an e·on company

Stephanie L. Stumbo
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

RECEIVED
MAR 28 2008
PUBLIC SERVICE
COMMISSION

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

Robert M. Conroy
Director - Rates
T 502-627-3324
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robert.conroy@eon-us.com

March 28, 2008

RE: ***APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY TO FILE DEPRECIATION STUDY***
CASE NO. 2007-00564

Dear Ms. Stumbo:

Please find enclosed and accept for filing the original and seven (7) copies of the Response of Louisville Gas and Electric Company to the Attorney General's Initial Requests for Information dated February 4, 2008, in the above-referenced matter.

The Verification Page for John J. Spanos will be filed the week of March 31-April 4, 2008 on his return to the office.

Also enclosed with this filing are an original and ten (10) copies of a Petition for Confidential Protection regarding information provided in response to Questions 6 and 7.

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

Sincerely,

Robert M. Conroy

Robert M. Conroy

Enclosures

cc: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED
MAR 28 2008
PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY TO FILE DEPRECIATION STUDY	)))	CASE NO. 2007-00564

RESPONSE OF
***LOUISVILLE* GAS AND ELECTRIC COMPANY**
TO THE
ATTORNEY GENERAL'S
INITIAL REQUESTS FOR INFORMATION
DATED FEBRUARY 4, 2008

FILED: MARCH 28, 2008

VERIFICATION

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Shannon L. Charnas**, being duly sworn, deposes and says that she is the Director, Utility Accounting and Reporting for E.ON U.S. Services Inc., that she has personal knowledge of the matters set forth in the responses for which she is identified as the witness, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

Shannon L Charnas
SHANNON L. CHARNAS

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 26th day of March, 2008.

Tina N Sizemore (SEAL)
Notary Public

My Commission Expires:

July 1, 2008

VERIFICATION

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Robert M. Conroy**, being duly sworn, deposes and says that he is the Director, Rates for E.ON U.S. Services Inc., that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Robt M. Conroy
ROBERT M. CONROY

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 26th day of March, 2008.

Victoria B Harper (SEAL)
Notary Public

My Commission Expires:

Sept 20, 2010

VERIFICATION

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **J. Scott Cooke**, being duly sworn, deposes and says that he is the Manager, Generation Planning for E.ON U.S. Services Inc., that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

J Scott Cooke
J. SCOTT COOKE

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 26th day of March, 2008.

Victoria B. Harper (SEAL)
Notary Public

My Commission Expires:
Sept 20, 2010

VERIFICATION

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Barry R. Walker**, being duly sworn, deposes and says that he is the Director, Gas Storage Control and Compliance for E.ON U.S. Services Inc., that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Barry R. Walker

BARRY R. WALKER

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 26TH day of March, 2008.

J. D. Dillman (SEAL)
Notary Public

My Commission Expires:
Notary Public, State at Large, KY
My commission expires March 27, 2011

VERIFICATION

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **W. Michael Winkler**, being duly sworn, deposes and says that he is the Manager, Environmental Programs for E.ON U.S. Services Inc., that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

W. Michael Winkler
W. MICHAEL WINKLER

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 26th day of March, 2008.

Victoria B. Harper (SEAL)
Notary Public

My Commission Expires:
Sept 20, 2010

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 1

Witness: John J. Spanos

Q-1. Please provide copies of all workpapers underlying the Depreciation Study prepared by John Spanos of Gannett Fleming. Provide in hard copy and, when applicable, in electronic format (Excel) with all formulae intact.

A-1. The attached CD contains the workpapers underlying the depreciation study prepared by John Spanos of Gannett Fleming, Inc. By agreement with the Attorney General, hard copies are not being provided.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 2

Witness: John J. Spanos

Q-2. Please provide all information obtained by Mr. Spanos and/or Gannett Fleming from Company operating personnel, and separately, financial management personnel relative to current operations and future expectations in the preparation of the Depreciation Study. All information should be provided in the same format it was provided to Mr. Spanos. Also, please provide all notes taken during any meetings with Company personnel regarding this study. Please identify by name and title, all Louisville Gas and Electric Company ("LG&E") personnel who provided the information, and explain the extent of their participation and the information they provided.

A-2. See the response to AG-1.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 3

Witness: John J. Spanos

Q-3. Please identify all plant tours taken during the preparation of the Depreciation Study.

a. Identify those in attendance and their titles and job descriptions.
b. Provide all conversation notes taken during the tour.
c. Provide all photographs and images taken during the tour.

A-3. a. The following table sets forth those in attendance and their titles, during the various field tours taken for the Depreciation Study.

Name	Title
John Spanos	Vice President, Gannett Fleming
Sara Wiseman	Manager, Property Accounting
Eric Riggs	Property Accounting Analyst
Diana Wacker	Property Accounting Analyst
Bruce Rose	Property Accounting Analyst
Ed Clark	Property Accounting Analyst
Steven Turner	General Manager, Cane Run, Ohio Falls, Combustion Turbines
Michael Buckner	Production Supervisor, Mill Creek
Wesley Moll	Manager – Production, Trimble County
Samuel Carr	Manager, Commercial Operations, E.W. Brown
Thomas Moore	Manager, E.W. Brown Major Construction
Chris Brown	Group Leader, Substation Construction & Maintenance
Fred Jackson	Director, Generation Services
Jeff Joyce	General Manager, Ghent
Paul Wright	Manager – Production, Ghent
Mark Bradshaw	Electric System Coordinator,

	Transmission
David Cosby	Commercial Operations Manager, Trimble County
Mike Collins	Team Leader, Instrument Measurement & Electric, Distribution Operations
Dave Harmeling	Engineer – Gas Storage, Muldraugh
Tim Sanders	Supervisor, Facility Operations

b. & c. The notes and photographs taken during the site visits in May 2007 are being provided on the attached CD.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 4

Witness: Shannon L. Charnas

Q-4. Provide all internal and external audit reports, management letters, consultants' reports etc. from 2005-2007, inclusive, which address in any way, the Company's property accounting and/or depreciation practices.

A-4. Please see the Company's response to AG-1 for the Life Assessment Study and AG-103 for certain Reports of Independent Public Accounting Firms.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 5

Witness: Shannon L. Charnas

Q-5. Please provide copies of all Board of Director's minutes and internal management meeting minutes from 2005-2007, inclusive, in which the subject of the Company's depreciation rates or retirement unit costs were discussed.

A-5. There were no Board of Director meeting minutes in which the subject of depreciation rates or retirement unit costs were discussed. Please see the Company's response to AG-98 for internal management meeting minutes.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 6

Witness: Shannon L. Charnas / Robert M. Conroy

Q-6. Please provide copies of all internal correspondence from 2005-2007, inclusive, which deals in any way with the Company's retirement unit costs, electric, gas and/or common depreciation rates, and/or the Depreciation Study.

A-6. LG&E has sought confidential treatment for certain documents in response to this question through the filing of a Joint Petition for Confidential Protection in this proceeding. A copy of all non-confidential documents responsive to this request that also are not subject to the attorney-client privilege or attorney work product protection are provided on the attached CD.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 7

Witness: John J. Spanos

Q-7. Please provide copies of all external correspondence from 2005-2007, inclusive, including correspondence with Mr. Spanos and/or Gannett Fleming., which deals in any way with the Company's retirement unit costs, electric, gas and/or common depreciation rates, and/or the Depreciation Study.

