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

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COMMISSION

March 29, 2007

RE: AN ADJUSTMENT OF THE GAS AND ELECTRIC RATES, TERMS AND CONDITIONS OF LOUISVILLE GAS AND ELCTRIC COMPANY CASE NO 2003-00433

RE: AN ADJUSTMENT OF THE ELECTRIC RATES, TERMS AND CONDITIONS OF KENTUCKY UTILITES COMPANY CASE NO. 2003-00434

Dear Ms O'Donnell:

Pursuant to Ordering Paragraph No. 6 of the Commission's Order dated June 30, 2004, in the aforementioned proceedings, Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU), collectively, (the Companies), hereby submit an original and ten (10) copies of a progress report on its plan, which was filed by the Companies on June 30, 2005 pursuant to the same ordering paragraph, to address the Commission's concerns with respect to the funding status of the Companies' pension and post-retirement benefit plans.

In addition, the Companies' also submit an original and ten (10) copies of a motion to eliminate, prospectively, the filing requirement for such progress reports based on the funding status of the plans as described in this current submission.

Should you have any questions about this report, please contact me at (502) 627-2573.

Very truly yours,

Kent W. Blake

Kent W. Blake,
Director, State Regulation & Rates

cc: parties of record

Response of Louisville Gas and Electric Company and Kentucky Utilities Company
to the Commission's Inquiry Concerning the
Status of the Companies' Pension and Post-Retirement Plans
March 29, 2007

In its Final Orders dated June 30, 2004 in Case Nos. 2003-00433 and 2003-00434, the Kentucky Public Service Commission ("the Commission") expressed some concern over the under-funded status of pension and postretirement plans of the Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU"). Specifically, the Commission stated in the LG&E Order:

"The Commission does have some concerns about the under-funded status of LG&E's pension and post-retirement plans. LG&E should develop and implement a plan that eliminates the under-funding within a reasonable period of time. This plan should be filed with the Commission within one year from the date of this Order. In addition, LG&E should file progress reports describing the progress made in eliminating the under-funding of its pension and post-retirement plans. The progress reports should be filed every two years, and will be due with the filing of LG&E's annual financial report. The first progress report should be filed by March 31, 2007." The Commission ordered the same requirement for KU in Case No. 2003-00434.

E.ON U.S. ("EUS" or the "Company") provides this Progress Report on behalf of LG&E and KU pursuant to the aforementioned requirements. The report provides information regarding the funding strategy and status with respect to their pension and postretirement plans.

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E.ON U.S. LLC & THE LG&E PENSION PLANS

The E.ON U.S. LLC Retirement Plan[1] (formerly known as the LG&E Energy LLC Retirement Plan) and the LG&E Union Retirement Plan[1] continue to be subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended and the Pension Benefit Guaranty Corporation ("PBGC"). In addition, in 2006 there were two significant changes affecting the funding of and accounting for Pensions: President Bush signed the Pension Protection Act of 2006 ("PPA") and the Financial Accounting Standards Board ("FASB") adopted Statement of Financial Accounting Standards ("SFAS") No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans.* EUS continues to utilize Mercer Human Resources Consulting ("Mercer") to assist in administering the pension plans.

Significant Changes in Pension Accounting and Funding

Since 2000, two main circumstances led to increased underfunding of defined benefit pension ("DB") plans – declining stock market values and low interest rates used for discounting pension obligations. These factors, combined with an increase in retirements, dramatically increased the cost of DB plans. In response to underfunding of the pension plans and increasing takeover of financially troubled plans by the PBGC, particularly in the airline and automotive industry, Congress passed the PPA, which modifies the ERISA rules governing the funding of DB plans. The PPA requires employers to fund liabilities over significantly shorter periods, generally so the plans reach 100% "funded status" within seven years. The PPA also modified the calculation of "funded status" by adopting a new measure of the liability using a methodology similar to the FASB concept of Accumulated Benefit Obligation ("ABO"). Plans that do not meet the new funding standards will pay a 0.9% PBGC premium for unfunded vested benefits. Prior to the PPA, the .9% applied to a target liability discounted at the expected rate of return on assets. The PPA applies a lower discount rate of approximately 6%, thereby increasing the liability. These provisions are effective for plan years beginning in 2008.

