LG&E

an e·on company

RECEIVED

DEC 28 2007

PUBLIC SERVICE COMMISSION

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

Louisville Gas and Electric Company
State Regulation and Rates
220 West Main Street
PO Box 32010
Louisville, Kentucky 40232
www.eon-us.com

Lonnie E. Bellar
Vice President
T 502-627-4830
F 502-217-2109
lonnie.bellar@eon-us.com

December 28, 2007

RE: The Plan of Louisville Gas and Electric Company For The Future Disposition Of The Merger Surcredit Mechanism

Dear Ms. O'Donnell:

CASE 2007-00562

Please find enclosed and accept for filing the original and ten (10) copies of the Application of Louisville Gas and Electric Company addressing its Plan for the Future Disposition of the Merger Surcredit Mechanism.

Should you have any questions concerning the enclosed, please contact me at your convenience.

Sincerely,

Lonnie E. Bellar

Lonnie E. Bellar

Enclosures

cc: Office of the Attorney General
Boehm Kurtz & Lowry

RECEIVED
DEC 28 2007
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE FUTURE DISPOSITION OF THE MERGER SURCREDIT MECHANISM	))))	**CASE NO. 2007-** 00562

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 Kentucky Public Service Commission ("Commission") Order and Settlement Agreement in Case No. 2002-00430[1], hereby applies to the Commission for authority to withdraw from service its Merger Surcredit Rider tariff for electric service following the expiration of the ten year period ending June 30, 2008, subject to any final balancing adjustment.

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

1. Address: 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.

[1] In the Matter of: Louisville Gas and Electric Company's Plan To Address The Future Of The Merger Surcredit Approved By The Kentucky Public Service Commission In Case No. 97-300.

2. Articles of Incorporation: A certified copy of LG&E's Articles of Incorporation is on file with the Commission in Case No. 2005-00471, *In the Matter of: Application of Louisville Gas and Electric Company and Kentucky Utilities Company for Authority to Transfer Functional Control of their Transmission System*, filed on November 18, 2005, and is incorporated by reference herein pursuant to 807 KAR 5:001, Section 8(3).

3. LG&E is a public utility, as defined in KRS 278.010(3)(a), 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, Spencer, Trimble and Washington Counties.

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

Lonnie E. Bellar, Vice President
State Regulation and Rates
E.ON U.S. LLC
220 West Main Street
Louisville, Kentucky 40202

Allyson K. Sturgeon
Senior Corporate Attorney
E.ON U.S. LLC
220 West Main Street
Louisville, Kentucky 40202

Kendrick R. Riggs
Stoll Keenon Ogden PLLC
2000 PNC Plaza

500 West Jefferson Street
Louisville, Kentucky 40202

5. This Application is filed pursuant to Item 4 of the Terms of Distribution in the Merger Surcredit Rider Tariff, Sheet No. 73.1, which requires LG&E to present a plan for the future disposition of the merger surcredit midway through Year 10 of the rate schedule.

6. This Application and supporting testimony constitutes LG&E's Plan under Item 4 of the Merger Surcredit Rider. Upon receipt of a Commission Order, the Merger Surcredit will be allowed to expire subject to the final balancing adjustment, after which the Merger Surcredit Rider tariff will be cancelled and withdrawn.

7. LG&E supports its request for authority to withdraw the Merger Surcredit Rider tariff with the testimony of Lonnie E. Bellar, Vice President, State Regulation and Rates for E.ON U.S. Services Inc. Mr. Bellar will present LG&E's Plan for withdrawal of the Merger Surcredit. Mr. Bellar's testimony will also present the supporting reasons why LG&E's Plan is reasonable and should be approved.

8. This Application constitutes notice to the Commission of the proposed termination and withdrawal from service of LG&E's Merger Surcredit Rider tariff for electric service by the expiration of the ten year period ending June 30, 2008. Pursuant to the Merger Surcredit Rider, the tariff will remain in effect until the Commission issues its final order in this proceeding. The final balancing adjustment will be applied to customer billings in the second month following the receipt of the Commission's order. The Merger Surcredit Rider tariff shall be withdrawn from service as of the first day of the month following the distribution of the final balancing adjustment.