A-7. The correspondence between Mr. Spanos and E.ON U.S. personnel related to the Depreciation Study is being provided on the attached CD. Also, see the response to AG-6. LG&E has sought confidential treatment for certain documents in response to this question through the filing of a Joint Petition for Confidential Protection in this proceeding.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 8

Witness: John J. Spanos

Q-8. Please provide copies of all industry statistics available to Mr. Spanos and/or LG&E relating to electric or common depreciation rates. Also, identify all industry statistics upon which Mr. Spanos or the Company relied in formulating the depreciation proposals.

A-8. The industry statistics primarily relied upon by Mr. Spanos in formulating the depreciation proposals are being provided on the attached CD.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 9

Witness: John J. Spanos

Q-9. On an account-by-account basis, which accounting method is reflected in the life studies; "location-life" or "cradle-to-grave"? Also, what is impact of the accounting method used on the lives calculated in the Depreciation Study?

A-9. Based on the manner in which the question is formulated, all production plant is based on probable retirement dates and interim survivor curves by location, therefore, "location-life." All transmission, distribution and general plant is "cradle-to-grave". Mr. Spanos views all assets to be "cradle-to-grave".

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 10

Witness: Shannon L. Charnas

Q-10. Please provide explanatory examples of the debits and credits relating to customer advances and contributions-in-aid of construction.

A-10. Customer advances for construction are amounts advanced by customers to extend service that are subject to refund in whole or in part. The time or extent of refund is dependent on the terms of specific customer contracts and agreements. The advance is initially established in a deferred credit account. Throughout the term of the agreement, refunds may be given to the customer if original costs paid by that customer are offset by new customers. When the agreement terminates, any un-refunded balance is transferred to the appropriate plant account as a Contribution in Aid of Construction. The entries for this process are:

<u>Create invoice based on contract terms:</u>
Debit 143007 – Accounts Receivable – Non Project Utility Acctg Use Only
Credit 184650 – Customer Advances Clearing

<u>Payment received:</u>
Debit 184650 – Customer Advances Clearing
Credit 252001 – Line Extensions

Debit 131092 – Cash – BOA Funding
Credit 143007 – Accounts Receivable – Non Project Utility Acctg Use Only

<u>Refund paid:</u>
Debit 252001 – Line Extensions
Credit 232008 – Sundry Billing Refunds

Debit 232008 – Sundry Billing Refunds
Credit 131092 – Cash – BOA Funding

<u>Un-refunded balance:</u>
Debit 252001 – Line Extensions
Credit 107001 – Construction Work In Progress

Contributions in Aid of Construction are non-refundable amounts paid by states, municipalities, other governmental agencies, individuals, and others for construction of facilities. The total contribution in aid of construction is credited to Account 101, Plant in Service. In instances where this would result in negative property unit values, the excess amounts of such contributions are credited to account 108 Accumulated Provision for Depreciation of Utility Plant. The entries for this process are:

Create invoice based on contract terms:
Debit – 143 Other Accounts Receivable
Credit 107001 – Construction Work in Progress

Payment received:
Debit 131050 – Sundry Cash Collect
Credit 143 – Other Accounts Receivable
Credit 108001 – Accumulated Depreciation – Plant

Classified to plant in service:
Debit 107001 - Construction Work In Progress
Credit 101 - Plant in Service

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 11

Witness: Shannon L. Charnas

Q-11. Please provide explanatory examples of the debits and credits relating to the accounts for which depreciation is charged to clearing accounts.

A-11. Consistent with FERC plant instructions, depreciation expense on utility owned equipment used to transport fuel from the point of acquisition to the unloading point is charged to account 151 Fuel Stock. This equipment primarily consists of rail cars and locomotives. No further allocation is required. Account 151 is debited with the monthly depreciation expense with a corresponding credit charged to account 108, Accumulated Reserve for Depreciation.

Depreciation expense on transportation equipment is charged to clearing account 184 with a corresponding credit to account 108, Accumulated Reserve for Depreciation. On a monthly basis the amounts charged to 184 are allocated to the specific responsible center to which the vehicle is assigned. This allocation is based on labor dollars charged to the responsible center.

For example, assume the responsible center in the following example has one vehicle with monthly depreciation expense of $100. Each project within the expenditure organization is allocated a portion of depreciation expense based on total labor dollars.

	Labor Dollars		Depreciation Expense	Allocated Depreciation	Total Project Charges
Project 1	500.00	6.2%		6.20	506.20
Project 2	600.00	7.4%		7.40	607.40
Project 3	7,000.00	86.4%		86.40	7,086.40
	$ 8,100.00		$ 100	$ 100.00	$ 8,200.00

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 12

Witness: Shannon L. Charnas

Q-12. Please provide a copy of the Company's current capitalization policy. If the policy has changed at all since 2000, please provide a copy of all prior policies in effect during any portion of that period.

A-12. See attached.

E.ON US
Capitalization Policy

Effective 12/01/07 to Present

E.ON U.S. LLC Policy

Capital and Investment Review

Policy
The primary purpose of the Capital and Investment Review Policy is to establish a uniform process for:

1. capital planning and budgeting;
2. authority for the expenditure of funds;
3. control and reporting of capital expenditures;
4. development of review criteria for the authorization process;
5. recording lessons learned for future investments and decisions; and
6. determining how the investment is operating and how the returns compare to the project as sanctioned.

Further, these policies will provide management with the necessary tools to make informed business decisions. A capital expenditure includes adding, replacing or retiring units of property through the construction or acquisition process. Generally, it is inappropriate to capitalize expenditures that are part of routine or necessary maintenance programs. If a substantial improvement is made to an asset, the following criteria should be used to determine whether or not capitalization is appropriate:

1. Does the improvement extend the original useful life of the asset?
2. Does the improvement increase the throughput or capacity of the asset?
3. Has operating efficiency been improved?
4. Does the expenditure meet the definition of a capitalizable cost under the FERC Uniform System of Accounts?

If you answer yes to any of the above questions, capitalization is appropriate for your project. Questions relating to the categorization of an expense as capital or O&M should be referred to Property Accounting for utility matters or the appropriate fixed-asset accounting group for non-utility operations. The Controller will have the ultimate authority of interpreting expense versus capital decisions based on generally accepted accounting principles. See Property Accounting's Home Page.

Scope
This policy applies to all E.ON U.S. LLC and its subsidiaries' (Company) employees.

General Requirements
1. All capital spending that is expected to occur during the year must be budgeted in the current-year commitment.
2. There will be no carry-over of spending capital authority from one year to the next.
3. An Authorization for Investment Proposal (AIP) form must be completed for **all** capital spending projects.
4. Projects with a total cost of $2,000 or less will be expensed.
5. An Investment Proposal must be completed for all capital spending projects greater than $300,000.

6. The Information Technology Department must approve **all** capital projects involving anything related to information technology.
7. All information technology or development projects greater than $ 500,000 and all other projects greater than $1,000,000 require the approval of the Investment Committee.

Capital Planning

The multi-year Capital Investment Plan will be used to inform senior management of future capital-spending projections. These plans are prepared annually on an operating business unit (OBU) basis and include the forecast of capital projections during the annual planning period. The first year of the capital investment plan, once approved, becomes the formal budget for that year.

Carry-Over Spending: During preparation of the Three-year Capital Investment Plans, each OBU will review all current-year projects to determine if they will be completed as of the end of the year. If a project is expected to be in process at year-end, but not complete, it must be included in the following year's Three-year Capital Investment Plan for additional funds to be approved.

