E's cost of service study to reflect the increase authorized by the Commission for Rate FT in Case No. 2003-00433.

Rate Schedule FT costs were used for two main reasons. First, the character of service provided under this rate is consistent with the service provided under LG&E's Standard Rate Schedule FT. LG&E transports gas which the customer (whether or not an affiliate) has purchased from a third-party supplier through LG&E's system to the point of consumption. Second, customers served under the Standard Rate Schedule FT are LG&E's largest natural gas customers. LG&E would only provide service under these unbundled rates to large customers.

The costs associated with, and derivation of, each cost component are shown in Attachment A with the appropriate references to the cost of service Exhibits filed by LG&E in Case No. 2003-00433.² These customer-, demand-, and commodity-related unit costs were developed using only the costs associated with high-pressure mains consistent with the cost-of-service study performed for customers served under Standard Rate Schedule FT. Each cost component reflects the costs associated with that component. Therefore, the unbundled rate components (demand, commodity, and

² The references identified in the three attachments refer to the Exhibits to the Direct Testimony of William Steven Seelye submitted in Case No. 2003-00433. However, the rates of return in the cost of service study were modified to reflect the service rates authorized by the Kentucky Public Service Commission.

customer) charged to the customer (whether or not an affiliate) are the costs that are imposed on the system due to the transportation of gas through LG&E's system. The underlying assumption in developing the demand charge is that the customer would take service at a specified uniform contract demand for 12 months.

Firm Sales Service Unbundled Cost Components.

The unbundled cost components for firm sales service consist of the following unit costs:

Monthly Customer Charge	\$ 68.00
Demand Charge Per Mcf	\$ 8.30
Commodity Charge Per Mcf	\$0.2253

The above unit costs were developed based on the Standard Rate Schedule IGS costs contained in LG&E's gas cost-of-service study developed in connection with LG&E's rate application in Case No. 2003-00433. The return component included in these unit costs corresponds to the rate of return for Rate IGS determined by updating test-year revenues in LG&E's cost of service study to reflect the increase authorized by the Commission for Rate IGS in Case No. 2003-00433.

Standard Rate Schedule IGS costs were used for two main reasons. First, the type of service provided under this rate is consistent with the service provided under LG&E's standard Standard Rate Schedule IGS. The customer (whether or not an affiliate) purchases gas from LG&E, not a third party, and LG&E uses all the same facilities to provide sales service (including storage) to serve the gas load. Second, the customers served under Standard Rate Schedule IGS are also LG&E's largest gas sales customers. LG&E would only provide service under these unbundled rates to large customers.

The costs associated with, and derivation of, each cost component are shown in Attachment B with appropriate references to the cost of service Exhibits filed by LG&E in Case No. 2003-00433. Each cost component reflects the costs associated with that component. Therefore, the unbundled rate components (demand, commodity, and customer) charged to the customer (whether or not an affiliate) are the costs that are imposed on the system due to the delivery of sales gas through LG&E's system. The underlying assumption in developing the demand charge is that the customer would take service at a specified uniform contract demand for 12 months.

Storage Service Unbundled Cost Components.

The unbundled cost components for storage service consist of the following unit costs:

Storage Charge Per Maximum Mcf/Day Withdrawal	\$ 9.64
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Because there is no equivalent tariffed storage service from which to extract the unbundled cost components, the unit costs were developed by identifying total system storage costs from the gas cost-of-service study developed in connection with LG&E's rate application in Case No. 2003-00433. The return component included in these unit costs corresponds to the overall rate of return determined by updating test-year revenues in LG&E's cost of service study to reflect the overall increase authorized by the Commission in Case No. 2003-00433.

The costs associated with, and derivation of, the storage cost component are shown in Attachment C with appropriate references to the cost of service Exhibits filed by LG&E in Case No. 2003-00433. The storage service, for which the unbundled rate components compensate LG&E, allows a customer to purchase gas from a third-party supplier and inject it into LG&E's underground storage and withdraw that gas from storage for later use. The unit cost for storage service was derived by dividing test-year storage revenue requirement by LG&E's peak day withdrawals from storage.³ The rate does not include a customer component because it assumes that the customer will take some type of sales or transportation service and that, consequently, there would not be any additional customer-related costs identified from the cost of service study.⁴

The charge will be billed based on the customer's maximum day withdrawal volume, which will be established by the contract. The storage charge will therefore apply to the maximum daily withdrawal capability for each month in which such service is applicable.

