LG&E ENERGY

Kent W. Blake
Director
State Regulation and Rates

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September 30, 2005

RECEIVED

SEP 30 2005

PUBLIC SERVICE
COMMISSION

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

RE: ***The Plan of Kentucky Utilities Company for the Value Delivery Surcredit Mechanism***
Case No. 2005-00351

Dear Ms. O'Donnell:

Enclosed please find an original and ten (10) copies of Kentucky Utilities Company's ("KU") Application and Testimonies of Kent. W. Blake, Valerie L. Scott and S. Bradford Rives in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to contact me at (502) 627-2573.

Sincerely,

Kent W. Blake

Kent W. Blake

cc: Elizabeth E. Blackford
Michael L. Kurtz

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF KENTUCKY UTILITIES COMPANY FOR THE VALUE DELIVERY SURCREDIT MECHANISM	))))	**CASE NO. 2005-00351**

APPLICATION OF KENTUCKY UTILITIES COMPANY

Applicant, Kentucky Utilities Company ("KU"), pursuant to Chapter 278 of the Kentucky Revised Statutes and Kentucky Public Service Commission ("Commission") Order and Settlement Agreement in Case No. 2001-00169[1], hereby applies to the Commission for authority to withdraw from service its Value Delivery Surcredit Rider tariff for electric service following the expiration of the sixty month period ending March 31, 2006, subject to any final balancing adjustment.

In support of its Application, KU states as follows:

1. The full name and mailing address of the Applicant is: Kentucky Utilities Company c/o Louisville Gas and Electric Company, Post Office Box 32010, 220 West Main Street, Louisville, Kentucky 40232. KU is a Kentucky corporation authorized to do business in the Commonwealth of Kentucky.

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[1] In the Matter of: The Annual Earnings Sharing Mechanism Filing of Louisville Gas And Electric Company, Case No. 2001-00054 and The Annual Earnings Sharing Mechanism Filing of Kentucky Utilities Company, Case No. 2001-00055 and Application of Kentucky Utilities Company for an Order Approving Revised Depreciation Rates, Case No. 2001-00140 and Application of Louisville Gas and Electric Company for an Order Approving Revised Depreciation Rates, Case No. 2001-00141 and Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be included in Earnings Sharing Mechanism Calculations, Case No. 2001-00169, Order (December 3, 2001).

2. KU is a utility engaged in the electric business. KU generates and purchases electricity, and distributes and sells electricity at retail in the following counties in Central, Northern, Southeastern and Western Kentucky:

Adair	Edmonson	Jessamine	Ohio
Anderson	Estill	Knox	Oldham
Ballard	Fayette	Larue	Owen
Barren	Fleming	Laurel	Pendleton
Bath	Franklin	Lee	Pulaski
Bell	Fulton	Lincoln	Robertson
Bourbon	Gallatin	Livingston	Rockcastle
Boyle	Garrard	Lyon	Rowan
Bracken	Grant	Madison	Russell
Bullitt	Grayson	Marion	Scott
Caldwell	Green	Mason	Shelby
Campbell	Hardin	McCracken	Spencer
Carlisle	Harlan	McCreary	Taylor
Carroll	Harrison	McLean	Trimble
Casey	Hart	Mercer	Union
Christian	Henderson	Montgomery	Washington
Clark	Henry	Muhlenberg	Webster
Clay	Hickman	Nelson	Whitley
Crittenden	Hopkins	Nicholas	Woodford
Daviess			

3. A certified copy of KU's Articles of Incorporation, as amended, are on file with the Commission in Case No. 2001-104, *In the Matter of: Joint Application of E.ON AG, Powergen plc, LG&E Energy Corp., Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of an Acquisition.*

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

Kent W. Blake
Director, State Regulation and Rates
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202

Elizabeth L. Cocanougher
Senior Corporate Attorney
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202

Kendrick R. Riggs
Ogden Newell & Welch PLLC
1700 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202

Value Delivery Team Initiative

5. In connection with their Value Delivery Team ("VDT") initiative, including the 2001 Workforce Separation Program ("Workforce Separation"), on June 1, 2001, KU and Louisville Gas and Electric Company ("LG&E") filed a joint Application with the Commission requesting an order approving certain accounting debits and declaring the amortization of the deferred debits to be included in the calculation of the existing Earnings Sharing Mechanism. In February 2001, KU recorded an estimated Workforce Reduction expense of $63,787,914 for the total company operations with $56,267,319 allocated to Kentucky retail operations. In the joint application KU proposed this expense entry would be reversed and the estimated amounts capitalized and recorded as a deferred debit.

2001 Settlement Agreement

6. The representatives of consumer interests, including the Attorney General, met with the Commission Staff, LG&E and KU at the Commission's office during the fall of 2001 and reached a unanimous Settlement Agreement ("2001 Settlement Agreement"). Under the terms of the 2001 Settlement Agreement, KU recorded an estimated deferred debit of $56,300,000. These amounts were to be amortized over a sixty month period, beginning April 1, 2001 and terminating on March 31, 2006, in equal monthly amounts, except as adjusted for certain timing differences allocated during the nine months ending December 31,

2001. In the 2001 Settlement Agreement, the parties agreed to use a surcredit mechanism designated as the "Value Delivery Surcredit." Under the Value Delivery Surcredit mechanism, the estimated savings from the Value Delivery Team initiative were netted against the monthly amortization of the deferred debits. The resulting net savings were then to be shared 40 percent to ratepayers and 60 percent to the shareholder. The 2001 Settlement Agreement further expressly provided that "[t]he surcredit mechanisms will terminate and be withdrawn from service following the expiration of the sixty month period ending March 31, 2006, subject to any final balancing adjustment." The Commission approved the 2001 Settlement Agreement in its Order dated December 3, 2001 in Case No. 2001-00169.

The Plan

7. In Case No. 2003-00434,[2] the Commission's June 30, 2004 Order approved the Partial Settlement Agreement, Stipulation and Recommendation. Under Section 3.5 of the Partial Settlement Agreement, Stipulation and Recommendation, KU is required to file a "plan for the future ratemaking treatment of the VDT surcredits, the shareholder savings, the amortization of VDT costs and all other VDT-related issues" ("the Plan").

8. This Application and supporting testimony constitutes KU's Plan under Section 3.5 of the Partial Settlement Agreement, Stipulation and Recommendation. Effective for electric service rendered on and after April 1, 2006, the Value Delivery Surcredit will be allowed to expire subject to the final balancing adjustment to be billed in May 2006.

9. KU supports its request for authority to withdraw the Value Delivery Surcredit Rider tariff with the testimony of:

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[2] In the Matter of: An Adjustment of the Electric Rates, Terms and Conditions of Kentucky Utilities Company, Case No. 2003-00433, Order (June 30, 2004).

- Kent W. Blake, State Regulation and Rates for LG&E Energy Services Inc. – Mr. Blake will present KU's Plan for withdrawal of the Value Delivery Surcredit effective April 1, 2006. Mr. Blake's testimony will also present the supporting analysis which demonstrates why KU's Plan is reasonable and should be approved. In addition, his testimony will support certain pro forma adjustments to the Company's operating income for the twelve months ended June 30, 2005, demonstrate that those adjustments are known, measurable and reasonable, and affirm certain reference schedules supporting the Company's Plan.
- Valerie L. Scott, Controller – Ms. Scott will support certain pro forma adjustments to the Company's operating income for the twelve months ended June 30, 2005, demonstrate that those adjustments are known, measurable and reasonable, and affirm certain reference schedules supporting the Company's Plan; and
- S. Bradford Rives, Chief Financial Officer – Mr. Rives will describe the financial and operating condition of the Company and discuss the Company's capital structure and adjustments to the capital structure.

10. This Application constitutes notice to the Commission of the proposed termination and withdrawal from service of KU's Value Delivery Surcredit Rider tariff for electric service by the expiration of the sixty month period ending March 31, 2006. Pursuant to the Value Delivery Surcredit Rider, the final balancing adjustment will be applied to customer billings in the second month following the fifth distribution year. The final balancing adjustment shall be performed no later than May 2006. The Value Delivery

Surcredit Rider tariff, presented in Exhibit 1 to this Application for reference, shall be withdrawn from service as of June 1, 2006.

11. Based on the twelve month period ending June 30, 2005, KU's earned return on electric operations, adjusted for accepted ratemaking adjustments and other known and measurable changes is 8.49 percent. In KU's most recent rate case, Case No. 2003-00434, the Commission issued an order on June 30, 2004 authorizing a required return on equity for KU within a range of 10.00 to 11.00 percent with a midpoint of 10.50 percent. More recently, in connection with KU's 2004 Environmental Cost Recovery ("ECR") application, Case No. 2004-00426, the Commission issued an order on June 20, 2005, concluding that "a range of 10.0 to 11.0 percent, with a midpoint of 10.5 percent, continues to be a reasonable ROE for KU." Thus, KU's electric operation has a revenue deficiency clearly below the authorized range of return on equity before the Value Delivery Surcredit expires.

12. Expiration of the Value Delivery Surcredit does not cause the Company's financial returns to exceed the authorized range of return approved by the Commission. Moreover, the Company expects to sustain further attrition in earnings from significant capital investments in the Company's infrastructure until its next base rate case. Rate stability and continuity support allowing the Value Delivery Surcredit to expire according to the terms of the 2001 Settlement Agreement. If the Plan is approved, the Commission will, of course, retain the authority to monitor the Company's financial performance and take any actions necessary in the future should economic circumstances and the Company's financial performance dictate such action.

WHEREFORE, Kentucky Utilities Company respectfully requests the Kentucky Public Service Commission to enter an order:

1. Approving the termination and withdrawal from service of its Value Delivery Surcredit Rider tariff for service as proposed herein; and

2. Granting all other relief to which Kentucky Utilities Company may be entitled.

Respectfully submitted,

Elizabeth L. Cocanougher
Senior Corporate Attorney
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202
Telephone: (502) 627-4850

Kendrick R. Riggs
Ogden Newell & Welch PLLC
1700 PNC Plaza
500 West Jefferson Street
Louisville, Kentucky 40202
Telephone: (502) 582-1601

Counsel for Kentucky Utilities Company

CERTIFICATE OF SERVICE

The undersigned hereby certifies that an original and ten copies of this Application was hand delivered to Elizabeth O'Donnell, Executive Director, Kentucky Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601, and that a copy of the Application was mailed to Elizabeth E. Blackford, Assistant Attorney General, Office of Rate Intervention, 1024 Capital Center Drive, Frankfort, Kentucky 40601 on the 30th day of September 2005.

Counsel for Kentucky Utilities Company

VDSR
Value Delivery Surcredit Rider

APPLICABLE
In all territory served. T

AVAILABILITY OF SERVICE
To all electric rate schedules. T

T

RATE
The monthly billing amount computed under each of the rate schedules to which this surcredit is applicable shall be adjusted by the Value Delivery Surcredit Factor, which shall be calculated in accordance with the following formula:

Value Delivery Surcredit Factor = VDS + BA

Where:

(VDS) is the Value Delivery Surcredit which is based on the total Company net savings that are to be distributed to the Company's Kentucky jurisdictional retail customers in each 12-month period.

	Net Savings To be Distributed	Value Delivery Surcredit (VDS)
Year 1, Dec 1, 2001 to Dec 31, 2001	$ 480,000	0.85%
Year 2, Jan 1, 2002 to Dec 31, 2002	$ 640,000	0.10%
Year 3, Jan 1, 2003 to Dec 31, 2003	$2,360,000	0.33%
Year 4, Jan 1, 2004 to Dec 31, 2004	$2,880,000	0.38%
Year 5, Jan 1, 2005 to Dec 31, 2005	$3,360,000	0.45%
Year 6, Jan 1, 2006 to Mar 31, 2006	$ 840,000	0.44%

(BA) is the Balancing Adjustment for the second through the twelfth months of the current distribution year which reconciles any over- or under-distribution of the net savings from prior periods. The Balancing Adjustment will be determined by dividing the differences between amounts which were expected to be distributed and the amounts actually distributed from the application of the Value Delivery Surcredit Factor from the previous year by the expected Kentucky jurisdictional retail electric revenues. The final Balancing Adjustment will be applied to customer billings in the second month following the fifth distribution year.

TERMS OF DISTRIBUTION
(1) The total distribution to Company's customers will, in no case, be less than the sum of the amounts shown above.

(2) In the event that the actual net savings to the customers differs from the values shown under "Net Savings to be Distributed" an adjustment shall be made to Year 6 via the Balancing Adjustment. The determination of any such adjustment shall be reported to the Commission when it becomes available.

Kentucky Utilities Company

VDSR

Value Delivery Surcredit Rider

(3) On or before the 21st of the first month of each distribution year following Year 1, the Company will file with the Commission a status report of the Surcredit. Such report shall include a statement showing the amounts which were expected to be distributed and the amounts actually distributed in previous periods, along with a calculation of the Balancing Adjustment (BA) which will be implemented with customer billings in the second month of that distribution year to reconcile any previous over-or under-distributions.

(4) The Value Delivery Surcredit shall be applied to the customer's bill following the rates and charges for electric service, but before application of the school tax, the franchise fee, sales tax or similar items.

(5) Unless the Public Service Commission has already modified or terminated the Value Delivery Team surcredits in a subsequent procedure the Company will file, six (6) months prior to the expiration of the sixty (60) month period in which the VDT surcredits are in operation, with the Commission a plan for the future ratemaking treatment of the VDT surcredits, the shareholder savings, the amortization of VDT costs, and all other VDT-related issues.

(6) The Value Delivery Surcredit shall remain in effect until the Public Service Commission enters an order on the ratemaking treatment of all VDT-related issues.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF KENTUCKY	)	
UTILITIES COMPANY FOR THE	)	CASE NO. 2005-00351
VALUE DELIVERY SURCREDIT	)	
MECHANISM	)	

TESTIMONY OF
KENT W. BLAKE
DIRECTOR, STATE REGULATION AND RATES
KENTUCKY UTILITIES COMPANY

Filed: September 30, 2005

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

A. My name is Kent W. Blake. I am Director of State Regulation and Rates for LG&E Energy Services Inc., which provides services to Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU" or "the Company") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky. A statement of my professional history and education is attached as an appendix hereto.