For 2006 and 2007, the PPA extends the previous ERISA funding rules applicable in 2005 to meet minimum funding requirements and avoid variable PBGC premiums, as well as the temporary use of the corporate bond index rate for current liability purposes as the required funding interest rate. Under the PPA beginning in 2008, the minimum required contribution will equal the sum of the plan's normal cost plus amounts required to amortize any funding shortfall over seven years. The shortfall is the plan's target liability for the benefits earned in prior years minus its assets, not including any carryover or prefunding balance. A summary of the primary changes in plan funding due to the PPA is provided below:

Item	Law Prior to PPA 2006	PPA 2006*
Benefit Discount Rate (Plan Liabilities)	Equal to assumed investment return. Mandated rate equal to four-year weighted average of corporate bond rates for current liability purposes	3 different corporate bond rates, averaged over 2 years, based on when benefits are expected to be paid (yield curve)
Funding Target	Generally 90% of liability for accrued benefits to avoid funding charges and participant notices	100% of liability** for accrued benefits
Amortization Period for Unfunded Liabilities	5 to 30 years	7 years

*Generally effective in 2008

** Liability based on more conservative mortality table which increases the liability

[1] On January 1, 2006, E.ON U.S. implemented a "soft freeze" of the pension plan in which there will be no new participants but current participants will continue to accrue benefits.

In September 2006, the FASB issued SFAS No. 158, which is effective for fiscal years ending after December 15, 2006, for employers with publicly traded equity securities and for employers controlled by entities with publicly traded equity securities. Since EUS is controlled by E.ON A.G., a publicly traded company, SFAS No. 158 applies to EUS for fiscal year ending December 31, 2006. This statement requires employers to recognize the overfunded or underfunded status of a DB and postretirement plan as an asset or a liability in the balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income.[2] The liability used in calculating these entries is the Projected Benefit Obligation ("PBO"), which equals the present value of all future anticipated pension payments including future pay increases based on service to date. This statement also requires employers to measure the funded status of a plan as of the date of its year-end balance sheet. This statement amended SFAS No. 87, *Employers' Accounting for Pensions*, SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, SFAS No. 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions*, and SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*.

EUS Funding Strategy

In the initial response to the KPSC in 2005, EUS noted that its funding strategy was to meet the "full funding limitation" established under ERISA. This funding strategy minimizes costs by avoiding more costly variable rate PBGC premiums while adequately funding plan liabilities consistent with the requirements of the PPA for 2006 and 2007. As noted above, the PPA full funding requirements become more stringent in 2008, but EUS plans to continue to meet the more stringent "full funding limitation" in the future. The Company proactively made a $107.9 million pension contribution in January 2007, which is included in the 2006 plan year numbers shown below. As a result of this action, the PPA requirement of reaching 100% funded status within seven years has already been met based on the estimated December 31, 2006 valuation and the funding strategy of avoiding PBGC variable rate premiums has been maintained, as of January 2007. In addition, forecasts suggest that the 2007 contribution will be sufficient to avoid the variable rate premium in 2008. If, based on actuarial calculation performed by Mercer later in 2007, additional funding is needed to avoid the more costly PBGC variable rate premiums, the Company plans to fund these incremental amounts. The PPA requires companies to pay the more costly variable rate PBGC premiums if the target liability is not fully funded. The liability is expected to grow as a result of service credits and pay increases and possibly as the result of lower interest rates. Consequently, contributions beyond 2008 will likely be required and the Company plans to make such contributions consistent with its stated policy.