9. LG&E's next base rate case will guarantee that 100% of the financial impact of operating efficiencies that originated with the merger with Kentucky Utilities Company

will be provided to LG&E's customers. Unlike in previous cases, LG&E will not include an expense adjustment for the shareholder portion of merger savings, thereby ensuring that customers receive the full benefit of all future operating efficiencies.

WHEREFORE, Louisville Gas and Electric Company respectfully requests the Kentucky Public Service Commission to enter an order approving the termination and withdrawal from service of its Merger Surcredit Rider tariff effective June 30, 2008 as proposed herein.

Dated: December 28, 2007

Respectfully submitted,

Allyson K Sturgeon

Allyson K. Sturgeon
Senior Corporate Attorney
E.ON U.S. LLC
220 West Main Street
Post Office Box 32010
Louisville, Kentucky 40232
Telephone: (502) 627-2088

Kendrick R. Riggs
Stoll Keenon Ogden PLLC
2000 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202-2828
Telephone: (502) 333-6000

Counsel for Louisville Gas and Electric Company

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Application was sent to the following attorneys of record by U.S. mail, postage prepaid, on this 28th day of December, 2007.

Dennis Howard II
Lawrence Cook
Assistant Attorneys General
Office of the Attorney General
Office of Rate Intervention
1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204

Michael L. Kurtz
David F. Boehm
Boehm Kurtz & Lowry
35 E. Seventh Street
Suite 1510
Cincinnati, OH 45202

Allyson K Sturgeon

Counsel for Louisville Gas and Electric Company

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE FUTURE DISPOSITION OF THE MERGER SURCREDIT MECHANISM	))))	CASE NO. 2007-00xxx

TESTIMONY OF
LONNIE E. BELLAR
VICE PRESIDENT, STATE REGULATION AND RATES
E.ON U.S. SERVICES, INC.

Filed: December 28, 2007

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

A. My name is Lonnie E. Bellar. I am Vice President, State Regulation and Rates for E.ON U.S. Services Inc., which provides services to Louisville Gas and Electric Company ("LG&E" or "the Company") and Kentucky Utilities Company ("KU") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky. A statement of my professional history and education is attached to this testimony as Appendix A.

Q. Have you previously testified before this Commission?

A. Yes. I have previously testified before this Commission in environmental surcharge, fuel adjustment clause and other proceedings in my previous positions with the Companies.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss the merger surcredit and to present LG&E's "plan for the future disposition of the merger surcredits"[1] ("the Plan") and to demonstrate why LG&E's Plan is reasonable and should be approved.

Merger Surcredit Mechanism

Q. Please describe the history of the Merger Surcredit rate mechanism.

A. In their Application to the Commission for approval of their merger in Case No. 97-300, LG&E and KU proposed to share with customers, through a merger surcredit, 50% of the estimated non-fuel savings resulting from the merger, for the first five years after the merger. This surcredit was based on an analysis conducted by the Deloitte & Touche Consulting Group, LLC ("Deloitte & Touche") on behalf of the

[1] Section 4.1 of the Settlement Agreement approved by the Commission's October 16, 2003 orders in Case Nos. 2002-00429 and 2002-00430.

Companies prior to the public announcement of the transaction in May 1997, which estimated LG&E's and KU's post-merger savings for a period of 10 years. In its September 12, 1997 Order approving the merger of LG&E and KU, the Commission approved the proposed merger surcredit for the first five-year period and further ordered the Companies to initiate, in the fifth year following the merger, a proceeding to address the future of the merger surcredit. LG&E customers received over $55 million in surcredit benefits over the first five-year period.

On January 13, 2003, the Companies filed an application[2] to continue the fifth year level of gross merger savings from the Deloitte & Touche study on a continued 50-50 basis, for years six through ten following the merger. The Companies assessed the reasonableness of the escalation and fixed charge rates used by Deloitte & Touche in the estimate for the savings over the ten-year period under then current economic conditions. This assessment demonstrated that using the gross fifth year level of non-fuel savings from the original Deloitte & Touche analysis for the remaining five-year period was within the range of scenarios analyzed with the updated economic conditions.