Q. Have you previously testified before this Commission?

A. Yes. I have previously testified before this Commission in environmental surcharge, certificate and other proceedings.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss the Value Delivery Team ("VDT") surcredit and to present KU's "plan for the future ratemaking treatment of the VDT surcredits, the shareholder savings, the amortization of VDT costs and all other Value Delivery-related issues"[1] ("the Plan"). My testimony will also present the supporting analysis which demonstrates why KU's Plan is reasonable and should be approved. As part of KU's supporting analysis, my testimony will present certain pro forma adjustments to the Company's operating income for the twelve months ended June 30, 2005, demonstrate that those adjustments are known, measurable and reasonable, and affirm certain reference schedules supporting that analysis.

Q. Please describe the other witnesses offering direct testimony on behalf of the Company in this proceeding.

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[1] Section 3.5 of the Partial Settlement Agreement, Stipulation and Recommendation approved by the Commission's June 30, 2004 orders in Case Nos. 2003-00433 and 2003-00434.

A. KU is offering direct testimony from the following witnesses:

- Valerie L. Scott, Controller – Ms. Scott will support certain pro forma adjustments to the Company's operating income for the twelve months ended June 30, 2005, demonstrate that those adjustments are known, measurable and reasonable, and affirm certain reference schedules supporting the Company's Plan; and
- S. Bradford Rives, Chief Financial Officer – Mr. Rives will describe the financial and operating condition of the Company and discuss the Company's capital structure and adjustments to the capital structure.

Value Delivery Surcredit Mechanism

Q. Please describe the history of the Value Delivery rate mechanism.

A. In connection with their Value Delivery Team initiative, including the 2001 Workforce Separation Program ("Workforce Separation"), on June 1, 2001, LG&E and KU filed a joint Application requesting an order approving certain accounting debits and declaring the amortization of the deferred debits to be included in the calculation of the existing Earnings Sharing Mechanism. In February 2001, KU recorded an estimated Workforce Reduction expense of $63,787,914 for the total company operations with $56,267,319 allocated to Kentucky retail operations. In the joint application KU proposed this expense entry would be reversed and the estimated amounts capitalized and recorded as a deferred debit.

The representatives of consumer interests, including the Attorney General, met with the Commission Staff, LG&E and KU at the Commission's office during the fall of 2001 and reached a unanimous Settlement Agreement ("2001 Settlement Agreement")[2].

Under the terms of the 2001 Settlement Agreement, KU recorded an estimated deferred debit of $56,300,000. That amount was to be amortized over a sixty month period, beginning April 1, 2001 and terminating on March 31, 2006, in equal monthly amounts, except as adjusted for certain timing differences allocated during the nine months ending December 31, 2001.

In the 2001 Settlement Agreement, the parties agreed to use a surcredit mechanism designated as the "Value Delivery Surcredit." Under the Value Delivery Surcredit mechanism, the estimated savings from the Value Delivery Team initiative were netted against the monthly amortization of the deferred debits. The resulting net savings were then to be shared 40 percent to ratepayers and 60 percent to the shareholder.

The 2001 Settlement Agreement further expressly provided, on page 6, that "[t]he surcredit mechanisms will terminate and be withdrawn from service following the expiration of the sixty month period ending March 31, 2006, subject to any final balancing adjustment."

The Commission approved the 2001 Settlement Agreement in its Order dated December 3, 2001 in Case No. 2001-00169.

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[2] In the Matter of: Annual Earnings Sharing Mechanism Filing of Louisville Gas and Electric Company, Case No. 2001-054, Annual Earnings Sharing Mechanism Filing of Kentucky Utilities Company, Case No. 2001-055, Application of Kentucky Utilities Company For An Order Approving Revised Depreciation Rates, Case No. 2001-140, Application of Louisville Gas and Electric Company For An Order Approving Revised Depreciation Rates, Case No. 2001-141, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company For An Order Approving Proposed Deferred Debits and Declaring the Amortization Of The Deferred Debits To Be Included In Earnings Sharing Mechanism, Case No. 2001-169, Commission's Order dated December 3, 2001

Q. Please describe the ratemaking treatment associated with the Value Delivery Surcredit in KU's last base rate case.

The shareholder's portion of the net savings was included as an adjustment to operating expenses in the calculation of the Earnings Sharing Mechanism filings for 2001, 2002 and 2003. With the termination of the Earnings Sharing Mechanism in Case No. 2003-00434, the shareholder adjustment was similarly included in the calculation of the revenue requirement for KU's base electric rates by an adjustment to operating expenses. The rate case test year also included 12 months amortization of the costs to achieve and the Value Delivery Surcredit.

The table below is used to clarify how base rates in Case No. 2003-00434 were impacted by the 2001 Settlement Agreement:

Test Year Ended September 30, 2003	$ millions
Gross Savings from VDT initiative	$ 16.3
Less: Amortization of Costs to Achieve	(11.5)
Net VDT Savings	**4.8**
Less: Revenue Reduction for Value Delivery Surcredit (customer's 40% share of net savings)	(1.9)
Impact on Net Operating Income	**2.9**
Less: Pro-forma Adjustment for Shareholder Savings (made in order for KU to retain its 60% share of net savings)	(2.9)
Net Impact on Base Rates	**0**
Customers' 40% share of Net Savings provided via Value Delivery Surcredit	$ **1.9**

Q. Has the Value Delivery Surcredit mechanism been successful?

A. Yes. The Value Delivery Surcredit mechanism is providing KU's Kentucky jurisdictional customers with the approved $10.6 million of net savings over the sixty month period in which the mechanism is intended to be in effect.

Plan for the Value Delivery Surcredit

Q. Please describe the Plan for the Value Delivery Surcredit.

A. KU is proposing to allow the Value Delivery Surcredit Rider to expire and withdraw the tariff from electric service effective March 31, 2006 subject to a final balancing adjustment in May 2006.

Q. Why should the Value Delivery Surcredit be allowed to expire at this time?

A. Under the express terms of the 2001 Settlement Agreement, the Value Delivery Surcredit is to "terminate and be withdrawn from service following the expiration of the sixty month period ending March 31, 2006, subject to any final balancing adjustment." The cost to achieve the 2001 Workforce Separation has been recovered and there is no longer any need to continue the mechanism.

Q. Please describe how KU's proposed Plan will be implemented.

A. Effective for service rendered on and after April 1, 2006, the Value Delivery Surcredit will be allowed to expire subject to the final balancing adjustment to be billed in May 2006.

From that point forward, in future base rate cases, KU will not make a pro-forma adjustment to retain its 60% share of the net savings from the VDT initiative. Of course, KU's net operating income in any future test year will also not include the costs to achieve these savings since the amortization period will have expired. Similarly, revenues will not be reduced by the Value Delivery Surcredit in any future test year upon expiration of the Value Delivery Surcredit Rider tariff.

These future impacts are applied to the twelve months ended June 30, 2005, on lines 31 through 34 in Blake Exhibit 1. These adjustments demonstrate the effect of the Value Delivery Surcredit expiration.

Q. Please explain the purpose of Blake Exhibit 1.

A. KU believed that the Commission and other parties to the case would want to know the Company's current financial returns from base rates prior to reaching conclusions on the reasonableness of the Company's Plan to allow the Value Delivery Surcredit to expire.

Blake Exhibits 1-4 provide a traditional revenue requirements calculation for the twelve months ended June 30, 2005. It should be noted that this period represents the first full year under KU's current base rates and is the most recent quarter ended prior to the date of this filing. Blake Exhibit 5 shows the return on equity both under the existence of the Value Delivery Surcredit and upon expiration of the Value Delivery Surcredit for the twelve months ended June 30, 2005.

Blake Exhibit 1 begins by showing operating revenues and expenses, and net operating income per books for jurisdictional operations for the twelve months ended June 30, 2005. The terms of this schedule are presented in detail later in my testimony.

Blake Exhibit 1, line 30, shows the net operating income per books for KU's jurisdictional operations for the twelve months ended June 30, 2005, with pro-forma adjustments based on the established methodology approved by this Commission to eliminate other rate mechanisms, eliminate revenue and expense items as previously ordered by this Commission in prior rate cases, normalize significant variable activity during a twelve month period, annualize significant changes during a twelve month period and remove non-recurring items. These adjustments include an adjustment for

KU's share of the net VDT savings consistent with the method used in Case No. 2003-00434.

Blake Exhibit 1, line 37, shows the impact on net operating income of the expiration of the Value Delivery Surcredit. First, the adjusted net operating income per books for KU's jurisdictional operations for the twelve months ended June 30, 2005 from line 30 is adjusted by $4,680,000 to remove the net savings to the shareholder by a decrease in expenses. Secondly, revenues are increased by $3,227,105 to reflect the withdrawal of the Value Delivery Surcredit. Finally, expenses are adjusted by $11,753,520 to remove the amortization of the costs to achieve the savings. The tax effect of these adjustments is also shown on Blake Exhibit 1, line 35.

The resulting pro-forma net operating income from line 30 (prior to VDT expiration) and line 37 (after VDT expiration) are both carried forward to Blake Exhibit 4 to calculate the resulting revenue deficiency, and to Blake Exhibit 5 to calculate the earned return on equity for KU both prior to VDT expiration and after VDT expiration.

Q. Please identify and explain what is contained in Blake Exhibit 2.

A. Blake Exhibit 2 calculates adjusted capitalization as of June 30, 2005, as well as the weighted average cost of capital to apply to the adjusted capitalization. The details of the calculations of the adjusted capitalization and KU's capital structure are addressed in the direct testimony of Mr. Rives.

Q. Please identify and explain what is contained in Blake Exhibit 3.

A. Blake Exhibit 3 computes KU's net original cost rate base and the related Kentucky jurisdictional percentage used to jurisdictionalize total capitalization in Blake Exhibit 2.

Q. Is there reason to expect any significant change in the revenue requirement for KU in the near term?

A. Yes. KU is in the process of making significant capital investments in generation, transmission and distribution facilities in order to continue to provide safe and reliable service to its customers. Some of the more significant capital projects are the subject of certificate of convenience and necessity cases before this Commission. These investments in the service facilities are necessary for the public convenience and necessity.

The construction of these projects however will also cause KU to sustain further attrition in its earnings from the level that is presently required for the Company to maintain its financial strength and favorable financial ratings for borrowing money and otherwise raise capital.

Q. Has the Commission recently approved an authorized required return on equity for KU?

A. Yes. In KU's most recent rate case, Case No. 2003-00434, the Commission issued an order on June 30, 2004 authorizing a required return on equity for KU within a range of 10.00 to 11.00 percent with a midpoint of 10.50 percent. More recently, in connection with KU's 2004 ECR application, Case No. 2004-00426, the Commission issued an order on June 20, 2005, concluding that "a range of 10.0 to 11.0 percent, with a midpoint of 10.5 percent, continues to be a reasonable ROE for KU."

Q. What do Blake Exhibits 4 and 5 show for the return on equity earned by KU?

A. Blake Exhibit 4 demonstrates that KU has a revenue deficiency clearly below the authorized range of return on equity before the Value Delivery Surcredit expires and shows KU could reasonably expect to have sufficient revenues, with the earned return on equity within a revenue deficiency below the authorized range of return on equity after the Value Delivery Surcredit expires. Blake Exhibit 5 shows the return on equity for KU to be 8.49% with the Value Delivery Surcredit effective and 10.07% after the pro-forma adjustments are made to reflect the expiration of the Value Delivery Surcredit as proposed in this Plan.

Q. Given the results shown on Blake Exhibit 4, is KU planning to file for a base rate increase?

A. Not at this time. Upon the expiration of the Value Delivery Surcredit and the full amortization of related costs, Exhibits 4 and 5 show that KU's return on equity is expected to be within the range of return authorized by the Commission. Future base rate cases are likely to be dependent upon the timing and nature of capital expenditures required to support the Company's infrastructure. Extending the Value Delivery Surcredit after March 31, 2006 however could cause KU to file a base rate case sooner and for a greater amount than otherwise would be necessary due to the cumulative impact of the planned construction expenditures and the extension of the Value Delivery Surcredit.

Q. Should the Commission consider the potential impact of filing a new base rate case in connection with determining whether to extend the Value Delivery Surcredit mechanism in this case?

A. Yes. Rate stability and continuity are important ratemaking considerations. It is important that the Commission consider the potential impact of extending the Value Delivery Surcredit beyond its scheduled expiration on the timing and magnitude of upcoming base rate cases given the planned construction schedule of transmission and generation projects.

As Blake Exhibits 4 and 5 show, with the Value Delivery Surcredit in place, KU's operation is presently earning a return below the currently authorized range of return. If the Value Delivery Surcredit is extended, the benefit to customers of extending this rate mechanism would likely be very short-lived and would cause KU to file a base rate case sooner and for a greater amount than if the mechanism expires according to the terms in the 2001 Settlement Agreement. By allowing the Value Delivery Surcredit to expire under the terms in the 2001 Settlement Agreement, the Commission can advance the important goals of rate stability and continuity for customers.

Q. What consideration should the Commission give to this analysis on Blake Exhibits 1-5 in making its decision on the resolution of the Value Delivery Surcredit?

A. The Company's pro-forma analysis is a sound indication of what the Company's financial returns are reasonably expected to be following the expiration of the Value Delivery Surcredit. The Company believes it is a reasonable effort, consistent with the Commission's prior orders and policies, to estimate the impact of this decision on the Company's financial returns. Actual Company returns will, of course, be dependent upon any number of factors including, but not limited to, capital investments, market interest rates, the economy, the weather and market prices for power, natural gas and fuel. Should the Commission agree with the Company's Plan to allow the Value Delivery Surcredit to expire as originally intended, the Commission will, of course, retain the authority to monitor the Company's financial performance and take any action necessary in the future should economic circumstances and the Company's financial performance dictate such action.