Capital Approval Process

Authorization for Investment Proposal: Although specific capital projects are identified in the budgeting process, they are still subject to the Authority Limit Matrices signature requirements and all other signature reviews as stated on the face of the AIP. Projects are not considered approved until appropriate signatures are obtained as stated on the AIP form.

The AIP form is used to request the appropriate approvals for spending on capital projects. A completed AIP is required under the following conditions:

- An AIP form must be submitted and approved prior to committing to or incurring any capital expenditure. Approvals must be obtained in the sequence shown in the approval section of the AIP form.
- Approvals must be obtained up to the levels designated in the Authority Limit Matrices for the dollar amount of any project (which may include multiple AIPs).
- Any AIP over $300,000, except for development proposals, must include an Investment Proposal and Capital Evaluation Model and must be submitted to the appropriate Financial Planning Department for approval. Development proposals must have other adequate supporting documentation attached and, should they become viable projects, must have a revised AIP submitted, accompanied by the Investment Proposal and Capital Evaluation Model if over the $300,000 threshold.
- A completed AIP form must be submitted and approved prior to the disposal of any capital asset. In addition, an Investment Proposal must be submitted for disposal projects of $300,000 or more.
- A revised AIP must be submitted for significant project overruns (See below).

- Instructions provided with the AIP form must be followed.

Investment Proposal: The Investment Proposal is used to explain in detail the nature and justification of the capital project. Capital projects over $300,000 on a fully loaded basis require the submittal of an Investment Proposal and Capital Evaluation Model along with the AIP. The following format will provide senior management with consistent information for evaluating capital projects. The Investment Proposal should include the following sections:

- Full description, including alternative options and strategic justification.
- Breakdown of investment amount by year, by type of spend (capital/revenue/working capital).
- Cost of own staff allocated to the project is not included in the investment value but should be separately disclosed.
- The amount to be sanctioned must include an appropriate risk margin.
- Capitalized interest must be included as part of capital spending on discrete projects in excess of €50 million based on the current exchange rate at the time of the preparation of the Investment Proposal which can be obtained at the xe.com website. Please consult Property Accounting for the current interest rate to use in the Capital Evaluation Model based on the most recent embedded cost of debt calculation. Also, if in doubt about whether the project qualifies for capitalized interest, please consult Property Accounting for assistance. When a project qualifies for capitalized interest, two Capital Evaluation Models must be run and attached to the Investment Proposal: one without capitalized interest for regulatory purposes and one with capitalized interest under International Financial Reporting Standards (IFRS). Approved spending levels and analysis of the economics of the project are to be based solely on the IFRS view, inclusive of capitalized interest.
- Economics:
    - NPV* and IRR* should be based on the post tax nominal cash flows.
    - The economics should be calculated on central case cash flows, but include the full investment amount (i.e. including any risk margin).
    - For projects that will not be consolidated (generally less than 50% ownership) the economics should be calculated on the dividend stream to the Company. The project return should also be shown, but this measure is second order to the equity impact.
    - Value added* is calculated as the difference between the ROCE* and the pre tax nominal cost of capital, multiplied by the capital employed.

      Value Added* = ROCE* – [E.ON WACC * Capital Employed for the Project]

      $$\text{ROCE*} = \frac{\text{Earnings before tax}}{\text{Capital Employed Company-wide}}$$

    - Other economic measures may be shown e.g. payback period (number of years for the cumulative nominal post tax cash flows to exceed the investment cost).

Capital and Investment Review

- Impact on E.ON U.S. financial statements. The impact on EBIT, internal operating profit, net income, net debt and cash flow should be shown at a minimum. The time horizon should be appropriate to the investment.
- Risk assessment and sensitivity analysis. Sensitivities should show the impact on the financial statements (particularly internal operating profit and cash flow) as well as the impact on the NPV* and IRR*.
- Breakdown of synergies; indicating a sensitivity to show the impact of not achieving the synergies.
- How the project will be managed including accountabilities (especially for realizing the synergies) in all stages of the process.
- Assumptions must be stated.
- Reference to supporting documents (e.g. functional reports).
- Budget / plan provision for project.
- Milestone plan.
- Environmental impact of the investment.

*For these and other definitions, see Investment Proposal Guidelines (EON Planning and Controlling Manual, section C.8.5.3).

Unbudgeted Projects: Any capital expenditure that is not included in the original, approved budget, must either be offset by a like reduction in one or more budgeted projects, or the overspending requires prior written approval by the E.ON U.S. LLC Chief Financial Officer (CFO) and Chief Executive Officer (CEO). The Financial Planning Department must approve AIPs for unbudgeted projects (see *Approvals* below). In addition, unbudgeted project spending greater than $300,000 is subject to the Resource Allocation Committee (RAC) Tenets. Certain Generation Miscellaneous Projects, as described below, are exempt from being considered unbudgeted.

Under-Funded Projects: Projects that are submitted for approval that were included in the original approved budget, where the requested capital amount is greater than the budgeted amount for that project, must either be offset by a like reduction in one or more budgeted projects, or the additional funding requires prior written approval by the E.ON U.S. LLC CFO and CEO.

Project Overruns: When it is apparent that the amount approved on the original AIP will be insufficient (project is expected to be 10% or $100,000 over; whichever is less, subject to a minimum of $25,000) to complete the project, a revised AIP must be completed as soon as possible. If a revised AIP is required and the revised total is $300,000 or greater, a new Investment Proposal is also required. **At no time should overspending occur prior to the approval of the new AIP** (subject to the emergency provision of the Delegated Powers of Authority). The additional funding requested must either be offset by a like reduction in one or more budgeted projects, or the additional funding requires prior written approval by the E.ON U.S. LLC CFO and CEO.

Revised AIPs must be approved for the total revised dollar amount using the approval limits in the Authority Limit Matrices. All revised AIPs must be submitted to the Financial Planning Department with a copy of the original AIP attached. Revised AIPs which meet the spending level threshold for Investment Committee approval will be provided to the Investment Committee for review.

Projects expected to exceed the approved AIP by less than 10% or $100,000 (whichever is less) do not require further approval or review, but the funding must also be offset by a like reduction in one or more budgeted projects.

Approvals: Unbudgeted projects or those projects requiring an Investment Proposal (i.e. over $300,000) must be forwarded to the appropriate department for review and approval:

- **Utility and SERVCO**: Financial Planning -- Utility Operations
- **All Other**: Financial Planning & Controlling -- E.ON U.S. LLC

If the appropriate financial planning and controlling department does not concur with an Investment Proposal and does not approve the AIP, then the project will require a signature one level above that which is normally required by the Authority Limit Matrices.

Budgeted projects less than $300,000 are approved as normally required by the Authority Limit Matrices and do not require the prior approval of the appropriate Financial Planning Department.

Generation Miscellaneous Projects: Each Generation plant site may have one miscellaneous project not to exceed $300,000 which is budgeted to serve as a placeholder for small individual projects which arise during the year and which cannot be specifically anticipated during the budgeting process. This category of projects is different from Blanket Projects described elsewhere in this policy. Each Generation Miscellaneous Project must be budgeted, but an AIP must not be prepared for it and therefore it will not be activated in Oracle. Instead, as specific work is identified, the appropriate budget coordinator must create a new project number for the charges and prepare an AIP for the new project which references the budgeted placeholder project number. The new project is not considered unbudgeted to the extent that unused budget dollars are available in the budgeted placeholder project to cover it. The budget coordinator is responsible for tracking the accumulated spending of the individual projects to ensure that the budget is not exceeded. Property Accounting will also monitor the accumulated spending to ensure that the budget has not been exceeded.