Representatives of consumer interests, including the Attorney General, met with LG&E and KU at the Attorney General's office during the summer of 2003 and reached a unanimous Settlement Agreement ("2003 Settlement Agreement"). Under the terms of the 2003 Settlement Agreement, LG&E's electric customers, excluding certain accounts for specific LG&E industrial customers, were to receive a total of

---

[2] *In the Matter of: Louisville Gas and Electric Company's Plan to Address the Future of the Merger Surcredit Approved by the Kentucky Public Service Commission in Case No. 1997-00300,* Case No. 2002-00430, *Kentucky Utilities Company's Plan to Address the Future of the Merger Surcredit Approved by the Kentucky Public Service Commission in Case No. 1997-00300,* Case No. 2002-00429

$90,226,275 over the five-year period ending June 30, 2008, through the operation of LG&E's merger surcredit mechanism. Included in the 2003 Settlement Agreement was a provision for certain accounts for specific LG&E industrial customers to receive their five year merger surcredit distributions as one lump-sum payment, discounted to present value, and paid out in 2003 to those customers.

The Commission approved the 2003 Settlement Agreement in its Order dated October 16, 2003 in Case No. 2002-00430.

Q. Please describe the ratemaking treatment associated with the Merger Surcredit.

A. The shareholder portion of the merger surcredit was first included in LG&E's electric base rates as a result of the Commission's January 7, 2000 Order in Case No. 1998-00426.[3] LG&E's net operating income found reasonable was adjusted by an increase to jurisdictional expense to reflect eight months of the gross level of savings. In LG&E's 2003 rate case, the shareholder adjustment was also included in the calculation of the revenue requirement for LG&E's base electric rates by a separate adjustment to test year operating expenses. The rate case test year used to calculate the electric revenue requirements also included an adjustment to remove amortization of the costs to achieve, since those costs were fully amortized during the test year and therefore did not represent an ongoing expense.

Q. Has the Merger Surcredit mechanism been successful?

A. Yes. The Merger Surcredit mechanism is providing LG&E's electric customers with their share of the merger savings or $145.7 million over the ten-year period in which the mechanism is intended to be in effect.

[3] In the Matter of: The Application of Louisville Gas and Electric Company For Approval Of An Alternative Method Of Regulation Of Its Rates and Services, Case No. 98-426, Order (January 7, 2000)

Plan for Merger Surcredit

Q. Please describe the Plan for the Merger Surcredits.

A. LG&E is proposing to allow the Merger Surcredit Rider to expire and withdraw the tariffs from electric service effective June 30, 2008 subject to a final balancing adjustment. However, in accordance with the terms of Item 4 of the Terms of Distribution in the Merger Surcredit Rider Tariff, Sheet No. 73.1, LG&E will continue the merger surcredit until the Commission enters an order, if such order is not received prior to the scheduled expiration date of the Merger Surcredit Rider. But, as discussed below, simply allowing the Merger Surcredit Rider Tariff to continue to operate after June 30, 2008 creates complications and problems.

Q. Why should the Merger Surcredit expire on June 30, 2008?

A. As previously discussed, the merger surcredit was established for a ten-year period based on merger savings estimates provided by Deloitte & Touche that are now more than ten years old. That ten-year period will end June 30, 2008. By the end of the ten-year period, the Merger Surcredit will have provided a total of $145.7 million in net savings for LG&E's electric customers, representing 50% of the net savings estimated by Deloitte & Touche. Thus, by June 30, 2008, the merger surcredit will have served its purpose and run its course. The appropriate question for decision in this case, therefore, is not whether to extend the merger surcredit, but how to equitably terminate the surcredit.