Analysis of Net Operating Income

Q. Please further describe Blake Exhibit 1 and its purpose.

A. Blake Exhibit 1 shows operating revenues and expenses, and net operating income per books for jurisdictional operations for the twelve months ended June 30, 2005. Because a historical year is used instead of a forecasted year, it is necessary that the historical year be adjusted to reflect changes in revenues and expenses that can be expected to occur during the period after the discontinuation of the Value Delivery Surcredit. This Exhibit sets forth adjustments for the known and measurable changes and eliminates unrepresentative conditions in order to "pro form" or make the year suitable for use in determining the deficiency/sufficiency of current revenues upon the expiration of the Value Delivery Surcredit. A further description of, and support for, each adjustment is contained in supporting Reference Schedules 1.11 through 1.74 of this Exhibit.

Q. Briefly describe the nature of the pro forma adjustments you have made for KU for the twelve months ended June 30, 2005 shown on Blake Exhibit 1.

A. The adjustments are consistent with previous adjustments approved by the Commission in KU's last base rate case or the Commission's policy with respect to known and measurable adjustments.

For the twelve month period ended June 30, 2005, KU has made adjustments which:

a) Remove the impact of items included in other rate mechanisms (Reference Schedules 1.11 - 1.16),

b) Eliminate certain revenue and expense items as previously ordered by this Commission (Reference Schedules 1.20 – 1.22),

c) Normalize certain revenues and expenses (Reference Schedules 1.30 - 1.32),

d) Annualize year end facts and circumstances (Reference Schedules 1.40 - 1.45),

e) Adjust for non-recurring items in the test year (Reference Schedules 1.50 – 1.51),

f) Adjust for VDT-related items (Reference Schedules 1.60 - 1.61), and

g) Adjust for Federal and state income tax expenses for these pro-forma adjustments (Reference Schedules 1.70 - 1.74).

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.11 of Blake Exhibit 1.

A. This adjustment removes environmental cost recovery ("ECR") revenues and expenses from net operating income because those revenues and expenses are addressed by a separate rate mechanism. Consistent with the Commission's practice of eliminating the revenues and expenses associated with full-recovery cost trackers, an adjustment was made to eliminate $21,777,415 of ECR revenues and $8,896,292 in ECR costs. The adjustment is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434. The ECR surcharge provides for full recovery of environmental costs that qualify for the surcharge and contains a mechanism to true up actual ECR revenues to allowed ECR revenues under the surcharge. The adjustment to revenues includes all ECR billings during the twelve months ended June 30, 2005. The adjustment to expenses includes operating expenses recovered under the ECR during the twelve months ended June 30, 2005 for compliance costs that will continue to be recovered through the surcharge (i.e., operating expenses relating to the post-1994 ECR Plan). KU's capitalization includes an adjustment to eliminate the ECR rate base for the post-1994 ECR Plan (see Blake Exhibit 2).

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.12 of Blake Exhibit 1.

A. This adjustment has been made to remove the impact of the revenues and expenses associated with KU's demand-side management mechanism from the twelve months ended June 30, 2005 revenues and expenses. The impact of rate mechanisms, like the demand-side management mechanism, should be removed from the twelve months ended June 30, 2005 revenues when assessing the adequacy of base rates. Consistent with the Commission's practice of eliminating the revenues and expenses associated with full-recovery cost trackers, an adjustment was made to eliminate $3,982,650 of revenue recovered through the Demand-Side Management Cost Recovery Mechanism ("DSMRM") and the corresponding $3,874,591 of demand-side management expenses recorded during the twelve months ended June 30, 2005. The DSMRM includes a balance adjustment that automatically adjusts unit charges under the mechanism to account for differences between revenues collected and demand-side management program costs incurred during the applicable period. The adjustment is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.13 of Blake Exhibit 1.

A. This adjustment has been made to eliminate the impact of accrued revenues recorded in the twelve months ended June 30, 2005 associated with the Environmental Cost Recovery and Fuel Adjustment Clause from Accounts 440-445 and Rate Refund Account 449. The impact of rate mechanisms, such as these, should be removed from the twelve months ended June 30, 2005 revenues when assessing the adequacy of base rates. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.14 of Blake Exhibit 1.

A. This adjustment is made to reflect the current customers' and shareholder's portions of the merger savings approved by the Commission in its October 16, 2003 Order in Case No. 2002-00429. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.15 of Blake Exhibit 1.

A. This adjustment has been made to account for the timing mismatch in fuel cost expenses and revenues under the Fuel Adjustment Clause ("FAC") for the twelve months ended June 30, 2005. Consistent with past Commission practice, the mismatch between fuel costs and fuel cost recovery through KU's FAC has been eliminated. These over- or under-recoveries were taken directly from KU's monthly FAC filings. The adjustment is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.16 of Blake Exhibit 1.

A. This adjustment includes the environmental compliance costs associated with off-system sales revenues. This adjustment is made in accordance with the methodology approved by the Commission in its June 1, 2000 Order in Case No. 98-474 and applied in Case No. 2003-00434. It is also consistent with the Commission's determination in Case No. 95-060 that eligible environmental compliance costs attributable to off-system sales are not otherwise eligible for environmental surcharge recovery. In the determination of the ECR surcharge, a portion of KU's environmental compliance costs eligible for recovery through the surcharge are allocated to off-system sales. Since jurisdictional customers receive the benefit of off-system sales margins in all revenue requirements calculations, the Commission has previously determined that reducing off-system sales margins to reflect environmental costs incurred but not recovered through the surcharge is a correct adjustment to operating results for the twelve month period. Therefore, consistent with the methodology prescribed in the Commission's Order on rehearing in Case No. 98-474 dated June 1, 2000, an adjustment of $857,672 was made to reduce revenues to reflect the environmental surcharge calculations recognized in the determination of off-system sales.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.20 of Blake Exhibit 1.

A. This adjustment has been made to eliminate the effect of unbilled revenues. Consistent with prior rate cases, unbilled revenues were removed from the twelve months ended June 30, 2005 operating revenues. For KU, $6,460,000 of unbilled revenues were removed from operating results for this period. An adjustment to remove unbilled revenues was accepted by the Commission in KU's last base rate case, Case No. 2003-00434, and LG&E's last three base rate cases, Case No. 2003-00433, Case No. 2000-080 and Case No. 90-158.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.21 of Blake Exhibit 1.

A. This adjustment has been made to eliminate electric brokered sales revenues and expenses as directed by the Commission in Case No. 98-474. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.22 of Blake Exhibit 1.

A. This adjustment eliminates advertising expenses, was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.30 of Blake Exhibit 1.

A. This adjustment has been made to reflect a normalized level of storm damage expenses. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.31 of Blake Exhibit 1.

A. This adjustment is made to normalize the expense levels in Account 925 "Injuries and Damages." This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.32 of Blake Exhibit 1.

A. This adjustment is made to normalize the Off-System Sales Margins to a five-year level. The level of off-system sales during the twelve months ended June 30, 2005 is not representative of a sustainable level due to market and operating conditions unique to that specific time period. The twelve months ended June 30, 2005, included unusually high plant availability and wholesale power prices. The Equivalent Forced Outage Rate ("EFOR") for the combined LG&E and KU system was below 3.0% for the calendar year 2004 (a record low rate) and continued to be below historical levels during the twelve months ended June 30, 2005 at 3.6%. Electricity prices in the wholesale market have increased over historical levels due primarily to increased fuel prices. As such the level of off-system sales margins in the twelve month period ending June 30, 2005 is not indicative of the amount that can be expected going forward and an adjustment of $10,335,215 was made to reduce revenues to reflect a level of off-system sales margins consistent with a five-year average.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.40 of Blake Exhibit 1.

A. This adjustment has been made to annualize revenues based on actual customers at June 30, 2005 and is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434. The numbers of customers served at the end of the twelve months ended June 30, 2005 for the rate classes were higher than the 13-month average number of customers. The differences between the number of customers served at year-end and the 13-month average number for each rate class was multiplied by the average annual kWh usage per customer. The average usage for each rate class was then multiplied by the average revenue per kWh (including customer charges, energy charges, demand charges and minimum bills), resulting in an upward adjustment to operating revenue of $2,524,868.

The additional operating expenses associated with serving the higher number of customers and volumes were calculated by applying an operating ratio to the revenue adjustment. Consistent with the Commission's practice, the operating ratio of 54.89 percent was determined by dividing operation and maintenance expenses, exclusive of wages and salaries, pensions and benefits, and regulatory commission expenses, by base rate revenues calculated at the currently effective rates. When applied to the year-end revenue adjustment, the application of the operating ratio resulted in an upward adjustment to expenses of $1,385,900.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.41 of Blake Exhibit 1.

A. This adjustment has been made to reflect annualized depreciation expenses under the existing rates applied to plant-in-service as of June 30, 2005. The calculation of the adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.42 of Blake Exhibit 1.

A. This adjustment has been made to reflect increases in labor and labor-related costs as applied to the twelve months ended June 30, 2005, and includes specific adjustments for wages, payroll taxes and KU's 401(k) match. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.43 of Blake Exhibit 1.

A. This adjustment has been made to reflect an annual level of Midwest Independent Transmission System Operator, Inc. ("MISO") administrative expenses associated with the operation of the "Day 2" markets. More specifically the administrative expenses are those contained in Schedules 16 and 17 of the MISO Energy Markets Tariff filed with and approved by the Federal Energy Regulatory Commission ("FERC"). The MISO Day 2 market began April 1, 2005; therefore, only three months of expenses were contained in the twelve months ended June 30, 2005[3]. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

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[3] In the Matter of: Investigation into the Membership of Louisville Gas and Electric Company and Kentucky Utilities Company in the Midwest Independent Transmission Operator, Inc., Case No. 2003-00266.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.44 of Blake Exhibit 1.

A. This adjustment has been made to reflect an annual level of the MISO Revenue Neutrality Uplift charges associated with the operation of the Day 2 market. The MISO Day 2 market began April 1, 2005; therefore, only three months of expenses were contained in the twelve months ended June 30, 2005. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.45 of Blake Exhibit 1.

A. This adjustment has been made to reflect an annual level of the MISO Revenue Sufficiency Guarantee ("RSG") make-whole Payments (net of production expenses associated with units receiving RSG make-whole Payments), and the MISO RSG Distribution Amount charges associated with the operation of the Day 2 market. The MISO Day 2 market began April 1, 2005; therefore, only three months of these revenues and expenses were contained in the twelve months ended June 30, 2005. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.50 of Blake Exhibit 1.

A. This adjustment is to remove a non-recurring item related to the reclassification of RSG revenues for the twelve months ended June 30, 2005. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.51 of Blake Exhibit 1.

A. This adjustment is to remove a non-recurring item related to a transmission revenue refund to East Kentucky Power Cooperative pursuant to FERC Order ER02-2560-002. The refund represents a one-time, non-recurring item recognized during the 12 months ending June 30, 2005. The adjustment increases revenue by $708,301.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.60 of Blake Exhibit 1.

A. This adjustment is to recognize the Value Delivery Team net savings to the shareholder recognized by the Commission in its Order of December 3, 2001 in Case No. 2001-169. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.61 of Blake Exhibit 1.

A. This adjustment has been made to remove the amount of the Value Delivery Surcredit contained in revenues for the twelve months ended June 30, 2005 and to remove from expenses the amount of the Value Delivery Cost Amortization included in base rates that will not exist after expiration of the Value Delivery Surcredit on March 31, 2006. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.70 of Blake Exhibit 1.

A. This adjustment is for federal and state income taxes corresponding to the base revenues and expense adjustments discussed above. Reference Schedule 1.70 shows the calculation of a composite federal and state income tax rate. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.71 of Blake Exhibit 1.

A. This adjustment is for federal and state income taxes corresponding to the annualization and adjustment of year-end interest expense. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.72 of Blake Exhibit 1.

A. This adjustment is for income tax true-ups and adjustments made during the twelve months ended June 30, 2005 that relate to prior periods. This adjustment was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.73 of Blake Exhibit 1.

A. This adjustment is for the tax adjustment for manufacturing activities and was prepared by Ms. Scott and is discussed in her testimony.

Q. Please explain Reference Schedule 1.74 of Blake Exhibit 1.

A. This schedule calculates the revenue gross up factor, was prepared by Ms. Scott and is discussed in her testimony.

Conclusion

Q. What is KU's recommendation for the Commission in this proceeding?

A. The Commission should approve KU's Plan and issue an order permitting the expiration of the Value Delivery Surcredit from service rendered on and after April 1, 2006, subject to a final balancing adjustment in the May 2006 billing.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Kent W. Blake**, being duly sworn, deposes and says he is the Director of State Regulation and Rates for LG&E Energy Services Inc., that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Kent W. Blake

KENT W. BLAKE

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 30th day of September 2005.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

APPENDIX A

Kent W. Blake

Director, State Regulation and Rates
LG&E Energy Services Inc.
220 West Main Street
P. O. Box 32010
Louisville, Kentucky 40202
(502) 627-2573

Education

University of Kentucky, B.S. in Accounting, May 1988
Certified Public Accountant, Kentucky, January 1991

Previous Positions

LG&E Energy LLC, Louisville, Kentucky
- 2003 (Sept) – 2004 (Oct) – Director, Regulatory Initiatives
- 2003 (Feb) – 2003 (Sept) – Director, Business Development
- 2002 (Aug) – 2003 (Feb) – Director, Finance and Business Analysis

Mirant Corporation (f.k.a. Southern Company Energy Marketing)
- 2002 (Feb-Aug) – Senior Director, Applications Development
- 2000-2002 – Director, Systems Integration
- 1998-2000 – Trading Controller

LG&E Energy Corp.
- 1997-1998 – Director, Corporate Accounting and Trading Controls

Arthur Andersen LLP
- 1992-1997 – Manager, Audit and Business Advisory Services
- 1990-1992 – Senior Auditor
- 1988-1990 – Audit Staff

KENTUCKY UTILITIES

Adjustments to Operating Revenues, Operating Expenses and Net Operating Income
For the Twelve Months Ended June 30, 2005