Reimbursable Projects: Projects which will have all or a portion of the spending amount reimbursed by an outside party must follow the same guidelines as non-reimbursable projects, except as noted as follows: Tax Department review indicating whether Contribution in Aid of

E.ON U.S. LLC Policy

Capital and Investment Review

Construction is taxable must occur prior to any reimbursement agreement being finalized and evidence of such review must be attached to the AIP. Also, if a fully executed agreement specifying the terms of reimbursement is attached to an AIP with gross spending under $1 million for non-IT projects and under $500,000 for IT projects, the net spending amount may be used to determine whether an Investment Proposal and Capital Evaluation Model are required. Jointly-owned utility projects under the specified gross spending thresholds qualify for this exception without requiring the attachment of the executed joint ownership agreement. For all projects, the gross spending amount must always be used to determine the appropriate approval level.

Government-Mandated/Regulatory Compliance Projects: Projects which are not reimbursable but which are mandated by governmental legislation or other governmental authority must follow the same guidelines as all other projects except that for such AIPs with gross spending under $1 million for non-IT projects and under $500,000 for IT projects, neither the Investment Proposal nor the Capital Evaluation Model are required, provided that the appropriate legislative docket numbers or applicable statute references are provided with the AIP.

Early Activation Guidelines
In order for a project to be early activated, the following criteria must be met:

1. The expenditure must be the result of a true emergency: 1) the equipment has failed; 2) a material problem has been found, requiring it to be replaced immediately in order to maintain the reliability of the system; 3) or the expenditure is needed to address an immediate safety risk.

OR

2. The equipment vendor has provided a quote for the capital purchase that is only valid for a short period of time. The time frame would not be long enough to complete all the necessary paperwork, and acquire all necessary approvals in time to place the order at the reduced price.

Process requirements for an Early Activated AIP:

- For each AIP that is early activated, Property Accounting must first receive email approval from the highest level of LOB authority based on the total amount of the AIP as per the AIP signature process. Financial Planning must also be copied on this email. Should the AIP be for an unbudgeted project, approval from Financial Planning will be required for the Early Activation.

- In the event the project has been previously approved by the Investment Committee, the above email from the highest LOB authority would not be required. Instead, verification from Financial Planning that the project had indeed been approved by the Investment Committee would be sufficient approval.

- The approval request email must include the following info: 1) Project Number; 2) Project Description; 3) Total Project amount; 4) Name of the individual whose highest level of signature authority is required, and any associated DOA's; 5) Description of the need for the early activation; 6) If the request is for an unbudgeted project, the email must contain the budgeted project number that will cover the unbudgeted spending.

- All normally required signatures must still be acquired on the AIP prior to sending the AIP to Property Accounting.

- The Property Accounting Department will maintain a log of Early Activated projects, and copies of the email approvals will be filed with the AIP.

- All AIPs that are early activated must be received by the Property Accounting Department, or Financial Planning if necessary, with all required approvals, within 10 business days of the early activation. Repeated failure to comply with this timing will require email approval by the appropriate LOB VP for Early Activation of all future AIPs.

Project Completion

Upon project completion the project manager or budget coordinator closest to the project is required to:

1. Verify completion date (report to Property Accounting if different from AIP).
2. Update ORACLE project status to "completed".
3. Verify actual in-service date (report to Property Accounting if different from AIP).
4. Verify actual installed costs (report/explain any variances greater than 10% from the AIP to Property Accounting).
5. Verify actual removal costs (report/explain any variances greater than 10% from the AIP to Property Accounting).
6. Verify units of property installed (report to Property Accounting if different from AIP).
7. Verify units of property retired (report to Property Accounting if different from AIP).

Budget coordinators are required to perform a post-completion audit for any project that required Investment Committee approval except for blanket capital projects (discussed below). The review must follow the requirement specified in the EON Planning and Controlling Manual (section C.8.4). The review must be provided to the Financial Planning Department and the

Investment Committee within one year of the project's completion (based on the record history update date on the Oracle project, found under Help/Record History).

Leases

Prior to the execution of any new lease entered into on behalf of the Company, a review must be conducted by the budget coordinator for the appropriate OBU, Financial Accounting and Reporting to determine if the lease is structured as a capital or operating lease, and by the Tax department. Additional reviews by Legal and Corporate Finance may be required depending on the total amount of the lease. See the E.ON U.S. LLC Lease Policy for more details.

Blanket Capital Projects

Background: Several lines of business (primarily Distribution and Transmission) use blanket capital projects to procure routine, frequently used assets (i.e., poles, meters, transformers) or to facilitate routine work for which specific information is not available at the time the budget is prepared (i.e. Gas and Electric Distribution New Business by area.) The blanket projects hold a "bucket" of budget dollars which is used to fund specific tasks (subprojects) under $300,000 as they are identified throughout the year. Blanket projects are not closed each year but they are rebudgeted each year and are unitized on an "as-spent" basis.

Authorization: At the beginning of each calendar year, a list of all budgeted blanket projects must be submitted to the Investment Committee for approval, along with a summary of the previous year's blanket capital spending. (A post-completion audit will not be required for blanket capital projects.)

Criteria for Spending under an Existing Blanket Project: Only work and materials of a routine nature which cannot be specifically identified at the time of budget preparation may be charged to a blanket project. Individual tasks (which may consist either of individual parts or of work orders containing both labor and material) must fall below a $300,000 gross (of reimbursement) spending level. Otherwise, a separate, non-blanket capital project must be created which is subject to all requirements described elsewhere in this policy. Moreover, the same rules for spending authorization levels apply for spending under blanket capital projects as described elsewhere in this policy.

Criteria for Creating a New Unbudgeted Blanket Project: New blanket capital projects created after the budget process is complete do not require an approved AIP, but the request to open the project must be submitted to both Property Accounting and Financial Planning. New blanket capital projects are always considered to be unbudgeted and are therefore subject to the same requirements for unbudgeted projects described elsewhere in this policy. The unbudgeted project authorized spending must be covered by either a budgeted blanket or a non-blanket project in accordance with the RAC Tenets.

E.ON U.S. LLC Policy

Capital and Investment Review

Monthly Spending Report: The budget coordinator for each line of business incurring spending under blanket capital projects is required to prepare a monthly report listing all blanket projects and comparing the total year-to-date spending against budget. Any substitution of non-blanket projects' budgets to cover new blanket projects' budgets must be noted on the report and tracked throughout the year. This report must be submitted to Financial Planning for review by the eleventh business day of the following month.

Penalties for Noncompliance
Failure to comply with this policy may result in disciplinary action, up to and including discharge.

Reference: Authority Limit Matrices; Authorization for Investment Proposal; Capital Evaluation Model; Lease Policy; Resource Allocation Committee Tenets; and Investment Proposal forms.
Key Contact:

- Financial Planning
- **Accounting Matters**: Property Accounting, Utility Accounting & Reporting, & Controller
- **Capital Leases**: Corporate Finance and Financial Accounting and Reporting

Administrative Responsibility: Chief Financial Officer.