The following tables, based on information provided by the Company's actuary, Mercer, indicate that the ERISA requirements were met for 2005 and 2006. 2007 illustrates that the plan will be fully funded under PPA as of January 1, 2008:

Non-Union Retirement Plan	Plan Year *{In Millions}*		
	2007*	2006	2005
1. Expected liability at end of plan year	$ 567.7	$ 465.1	$ 439.2
2. Expected assets at end of plan year	$ 567.7	$ 459.4	$ 449.8
3. Full Funding Limit (1) - (2), not less than zero	$ -	$ 5.7	$ -
4. Funded Percentage Prior to Contribution	100.0%	98.8%	102.4%
5. Contribution Made	$ -	$ 69.9	$ 6.0
6. Funded Percentage After Contribution	100.0%	113.8%	103.8%

* Based on actuarial valuation data as of January 1, 2006. The target liabilities under PPA were projected to January 1, 2008, assuming that plan experience matches the valuation assumptions during 2006 and 2007. (Mortality tables were updated to reflect proposed IRS regulations under PPA and discount rates based on current yield curves.)

[2] SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, provides guidance to regulated utilities for deferring costs that would otherwise be charged to expense or equity by non-regulated enterprises. In Case No. 2003-00433 and 2003-00434, the Commission ordered that the unfunded pension benefit (minimum pension liability) should be reversed from other comprehensive income and recorded as a regulatory asset. In applying the provisions of SFAS No. 71 to the requirements of SFAS No. 158, LG&E and KU, consistent with the Commission's orders, recorded a regulatory asset representing the adjustment to the pension liability in recognizing the funded status of the pension liability. This adjustment would have been represented in Accumulated Other Comprehensive Income without the application of SFAS No. 71.

Union Retirement Plan [Covers full-time employees of the LG&E who are members of Local 2100 of IBEW hired prior to January 1, 2006]	Plan Year *(In Millions)*		
	2007*	2006	2005
1. Expected liability at end of plan year	$ 243.7	$ 183.8	$ 181.7
2. Expected assets at end of plan year	$ 243.7	$ 205.9	$ 194.4
3. Full Funding Limit (1) - (2), not less than zero	$ -	$ -	$ -
4. Funded Percentage Prior to Contribution	100.0%	112.0%	107.0%
5. Contribution Made	$ -	$ 38.0	$ 17.5
6. Funded Percentage After Contribution	100.0%	132.7%	116.6%

* Based on actuarial valuation data as of January 1, 2006. The target liabilities under PPA were projected to January 1, 2008, assuming that plan experience matches the valuation assumptions during 2006 and 2007. (Mortality tables were updated to reflect proposed IRS regulations under PPA and discount rates based on current yield curves.)

As noted in the Companies' report of action filed in June 2005, there are several different measurements of the liability. The table below compares the projected funded status as of December 31, 2006 based on old ERISA, new ERISA projected to Jan 1, 2008, ABO, and PBO:

	Plan Assets*	**Discount Rate for Liabilities**	**Future Wage Escalation**	**PV of Liabilities**	**Assets in Excess of (less than) Liabilities**	**Funded Status (%)**
OLD ERISA	$773.2	8.25%	5.25%	$648.9	$124.3	119%
ERISA**	$811.4	6.00%	5.25%	$811.4	$0.0	100%
ABO	$822.9	5.96% ***	N/A	$779.1	$43.8	106%
PBO	$822.9	5.96% ***	5.25%	$892.5	($69.6)	92%

* Includes contribution of $107.9 million in January 2007. ABO and PBO are based on actual plan assets as of December 31, 2006.

** Projected to January 1, 2008. Based on actuarial valuation data as of January 1, 2006. The target liabilities under PPA were projected to January 1, 2008, assuming that plan experience matches the valuation assumptions during 2006 and 2007. (Mortality tables were updated to reflect proposed IRS regulations under PPA and discount rates based on current yield curves.)

*** 5.91% for Union Plan

The $107.9 million contribution in January 2007 was calculated using an updated mortality table and a target liability as of January 1, 2008. Therefore, an additional year of credited service is included in the contribution that is not reflected in the December 31, 2006 ABO. In summary, the Company's funded status using the old ERISA and ABO standards is approximately 19% and 6% over-funded, respectively as of December 31, 2006, and is funded at 100% as projected to the end of 2007.