	Reference Schedule (1)	Operating Revenues (2)	Operating Expenses (3)	Net Operating Income (4)
1. Jurisdictional amount per books		933,078,332	802,331,440	$ 130,746,892
2. Adjustments for known changes and to eliminate unrepresentative conditions:				
3. Adjustment to eliminate environmental surcharge revenues and expenses	1.11	(21,777,415)	(8,896,292)	(12,881,123)
4. Eliminate DSM revenue and expenses	1.12	(3,982,650)	(3,874,591)	(108,059)
5. To eliminate ECR and FAC accruals	1.13	(22,528,436)	-	(22,528,436)
6. Adjustment for merger savings	1.14	1,739,220	18,968,825	(17,229,605)
7. To adjust mismatch in fuel cost recovery	1.15	(43,439,216)	(61,956,490)	18,517,274
8. Off-system sales revenue adjustment for the ECR calculation	1.16	(857,672)	-	(857,672)
9. Adjustment to eliminate unbilled revenues	1.20	(6,460,000)	-	(6,460,000)
10. To eliminate electric brokered sales revenues and expenses	1.21	277,850	(91,492)	369,342
11. Adjustment to eliminate advertising expenses pursuant to Commission Rule 807 KAR 5:016	1.22	-	(169,974)	169,974
12. Adjustment to reflect normalized storm damage expense	1.30	-	(559,863)	559,863
13. Adjustment for injuries and damages FERC account 925	1.31	-	1,209,867	(1,209,867)
14. To reflect representative level of off-system sales margins	1.32	(10,335,215)	-	(10,335,215)
15. Adjustment to annualize year-end customers	1.40	2,524,868	1,385,900	1,138,968
16. Adjustment to reflect annualized depreciation expenses under current rates	1.41	-	(1,319,539)	1,319,539

KENTUCKY UTILITIES

Adjustments to Operating Revenues, Operating Expenses and Net Operating Income
For the Twelve Months Ended June 30, 2005

		Reference Schedule (1)	Operating Revenues (2)	Operating Expenses (3)	Net Operating Income (4)
17. Adjustment to reflect increases in labor and labor related costs		1.42	-	744,930	(744,930)
18. Adjustment to annualize MISO schedules 16 and 17		1.43	-	3,037,717	(3,037,717)
19. Adjustment to annualize MISO revenue neutrality uplift		1.44	-	16,087,195	(16,087,195)
20. Adjustment to annualize RSG revenues and expenses		1.45	20,750,244	22,066,018	(1,315,774)
21. Adjustment for reclassification of RSG		1.50	5,791,428	-	5,791,428
22. Adjustment to remove non-recurring EKPC transmission refund		1.51	708,301	-	708,301
23. Adjustment to reflect VDT net shareholder savings		1.60	-	4,680,000	(4,680,000)
24. Total of above adjustments prior to Value Delivery Surcredit expiration			(77,588,693)	(8,687,789)	$ (68,900,904)
25. Federal and state income taxes corresponding to base revenue and expense adjustments and above adjustments -	39.5500 %	1.70		(27,250,308)	27,250,308
26. Federal and state income taxes corresponding to annualization and adjustment of year-end interest expense		1.71		11,406	(11,406)
27. Prior income tax true-ups and adjustments		1.72		1,202,473	(1,202,473)
28. Tax deduction for manufacturing activities (TDMA) adjustment		1.73		(340,446)	340,446
29. Total adjustments prior to Value Delivery Surcredit expiration			(77,588,693)	(35,064,664)	$ (42,524,029)
30. Adjusted Net Operating Income prior to Value Delivery Surcredit expiration			855,489,639	767,266,776	$ 88,222,863

KENTUCKY UTILITIES

Adjustments to Operating Revenues, Operating Expenses and Net Operating Income
For the Twelve Months Ended June 30, 2005

		Reference Schedule (1)	Operating Revenues (2)	Operating Expenses (3)	Net Operating Income (4)
31. Adjustments for expiration of Value Delivery Surcredit:					
32. Adjustment to remove VDT net shareholder savings		1.60	-	(4,680,000)	4,680,000
33. Adjustment to remove Value Delivery Surcredit and cost amortization		1.61	3,227,105	(11,753,520)	14,980,625
34. Total of above adjustments for expiration of Value Delivery Surcredit			3,227,105	(16,433,520)	$ 19,660,625
35. Federal and state income taxes corresponding to base revenue and expense adjustments and above adjustments -	39.5500 %	1.70		7,775,777	(7,775,777)
36. Total adjustments for expiration of Value Delivery Surcredit			3,227,105	(8,657,743)	$ 11,884,848
37. Adjusted Net Operating Income for expiration of Value Delivery Surcredit			858,716,744	758,609,033	$ 100,107,711

KENTUCKY UTILITIES

Adjustment to Eliminate Environmental Surcharge Revenues and Expenses
For the Twelve Months Ended June 30, 2005

Expense Month	Revenues All Plans	Expenses Post '94 Plan	Expenses Roll-In	Net of Roll-In Expenses Post '94 Plan	Net
Jul-04	$ 1,576,134	$ 458,578	$ (6,197)	$ 452,381	
Aug-04	1,282,367	417,126	(6,197)	410,929	
Sep-04	1,115,530	436,502	(6,197)	430,305	
Oct-04	1,099,282	412,893	(6,197)	406,696	
Nov-04	1,676,595	258,327	(6,197)	252,130	
Dec-04	1,958,572	4,627,568	(6,197)	4,621,371	
Jan-05	2,279,163	727,540	(6,197)	721,343	
Feb-05	4,312,170	683,523	(6,197)	677,326	
Mar-05	1,381,557	765,330	(6,197)	759,133	
Apr-05	1,226,103	671,457	(6,197)	665,260	
May-05	1,665,912	(337,492)	(6,197)	(343,689)	
Jun-05	2,204,030	1,206,567	(6,197)	1,200,370	
		10,327,919	(74,364)	10,253,555	
Jurisdictional %				86.763%	
Total	$ 21,777,415			$ 8,896,292	$ 12,881,123
Adjustment	$(21,777,415)			$ (8,896,292)	$ (12,881,123)

Blake Exhibit 1
Reference Schedule 1.12
Sponsoring Witness: Kent Blake

KENTUCKY UTILITIES

Eliminate DSM Revenues and Expenses
For the Twelve Months Ended June 30, 2005

1. DSM Revenue adjustment	$	(3,982,650)
2. DSM Expense adjustment		(3,874,591)
3. Total	$	(108,059)

Blake Exhibit 1
Reference Schedule 1.13
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

To Eliminate ECR and FAC Accruals
For the Twelve Months Ended June 30, 2005

1. ECR Accrued Revenue in Account 449	$ 2,494,082
2. FAC Accrued Revenue in Account 449	(488,683)
3. ECR Accrued Revenue in Accounts 440-445	(773,713)
4. FAC Accrued Revenue in Accounts 440-445	20,751,078
5. Total Accrued Revenues	$ 21,982,764
6. Less ODP FAC Revenue included in Line 2	(545,672)
7. Kentucky Jurisdictional Accrued Revenues	$ 22,528,436
8. Adjustment	$ (22,528,436)

Blake Exhibit 1
Reference Schedule 1.14
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment for Merger Savings
For the Twelve Months Ended June 30, 2005

1.	Customer portion of merger surcredit per agreement	$ 18,968,825
2.	Revenue returned to customers through the merger surcredit and amortization of amounts previously returned to customers for 12 months ended June 30, 2005	20,708,045
3.	Adjustment to savings due customers	$ 1,739,220
4.	Shareholder's portion of merger surcredit per agreement	$ 18,968,825

NOTE: Merger surcredit per Commission's order dated October 16, 2003 in Case No. 2002-00429.

Blake Exhibit 1
Reference Schedule 1.15
Sponsoring Witness: Kent Blake

KENTUCKY UTILITIES

To Adjust Mismatch in Fuel Cost Recovery
For the Twelve Months Ended June 30, 2005

Expense Month	Revenue Form A Page 5 of 6 Line 3	Expense Form A* Page 5 of 6 Line 8
Jul-04	$ 106,127	$ 2,348,631
Aug-04	1,961,685	3,243,211
Sep-04	2,247,312	4,367,088
Oct-04	2,761,803	3,871,540
Nov-04	3,841,201	2,703,124
Dec-04	4,516,505	4,475,728
Jan-05	3,431,547	5,061,676
Feb-05	4,229,000	4,922,385
Mar-05	4,847,682	4,019,243
Apr-05	4,774,175	6,523,479
May-05	3,304,805	5,860,308
Jun-05	7,417,374	14,560,077
Total	$ 43,439,216	$ 61,956,490
Adjustment	$ (43,439,216)	$ (61,956,490)

* NOTE : Expenses are recovered in the second succeeding month. For example, January 2005 would be reflected in March 2005.

Blake Exhibit 1
Reference Schedule 1.16
Sponsoring Witness: Kent Blake

KENTUCKY UTILITIES

Off-System Sales Revenue Adjustment for the ECR Calculation
For the Twelve Months Ended June 30, 2005

	(1) KU Off-System Sales Revenue	(2) KU Off-System Sales Intercompany Revenue	(3) KU Off-System Sales Revenue Less Intercompany (Col. 1 - 2)	(4) Monthly Environmental Surcharge Factor	(5) Average Environmental Surcharge Factor	(6) Off-System Sales Environmental Cost (Col. 3 * 5)
Jul-04	$ 5,883,026	$ 3,792,699	$ 2,090,327	1.69%	2.80%	$ 58,529
Aug-04	4,164,627	3,025,760	1,138,867	1.85%	2.80%	31,888
Sep-04	9,641,983	5,721,334	3,920,649	2.88%	2.80%	109,778
Oct-04	14,128,999	6,206,460	7,922,539	2.85%	2.80%	221,831
Nov-04	5,334,411	4,743,419	590,992	3.05%	2.80%	16,548
Dec-04	9,761,073	8,157,130	1,603,943	6.03%	2.80%	44,910
Jan-05	15,389,623	10,517,816	4,871,807	1.92%	2.80%	136,411
Feb-05	12,700,238	11,085,362	1,614,876	1.90%	2.80%	45,217
Mar-05	12,650,080	8,550,509	4,099,571	2.85%	2.80%	114,788
Apr-05	5,157,811	4,827,779	330,032	3.15%	2.80%	9,241
May-05	8,553,721	7,900,050	653,671	2.01%	2.80%	18,303
Jun-05	7,692,008	5,898,153	1,793,855	3.43%	2.80%	50,228
Total	$ 111,057,600	$ 80,426,471	$ 30,631,129			$ 857,672
Average				2.80%		
Adjustment						$ (857,672)

Blake Exhibit 1
Reference Schedule 1.20
Sponsoring Witness: Kent Blake

KENTUCKY UTILITIES

Adjustment to Eliminate Unbilled Revenues

1. Unbilled revenues at June 30, 2004	$	34,203,000
2. Unbilled revenues at June 30, 2005		(40,663,000)
3. Decrease in book revenues due to unbilled revenues	$	(6,460,000)

Blake Exhibit 1
Reference Schedule 1.21
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

To Eliminate Electric Brokered Sales Revenues and Expenses
For the Twelve Months Ended June 30, 2005

1.	Brokered Sales	$ 14,288,689
2.	Brokered Expense recorded in revenues	14,611,025
3.	Net Brokered Sales revenue adjustment	(322,336)
4.	Kentucky Jurisdiction	86.199%
5.	Kentucky Jurisdiction Net Brokered Sales Revenue	$ (277,850)
6.	Kentucky Jurisdiction Net Brokered Sales Revenue adjustment	$ 277,850
7.	Operating Expense related to Brokered Sales	106,141 *
8.	Kentucky Jurisdiction	86.199%
9.	Kentucky Jurisdiction Brokered Sales Operating Expense	$ 91,492
10.	Kentucky Jurisdiction Brokered Sales Operating Expense adjustment	$ (91,492)
11.	Net Kentucky Jurisdictional adjustment (Line 6 - Line 10)	$ 369,342

*NOTE: Reflects 5.9% of total labor and labor related costs from off-system sales activities.

Blake Exhibit 1
Reference Schedule 1.22
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment to Eliminate Advertising Expenses
Pursuant to Commission Rule 807 KAR 5:016
For the Twelve Months Ended June 30, 2005

1. Uniform System of Accounts - Account No. 930.1 General Advertising Expenses	$	179,269
2. Account No. 913 Advertising Expenses		-
3. Total		179,269
4. Kentucky Jurisdiction		94.815%
5. Kentucky Jurisdictional amount	$	169,974
6. Kentucky Jurisdictional adjustment	$	(169,974)

KENTUCKY UTILITIES

Adjustment to Reflect Normalized Storm Damage Expense
For the Twelve Months Ended June 30, 2005

1. Storm damage provision based upon six year average	$	2,076,957
2. Storm damage expenses incurred during the 12 months ended June 30, 2005		2,673,000
3. Total adjustment		(596,043)
4. Kentucky Jurisdiction		93.930%
5. Kentucky Jurisdictional adjustment	$	(559,863)

Year		Expense *	CPI-All Urban Consumers		Amount
2005	$	2,673,000	1.0000	$	2,673,000
2004		4,120,000	1.0296		4,241,952
2003		1,534,000	1.0571		1,621,591
2002		1,460,495	1.0812		1,579,087
2001		1,102,683	1.0982		1,210,966
2000		1,005,000	1.1295		1,135,148
Total				$	12,461,744
Six Year Average				$	2,076,957

* NOTE: 2005 expenses are for the 12 months ended June 30, 2005.
All other years expenses are for the calendar year. 2003 expenses exclude ice storm.

KU storm damage expenses are available for a six year period only.

Blake Exhibit 1
Reference Schedule 1.31
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment for Injuries and Damages FERC Account 925
For the Twelve Months Ended June 30, 2005

1. Injury/Damage provision based upon ten year average	$ 2,532,904
2. Injury/Damage expenses incurred during the 12 months ended June 30, 2005	1,171,514
3. Adjustment	1,361,390
4. Kentucky Jurisdiction	88.870%
5. Kentucky Jurisdictional adjustment	$ 1,209,867

Year	Amount *	CPI-All Urban Consumers	Adjusted Amount
2005	$ 1,171,514	1.0000	$ 1,171,514
2004	1,080,732	1.0296	1,112,722
2003	1,776,006	1.0571	1,877,416
2002	2,510,515	1.0812	2,714,369
2001	1,609,827	1.0982	1,767,912
2000	1,637,520	1.1295	1,849,579
1999	2,126,017	1.1675	2,482,125
1998	2,187,039	1.1933	2,609,794
1997	3,355,659	1.2118	4,066,388
1996	4,579,884	1.2396	5,677,224
Total			$ 25,329,043
Ten Year Average			$ 2,532,904

* NOTE: 2005 expenses are for the 12 months ended June 30, 2005.
All other years expenses are for the calendar year.