E.ON US
Capitalization Policy

Effective 8/23/05 to 11/30/07

LG&E Energy LLC Policy

Capital

Policy
The primary purpose of the Capital Policy is to establish a uniform process for:

1. capital planning and budgeting;
2. authority for the expenditure of funds;
3. control and reporting of capital expenditures; and
4. development of review criteria for the authorization process.

Further, these policies will provide management with the necessary tools to make informed business decisions. A capital expenditure includes adding, replacing or retiring units of property through the construction or acquisition process. Generally, it is inappropriate to capitalize expenditures that are part of routine or necessary maintenance programs. If a substantial improvement is made to an asset, the following criteria should be used to determine whether or not capitalization is appropriate:

1. Does the improvement extend the original useful life of the asset?
2. Does the improvement increase the throughput or capacity of the asset?
3. Has operating efficiency been improved?
4. Does the expenditure meet the definition of a capitalizable cost under the FERC Uniform System of Accounts?

If you answer yes to any of the above questions, capitalization is appropriate for your project. Questions relating to the categorization of an expense as capital or O&M should be referred to Property Accounting for utility matters or the appropriate fixed-asset accounting group for non-utility operations. The Controller will have the ultimate authority of interpreting expense versus capital decisions based on generally accepted accounting principles. See Property Accounting's Home Page.

Scope
This policy applies to all LG&E Energy LLC and its subsidiaries' (Company) employees.

General Requirements

1. All capital spending that is expected to occur during the year must be budgeted in the current-year commitment.
2. There will be no carry-over of spending capital authority from one year to the next.
3. An Authorization for Investment Proposal (AIP) form must be completed for **all** capital spending projects.
4. Projects with a total cost of $2,000 or less will be expensed.
5. An Investment Proposal must be completed for all capital spending projects greater than $300,000.
6. On a quarterly basis, the Financial Planning - Utility Operations Department will produce a Capital Projects over $500,000 report, which will include a project-to-date summary of all approved projects over $500,000.

Capital

7. The Information Technology Department must approve **all** capital projects involving anything related to information technology.
8. All information technology or development projects greater than $250,000 and all other projects greater than $1,000,000 require the approval of the Investment Committee.

Capital Planning

The multi-year Capital Investment Plan will be used to inform senior management of future capital-spending projections. These plans are prepared annually on an operating business unit (OBU) basis and include the forecast of capital projections during the annual planning period. The first year of the capital investment plan, once approved, becomes the formal budget for that year.

Carry-Over Spending: During preparation of the Three-year Capital Investment Plans, each OBU will review all current-year projects to determine if they will be completed as of the end of the year. If the project is expected to be in process at year-end, but not complete, it must be included in the following year's Three-year Capital Investment Plan for additional funds to be approved.

Capital Approval Process

Authorization for Investment Proposal: Although specific capital projects are identified in the budgeting process, they are still subject to the Authority Limit Matrices signature requirements and all other signature reviews as stated on the face of the AIP. Projects are not considered approved until appropriate signatures are obtained as stated on the AIP form.

The AIP form is used to request the appropriate approvals for spending on capital projects. A completed AIP is required under the following conditions:

- An AIP form must be submitted and approved prior to committing to or incurring any capital expenditure. Approvals should be obtained in the sequence shown in the approval section of the AIP form.
- Approvals must be obtained up to the levels designated in the Authority Limit Matrices for the dollar amount of any project (which may include multiple AIPs).
- Any AIP over $300,000 must include an Investment Proposal and Capital Evaluation Model and must be submitted to the appropriate Financial Planning Department for approval.
- A completed AIP form must be submitted and approved prior to the disposal of any capital asset. In addition, an Investment Proposal must be submitted for disposal projects of $300,000 or more.
- A revised AIP must be submitted for significant project overruns (See below).
- Instructions provided with the AIP form must be followed.

Investment Proposal: The Investment Proposal is used to explain in detail the nature and justification of the capital project. Capital projects over $300,000 on a fully loaded basis require

LG&E Energy LLC Policy

Capital

the submittal of an Investment Proposal and Capital Evaluation Model along with the AIP. The following format will provide senior management with consistent information for evaluating capital projects. The Investment Proposal should include the following sections:

- Full description, including alternative options and strategic justification.
- Breakdown of investment amount by year, by type of spend (capital/revenue/working capital).
- Cost of own staff allocated to the project is not included in the investment value but should be separately disclosed.
- The amount to be sanctioned must include an appropriate risk margin.
- Economics:
  - NPV* and IRR* should be based on the post tax nominal cash flows.
  - The economics should be calculated on central case cash flows, but include the full investment amount (i.e. including any risk margin).
  - For projects that will not be consolidated (generally less than 50% ownership) the economics should be calculated on the dividend stream to the Company. The project return should also be shown, but this measure is second order to the equity impact.
  - Value added* is calculated as the difference between the ROCE* and the pre tax nominal cost of capital, multiplied by the capital employed.

    Value Added* = ROCE* – [11% (E.ON WACC) * Capital Employed for the Project]

    $$\text{ROCE*} = \frac{\text{Earnings before tax}}{\text{Capital Employed Company-wide}}$$

  - Other economic measures may be shown e.g. payback period (number of years for the cumulative nominal post tax cash flows to exceed the investment cost).
- Impact on LG&E Energy financial statements. The impact on EBIT, internal operating profit, net income, net debt and cash flow should be shown at a minimum. The time horizon should be appropriate to the investment.
- Risk assessment and sensitivity analysis. Sensitivities should show the impact on the financial statements (particularly internal operating profit and cash flow) as well as the impact on the NPV* and IRR*.
- Breakdown of synergies; indicating a sensitivity to show the impact of not achieving the synergies.
- How the project will be managed including accountabilities (especially for realizing the synergies) in all stages of the process.
- Assumptions must be stated.
- Reference to supporting documents (e.g. functional reports).
- Budget / plan provision for project.
- Milestone plan.
- Environmental impact of the investment.

LG&E Energy LLC Policy

Capital

*For these and other definitions, see Investment Decision Procedure , Appendix C.

Unbudgeted Projects: Any capital expenditure that is not included in the original, approved budget, must either be offset by a like reduction in one or more budgeted projects, or the overspending requires prior written approval by the LG&E Energy LLC Chief Financial Officer (CFO) and Chief Executive Officer (CEO). The appropriate Financial Planning Department must approve AIPs for unbudgeted projects (see *Approvals* below).

Under-Funded Projects: Projects that are submitted for approval that were included in the original approved budget, where the requested capital amount is greater than the budgeted amount for that project, must either be offset by a like reduction in one or more budgeted projects, or the additional funding requires prior written approval by the LG&E Energy LLC CFO and CEO.

Project Overruns: When it is apparent that the amount approved on the original AIP will be insufficient (project is expected to be 10% or $100,000 over; whichever is less, subject to a minimum of $25,000) to complete the project, a revised AIP must be completed as soon as possible. If a revised AIP is required and the revised total is $300,000 or greater, a new Investment Proposal is also required. **At no time should overspending occur prior to the approval of the new AIP** (subject to the emergency provision of the Delegated Powers of Authority). The additional funding requested must either be offset by a like reduction in one or more budgeted projects, or the additional funding requires prior written approval by the LG&E Energy LLC CFO and CEO.

Revised AIPs must be approved for the total revised dollar amount using the approval limits in the Authority Limit Matrices. All revised AIPs must be submitted to the appropriate Financial Planning Department and will be provided to the Investment Committee for review.