Q. Why is LG&E's proposed Merger Surcredit termination plan equitable to shareholders and customers?

A. From its inception, the purpose of the Merger Surcredit has been to split evenly merger savings between LG&E's shareholders and customers. That is, customers would pay base rates which cover the cost of providing service, including a reasonable return on investment. The customers would then be guaranteed their share of the merger savings via the surcredit while LG&E would receive its share of the merger savings by including them as part of its revenue requirement. In practice, however, when LG&E has a need to file a base rate application, it is no longer receiving its share of the merger savings during the test year and until new base rates go into effect -- some 21 months after the beginning of a test year. Actually, under these circumstances, customers in effect are receiving 100% of the merger benefits when the Company's earnings deficit relative to authorized reasonable levels exceeds LG&E's share of the merger savings.

Moreover, when LG&E files its next application for a change in base rates, it will no longer make the pro forma adjustment to net operating income that has provided shareholder savings in the past and will make a pro forma adjustment to remove any surcredit payments made in the test year. As a result of LG&E's plan to terminate the merger surcredit in this fashion, customers will receive 100% of the merger savings going forward for an indefinite period of time. Under this approach LG&E anticipates filing a base rate application in 2008. LG&E asks in return that the Merger Surcredit be allowed to expire on June 30, 2008, the date on which it is currently scheduled to expire. This arrangement brings the Merger Surcredit to an equitable end by effectively providing customers with 100% of the savings well before the Merger Surcredit is set to expire and providing a defined limit to the negative implications of regulatory lag on shareholders.

Q. What practical and analytical difficulties will arise if the Merger Surcredit does not terminate on June 30, 2008?

A. Numerous significant practical and analytical difficulties will arise if the Merger Surcredit does not terminate on June 30, 2008. The first significant difficulty is that there simply are no reasonable data to support continuing the surcredit. As I stated earlier in this testimony, the current merger surcredit level is based solely on year five (i.e., 2002-03) projected savings data, adjusted by a five-year old, negotiated settlement. The original savings projected for years six through ten of the ten-year period are largely the function of the cost escalators that are now out of date and were applied to estimates of savings that were expected to occur during the first three years following the merger.

Data of actual savings simply does not and cannot exist: as Michael S. Beer stated in his testimony for LG&E in Case No. 2002-00430, "… LG&E and KU stated … they could not track savings once the merger was consummated, and have not done so."[4]

Second, the surcredit levels negotiated and implemented five years ago, which are currently in effect today, were adjusted to reflect certain large lump-sum payments LG&E made to several industrial customers. The lump-sum payments represented the total amount of merger surcredits for years six through ten that would have been included on those customers' bills, appropriately discounted to reflect their then-present value. The payments to LG&E industrial customers totaled $6,910,728; while payments to the industrial customers of LG&E's sister company, Kentucky

Utilities Company, totaled $5,202,222; and payments to certain accounts for LFUCG totaled $147,237. The agreed-upon payments to certain LG&E industrial customers were presented to the Commission as Exhibit 2 of the 2003 Settlement Agreement, and are reproduced and attached to my testimony as Exhibit LEB-1. The exhibits demonstrate that the Merger Surcredit cannot simply be extended at its current level because of the customers who received the lump sum payments almost five years ago.

Third, the existing surcredit amounts are the product of negotiations and unanimous settlement and not the function of any particular economic analysis. In fact, the gross fifth year level of non-fuel savings was adjusted through negotiation among all parties, and the final result is not equivalent to the gross fifth-year level of non-fuel savings. Negotiations resulted in a one percentage point increase in the discount rate used to calculate the then-present value of the merger surcredit payments to certain LG&E and KU industrial customers. This increase in the discount rate resulted in $300,000 being added to the surcredit payment to all other customers. Negotiations further resulted in an additional increase to the gross fifth year level of non-fuel savings of $700,000, contributed by the Companies, to provide compensation to all customers who were ineligible to receive the agreed-to lump-sum payments. These negotiated, agreed-to increases to non-fuel savings totaling $1 million complicates the continuation of the merger surcredit in a fair and equitable manner, and are further evidence that current merger surcredit levels are not based on current economic data.

Conclusion

[4] *In the Matter of: Louisville Gas and Electric Company's Plan to Address the Future of the Merger Surcredit Approved by the Kentucky Public Service Commission in Case No. 1997-00300*, Testimony of Michael S. Beer, page 7.