Blake Exhibit 1
Reference Schedule 1.32
Sponsoring Witness: Kent Blake

KENTUCKY UTILITIES

Adjustment to Reflect Representative Level of Off-System Sales Margins
For the Twelve Months Ended June 30, 2005

1. Off-System Sales margin based upon five year average	$	21,206,191
2. Off-System Sales margin incurred during the 12 months ended June 30, 2005		33,196,139
3. Adjustment		(11,989,948)
4. Kentucky Jurisdiction		86.199%
5. Kentucky Jurisdictional adjustment	$	(10,335,215)

	OSS Revenue	OSS Expenses	MISO Net RSG Margin		OSS Margin
2005	126,903,290	89,155,933	4,551,218		33,196,139
2004	103,694,523	81,511,670			22,182,853
2003	85,624,402	67,451,694			18,172,708
2002	52,822,684	47,213,917			5,608,767
2001	100,816,905	73,946,416			26,870,489
Total				$	106,030,956
Five Year Average				$	21,206,191

NOTE: 2005 values are for the 12 months ended June 30, 2005.
All other years values are for the calendar year.

Blake Exhibit 1
Reference Schedule 1.40
Sponsoring Witness: Kent Blake

KENTUCKY UTILITIES

Adjustment to Annualize Year-End Customers
At June 30, 2005

1. Revenue adjustment	$	2,524,868
2. Expense adjustment		1,385,900
3. Net adjustment	$	1,138,968

Blake Exhibit 1
Reference Schedule 1.41
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment To Reflect Annualized Depreciation Expenses Under Current Rates
At June 30, 2005

1. Depreciation expense per books excluding ARO and post-1994 ECR	$ 108,459,865
2. Annualized depreciation expense with current rates	106,946,094
3. Total Adjustment to reflect annualized depreciation expense	(1,513,771)
4. Kentucky Jurisdiction	87.169%
5. Kentucky Jurisdictional adjustment	$ (1,319,539)

KENTUCKY UTILITIES

Adjustment to Reflect Increases in Labor and Labor-Related Costs
As Applied to the Twelve Months Ended June 30, 2005

1.	Wages (Page 2)	$ 762,917
2.	Payroll Taxes (Page 3)	57,455
3.	401(k) (Page 4)	17,852
4.	Total	838,224
5.	Kentucky Jurisdiction	88.870%
6.	Kentucky Jurisdictional adjustment	$ 744,930

KENTUCKY UTILITIES

Adjustment to Reflect Increases in Labor and Labor-Related Costs
As Applied to the Twelve Months Ended June 30, 2005

	Operating	Construction/ Other	Total
1. Labor for 12 months ended June 30, 2005:			
2. Base	$ 34,913,287	$ 15,247,133	$ 50,160,420
3. Overtime and Premium	7,485,286	1,914,085	9,399,371
4. TIA	3,451,058	1,281,655	4,732,713
5. Total Labor	$ 45,849,631	$ 18,442,873	$ 64,292,504
6. Total Operating and Construction/Other %	71.3%	28.7%	100.0%

		Employees	
7. Annualized base labor at June 30, 2005:			
8. Union		150	$ 8,029,091
9. Exempt		130	9,418,760
10. Non-Exempt/Hourly		649	33,421,284
11. Total Annualized Labor		929	50,869,135
12. Union Wage increase effective August 2005 (Line 8 x 3.5%)			281,018
13. Union Overtime/Premiums (a)			2,052,442
14. Union wage increase applied to union overtime/premiums (Line 13 x 3.5%)			71,835
15. Non-Exempt/Hourly Overtime/Premium (a)			7,346,929
16. TIA - Exempt/Non-Exempt/Union (a)			4,732,713
17. Union wage increase applied to union TIA (Sum of Lines 12 and 14 x 6%)			21,171
18. Total Annualized Labor			$ 65,375,243
19. Operating Labor for 12 months ended June 30, 2005			$ 45,849,631
20. Operating Labor based on annualized labor $ 65,375,243	x	71.3%	46,612,548
21. Labor Adjustment Total			$ 762,917

(a) Represents actual numbers taken from the Company's financial records for the 12 months ended June 30, 2005.

KENTUCKY UTILITIES

Adjustments to Reflect Increases in Payroll Taxes
As Applied to the Twelve Months Ended June 30, 2005

1. Operating Labor increase (Page 2 Line 21)	$	762,917
2. Percentage of wages that do not exceed Social Security (OASDI) limit		98.08%
3. Operating Labor increase subject to Social Security tax	$	748,269
4. Medicare Tax (Line 1 x 1.45%)	$	11,062
5. Social Security Tax (Line 3 x 6.2%)		46,393
6. Payroll Tax adjustment	$	57,455

KENTUCKY UTILITIES

Adjustment to Reflect Increases in Company Match of 401(k)
As Applied to the Twelve Months Ended June 30, 2005

1. Direct total payroll for 12 months ended 06/30/05 (Page 2 Line 5)	$ 64,292,504
2. Total 401(k) Company Match for 12 months ended 06/30/05	1,504,773
3. 401(k) Company Match as a percent of payroll	2.34%
4. Operating Labor increase (Page 2 Line 21)	762,917
5. 401(k) Company Match operating increase (Line 3 x Line 4)	$ 17,852

Blake Exhibit 1
Reference Schedule 1.43
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment to Annualize MISO Schedules 16 and 17
For the Twelve Months Ended June 30, 2005

1. Actual MISO Schedules 16 and 17 incurred in the 12 months ended June 30, 2005 (April, May, and June 2005)	$ 1,019,114
2. Actual MISO Schedules 16 and 17 incurred in July and August 2005	875,913
3. Average MISO Schedules 16 and 17 monthly amount [(Line 1 + Line 2) / 5)	379,005
4. MISO Schedules 16 and 17 annual amount (Line 3 x 12)	4,548,060
5. MISO Schedules 16 and 17 incurred during 12 months ended June 30, 2005	1,019,114
6. MISO Schedules 16 and 17 annualization adjustment (Line 4 - Line 5)	$ 3,528,946
7. Kentucky Jurisdiction	86.080%
8. Kentucky Jurisdictional adjustment	$ 3,037,717

Blake Exhibit 1
Reference Schedule 1.44
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment to Annualize MISO Revenue Neutrality Uplift
For the Twelve Months Ended June 30, 2005

1. Actual MISO Revenue Neutrality Uplift incurred in the 12 months ended June 30, 2005 (April, May, and June 2005)	$ 4,131,708
2. Actual MISO Revenue Neutrality Uplift incurred in July and August 2005	5,376,776
3. Average MISO Revenue Neutrality Uplift monthly amount [(Line 1 + Line 2)/ 5]	1,901,697
4. MISO Revenue Neutrality Uplift annual amount (Line 3 x 12)	22,820,364
5. MISO Revenue Neutrality Uplift incurred during 12 months ended June 30, 2005	4,131,708
6. MISO Revenue Neutrality Uplift annualization adjustment (Line 4 - Line 5)	$ 18,688,656
7. Kentucky Jurisdiction	86.080%
8. Kentucky Jurisdictional adjustment	$ 16,087,195

KENTUCKY UTILITIES

Adjustment to Annualize MISO Revenue Sufficiency Guarantee
For the Twelve Months Ended June 30, 2005

Revenue	April-June 2005	July-August 2005		
1. RSG Make Whole Payments	$9,787,489	$ 4,334,701	$	14,122,190
2. RSG Make Whole Payment monthly amount (Line 1 / 5)				2,824,438
3. RSG Make Whole Payment annual amount (Line 2 x 12)				33,893,256
4. RSG Make Whole Payments earned during 12 months ended June 30, 2005 (Line 1 for April-June 2005)				9,787,489
5. Annualized Revenue Adjustment (Line 3 - Line 4)			$	24,105,767
Expenses				
6. Production cost for RSG Payments	5,236,271	2,250,153	$	7,486,424
7. RSG Distribution Amount	2,732,354	3,782,448		6,514,802
8. Monthly Expense amount [(Line 6 + Line 7) / 5]				2,800,245
9. Annual Expense Amount (Line 8 x 12)				33,602,940
10. MISO RSG Expenses incurred during 12 months ended June 30, 2005 (Line 6 + Line 7 for April-June 2005)				7,968,625
11. Annualized Expense Adjustment (Line 9 - Line 10)			$	25,634,315
12. Net Adjustment (Line 5 - Line 11)			$	(1,528,548)
13. Kentucky Jurisdiction				86.080%
14. Kentucky Jurisdictional adjustment			$	(1,315,774)

Blake Exhibit 1
Reference Schedule 1.50
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment for Reclassification of MISO Revenue Sufficiency Guarantee
For the Twelve Months Ended June 30, 2005

	(1) RSG based on Generating Unit Ownership	(2) RSG based on Off-System Sales	(3) Adjustment (Col 1 - Col 2)
1. April 2005	$ 1,534,096	$ 472,501	$ 1,061,595
2. May 2005	1,716,795	359,330	1,357,465
3. June 2005	6,536,598	2,227,698	4,308,900
4. Total	$ 9,787,489	$ 3,059,529	$ 6,727,960
5. Kentucky Jurisdiction			86.080%
6. Kentucky Jurisdictional Adjustment			$ 5,791,428

Blake Exhibit 1
Reference Schedule 1.51
Sponsoring Witness: Kent Blake

KENTUCKY UTILITIES

Adjustment for EKPC Transmission Refund (FERC Order ER02-2560-002)
For the Twelve Months Ended June 30, 2005

1.	EKPC Refund - Revenue	$	(987,749)
2.	EKPC Refund included in 12 months ended June 30, 2005		164,909
3.	Adjustment	$	822,840
4.	Kentucky Jurisdiction		86.080%
5.	Kentucky Jurisdictional adjustment	$	708,301

Blake Exhibit 1
Reference Schedule 1.60
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment for VDT Net Savings to Shareholder
For the Twelve Months Ended June 30, 2005

1. Adjustment to reflect VDT Net Shareholder Savings		$ 4,680,000
2. Adjustment to remove VDT Net Shareholder Savings		$ (4,680,000)

2004 Shareholder's portion of VDT Savings	$ 4,320,000	
July - December 2004 (50%)	2,160,000	$ 2,160,000
2005 Shareholder's portion of VDT Savings	5,040,000	
January - June 2005 (50%)	2,520,000	2,520,000
		$ 4,680,000

KENTUCKY UTILITIES

Adjustment to Remove Value Delivery Surcredit and Cost Amortization
For the Twelve Months Ended June 30, 2005

1. Actual Value Delivery Surcredit refunded	$ (3,227,105)
2. Value Delivery Surcredit revenue adjustment	$ 3,227,105
3. VDT cost amortization	$ 11,753,520
4. VDT cost adjustment	$ (11,753,520)
5. Total adjustment	$ 14,980,625

Blake Exhibit 1
Reference Schedule 1.70
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Calculation of Composite Federal and Kentucky Income Tax Rate (Based on Law in Effect June 30, 2005)

1. Assume pre-tax income of		$ 100.0000
2. State income tax at 7.00%		7.0000
3. Taxable income for Federal income tax		93.0000
4. Federal income tax at 35% (Line 3 x 35%)		32.5500
5. Total State and Federal income taxes (Line 2 + Line 4)		$ 39.5500
6. Therefore, the composite rate is:		
7. Federal	32.5500%	
8. State	7.0000%	
9. Total	39.5500%	

Blake Exhibit 1
Reference Schedule 1.71
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Calculation of Current Tax Adjustment Resulting From "Interest Synchronization"

1. Adjusted Jurisdictional Capitalization - Exhibit 2	$	1,368,045,946
2. Weighted Cost of Debt - Exhibit 2		1.65%
3. "Interest Synchronization"		22,572,758
4. Kentucky Jurisdictional Interest per books (excluding other interest)		22,601,598
5. "Interest Synchronization" adjustment	$	28,840
6. Composite Federal and State tax rate		39.5500%
7. Current tax adjustment from "Interest Synchronization"	$	11,406

Blake Exhibit 1
Reference Schedule 1.72
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment for Prior Period Income Tax True-Ups and Adjustments
For the Twelve Months Ended June 30, 2005

1.	2003 Income Tax True-up:	
2.	Federal Tax (benefit)	$ (415,283)
3.	State Tax (benefit)	(832,660)
4.	Total 2003 Income Tax True-up	$ (1,247,943)
5.	2004-2005 Other Tax adjustments:	
6.	Misc. Operating Tax Adjustments - 2004	$ (252,686)
7.	Kentucky Coal Credit - 2004	(61,032)
8.	Total 2004 & 2005 Other Tax adjustments:	$ (313,718)
9.	Total adjustments (Line 4 + Line 8)	$ (1,561,661)
10.	Kentucky Jurisdiction	88.846%
11.	Kentucky Jurisdiction amount before KY Tax Changes	$ (1,387,473)
12.	Kentucky Tax Rate Decrease -KY Jurisdiction	$ 185,000
13.	Kentucky Jurisdiction amount (Line 11 + Line 12)	$ (1,202,473)
14.	Kentucky Jurisdiction adjustment	$ 1,202,473

Blake Exhibit 1
Reference Schedule 1.73
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Adjustment for Tax Deduction for Manufacturing Activities (TDMA)
For the Twelve Months Ended June 30, 2005

1. TDMA Annual Amount for 2005	$ 2,000,000
2. TDMA included in 12 months ended June 30, 2005	1,000,000
3. TDMA Adjustment Amount (Line 1 - Line 2)	$ 1,000,000
4. Kentucky Jurisdiction	86.080%
5. Kentucky Jurisdictional amount	$ 860,800
6. Kentucky Jurisdictional adjustment	$ (860,800)
7. Composite Federal and State tax rate	39.5500%
8. Kentucky Jurisdictional TDMA Income Tax Adjustment	$ (340,446)

Blake Exhibit 1
Reference Schedule 1.74
Sponsoring Witness: Valerie Scott

KENTUCKY UTILITIES

Calculation of Revenue Gross Up Factor
(Based on Law in Effect June 30, 2005)

1. Assume pre-tax income of	$ 100.000000
2. Bad Debt at .16%	0.160000
3. PSC Assessment at .167%	0.167000
4. Taxable income for State income tax	99.673000
5. State income tax at 7.00%	6.977110
6. Taxable income for Federal income tax	92.695890
7. Federal income tax at 35%	32.443563
8. Total Bad Debt, PSC Assessment, State and Federal income taxes (Line 2 + Line 3 + Line 5 + Line 7)	39.747673
9. Assume pre-tax income of	$ 100.000000
10. Gross Up Revenue Factor	60.252327

NOTE: Bad debt percent is percent of net charge-offs to revenue for the 12 months ended June 30, 2005.