³ This same methodology was used to derive the monthly balancing charge included in Reserved Balancing Service -- Rate RBS approved by the Commission in its Order in Case No. 95-037 dated June 27, 1995.

⁴ Although customer-related costs were not identified from the cost of service study, this service may require additional administrative costs, which could be reflected in the rate as an administrative charge.

Attachment A

Louisville Gas and Electric Company

Unit Cost of Service Based on the Cost of Service Study
For the 12 Months Ended September 30, 2003

FT

Description	Reference	Customer Costs				Storage Demand-Related Costs	Storage Commodity-Related Costs	Other Commodity-Related Costs	Demand Related Low Pressure Mains Costs	Demand Related High Pressure Mains Costs	Total Costs
		Customer-Related Low Pressure Mains Costs	Customer-Related High Pressure Main Costs	Customer-Related Direct Costs	Total Customer-Related Costs						
(1) Rate Base	Exhibit 2 Pages 3 & 4 Proposed Overall ROR	\$ 1,168	\$ 321	\$ 862,849	\$ 864,337	\$ -	\$ 6,204	\$ 43,774	\$ 1,901,949	\$ 1,965,597	\$ 4,781,862
(2) Rate of Return		32.92%	32.92%	32.92%	32.92%	32.92%		32.92%	32.92%	32.92%	32.92%
(3) Return	(1) x (2)	\$ 384	\$ 106	\$ 284,010	\$ 284,500	\$ -	\$ 2,042	\$ 14,408	\$ 626,034	\$ 646,984	\$ 1,573,968
(4) Interest Expenses	Exhibit 2 Pages 13 & 14	\$ 20	\$ 5	\$ 11,114	\$ 11,139	\$ -	\$ 2,042	\$ 14,408	\$ 593,652	\$ 614,655	\$ 1,498,119
(5) Net Income	(3) - (4)	\$ 365	\$ 100	\$ 272,896	\$ 273,361	\$ -	\$ 1,196	\$ 8,442	\$ 347,840	\$ 360,147	\$ 877,797
(6) Income Taxes		\$ 214	\$ 59	\$ 159,899	\$ 160,112	\$ -	\$ 1,196	\$ 8,442	\$ 347,840	\$ 360,147	\$ 877,797
(7) Operation and Maintenance Expenses	Exhibit 2 Pages	\$ 101	\$ 28	\$ 120,498	\$ 120,627	\$ -	\$ 51,260	\$ 361,704	\$ 164,239	\$ 297,830	\$ 995,660
(8) Depreciation Expenses	Exhibit 2 Pages	\$ 58	\$ 16	\$ 44,392	\$ 44,467	\$ -	\$ -	\$ -	\$ 95,023	\$ 100,745	\$ 240,235
(9) Other Taxes	Exhibit 2 Pages	\$ 15	\$ 4	\$ 9,263	\$ 9,281	\$ -	\$ 729	\$ 8,593	\$ 24,093	\$ 26,647	\$ 69,343
(10) Expense Adjustments	Exhibit 2 Page 16	\$ 2	\$ 1	\$ 2,281	\$ 2,283	\$ -	\$ 970	\$ 6,847	\$ 3,109	\$ 5,638	\$ 18,847
(11) Total Cost of Service	(3)+(6)+(7)+(8)+(9)+(10)	\$ 774	\$ 213	\$ 620,343	\$ 621,271	\$ -	\$ 56,198	\$ 399,994	\$ 1,260,338	\$ 1,437,990	\$ 3,775,850
(12) Less: Misc Revenue	Exhibit 2 Page 15	\$ 4	\$ 1	\$ 2,820	\$ 2,824	\$ -	\$ 255	\$ 1,818	\$ 5,728	\$ 6,536	\$ 17,162
(13) Net Cost of Service	(11) - (12)	\$ 770	\$ 212	\$ 617,523	\$ 618,447	\$ -	\$ 55,943	\$ 398,176	\$ 1,254,609	\$ 1,431,454	\$ 3,758,688
(14) Billing Units	Exhibit 2 Page 35	20	73	75	75		8,184,029	8,184,029	9,366	49,067	
(15) Unit Costs	(13) / (14)	\$3.21/Cust/Mo	\$0.24/Cust/Mo	\$686.14/Cust/Mo	\$687.16/Cust/Mo	\$ -	\$0.0068/Mcf	\$0.0487/Mcf	\$133.9535/Mcf	\$29.1735/Mcf	

