LG&E ENERGY

LG&E Energy LLC
220 West Main Street (40202)
P.O. Box 32030
Louisville, Kentucky 40232

January 20, 2006

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PUBLIC SERVICE COMMISSION

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

RE: ***Adjustment of the Gas and Electric Rates, Terms and Conditions of Louisville Gas and Electric Company* - Case No. 2003-00433**

Dear Ms. O'Donnell:

Enclosed please find an original and six (6) copies of Louisville Gas and Electric Company's ("LG&E") response to the Rehearing Data Request of the Commission Staff dated January 6, 2006 in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to contact me at (502) 627-3324.

Sincerely,

Robert M. Conroy
Manager, Rates

cc: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE GAS AND ELECTRIC	) CASE NO.
RATES, TERMS AND CONDITIONS OF	) 2003-00433
LOUISVILLE GAS AND ELECTRIC COMPANY	)

RESPONSE OF
LOUISVILLE GAS AND ELECTRIC COMPANY
TO THE
REHEARING DATA REQUEST OF THE COMMISSION STAFF
DATED JANUARY 6, 2006

FILED: JANUARY 20, 2006

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2003-00433

Response to Rehearing Data Request of the Commission Staff Dated January 6, 2006

Question No. 1

Responding Witness: S. Bradford Rives

Q-1. During this proceeding, LG&E has opposed the use of the effective Kentucky corporate income tax rate to determine the tax expense resulting from its pro forma adjustments. Is this still LG&E's position? Explain the response.

A-1. Yes, this is still LG&E's position. LG&E continues to believe it is reasonable to use the statutory Kentucky Corporate Income Tax Rate. This rate is objective, known and measurable, readily verifiable and is unlike the effective tax rate which fluctuates from year to year based on changes in property, payroll and sales factors.

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2003-00433

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Question No. 2

Responding Witness: S. Bradford Rives

Q-2. Refer to LG&E's Response to the Commission's July 26, 2004 Order, Item 2. In that response, LG&E utilized a combined effective state income tax rate of 8.07 percent, which reflected both the Kentucky and Indiana income tax rates.

a. Provide the calculations used to determine the combined income tax rate of 8.07 percent.

b. Provide the Kentucky-only effective income tax rate, including all calculations used to determine the rate.

c. In the response to Item 2, LG&E determined that the difference in the "Overall Revenue Deficiency" using the 8.07 percent income tax rate was $504,596. Using the format shown in the response to Item 2, provide the calculation of the difference in the "Overall Revenue Deficiency" using the Kentucky-only effective income tax rate, as determined in part (b) above. Include any supporting calculations, workpapers, or assumptions used in calculating the difference.

A-2. a. See attached.

b. See attached. The Kentucky-only effective income tax rate is 7.87%. This Kentucky-only rate should not be used for LG&E as all of its operations benefit Kentucky ratepayers. Unlike KU, who has customers in jurisdictions outside of Kentucky, all LG&E customers are in Kentucky. The Indiana tax is due because of property in Indiana (primarily electric transmission) and sales outside of Kentucky (primarily off-systems sales). Since LG&E customers benefit from these activities they should bear the costs (e.g. the Indiana income tax) on these activities.

c. See attached. The difference in the "Overall Revenue Deficiency" using the Kentucky only effective income tax rate of 7.87% is $771,528. As discussed in b above, the Kentucky-only rate fails to incorporate all state taxes associated with providing service to LG&E's Kentucky customers and is therefore not appropriate. Furthermore, neither the effective state income tax rate that includes the Indiana taxes nor the Kentucky-only effective tax rate are significantly different from the Kentucky statutory income tax rate and should not replace this reliable rate.