KENTUCKY UTILITIES

Capitalization at June 30, 2005

		Per Books 6-30-05 (1)	Capital Structure (2)	Undistributed Subsidiary Earnings (3)	Investment in EEI (Col 2 x Col 4 Line 5) (4)	Investments in OVEC and Other (Col 2 x Col 5 Line 5) (5)	Adjustments to Total Co. Capitalization (6)	Adjusted Total Company Capitalization (7)	Jurisdictional Rate Base Percentage (Exhibit 3 Line 23) (8)	Kentucky Jurisdictional Capitalization (Col 7 x Col 8) (9)
1.	Short Term Debt	$ 93,130,000	5.17%	$ -	$ (749,117)	$ (35,743)	$ (784,860)	$ 92,345,140	87.96%	$ 81,226,785
2.	Long Term Debt	671,522,700	37.29%	-	(5,403,202)	(257,806)	(5,661,008)	665,861,692	87.96%	585,691,944
3.	Preferred Stock	39,726,895	2.21%	-	(320,222)	(15,279)	(335,501)	39,391,394	87.96%	34,648,670
4.	Common Equity	996,344,174	55.33%	(13,193,882)	(8,017,141)	(382,527)	(21,593,550)	974,750,624	87.96%	857,390,649
5.	Total Capitalization	$ 1,800,723,769	100.00%	$ (13,193,882)	$ (14,489,682)	$ (691,355)	$ (28,374,919)	$ 1,772,348,850		$1,558,958,048

		Kentucky Jurisdictional Capitalization (10)	Capital Structure (11)	Environmental Surcharge Post '94 Plan (Col 11 x Col 12 Line 5) (12)	Adjusted Kentucky Jurisdictional Capitalization (13)	Adjusted Capital Structure (14)	Annual Cost Rate (15)	Cost of Capital (Col 15 x Col 14) (16)
1.	Short Term Debt	$ 81,226,785	5.21%	$ (9,946,521)	$ 71,280,264	5.21%	3.060%	0.16%
2.	Long Term Debt	585,691,944	37.57%	(71,725,677)	513,966,267	37.57%	3.957%	1.49%
3.	Preferred Stock	34,648,670	2.22%	(4,238,249)	30,410,421	2.22%	5.679%	0.13%
4.	Common Equity	857,390,649	55.00%	(105,001,655)	752,388,994	55.00%	10.000% - 10.500% - 11.000%	5.50% - 5.78% - 6.05%
5.	Total Capitalization	$ 1,558,958,048	100.00%	$ (190,912,102)	$ 1,368,045,946	100.00%		7.28% - 7.56% - 7.83%

KENTUCKY UTILITIES

Net Original Cost Kentucky Jurisdictional Rate Base
At June 30, 2005

Title of Account (1)	Kentucky Jurisdictional Rate Base at June 30, 2005 (2)	Other Jurisdictional Rate Base at June 30, 2005 (3)	Total Company Rate Base at June 30, 2005 (4)
1. Utility Plant at Original Cost	$ 3,269,705,216	$ 486,359,003	$ 3,756,064,219
2. Deduct:			
3. Reserve for Depreciation	1,496,503,901	239,956,062	1,736,459,963
4. Net Utility Plant	1,773,201,315	246,402,941	2,019,604,256
5. Deduct:			
6. Customer Advances for Construction	1,536,470	15,105	1,551,575
7. Accumulated Deferred Income Taxes	265,911,069	40,161,335	306,072,404
8. Asset Retirement Obligation-Net Assets	5,652,637	914,078	6,566,715
9. Asset Retirement Obligation-Liabilities	(18,540,716)	(2,998,187)	(21,538,903)
10. Asset Retirement Obligation-Regulatory Assets	11,748,452	1,899,822	13,648,274
11. Asset Retirement Obligation-Regulatory Liabilities	(1,331,127)	(215,254)	(1,546,381)
12. Reclassification of Accumulated Depreciation associated with Cost of Removal for underlying ARO Assets	2,337,238	377,951	2,715,189
13. Investment Tax Credit	2,472,147	483,204	2,955,351
14. Total Deductions	269,786,171	40,638,053	310,424,224
15. Net Plant Deductions	1,503,415,144	205,764,888	1,709,180,032
16. Add:			
17. Materials and Supplies (a)	63,198,224	10,119,919	73,318,143
18. Prepayments (a)(b)	1,661,011	242,356	1,903,367
19. Emission Allowances	2,356,627	381,087	2,737,714
20. Cash Working Capital	59,630,561	6,597,745	66,228,306
21. Total Additions	126,846,423	17,341,107	144,187,530
22. Total Net Original Cost Rate Base	$ 1,630,261,567	$ 223,105,995	$ 1,853,367,562
23. Percentage of KY Jurisdictional Rate Base to Total Company Rate Base			87.96%

(a) Average for 13 months.

(b) Includes prepayments for property insurance only.

KENTUCKY UTILITIES

Calculation of Cash Working Capital
At June 30, 2005

Title of Account (1)	Kentucky Jurisdictional Rate Base at June 30, 2005 (2)	Other Jurisdictional Rate Base at June 30, 2005 (3)	Total Company Rate Base at June 30, 2005 (4)
1. Operating and maintenance expense for the 12 months ended June 30, 2005	$ 622,319,076	$ 92,848,845	$ 715,167,921
2. Deduct:			
3. Electric Power Purchased	145,274,584	23,305,571	168,580,155
4. Total Deductions	$ 145,274,584	$ 23,305,571	$ 168,580,155
5. Remainder (Line 1 - Line 5)	$ 477,044,492	$ 69,543,275	$ 546,587,766
6. Cash Working Capital	$ 59,630,561	$ 6,597,745	$ 66,228,306

Kentucky Jurisdictional (12 1/2% of Line 5)
Other Jurisdictional comprised of FERC, Tennessee, and Virginia Jurisdictional methodologies.

KENTUCKY UTILITIES

Calculation of Overall Revenue Deficiency/(Sufficiency) at June 30, 2005

	(1) ROE RANGE		
SECTION I - VALUE DELIVERY SURCREDIT EFFECTIVE	10.00% -	10.50% -	11.00%
1. Adjusted Kentucky Jurisdictional Capitalization (Exhibit 2, Col 13)	$1,368,045,946	$1,368,045,946	$1,368,045,946
2. Total Cost of Capital (Exhibit 2, Col 16)	7.28% -	7.56% -	7.83%
3. Net Operating Income Found Reasonable (Line 1 x Line 2)	$ 99,593,745 -	$ 103,424,274 -	$ 107,117,998
4. Pro-forma Net Operating Income prior to Value Delivery Surcredit expiration	88,222,863	88,222,863	88,222,863
5. Net Operating Income Deficiency/(Sufficiency) prior to Value Delivery Surcredit expiration	$ 11,370,882 -	$ 15,201,411 -	$ 18,895,135
6. Gross Up Revenue Factor - Blake Exhibit 1, Reference Schedule 1.74	0.60252327	0.60252327	0.60252327
7. Overall Revenue Deficiency/(Sufficiency) prior to Value Delivery Surcredit expiration	$ 18,872,104 -	$ 25,229,582 -	$ 31,360,008
SECTION II - VALUE DELIVERY SURCREDIT EXPIRED			
1. Adjusted Kentucky Jurisdictional Capitalization (Exhibit 2, Col 13)	$1,368,045,946	$1,368,045,946	$1,368,045,946
2. Total Cost of Capital (Exhibit 2, Col 16)	7.28% -	7.56% -	7.83%
3. Net Operating Income Found Reasonable (Line 1 x Line 2)	$ 99,593,745 -	$ 103,424,274 -	$ 107,117,998
4. Pro-forma Net Operating Income for expiration of Value Delivery Surcredit	100,107,711	100,107,711	100,107,711
5. Net Operating Income Deficiency/(Sufficiency) for expiration of Value Delivery Surcredit	$ (513,966) -	$ 3,316,563 -	$ 7,010,287
6. Gross Up Revenue Factor - Blake Exhibit 1, Reference Schedule 1.74	0.60252327	0.60252327	0.60252327
7. Overall Revenue Deficiency/(Sufficiency) for expiration of Value Delivery Surcredit	$ (853,023) -	$ 5,504,456 -	$ 11,634,882

KENTUCKY UTILITIES

Kentucky Jurisdictional Rate of Return on Common Equity
For the Twelve Months Ended June 30, 2005

Section I - Value Delivery Surcredit Effective

	Adjusted Kentucky Jurisdictional Capitalization (Exhibit 2 Col 13) (1)	Percent of Total (2)	Annual Cost Rate (Exhibit 2 Col 15) (3)		Weighted Cost of Capital (Col 2 x Col 3) (4)	
1. Short Term Debt	$71,280,264	5.21%	3.06%		0.16%	
2. Long Term Debt	$513,966,267	37.57%	3.96%		1.49%	
3. Preferred Stock	$30,410,421	2.22%	5.68%		0.13%	
4. Common Equity	$752,388,994	55.00%	8.49%	(a)	4.67%	(b)
5.	$1,368,045,946	100.00%			6.45%	

6. Pro-forma Net Operating Income prior to Value Delivery Surcredit expiration	$88,222,863	(c)
7. Net Operating Income / Total Capitalization	6.45%	(e)

Section II - Value Delivery Surcredit Expired

	Adjusted Kentucky Jurisdictional Capitalization (Exhibit 2 Col 13) (1)	Percent of Total (2)	Annual Cost Rate (Exhibit 2 Col 15) (3)		Weighted Cost of Capital (Col 2 x Col 3) (4)	
1. Short Term Debt	$71,280,264	5.21%	3.06%		0.16%	
2. Long Term Debt	$513,966,267	37.57%	3.96%		1.49%	
3. Preferred Stock	$30,410,421	2.22%	5.68%		0.13%	
4. Common Equity	$752,388,994	55.00%	10.07%	(a)	5.54%	(b)
5.	$1,368,045,946	100.00%			7.32%	

6. Pro-forma Net Operating Income for expiration of Value Delivery Surcredit	$100,107,711	(d)
7. Net Operating Income / Total Capitalization	7.32%	(e)

Notes: (a) - Column 4, Line 4 / Column 2, Line 4
(b) - Column 4, Line 5 - Line 1 - Line 2 - Line 3
(c) - Exhibit 1, Line 30, Column 4
(d) - Exhibit 1, Line 37, Column 4
(e) - Column 4, Line 6 divided by Column 1, Line 5

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF KENTUCKY UTILITIES COMPANY FOR THE VALUE DELIVERY SURCREDIT MECHANISM	))))	CASE NO. 2005-00351

TESTIMONY OF
VALERIE L. SCOTT
CONTROLLER
KENTUCKY UTILITIES COMPANY

Filed: September 30, 2005

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

A. My name is Valerie L. Scott. I am the Controller for LG&E Energy LLC and Kentucky Utilities Company ("KU" or "the Company"). I am employed by LG&E Energy Services Inc. which provides services to KU. My business address is 220 West Main Street, Louisville, Kentucky. A statement of my professional history and education is attached as an appendix hereto.

Q. Have you previously testified before this Commission?

A. Yes. I have previously testified before this Commission in rate and environmental surcharge proceedings.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to review KU's accounting records and support certain pro forma adjustments to KU's net operating income for the twelve months ended June 30, 2005. The pro forma adjustments are described on the Reference Schedules attached to Blake Exhibit 1. My testimony demonstrates that these adjustments are known and measurable and, therefore, reasonable.

Accounting Records

Q. Are the accounting records of KU kept in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission and adopted by the Kentucky Public Service Commission?

A. Yes. The records are kept in accordance with the Uniform System of Accounts prescribed for electric public utilities.

Q. Does KU file monthly and annual operating reports presenting financial results with the Kentucky Public Service Commission?

A. Yes.

Q. Is an audit of the financial statements of KU performed annually by independent public accountants?

A. Yes. PricewaterhouseCoopers audits KU's financial statements annually.

<u>Net Operating Income</u>

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.13 of Blake Exhibit 1.

A. This adjustment has been made to eliminate the impact of the revenues accrued, but unbilled, in the twelve months ended June 30, 2005, associated with the Environmental Cost Recovery and Fuel Adjustment Clause. These amounts were accrued in Rate Refund Account 449 during the six months ended December 31, 2004, and in Accounts 440 through 445, based on the customer class, during the six months ended June 30, 2005. KU has recorded accruals for Fuel Adjustment Clause revenues in the financial statements to better match revenues and expenses in the month they occur, eliminating the two month lag in billing or refunding customers for actual fuel clause expenses. The Environmental Cost Recovery accrual records additional amounts to be billed or refunded to customers due to differences in actual cost of capital versus authorized cost of capital and differences in actual non-Environmental Cost Recovery revenue and the twelve month average of non-Environmental Cost Recovery revenue. These differences in cost of capital and revenue have historically been adjusted in the six month Environmental Cost Recovery review proceedings held by the Commission. The impact of rate mechanisms, such as these, should be removed from the revenues for the twelve months ended June 30, 2005, when assessing the adequacy of base rates. The adjustment is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.14 of Blake Exhibit 1.