Generation Special Contract Rate	\$	686
Customer Charge	\$	2.43
Demand Charge	\$	0.0487
Commodity Charge	\$	

Attachment B

Louisville Gas and Electric Company

Unit Cost of Service Based on the Cost of Service Study
For the 12 Months Ended September 30, 2003

IGS

Description	Reference	Customer Costs				Storage Demand-Related Costs	Storage Commodity-Related Costs	Other Commodity-Related Costs	Demand Related Low Pressure Mains Costs	Demand Related High Pressure Mains Costs	Total Costs
		Customer-Related Low Pressure Mains Costs	Customer-Related High Pressure Main Costs	Customer-Related Direct Costs	Total Customer-Related Costs						
(1) Rate Base	Exhibit 2 Pages 3 & 4	\$ 13,199	\$ 1,011	\$ 323,889	\$ 338,099	\$ 2,124,327	\$ 28,328	\$ 7,392	\$ 2,991,230	\$ 641,155	\$ 6,130,531
(2) Rate of Return	Approved IGS ROR	9.14%	9.14%	9.14%	9.14%	9.14%	9.14%	9.14%	9.14%	9.14%	9.14%
(3) Return	(1) x (2)	\$ 1,206	\$ 92	\$ 29,591	\$ 30,889	\$ 194,083	\$ 2,588	\$ 675	\$ 273,286	\$ 58,577	\$ 560,099
(4) Interest Expenses	Exhibit 2 Pages 13 & 14	\$ 225	\$ 17	\$ 4,185	\$ 4,427	\$ 24,159	\$ -	\$ -	\$ 50,927	\$ 10,545	\$ 90,059
(5) Net Income	(3) - (4)	\$ 981	\$ 75	\$ 25,406	\$ 26,462	\$ 169,925	\$ 2,588	\$ 675	\$ 222,358	\$ 48,032	\$ 470,041
(6) Income Taxes		\$ 596	\$ 46	\$ 15,432	\$ 16,028	\$ 103,216	\$ 1,572	\$ 410	\$ 135,066	\$ 29,176	\$ 285,513
(7) Operation and Maintenance Expenses	Exhibit 2 Pages	\$ 1,140	\$ 87	\$ 117,027	\$ 118,254	\$ 125,841	\$ 234,073	\$ 61,082	\$ 258,301	\$ 97,149	\$ 894,701
(8) Depreciation Expenses	Exhibit 2 Pages	659	51	17,255	17,965	70,600	-	-	149,444	32,862	270,871
(9) Other Taxes	Exhibit 2 Pages	167	13	4,423	4,603	18,175	3,328	1,451	37,892	8,692	74,141
(10) Expense Adjustments	Exhibit 2 Page 16	69	5	7,100	7,175	7,635	14,201	3,706	15,671	5,894	54,282
(11) Total Cost of Service	(3)+(6)+(7)+(8)+(9)+(10)	\$ 3,837	\$ 294	\$ 190,829	\$ 194,914	\$ 519,551	\$ 255,763	\$ 67,325	\$ 869,660	\$ 232,350	\$ 2,139,607
(12) Less: Misc Revenue	Exhibit 2 Page 15	66	5	3,305	3,377	8,999	4,430	1,166	15,063	4,024	\$ 37,060
(13) Net Cost of Service	(11) - (12)	\$ 3,771	\$ 289	\$ 187,523	\$ 191,537	\$ 510,551	\$ 251,333	\$ 66,158	\$ 854,596	\$ 228,325	\$ 2,102,548
(14) Billing Units	Exhibit 2 Page 35	226	230	228	228	402,689	1,409,035	1,409,035	14,730	16,005	
(15) Unit Costs	(13) / (14)	\$1.39/Cust/Mo	\$0.10/Cust/Mo	\$68.54/Cust/Mo	\$70.01/Cust/Mo	\$ 1.2679	\$0.1784/Mcf	\$0.0470/Mcf	\$58.0171/Mcf	\$14.2658/Mcf	

Generation Special Contract Rate	
Monthly Customer Charge	\$ 68.64
Monthly Demand Charge	\$ 8.30
Commodity Charge	\$ 0.2253