Projects expected to exceed the approved AIP by less than 10% or $100,000 (whichever is less) do not require further approval or review, but the funding must also be offset by a like reduction in one or more budgeted projects.

Approvals: Unbudgeted projects or those projects requiring an Investment Proposal (i.e. over $300,000) must be forwarded to the appropriate department for review and approval:

- **Utility and SERVCO**: Financial Planning -- Utility Operations
- **All Other**: Financial Planning & Controlling -- LG&E Energy LLC

If the appropriate financial planning and controlling department does not concur with an Investment Proposal and does not approve the AIP, then the project will require a signature one level above that which is normally required by the Authority Limit Matrices.

LG&E Energy LLC Policy

Capital

Budgeted projects less than $300,000 are approved as normally required by the Authority Limit Matrices and do not require the prior approval of the appropriate Financial Planning Department.

Early Activation Guidelines
In order for a project to be early activated, the following criteria must be met:

1. The expenditure must be the result of a true emergency: 1) the equipment has failed; 2) a material problem has been found, requiring it to be replaced immediately in order to maintain the reliability of the system; 3) or the expenditure is needed to address an immediate safety risk.

OR

2. The equipment vendor has provided a quote for the capital purchase that is only valid for a short period of time. The time frame would not be long enough to complete all the necessary paperwork, and acquire all necessary approvals in time to place the order at the reduced price.

Process requirements for an Early Activated AIP:

- For each AIP that is early activated, Property Accounting must first receive email approval from the highest level of LOB authority based on the total amount of the AIP as per the AIP signature process. Financial Planning – Utility Operations should also be copied on this email. Should the AIP be for an unbudgeted project, approval from Financial Planning – Utility Operations will be required for the Early Activation.

- In the event the project has been previously approved by the Investment Committee, the above email from the highest LOB authority would not be required. Instead, verification from Financial Planning – Utility Operations that the project had indeed been approved by the Investment Committee would be sufficient approval.

- The approval request email should include the following info: 1) Project Number; 2) Project Description; 3) Total Project amount; 4) Name of the individual whose highest level of signature authority is required, and any associated DOA's; 5) Description of the need for the early activation; 6) If the request is for an unbudgeted project, the email needs to contain the budgeted project number that will cover the unbudgeted spending.

- All normally required signatures must still be acquired on the AIP prior to sending the AIP to Property Accounting.

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- The Property Accounting Department will maintain a log of Early Activated projects, and copies of the email approvals will be filed with the AIP.

- All AIP's that are early activated must be received by the Property Accounting Department, or Financial Planning – Utility Operations if necessary, with all required approvals, within 10 business days of the early activation. Repeated failure to comply with this timing will require email approval by the appropriate LOB VP for Early Activation of all future AIP's.

Project Completion
Upon project completion the project manager or budget coordinator closest to the project is required to:

1. Verify completion date (report to Property Accounting if different from AIP).
2. Update ORACLE project status to "completed".
3. Verify actual in-service date (report to Property Accounting if different from AIP).
4. Verify actual installed costs (report/explain any variances greater than 10% from the AIP to Property Accounting).
5. Verify actual removal costs (report/explain any variances greater than 10% from the AIP to Property Accounting).
6. Verify units of property installed (report to Property Accounting if different from AIP).
7. Verify units of property retired (report to Property Accounting if different from AIP).

Budget coordinators are required to perform a post-implementation review for any project that required Investment Committee approval. The review must follow the requirement specified in section 3 of the Investment Proposal guidelines. The review must be provided to the appropriate Financial Planning Department and the Investment Committee.

Capital Lease Guidelines
The following guidelines apply to all leases in excess of $50,000. Leases less than $50,000 will be treated as an operating lease.

Background: SFAS 13, "Accounting for Leases" and the Code of Federal Regulations, Part 101, General Instruction 19, impose stringent accounting and reporting requirements in connection with capital leases. Upon entering a capital lease the Company must record a capital asset and an offsetting obligation equal to the present value of the minimum lease payments. The offsetting obligation is reported as debt in the financial statements. Lease payments are allocated between interest expense and the reduction of the capital lease obligation.

Because capital lease obligations are classified as debt, a significant number or amount of capital leases will negatively impact the Company's debt ratios and credit ratings. Therefore, the Company chooses to avoid capital leases if possible.

LG&E Energy LLC Policy

Capital

Capital Lease Criteria: A capital lease exists if any one of the following conditions are met;

1. The lease transfers ownership of the property to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.
3. The lease term is equal to 75% or more of the economic life of the property.
4. The present value of the minimum payments, at the beginning of the lease term, equals 90% of the fair market value of the leased property.

Approvals: Prior to entering lease agreements in excess of $50,000, the lease must be reviewed by the budget coordinator for the OBU. If the lease meets any of the four capital lease criteria, the budget coordinator must submit an AIP for approval subject to the normal approval requirements for capital investment.

LG&E Energy's Corporate Finance Department must review any lease in excess of $1,000,000.

Record Retention: Original lease agreements should be retained by the appropriate function in accordance with the Record Retention Policy. The Corporate Law Department will maintain copies of all leases with aggregate rentals over $300,000 in a central lease file.

Penalties for Noncompliance
Failure to comply with this policy may result in disciplinary action, up to and including discharge.

Reference: Authority Limit Matrices; Authorization for Investment Proposal; Capital Evaluation Model; and Investment Proposal forms.
Key Contact:

- **Utility and SERVCO**: Financial Planning – Utility Operations
- **All Other**: Financial Planning & Controlling – LG&E Energy LLC
- **Investment Committee**: Financial Planning & Controlling
- **Accounting Matters**: Property Accounting, Utility Accounting & Reporting, & Controller
- **Capital Leases**: Corporate Finance

Administrative Responsibility: Chief Financial Officer.

E.ON US
Capitalization Policy

Effective 7/31/03 to 8/22/05

LG&E Energy LLC Policy

Capital

Policy

The primary purpose of the Capital Policy is to establish a uniform process for:

1. capital planning and budgeting;
2. authority for the expenditure of funds;
3. control and reporting of capital expenditures; and
4. development of review criteria for the authorization process.

Further, these policies will provide management with the necessary tools to make informed business decisions. A capital expenditure includes adding, replacing or retiring units of property through the construction or acquisition process. Generally, it is inappropriate to capitalize expenditures that are part of routine or necessary maintenance programs. If a substantial improvement is made to an asset, the following criteria should be used to determine whether or not capitalization is appropriate:

1. Does the improvement extend the original useful life of the asset?
2. Does the improvement increase the throughput or capacity of the asset?
3. Has operating efficiency been improved?
4. Does the expenditure meet the definition of a capitalizable cost under the FERC Uniform System of Accounts?

If you answer yes to <u>any</u> of the above questions, capitalization is appropriate for your project. Questions relating to the categorization of an expense as capital or O&M should be referred to Property Accounting for utility matters or the appropriate fixed-asset accounting group for non-utility operations. The Controller will have the ultimate authority of interpreting expense versus capital decisions based on generally accepted accounting principles. See Property Accounting's Home Page.

Scope

This policy applies to all LG&E Energy LLC and its subsidiaries' (Company) employees.