The Company's strategy is to fund the pension plans to the "full funding limitation", as defined by ERISA, while not surpassing the PBO. The Company does not intend to fund amounts in excess of the PBO because once contributions have been made to the pension plans, the assets cannot revert to the Company without significant penalty. Thus the goal is to fully fund the ABO but not exceed the PBO. The complexity of this strategy increases as the volatility of interest rates increases causing significant variability in the calculation of the projected future liabilities. A rising discount rate results in a lower liability and a corresponding increase in the funded status, while a declining discount rate has the opposite effect. For a 100 basis point change in the discount rate, the ABO as of December 31, 2006, for the Union Plan and the Non-Union Plan would change approximately $29.2 million and $73.5 million respectively.

Conclusion

The primary objective of the funding strategy for EUS and its subsidiaries has been to avoid higher cost variable rate PBGC premiums by meeting the "full funding limitation" as defined by ERISA. This objective remains unchanged following the modifications contained within the provisions of the PPA. As shown in the above table, the non-union and union plans, which include LG&E and KU, have achieved the fully funded requirement from an ERISA and ABO perspective following the 2007 contribution based on the

December 31, 2006 valuation. The Company continues to monitor the components that impact pension cost and funded status and respond accordingly, as evidenced by the Company's proactive funding in the amount of $107.9 million in January 2007.

E.ON U.S. LLC POSTRETIREMENT PLAN

The implementation of SFAS No. 158 had a similar impact on the accounting for Other Postretirement Benefits ("OPEB") with the full liability showing on the balance sheet. However, there were no legal changes to required funding for OPEB. EUS continues to offer a Retiree Medical Continuation Plan (the "Plan") to eligible employees. The Plan is subject to the provisions of ERISA, as amended. The Company also continues to use Mercer to provide actuarial assistance with respect to the Plan.

EUS Funding Strategy

As the Company indicated in its original filing with the PSC, the funding strategy for the postretirement plans differ from its pension strategy because the tax incentives and the penalties that exist for the pension plan funding are significantly reduced. The funding strategy for the EUS Plan is to continue funding postretirement benefits for current active and retired participants to the extent allowable under the 401(h) account in the E.ON U.S. LLC Retirement Plan with the remainder funded on a pay-as-you-go basis through the Voluntary Employee Benefit Account ("VEBA") trusts. Assets for the 401(h) are held for future obligations, while all current benefits are paid from VEBA trusts. Contributions are made to the VEBA trusts which in turn pay claims made by active employees and retirees for medical and dental benefits, and fees associated with the plan's administration. The employee and retiree contributions are immediately directed to VEBA trusts, with employer contributions occurring as needed.

EUS funded the 401(h) account in the amount of $5.1 million in 2006, and paid an additional amount of $15.2 million directly into the VEBA trusts to fund current benefit payments. 401(h) contributions are made in accordance with the maximum funding limitation governed by tax laws, which will generally allow the Company to fund approximately $5 million to $8 million per year into its 401(h). The Company continues to monitor the components that impact postretirement cost, market trends and funded status.

View of OPEB

Like EUS, most employers continue to fund their OPEB liability on a pay-as-you-go basis due to the lack of a statutory funding requirement, the limitations on tax-deductible funding and the fact that employers generally reserve the right to modify or terminate retiree medical benefits. Investment earnings within the VEBA for the union plan accrue tax-free; however, investment earnings within the VEBA for the non-union plans are subject to tax on unrelated business income. Consequently, non-union VEBA accounts are not efficient tax vehicles for prefunding OPEB liability and are not frequently utilized. According to the 2005 Mercer national Survey of Employer-Sponsored Health Plans, 91% of all large employers (defined as employers with 500 or more employees) and 74% of employers in the transportation/communication/ utilities industry do not utilize VEBA trusts to prefund retiree medical benefits.

Conclusion

Generally, OPEB continues to be largely unfunded and pay-as-you-go funding is still the norm for most companies. The vehicles for funding OPEB obligations have significant limitations on the Company's ability to prefund the OPEB on a tax efficient basis. EUS continues to fund post-retirement obligations through the 401(h) account under the Retirement Plan through the VEBA trusts. EUS will continue to monitor the components that impact post-retirement cost, market trends and funded status with the assistance of Mercer and execute its funding strategy as described in the report.