Attachment C

Louisville Gas and Electric Company

Unit Cost of Service Based on the Cost of Service Study
For the 12 Months Ended September 30, 2003

Total System

Description	Reference	Customer Costs				Storage Demand-Related Costs	Storage Commodity-Related Costs	Other Commodity-Related Costs	Demand Related Low Pressure Mains Costs	Demand Related High Pressure Mains Costs	Total Costs
		Customer-Related Low Pressure Mains Costs	Customer-Related High Pressure Mains Costs	Customer-Related Direct Costs	Total Customer-Related Costs						
(1) Rate Base	Exhibit 2 Pages 3 & 4	\$ 18,205,545	\$ 1,370,398	\$ 96,159,471	\$ 115,735,414	\$ 66,997,006	\$ 895,907	\$ 269,389	\$ 106,913,328	\$ 25,235,329	\$ 316,046,375
(2) Rate of Return	Proposed Overall ROR	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%
(3) Return	(1) x (2)	\$ 1,124,180	\$ 84,621	\$ 5,937,782	\$ 7,146,583	\$ 4,137,020	\$ 55,322	\$ 16,635	\$ 6,601,825	\$ 1,558,264	\$ 19,515,649
(4) Interest Expenses	Exhibit 2 Pages 13 & 14	\$ 309,959	\$ 23,332	\$ 1,463,961	\$ 1,797,252	\$ 761,922	\$ -	\$ -	\$ 1,820,256	\$ 415,051	\$ 4,794,481
(5) Net Income	(3) - (4)	\$ 814,221	\$ 61,289	\$ 4,473,821	\$ 5,349,331	\$ 3,375,097	\$ 55,322	\$ 16,635	\$ 4,781,570	\$ 1,143,213	\$ 14,721,168
(6) Income Taxes		\$ 505,703	\$ 38,066	\$ 2,778,635	\$ 3,284,338	\$ 2,096,231	\$ 34,360	\$ 10,332	\$ 2,969,774	\$ 710,036	\$ 9,143,136
(7) Operation and Maintenance Expenses	Exhibit 2 Pages	\$ 1,572,101	\$ 118,338	\$ 18,264,732	\$ 19,955,171	\$ 3,968,775	\$ 7,402,826	\$ 2,225,941	\$ 9,232,274	\$ 3,823,694	\$ 46,608,680
(8) Depreciation Expenses	Exhibit 2 Pages	909,561	68,466	6,830,097	7,808,124	2,226,592	-	-	1,293,418	16,669,595	16,669,595
(9) Other Taxes	Exhibit 2 Pages	230,622	17,360	1,212,296	1,460,278	573,197	105,252	52,880	5,341,461	342,104	3,888,055
(10) Expense Adjustments	Exhibit 2 Page 16	35,140	2,645	408,260	446,046	88,712	165,471	49,755	206,363	85,469	1,041,815
(11) Total Cost of Service	(3)+(6)+(7)+(8)+(9)+(10)	\$ 4,377,307	\$ 329,496	\$ 35,431,802	\$ 40,100,540	\$ 13,090,526	\$ 7,763,230	\$ 2,355,542	\$ 25,706,042	\$ 7,812,984	\$ 96,866,930
(12) Less: Misc Revenue	Exhibit 2 Page 15	86,223	6,490	697,923	790,636	257,853	152,917	46,399	506,349	153,897	1,908,051
(13) Net Cost of Service	(11) - (12)	\$ 4,291,085	\$ 323,006	\$ 34,733,879	\$ 39,309,904	\$ 12,832,674	\$ 7,610,313	\$ 2,309,143	\$ 25,199,693	\$ 7,659,087	\$ 94,958,879
(14) Billing Units	Exhibit 2 Page 35	311,736	311,815	311,352	311,352	12,700,000	50,462,077	50,462,077	526,486	629,947	
(15) Unit Costs	(13) / (14)	\$1.15/Cust/Mo	\$0.09/Cust/Mo	\$9.30/Cust/Mo	\$10.52/Cust/Mo	\$1.0104/Mcf	\$0.1508/Mcf	\$0.0458/Mcf	\$47.8639/Mcf	\$12.1583/Mcf	

Total Storage Revenue Requirement	\$ 20,442,987
Peak Day Requirements	442,031
Pipeline Demand	265,268
Peak Day Requirements From Storage	176,763
Storage Charge per max MCFd withdraw/injectio	9.64

■ The Prime Group ■

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