A. This adjustment is made to reflect the customers' and shareholder's portions of the merger savings in accordance with the Settlement Agreement approved by the Commission's October 16, 2003 Order in Case No. 2002-00430 and in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434. The customers' portion of the savings is adjusted to equal the amount attributed to the shareholder to reflect the 50/50 saving split per the Settlement Agreement. The shareholder's portion is adjusted by adding the settlement agreed upon amount to operating expenses in the twelve months ended June 30, 2005. Absent this adjustment, the shareholder would lose its share of such savings that were approved by the Commission in its Orders.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.21 of Blake Exhibit 1.

A. This adjustment has been made to eliminate brokered electric sales revenues and expenses as directed by the Commission in Case No. 98-474. Brokered transactions do not utilize company generation or transmission assets; accordingly, the related revenues and expenses are eliminated in determining base rates. The adjustment is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434.

Q. **Please explain the adjustment to operating expenses shown in Reference Schedule 1.22 of Blake Exhibit 1.**

A. This adjustment eliminates advertising expenses. Commission regulation 807 KAR 5:016, Section 2(1) provides that a utility will be allowed to recover, for ratemaking purposes, only those advertising expenses which produce a "material benefit" to its ratepayers. The advertising expenses eliminated by this adjustment are primarily institutional and promotional in nature. The adjustment is calculated in accordance with the Commission's determination in its Order of June 30, 2004 in Case No. 2003-00434.

Q. **Please explain the adjustment to operating expenses shown in Reference Schedule 1.30 of Blake Exhibit 1.**

A. This adjustment has been made to reflect a normalized level of storm damage expenses based upon a six-year average adjusted for inflation. This adjustment is calculated in accordance with the methodology approved by the Commission in its Order of June 30, 2004 in Case No. 2003-00434. In Case No. 2003-00434 KU used a four-year historical average adjusted for inflation and noted that four years was all of the historical data available. KU now has six years available and is using that period for this normalization adjustment. KU has also excluded from this normalization adjustment expenses incurred as a result of the February 2003 ice storm, consistent with treatment in the Commission's Order in Case No. 2003-00434.

Q. **Please explain the adjustment to operating expenses shown in Reference Schedule 1.31 of Blake Exhibit 1.**

A. This adjustment has been made to normalize the expense levels in Account 925 "Injuries and Damages" based upon a ten-year average adjusted for inflation. The adjustment is calculated in accordance with the methodology approved by the Commission in its Order of June 30, 2004 in Case No. 2003-00434.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.41 of Blake Exhibit 1.

A. This adjustment has been made to reflect annualized depreciation expenses. This adjustment calculates annual depreciation expense by multiplying the plant in service at June 30, 2005 (exclusive of Asset Retirement Obligations and post-1994 Environmental Cost Recovery assets) by the depreciation rates currently in effect. KU's current depreciation rates were approved in Case No. 2001-00140 based on a settlement, and the depreciation study filed in that case was based on plant in service as of December 31, 1999. The adjustment is calculated in accordance with the methodology approved by the Commission in its Order of June 30, 2004 in Case No. 2003-00434.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.42 of Blake Exhibit 1.

A. This adjustment has been made to reflect increases in labor and labor-related costs as applied to the twelve months ended June 30, 2005, and includes specific adjustments for wages, payroll taxes and KU 401(k) match. Page 1 of 4 presents an overview of the adjustment.

Page 2 of 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the adjustment for wage expenses. The adjustment reflects the annualized base labor of all KU employees at June 30, 2005, and it includes union contract rates effective August 1, 2005.

Under the terms of the current contract, beginning August 1, 2005, union employees received a three and one-half percent wage increase, which resulted in three and one-half percent increases in overtime wages and in the Team Incentive Award ("TIA"). An adjustment has been made to increase union wages overtime and TIA for the twelve months ended June 30, 2005, to recognize the impact of the August 1, 2005, contract increase. In Case No. 2003-00434 KU had reduced the labor adjustment to remove the amount of TIA guaranteed by E.ON to the extent that it exceeded what employees would have been paid, without the guarantee. No adjustment is necessary in the current labor adjustment because there was no E.ON TIA guarantee payment in the twelve months ended June 30, 2005.

Page 3 of 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the calculation of the component of the labor adjustment to reflect the increases in the Federal Insurance Contributions Act ("FICA") employer payroll taxes due to the increase in wages. The payroll tax increase reflects the methodology ordered by the Commission in Case No. 2003-00434 in calculating the impact of the Social Security wage limit.

Finally, page 4 of Reference Schedule 1.42 of Blake Exhibit 1 shows the calculation of the component of the labor adjustment to reflect the resulting increases in KU's match of 401(k) contributions as applied to the twelve months ended June 30, 2005, due to the adjustments to the increases in wages.

The labor adjustment follows the methodology approved by the Commission in its Order of June 30, 2004 in Case No. 2003-00434.

Q. **Please explain the adjustment to operating expenses shown in Reference Schedule 1.43 of Blake Exhibit 1.**

A. As a member of the Midwest Independent Transmission System Operator, Inc. ("MISO"), KU incurred charges, starting in April 2005, for Day 2 operations. Included as part of the Day 2 operations are Schedules 16 and 17 that are billed by MISO to KU to recover administrative costs for Financial Transmission Rights ("FTRs") and the day ahead and real time market. These charges are part of the MISO Energy Markets Tariff ("EMT") filed with and approved by the Federal Energy Regulatory Commission ("FERC"). Schedule 16 charges are based on the number of FTR megawatts times an administration rate per megawatt. Schedule 17 charges are based on the day ahead volumes bid into the market (generation, load and financial bi-lateral transactions) times an hourly energy market administration rate plus or minus the difference in volumes in the real time physical energy (generation, load and physical bi-lateral transactions) times the hourly energy market administration rate. The Schedule 16 and 17 charges began in April 2005 and are included in only three months of the twelve months ended June 30, 2005 (April – June 2005). This adjustment annualizes the twelve months ended June 30, 2005 for the Schedule 16 and 17 charges by multiplying the actual charges from MISO for the three months of April through June 2005 and for the months of July and August 2005, by twelve-fifths to arrive at a yearly charge and then subtracting the April through June 2005, amounts from the annualized yearly charge.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.44 of Blake Exhibit 1.

A. As a member of MISO, KU incurred uplift charges, starting in April 2005, for Day 2 operations pursuant to the MISO EMT filed with and approved by the FERC. Included as part of the uplift charges is the Revenue Neutrality Uplift charges that are billed by MISO to KU. Because MISO is a non-profit corporation and has no equity, it must collect from its members and other market participants an amount equivalent to its costs. Revenue Neutrality Uplift is the amount MISO charges its members for the difference between MISO's costs and its revenues. The Revenue Neutrality Uplift is a balancing mechanism for charges and credits for which there are no other methods of allocating to the asset owners. The charge or credit is allocated to asset owners using a ratio of their share of the overall load. The Revenue Neutrality Uplift charges began in April 2005, and are included in only three months of the twelve months ended June 30, 2005 (April – June 2005). This adjustment annualizes the twelve months ended June 30, 2005 for the Revenue Neutrality Uplift charges by multiplying the actual charges from MISO for the three months of April through June 2005 and for the months of July and August 2005, by twelve-fifths to arrive at a yearly charge and then subtracting the April through June 2005, amount from the annualized yearly charge.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.45 of Blake Exhibit 1.

A. As a member of MISO, KU has received revenues for Revenue Sufficiency Guarantee ("RSG") make-whole payments and incurred charges for RSG distribution amounts, starting in April 2005, for Day 2 operations pursuant to the MISO EMT filed with and approved by FERC. KU can receive RSG make-whole payments only when MISO commits a unit to run when the Locational Marginal Pricing ("LMP") is insufficient to cover the unit's offer price and meets eligibility requirements. RSG distribution amounts are the amounts that MISO members pay to compensate MISO for the RSG make-whole payments. MISO pays a generator an RSG make-whole payment when it runs the generator notwithstanding that the LMP at the generator is less than the generator's offer price. The RSG make-whole payment amount is the difference between the offer price and the LMP (e.g., if MISO runs a $100/MWh offer price generator at 100 MW for one hour while the LMP is only $80/MWh, MISO will pay the generator a RSG make-whole payment of $2,000 [($100-$80) x 100 MW]). MISO collects the amount required to make all such RSG make-whole payments from its members through RSG distribution charges.

The RSG make-whole payments and the RSG distribution charges began in April 2005 and are included in only three months of the twelve months ended June 30, 2005 (April – June 2005). This adjustment annualizes the twelve months ended June 30, 2005 for the RSG make-whole payments (net of production costs incurred) and the RSG distribution charges by multiplying the actual amounts from MISO (adjusted for the production costs incurred) for the three months of April through June 2005 and for the months of July and August 2005, by twelve-fifths to arrive at a yearly amount and then subtracting the April through June 2005 amounts from the annualized yearly amount.

Q. Please explain the adjustment to operating revenues shown in Reference Schedule 1.50 of Blake Exhibit 1.

A. This adjustment is to reclassify RSG make-whole payments to KU for payments originally attributed to Louisville Gas and Electric Company ("LG&E"). At the start of MISO Day 2 the LG&E and KU ("the Companies") allocated RSG make-whole payments to the company that was assigned the off-system sales. Since LG&E's generating units are generally less expensive to run than KU's, LG&E's excess generation often is used to serve KU's native load customers, rather than off-system sales. However, the sale of KU's excess generation is then allocated to LG&E to replace power sold to KU for its native load, resulting in LG&E having a higher percentage of off-system sales.

Upon further review of the allocation of RSG make-whole payments after the start of the Day 2 market, the Companies determined in early July 2005 that a more appropriate allocation would be one based on the ownership of the generating unit resulting in the payment. Since the owner of the generating unit incurs the costs of generation for which the RSG make-whole payments are paid, the owner of the unit should receive the benefit of the RSG make-whole payment. The Companies changed the method of allocating RSG make-whole payments in August 2005, and made an adjustment on their books for April through July. This adjustment is to change the allocation between the Companies for April through June in order to correctly reflect the allocation during the twelve month period ended June 30, 2005.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.60 of Blake Exhibit 1.

A. This adjustment is made to recognize the Value Delivery Team ("VDT") net savings to the shareholder recognized by the Commission in its Order of December 3, 2001 in Case No. 2001-169. In that case the Commission approved sharing of the net savings from the VDT initiative 40 percent with the customers and 60 percent with the shareholder. The customers' 40 percent share of the savings is distributed through the Value Delivery Surcredit Rider. This adjustment is necessary to recognize the shareholder's 60 percent portion of the net savings. This adjustment to expenses is consistent with the ratemaking treatment of the shareholder's portion of the VDT savings recognized by the Commission in its Order of June 30, 2004 in Case No. 2003-00434. If the Value Delivery Surcredit is allowed to expire at March 31, 2006, this adjustment is not necessary; however, the adjustment shown in Reference Schedule 1.61 of Blake Exhibit 1 must also be made.

Q. Please explain the adjustment to operating revenues and expenses shown in Reference Schedule 1.61 of Blake Exhibit 1.

A. This adjustment is made if the Value Delivery Surcredit is allowed to expire as of March 31, 2006. This adjustment removes the effect on revenues of the surcredit provided to customers for their 40 percent share of the net VDT savings during the twelve months ended June 30, 2005. This adjustment also removes the effect on operating expenses of the amortization of expenses incurred to achieve the VDT savings. These expenses were originally deferred and amortized over a five year period ending March 31, 2006. This adjustment removes the amortization expense recorded during the twelve months ended June 30, 2005.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.70 of Blake Exhibit 1.

A. This adjustment is for federal and state income taxes corresponding to the base revenue and expense adjustments discussed in Mr. Blake's and my testimony. Reference Schedule 1.70 shows the calculation of a composite federal and state income tax rate using a federal corporate income tax rate of 35%, and a Kentucky corporate income tax rate of 7%. As shown on Reference Schedule 1.70, the composite federal and state income tax rate is 39.55%.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.71 of Blake Exhibit 1.

A. This adjustment is for federal and state income taxes corresponding to the annualization and adjustment of year-end interest expense. The Commission has traditionally recognized the income tax effects of adjustments to interest expense through an interest synchronization adjustment. This adjustment is calculated following the methodology used by the Commission in its Order in Case No. 2003-00434. The total capitalization amount for KU is taken from Blake Exhibit 2 and is multiplied by KU's weighted cost of debt, and that amount is then compared to KU's interest expense per books (excluding other interest) to arrive at the interest synchronization amount. The composite federal and state income tax rate has been applied to the interest synchronization amount.

Q. Please explain the adjustment to operating expenses shown in Reference Schedule 1.72 of Blake Exhibit 1.

A. This adjustment is for income tax true-ups and adjustments made during the twelve months ended June 30, 2005, that relate to prior periods and is in accordance with the Commission's approval of this type of adjustment in Case No. 2003-00434.

Q. Please explain the adjustment to operating expense shown in Reference Schedule 1.73 of Blake Exhibit 1.

A. This adjustment is to recognize the estimated tax deduction for domestic manufacturing activities as provided in the American Jobs Creation Act of 2004. Section 102(a) of that Act added a new §199 to the Internal Revenue Code of 1986 entitled "Income Attributable to Domestic Production Activities". The §199 domestic manufacturing deduction is a deduction from taxable income that is equal to three percent of the lesser of: (1) the taxpayer's qualified production activities income ("QPAI") for the taxable year or (2) the taxpayer's taxable income for the taxable year. To determine the amount of the adjustment for this case, KU annualized the §199 tax deduction included in its 2005 tax provision at June 30, 2005. Preliminary guidance provided by the Edison Electric Institute was used to develop an estimate of the Company's QPAI. KU will not know the exact amount of the deduction until it files its 2005 tax return later next year.

Q. Please explain Reference Schedule 1.74 of Blake Exhibit 1.

A. This schedule calculates the revenue gross up factor. The revenue gross up factor recognizes the impact the overall revenue deficiency will have on the provision for uncollectible accounts, the PSC Assessment, Kentucky income taxes, and federal income taxes and is prepared in accordance with the Commission's Order in Case No. 2003-00434.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY	)	
	)	**SS:**
COUNTY OF JEFFERSON	)	

The undersigned, **Valerie L. Scott**, being duly sworn, deposes and says she is Controller for Kentucky Utilities Company, that she has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

Valerie L. Scott

VALERIE L. SCOTT

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 30th day of September 2005.