General Requirements

1. All capital spending that is expected to occur during the year must be budgeted in the current-year commitment.
2. There will be no carry-over of spending capital authority from one year to the next.
3. An Authorization for Investment Proposal (AIP) form must be completed for **all** capital spending projects.
4. Projects with a total cost of $2,000 or less will be expensed.
5. An Investment Proposal must be completed for all capital spending projects greater than $300,000.
6. On a quarterly basis, the Financial Planning - Utility Operations department will produce a Capital Projects over $500,000 report, which will include a project-to-date summary of all approved projects over $500,000.

7. The Information Technology Department must approve **all** capital projects involving anything related to information technology.
8. All information technology or development projects greater than $250,000 and all other projects greater than $1,000,000 require the approval of the Investment Committee.

Capital Planning

The multi-year Capital Investment Plan will be used to inform senior management of future capital-spending projections. These plans are prepared annually on an operating business unit (OBU) basis and include the forecast of capital projections during the annual planning period. The first year of the capital investment plan, once approved, becomes the formal budget for that year.

Carry-Over Spending: During preparation of the Three-year Capital Investment Plans, each OBU will review all current-year projects to determine if they will be completed as of the end of the year. If the project is expected to be in process at year-end, but not complete, it must be included in the following year's Three-year Capital Investment Plan for additional funds to be approved.

Capital Approval Process

Authorization for Investment Proposal: Although specific capital projects are identified in the budgeting process, they are still subject to the Authority Limit Matrices signature requirements and all other signature reviews as stated on the face of the AIP. Projects are not considered approved until appropriate signatures are obtained as stated on the AIP form.

The AIP form is used to request the appropriate approvals for spending on capital projects. A completed AIP is required under the following conditions:

- An AIP form must be submitted and approved prior to committing to or incurring any capital expenditure. Approvals should be obtained in the sequence shown in the approval section of the AIP form.
- Approvals must be obtained up to the levels designated in the Authority Limit Matrices for the dollar amount of any project (which may include multiple AIPs).
- Any AIP over $300,000 must include an Investment Proposal and Capital Evaluation Model and must be submitted to the appropriate Financial Planning department for approval.
- A completed AIP form must be submitted and approved prior to the disposal of any capital asset. In addition, an Investment Proposal must be submitted for disposal projects of $300,000 or more.
- A revised AIP must be submitted for significant project overruns (See below).
- Instructions provided with the AIP form must be followed.

Investment Proposal: The Investment Proposal is used to explain in detail the nature and justification of the capital project. Capital projects over $300,000 on a fully loaded basis require

LG&E Energy LLC Policy

Capital

the submittal of an Investment Proposal and Capital Evaluation Model along with the AIP. The following format will provide senior management with consistent information for evaluating capital projects. The Investment Proposal should include the following sections:

- Full description, including alternative options and strategic justification.
- Breakdown of investment amount by year, by type of spend (capital/revenue/working capital).
- Cost of own staff allocated to the project is not included in the investment value but should be separately disclosed.
- The amount to be sanctioned must include an appropriate risk margin.
- Economics:
  - NPV* and IRR* should be based on the post tax nominal cash flows.
  - The economics should be calculated on central case cash flows, but include the full investment amount (i.e. including any risk margin).
  - For projects that will not be consolidated (generally less than 50% ownership) the economics should be calculated on the dividend stream to the Company. The project return should also be shown, but this measure is second order to the equity impact.
  - Value added* is calculated as the difference between the ROCE* and the pre tax nominal cost of capital, multiplied by the capital employed.

    Value Added* = ROCE* – [11% (E.ON WACC) * Capital Employed for the Project]

    $$\text{ROCE*} = \frac{\text{Earnings before tax}}{\text{Capital Employed Company-wide}}$$

  - Other economic measures may be shown e.g. payback period (number of years for the cumulative nominal post tax cash flows to exceed the investment cost).
- Impact on LG&E Energy financial statements. The impact on EBIT, internal operating profit, net income, net debt and cash flow should be shown at a minimum. The time horizon should be appropriate to the investment.
- Risk assessment and sensitivity analysis. Sensitivities should show the impact on the financial statements (particularly internal operating profit and cash flow) as well as the impact on the NPV* and IRR*.
- Breakdown of synergies; indicating a sensitivity to show the impact of not achieving the synergies.
- How the project will be managed including accountabilities (especially for realizing the synergies) in all stages of the process.
- Assumptions must be stated.
- Reference to supporting documents (e.g. functional reports).
- Budget / plan provision for project.
- Milestone plan.
- Environmental impact of the investment.

LG&E Energy LLC Policy

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*For these and other definitions, see Investment Decision Procedure , Appendix C.

Unbudgeted Projects: Any capital expenditure that is not included in the original, approved budget, must either be offset by a like reduction in one or more budgeted projects, or the overspending requires prior written approval by the LG&E Energy LLC Chief Financial Officer (CFO) and Chief Executive Officer (CEO). The appropriate Financial Planning department must approve AIPs for unbudgeted projects (see *Approvals* below).

Under-Funded Projects: Projects that are submitted for approval that were included in the original approved budget, where the requested capital amount is greater than the budgeted amount for that project, must either be offset by a like reduction in one or more budgeted projects, or the additional funding requires prior written approval by the LG&E Energy LLC CFO and CEO.

Project Overruns: When it is apparent that the amount approved on the original AIP will be insufficient (project is expected to be 10% or $100,000 over; whichever is less, subject to a minimum of $25,000) to complete the project, a revised AIP must be completed as soon as possible. If a revised AIP is required and the revised total is $300,000 or greater, a new Investment Proposal is also required. **At no time should overspending occur prior to the approval of the new AIP** (subject to the emergency provision of the Delegated Powers of Authority). The additional funding requested must either be offset by a like reduction in one or more budgeted projects, or the additional funding requires prior written approval by the LG&E Energy LLC CFO and CEO.

Revised AIPs must be approved for the total revised dollar amount using the approval limits in the Authority Limit Matrices. All revised AIPs must be submitted to the appropriate Financial Planning and Accounting department and will be provided to the Investment Committee for review.

Projects expected to exceed the approved AIP by less than 10% or $100,000 (whichever is less) do not require further approval or review, but the funding must also be offset by a like reduction in one or more budgeted projects.

Approvals: Unbudgeted projects or those projects requiring an Investment Proposal (i.e. over $300,000) must be forwarded to the appropriate department for review and approval:

- **Utility and SERVCO**: Financial Planning & Accounting -- Utility Operations
- **All Other**: Financial Planning & Accounting -- LG&E Energy LLC

If the appropriate financial planning and accounting department does not concur with an Investment Proposal and does not approve the AIP, then the project will require a signature one level above that which is normally required by the Authority Limit Matrices.

Capital

Budgeted projects less than $300,000 are approved as normally required by the Authority Limit Matrices and do not require the prior approval of the appropriate Financial Planning department.

Project Completion
Upon project completion the project manager or budget coordinator closest to the project is required to:

1. Verify completion date (report to Property Accounting if different from AIP).
2. Update ORACLE project status to "completed".
3. Verify actual in-service date (report to Property Accounting if different from AIP).
4. Verify actual installed costs (report/explain any variances greater than 10% from the AIP to Property Accounting).
5. Verify actual removal costs (report/explain any variances greater than 10% from the AIP to Property Accounting).
6. Verify units of property installed (report to Property Accounting if different from AIP).
7. Verify units of property retired (report to Property Accounting if different from AIP).