Louisville Gas & Electric Company
Combined KY/Indiana State Income Tax Rate

LG&E	Kentucky 2002	Indiana 2002	Total 2002
1 State Taxable Income	64,717,944	54,598,148	
2 State Apportionable Income	61,723,509	464,084	
3 State Tax	5,092,093	108,699	
4 Credits (Recycling)	-	-	
5 State Tax after Utilized Credits	5,092,093	108,699	
6 Effective Rate excluding Credits (Line 3/1)	7.87%	0.20%	8.07%
7 Effective Rate including Credits (Line 5/1)	7.87%	0.20%	8.07%

Louisville Gas & Electric Company
Revenue Deficiency at 7.87% Effective Tax Rate

State Tax Rate	Co Eff Rate 7.87%	Difference
1 Net Operating Income per books	109,177,417	494,024
2 PSC ordered adjustments	(58,951,423)	
3 Federal and State income tax on adjustments	23,648,658	(145,610)
4 Other tax adjustments	284,703	(1,392)
5 Total Rate Case Adjustments (Line 2+3+4)	(35,018,062)	(147,002)
6 Adjusted Net Operating Income (Line 1+5)	74,159,355	347,022
7 Net Operating Income found Reasonable	100,829,155	
8 Adjusted Net Operating Income (Line 6)	74,159,355	
9 Net Operating Income Deficiency (Line 7-8)	26,669,800	
10 Gross Up	59.4819%	
11 Overall Revenue Deficiency (Line 9/10)	44,836,837	771,528
12 Incremental "gross-up" adjustment (Line 11-6)		424,506

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2003-00433

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Question No. 3

Responding Witness: S. Bradford Rives

Q-3. On page 10 of the Rebuttal Testimony of S. Bradford Rives is the statement that LG&E pays Indiana income taxes on a portion of its off-system sales. Is this the only type of transaction on which LG&E pays Indiana income taxes? Explain the response.

A-3. Corporations such as LG&E are subject to tax in governmental jurisdictions where they have "nexus" with that particular jurisdiction. Nexus is sometimes defined as "a connection or link" and is often interpreted by states to be a physical or economic presence within their borders. Levels and frequency of economic activities, owning or renting property or inventory, and the presence of employees or contractors are typical indicators of nexus. Once a corporation is determined to have nexus, tax returns such as income, sales/use, property, payroll, etc. are required.

LG&E has both a physical and economic presence in Indiana as well as Kentucky. This nexus requires the company to be subject to tax in both states. Since income and property of both jurisdictions are part of the Louisville Gas and Electric Company, total company income is initially considered when determining income taxes due to each state.

To determine the tax due to Indiana, total company income is apportioned based on the percentage of sales, property, and payroll in Indiana compared to sales, property and payroll everywhere. This method does not tax specific transactions, such as off-system sales, but taxes portions of all company taxable income based on this apportionment concept.

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE NO. 2003-00433

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Question No. 4

Responding Witness: S. Bradford Rives

Q-4. The pro forma adjustments as determined by the Commission in its June 30, 2004 Order were related to all of LG&E's operations, not just its off-system sales. If its off-system sales are the only transactions on which LG&E pays Indiana income taxes, explain in detail why LG&E believes a combined Kentucky and Indiana income tax rate should be used to determine the state income tax expense resulting from those pro forma adjustments.

A-4. As outline in Q-3 above, LG&E's total company income is apportioned based on the percentage of sales, property, and payroll in Indiana compared to sales, property and payroll everywhere. This method does not tax specific transactions, such as off-system sales, but taxes portions of all company taxable income based on this apportionment concept.

It would not be proper for LG&E's Kentucky customers to benefit from its non-Kentucky property and out-of-state sales transactions without being responsible for the costs of owning such property or participating in these transactions. LG&E is unlike KU who has retail customers outside of Kentucky. The non-Kentucky state income tax costs are associated with serving KU customers and accordingly should be matched with the Virginia and Tennessee retail customers. In contrast, LG&E has no Indiana customers and all of LG&E's Kentucky customers directly benefit from the property in Indiana (primarily electric transmission) and sales outside of Kentucky (primarily off-systems sales). LG&E has only Kentucky customers; therefore, the use of a Kentucky-only rate would fail to account for reasonable expenses incurred on behalf of the Kentucky ratepayers.