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

A. The Commission should approve LG&E's Plan and issue an order permitting the withdrawal of the Merger Surcredit from electric service rendered on and after June 30, 2008, subject to a final balancing adjustment in the August 2008 billing month.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Lonnie E. Bellar**, being duly sworn, deposes and says he is the Vice President State Regulation and Rates for E.ON U.S. 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.

Lonnie E Bellar
LONNIE E. BELLAR

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 19th day of December 2007.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:
November 9, 2010

Appendix A

Lonnie E. Bellar
E.ON U.S. Services Inc.
220 West Main Street
Louisville, Kentucky 40202
(502) 627-4830

Education

Bachelors in Electrical Engineering;
University of Kentucky, May 1987
Bachelors in Engineering Arts;
Georgetown College, May 1987
E.ON Academy, Intercultural Effectiveness Program: 2002-2003
E.ON Finance, Harvard Business School: 2003
E.ON Executive Pool: 2003-2007
E.ON Executive Program, Harvard Business School: 2006
E.ON Academy, Personal Awareness and Impact: 2006

Professional Experience

E.ON U.S.

Vice President, State Regulation and Rates	Aug. 2007 – Present
Director, Transmission	Sept. 2006 – Aug. 2007
Director, Financial Planning and Controlling	April 2005 – Sept. 2006
General Manager, Cane Run, Ohio Falls and Combustion Turbines	Feb. 2003 – April 2005
Director, Generation Services	Feb. 2000 – Feb. 2003
Manager, Generation Systems Planning	Sept. 1998 – Feb. 2000
Group Leader, Generation Planning and Sales Support	May 1998 – Sept. 1998

Kentucky Utilities Company

Manager, Generation Planning	Sept. 1995 – May 1998
Supervisor, Generation Planning	Jan. 1993 – Sept. 1995
Technical Engineer I, II and Senior, Generation System Planning	May 1987 – Jan. 1993

Professional Memberships

IEEE

Exhibit 2

Louisville Gas and Electric Company

One-time Payments to Certain Industrial Customers

Customer	Account	Total Billings	Merger Surcredit	Total Billings Less Merger Surcredit	Allocation Factor	Discounted Merger Surcredit Amount
		12 Months Ended December 2002				
						$ 78,165,944
E I duPont & Co Inc	1000593434001	$ 4,871,515.53	$ (125,650.01)	$ 4,997,165.54	0.829805%	$ 648,625.10
Golden Foods	8000001882001	602,725.35	(15,546.33)	618,271.68	0.102667%	80,250.80
Carbon Industries, LLC	0000945185001	6,791,778.43	(174,839.64)	6,966,618.07	1.156843%	904,257.28
Arch Chemicals, Inc.	9000000737001	1,871,213.33	(48,295.36)	1,919,508.69	0.318744%	249,149.54
Ford Motor Company-KTP	7000596830001	8,858,266.05	(228,350.30)	9,086,616.35	1.508880%	1,179,430.09
Ford Motor Company-LAP	9000000182001	5,088,919.89	(131,218.89)	5,220,138.78	0.866831%	677,566.71
Kosmos Cement Co Inc	1000596121001	5,255,116.15	(135,706.87)	5,390,823.02	0.895174%	699,721.29
Rohm & Haas Co	9000000656001	3,402,928.39	(87,780.73)	3,490,709.12	0.579650%	453,089.16
Oxy Vinyls LP	3000861188001	5,765,179.76	(148,510.77)	5,913,690.53	0.981999%	767,588.76
General Electric Co	000596953001	7,907,696.93	(203,798.29)	8,111,495.22	1.346956%	1,052,860.73
Alcan Rolled Products	8000002567001	608,870.09	(15,744.13)	624,614.22	0.103720%	81,074.05
Protein Technologies	8000002662002	879,604.04	(22,671.14)	902,275.18	0.149827%	117,114.06
Total KIUC Members served by LG&E		$ 51,903,813.94	$ (1,338,112.46)	$ 53,241,926.40	8.841098%	$ 6,910,727.58
Total LG&E		$ 587,153,607.29	$ (15,055,844.00)	$ 602,209,451.29		
Percentage of Total		8.839904%	8.887662%	8.841098%		