Budget coordinators are required to perform a post-implementation review for any project that required Investment Committee approval. The review must follow the requirement specified in section 3 of the Investment Proposal guidelines. The review must be provided to the appropriate Financial Planning department and the Investment Committee.

Capital Lease Guidelines
The following guidelines apply to all leases in excess of $50,000. Leases less than $50,000 will be treated as an operating lease.

Background: SFAS 13, "Accounting for Leases" and the Code of Federal Regulations, Part 101, General Instruction 19, impose stringent accounting and reporting requirements in connection with capital leases. Upon entering a capital lease the Company must record a capital asset and an offsetting obligation equal to the present value of the minimum lease payments. The offsetting obligation is reported as debt in the financial statements. Lease payments are allocated between interest expense and the reduction of the capital lease obligation.

Because capital lease obligations are classified as debt, a significant number or amount of capital leases will negatively impact the Company's debt ratios and credit ratings. Therefore, the Company chooses to avoid capital leases if possible.

Capital Lease Criteria: A capital lease exists if any one of the following conditions are met;

1. The lease transfers ownership of the property to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.

LG&E Energy LLC Policy

Capital

3. The lease term is equal to 75% or more of the economic life of the property.
4. The present value of the minimum payments, at the beginning of the lease term, equals 90% of the fair market value of the leased property.

Approvals: Prior to entering lease agreements in excess of $50,000, the lease must be reviewed by the budget coordinator for the OBU. If the lease meets any of the four capital lease criteria, the budget coordinator must submit an AIP for approval subject to the normal approval requirements for capital investment.

LG&E Energy's Corporate Finance department must review any lease in excess of $1,000,000.

Record Retention: Original lease agreements should be retained by the appropriate function in accordance with the Record Retention Policy. The Corporate Law Department will maintain copies of all leases with aggregate rentals over $300,000 in a central lease file.

Penalties for Noncompliance
Failure to comply with this policy may result in disciplinary action, up to and including discharge.

Reference: Authority Limit Matrices; Authorization for Investment Proposal; Capital Evaluation Model; and Investment Proposal forms.
Key Contact:

- **Utility and SERVCO**: Financial Planning & Accounting – Utility Operations
- **All Other**: Financial Planning & Accounting – LG&E Energy LLC
- **Investment Committee**: Planning & Controlling

Administrative Responsibility: Chief Financial Officer.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 13

Witness: John J. Spanos

Q-13. Please identify and explain all changes since the last depreciation study which might affect depreciation rates.

A-13. Depreciation rates are affected by life and net salvage parameters, plant activity, ratio of plant to depreciation reserve and depreciation procedure. Each account has experienced at least two of these factors and many accounts were exposed to all four factors since the last depreciation study.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 14

Witness: Robert M. Conroy

Q-14. Please provide the Company's most recent Asset Management Plan.

A-14. The Company does not prepare a document named "Asset Management Plan". All aspects of operating the business consider how assets will be managed and maintained. This process goes into developing the business plans for each area of the Company, the investment proposals for new assets, and all other aspects of the business. No single document covers a specific asset management plan. However, the Company's most recent Integrated Resource Plan ("IRP") filing, Case No. 2005-00162, can be found at the following website: http://psc.ky.gov/pscscf/2005%20cases/2005-00162/.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's Initial Requests for Information Dated February 4, 2008

Case No. 2007-00564

Question No. 15

Witness: Shannon L. Charnas

Q-15. Please provide a copy of the Company's 2003 through 2007 annual reports to the KY Public Service Commission. Please reconcile the December 31, 2006 plant shown in the Depreciation Study with the December 31, 2006 plant shown in the 2006 PSC Report, and provide a complete explanation for each difference.

A-15. Please see the FERC Form 1 and 2, and KPSC .pdf format files on the attached CD.

Reconciliation of Form 1 Electric Plant to the Depreciation Study

Electric Plant in Service:	
LG&E 2006 Form 1, page 207, line 104, column (g):	$ 3,199,114,843
(Less) Asset Retirements Costs not included in study--	
LG&E 2006 Form 1, page 205, line 15, column (g):	(5,697,179)
LG&E 2006 Form 1, page 205, line 34, column (g):	(31,163)
LG&E 2006 Form 1, page 205, line 44, column (g):	(297,215)
LG&E 2006 Form 1, page 207, line 57, column (g):	(5,687)
LG&E 2006 Form 1, page 207, line 74, column (g):	(37,674)
	$ 3,193,045,925
Depreciation Study, page III-9, Total Electric Plant, Original Cost, column (4)	$ 3,193,045,925
Difference	-

Reconciliation of Form 2 Gas Plant to the Depreciation Study

Gas Plant in Service:		
LG&E 2006 Form 2, page 209, line 130, column (g):	$	524,410,592
(Less) Asset Retirements Costs--		
LG&E 2006 Form 2, page 207, line 54, column (g):		(541,132)
LG&E 2006 Form 2, page 209, line 110, column (g):		(30,769)
	$	523,838,691
Depreciation Study, page III-11, Total Gas Plant, Original Cost, column (4)	$	523,838,690
Difference due to rounding		1

Reconciliation of Form 1 Common Plant to the Depreciation Study

Common Plant in Service:		
LG&E 2006 Form 1, page 201, line 8, column (h):	$	179,690,929
(Less) Asset Retirements Costs not included in study: *		(3,736)
	$	179,687,193
Depreciation Study, page III-12, Total Common Plant, Original Cost, column (4)	$	179,687,193
Difference		-

* FERC Form 1, page 201 was used to tie to the Depreciation Study. Common does not reflect the same level of detail for asset retirement costs as Electric and Gas.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Attorney General's
Initial Requests for Information Dated February 4, 2008

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Question No. 16

Witness: John J. Spanos

Q-16. Please provide all tabulations included in the Depreciation Study and all data necessary to recreate in their entirety, all analyses and calculations performed for the preparation of the Depreciation Study. Please provide this and all electronic data in Excel (or .txt format if appropriate), with all formulae intact. Please provide any record layouts necessary to interpret the data. Include in the response electronic spreadsheet copies of all of the schedules and/or tables included in the Depreciation Study, with all formulae intact. Identify and explain any and all unique spreadsheet formula's or assumptions required to recreate in their entirety all of Mr. Spanos's calculations given his inputs.

A-16. The requested data is included on the attached CD.

LOUISVILLE GAS AND ELECTRIC COMPANY

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Question No. 17

Witness: John J. Spanos

Q-17. For *each* plant account, and for each year since the inception of the account up to and including 2006, please provide the following standard depreciation study data as identified at pages 30-33 of the August 1996 NARUC Public Utility Depreciation Practices Manual ("NARUC Manual"). At a minimum, the data provided should be the same data set used to conduct the life analyses included in the Depreciation Study. Please provide the data in electronic format (Excel or .txt). Provide aged vintage data if available. Use the codes identified for each type of data, unless the Company regularly uses other codes. In those circumstances, identify and explain the Company's coding system.

Code	Data Type
9	Addition
0	Ordinary Retirement
1	Reimbursement
2	Sale
3	Transfer – In
4	Transfer – Out
5	Acquisition
6	Adjustment
7	Final retirement of life span property (see NARUC Manual, Chapter X)
8	Balance at Study Date
	Initial Balance of Installation

A-17. The service life data is included on the attached CD in .txt format for each plant account from the first year of available activity through 2006. This is the same data that was utilized in the service life study.