Tammy J. Elzy (SEAL)

Notary Public

My Commission Expires:

TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

APPENDIX A

Valerie L. Scott

Controller
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202
(502) 627-3660

Professional Memberships:

American Institute of Certified Public Accountants (AICPA)
Kentucky Society of Certified Public Accountants (KSCPA)

Education:

University of Louisville, Masters of Business Administration (with high distinction), 1994
University of Louisville, Bachelor of Science in Commerce with a major in Accounting (with honors), 1978

Previous Positions with LG&E Energy LLC:

- August 2002 – December 2004 – Director, Financial Planning and Accounting – Utility Operations
- February 1999 – August 2002 – Director, Trading Controls & Energy Marketing Accounting
- May 1998 – February 1999 – Manager, Trading Controls and Manager, Financial Planning, Reporting and Special Projects
- July 1993 – May 1998 – Manager, Corporate Internal Auditing
- October 1991 – July 1993 – Senior Staff Accountant

Previous Positions prior to LG&E Energy LLC:

- 1986 – 1990 Frankenthal Group, Controller
- 1978 – 1986 Arthur Young & Company (now Ernst & Young)
  1978 – 1979 Audit Staff
  1979 – 1983 Senior Auditor
  1983 – 1986 Audit Manager

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PLAN OF KENTUCKY	)	
UTILITIES COMPANY FOR THE	)	CASE NO. 2005-00351
VALUE DELIVERY SURCREDIT	)	
MECHANISM	)	

TESTIMONY OF
S. BRADFORD RIVES
CHIEF FINANCIAL OFFICER
KENTUCKY UTILITIES COMPANY

Filed: September 30, 2005

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

A. My name is S. Bradford Rives. I am the Chief Financial Officer for LG&E Energy LLC and Kentucky Utilities Company ("KU" or "the Company"). I am employed by LG&E Energy Services Inc. which provides services to KU. My business address is 220 West Main Street, Louisville, Kentucky. A statement of my professional history and education is attached as an appendix hereto.

Q. Have you previously testified before this Commission?

A. Yes. I have previously testified before this Commission in rate proceedings, administrative investigations and environmental surcharge proceedings.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe why the financial conditions of KU require the discontinuance of the Value Delivery Surcredit and the maintenance of base rates as ordered in Case No. 2003-00434. My testimony also supports the analysis of capitalization contained in Blake Exhibit 2 as of June 30, 2005.

KU's Current Financial and Operating Condition

Q. How would you describe KU's present financial circumstances?

A. KU's operational performance remains strong, but its financial condition has deteriorated since Case No. 2003-00434. This is primarily due to increased investment in plant and increases in cost of capital since September 30, 2003. KU's financial results (with the Value Delivery Surcredit effective) for the twelve months ended June 30, 2005, are below the authorized level set in Case No. 2003-00434 and reaffirmed by the Commission in Case No. 2004-00426.

It is essential that KU achieve and maintain a strong financial condition to allow it to continue to provide safe, reliable service to its customers. The Value Delivery Surcredit should be allowed to expire and the tariff withdrawn with the final balancing adjustment in May 2006 and base rates should remain at the level authorized in Case No. 2003-00434.

Q. Has KU's investment in electric utility plant increased since September 30, 2003, the test period used in Case No. 2003-00434?

A. Yes. The following chart shows KU's investment in net electric utility plant (excluding Asset Retirement Obligations ("ARO") and post-1994 Environmental Cost Recovery ("ECR") assets) has increased by approximately $127 million since September 30, 2003:

Net Electric Utility Plant

	June 30, 2005	**September 30, 2003**	**Increase**
Electric utility plant	$3,504,423,302	$3,181,376,304	$323,046,998
Accumulated depreciation	1,727,218,099	1,531,208,826	196,009,273
Net electric utility plant	$1,777,205,203	$1,650,167,478	$127,037,725

Q. Did KU earn its authorized return on equity for the twelve months ended June 30, 2005?

A. No. As shown in Blake Exhibit 5, for the twelve months ended June 30, 2005, the return on equity is 8.49% and the return on capital is 6.45% for KU's operations prior to the expiration of the Value Delivery Surcredit. With the expiration of the Value Delivery Surcredit the return on equity is 10.07% and the return on capital is 7.32%

for the twelve months ended June 30, 2005, as also shown on Exhibit 5. With the expiration of the Value Delivery Surcredit the return on equity is within the range established by the Commission in Case No. 2003-00434. As recently as June 2005, in the Commission's order in Case No. 2004-00426, the Commission found that a range of 10.0 to 11.0 percent, with a midpoint of 10.5 percent, continues to be a reasonable return on equity for KU.

Q. Has the Company continued to provide high level customer service since its last base rate case?

A. Yes. LG&E Energy was rated #1 in the Midwest and #2 nationally among large utilities in the most recent J.D. Power Residential Electric Customer Satisfaction survey. Additionally, LG&E Energy was rated #1 in the Midwest in five of the six categories in that survey.

The Companies' improved service and reliability was specifically recognized in connection with the most recent J.D. Power Award. The Company remains committed to providing low cost, high quality electric service to its native load customers.

Q. Has the Company continued to meet or exceed customer expectations when responding to customer inquires?

A. Yes. The residential call center continues to meet or exceed customer expectations. In the most recent survey, 88% of those surveyed rated the overall handling of their call as "very good" or "outstanding" and 94% gave similar ratings for the courtesy with which their call was handled.

Q. Did the Companies' safety record continue to remain at a high level since the last rate cases?

A. Yes. In 2004, LG&E Energy Delivery employees had the lowest KOSHA recordable safety injury rate since the merger of Louisville Gas and Electric Company ("LG&E") and KU. The 2004 Energy Delivery year-end recordable rate was 1.47 compared to the National Safety Council industry average of 5.0. Also, in 2004, LG&E Energy Delivery had the lowest contractor recordable safety injury rate since the merger of LG&E and KU. The 2004 year-end recordable injury rate for contractors was 3.16 in comparison to the National Safety Council industry average of 7.6.

For 2005 to-date, the injury rate continues to trend downward; safety performance for both Energy Delivery employees and contractors continue to outperform the previous year's performance in 2004.

Capitalization and Weighted Average Cost of Capital

Q. Please explain the capital structure strategy of KU.

A. As I have expressed in previous testimony before the Commission, including most recently in Case No. 2003-00434, KU is firmly committed to maintaining the financial strength of the Company. The Company has a target capital structure of the midpoint of the range for "A" rated utilities published by Standard and Poor's.

Q. What is the current target capital structure?

A. The midpoint of the total debt to total capital range for utilities with a business position "5" (KU's current business position) is 46%. This midpoint was established by Standard and Poor's. The range established by Standard and Poor's is 42% to

50%. This indicates an acceptable range for the equity component of capital of 50% to 58%.

When rating agencies evaluate the Company's debt to capital ratio, the agencies require purchased power agreements to be treated as fixed obligations equivalent to debt. KU has significant purchased power obligations in contracts with Electric Energy Inc., Owensboro Municipal Utilities, and Ohio Valley Electric Corporation. Although these contracts are currently attractively priced, the rating agencies consider a portion of these payments to be debt equivalents in establishing the ratings. Standard and Poor's review of KU noted that it has imputed $127 million of debt equivalent to KU for 2005. As indicated in the table below, if this adjustment is made to the capital structure shown in Blake Exhibit 2, KU's debt to total capitalization ratio increases to 47.10% - within the range published by Standard and Poor's. This indicates an equity component of capital of 52.90% (common and preferred), approximately the midpoint of the Standard and Poor's guideline range. Disregarding the impact of the purchased power agreements could limit the Company's future access to attractively priced debt capital.

	Adjusted Kentucky Jurisdictional Capitalization (Exhibit 2, Col. 13)	Jurisdictional Imputed Debt per S&P (87.96% X $127 mill)	Imputed Kentucky Jurisdictional Capitalization (Col 1 + Col 2)	Imputed Capital Structure
	(1)	(2)	(3)	(4)
Short Term Debt	$ 71,280,264		$ 71,280,264	4.82%
Long Term Debt	513,966,267		513,966,267	34.73%
Power Purchase Agreements		$ 111,709,200	111,709,200	7.55%
Preferred Stock	30,410,421		30,410,421	2.06%
Common Equity	752,388,994		752,388,994	50.84%
	$ 1,368,045,946	$ 111,709,200	$ 1,479,755,146	100.00%

Q. In light of the Companies' current proposed construction program, has KU made efforts to lower debt and retain earnings?

A. Since the last rate case, KU has refinanced $133 million of debt to lower interest rates. In addition, the Company has retained earnings in anticipation of the requirements of its construction program. The current common equity ratio of KU is not only consistent with the Company's longstanding targeted debt-to-capital structure previously discussed, but is reasonable in light of the anticipated construction program.

Q. Can you explain what is contained in Blake Exhibit 2?

A. Yes. Blake Exhibit 2 calculates adjusted capitalization as of June 30, 2005, as well as the weighted average cost of capital to apply to the adjusted capitalization.

Q. Please explain the calculation of the adjusted capitalization.

A. Column 1 of Blake Exhibit 2 contains the components of capitalization as recorded on the Company's books and records as of the end of the twelve months ended June 30, 2005. Column 2 of Blake Exhibit 2 calculates the relative capitalization percentages of each component of capitalization to the total capitalization (e.g., line 1, column 1 divided by line 5, column 1 equals line 1, column 2). Columns 3 through 5 are adjustments to capitalization that are totaled in column 6 of Blake Exhibit 2. The three adjustments are to remove undistributed subsidiary earnings, to remove KU's equity investment in Electric Energy Inc., and to remove KU's investment in Ohio Valley Electric Corporation and other investments consistent with the adjustments approved in the Commission's Order in Case No. 2003-00434. Column 7 is the total of column 1 and column 6. Column 8 of Blake Exhibit 2 contains the allocation factor to jurisdictionalize KU's Kentucky capitalization. The factor in column 8 was calculated based on net original cost rate base, excluding the net ARO assets, as shown on Blake Exhibit 3. Column 9 calculates the relative Kentucky jurisdictional capitalization components by multiplying column 7 by the factor in column 8. Column 10 equals column 9. Column 11 calculates the relative capitalization percentages of each component of capitalization to the total capitalization (e.g., line 1, column 10 divided by line 5, column 10 equals line 1, column 11). Column 12 removes the post-1994 environmental surcharge plan using the relative capitalization percentage in column 11. Column 13 is the total of column 10 and column 12.

Q. Please explain the adjustment shown in Column 12 of Blake Exhibit 2 for the Environmental Surcharge Post-1994 Plan.

A. KU removed the capitalization of its ECR rate base that is not recovered through base rates. The adjustment removes the environmental surcharge rate base at June 30, 2005, as shown on June's expense month ECR filing, reduced by the environmental surcharge rate base of the post-1994 ECR plan that was rolled into base rates in Case No. 2003-068. Removing the environmental surcharge rate base from the capital structure is necessary because KU is recovering its investment through the ECR plan.

Q. Please explain why a capitalization adjustment for ARO assets is not used in the calculation of the weighted cost of capital in Blake Exhibit 2.

A. In Case No. 2003-00434 the Commission made an adjustment to exclude ARO assets from capitalization. The Commission found that the capitalization adjustment was consistent with other Commission decisions when items are removed from calculation of rate base. KU believes that an adjustment is not needed for capitalization because the accounting for the AROs, consistent with the Commission's December 23, 2003 Order in Case No. 2003-00427, effectively removes all impacts of ARO accounting from the income statement and net assets in the balance sheet; accordingly, there is no impact on common equity or other capitalization accounts. The recorded regulatory assets, liabilities and credits offset the effects of the ARO accounting. KU removed the AROs from rate base in Blake Exhibit 3, in accordance with the December 23, 2003 Order.

Q. Please explain how the weighted average cost of capital is calculated.

A. Column 14 of Blake Exhibit 2 calculates the respective capitalization percentages for the components of adjusted capitalization (e.g., line 1, column 13 divided by line 5, column 13 equals line 1, column 14). Column 15 includes the embedded costs of the components of capital except the return on equity. The annual rate used for Short Term Debt is the actual rate as of June 30, 2005. The annual cost rate for Long Term Debt is the embedded cost of the first mortgage bonds and intercompany loans outstanding as of June 30, 2005. The intercompany loans were approved by the Commission in its April 30, 2003 Order in Case No. 2003-00059. The annual cost rate for Preferred Stock is its embedded cost as of June 30, 2005. The cost of equity is the range, including the midpoint, of the equity established by the Commission in Case No. 2003-00434. Column 16 then calculates the weighted average cost of capital by multiplying column 14 by column 15, resulting in 7.56% for electric operations using the 10.5 percent midpoint of the return on equity range.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **S. Bradford Rives**, being duly sworn, deposes and says he is the Chief Financial Officer for Kentucky Utilities Company, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

S B Rives
S. BRADFORD RIVES

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 30th day of September 2005.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

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TAMMY J. ELZY
NOTARY PUBLIC
STATE AT LARGE
KENTUCKY
My Commission Expires Nov. 9, 2006

APPENDIX A

S. Bradford Rives

Chief Financial Officer
LG&E Energy LLC
220 West Main Street
Louisville, Kentucky 40202
(502) 627-3990

Civic Activities

University of Louisville, School of Business – Board of Advisors
Lincoln Heritage Council, Boy Scouts of America - Executive Board
Metro United Way of Louisville - Board of Directors
National Kidney Foundation of Kentucky –
  Board of Directors and Treasurer
  Chair of Cadillac Invitational Golf Tournament
St. Margaret Mary Parish Council

Professional/Trade Memberships

American Institute of Certified Public Accountants (AICPA)
Financial Executives Institute
Kentucky Bar Association
Kentucky Society of Certified Public Accountants
Louisville Bar Association

Education

University of Louisville School of Law, J.D. (cum laude) -- 1988
University of Kentucky, B.S. in Accounting -- 1980

Previous Positions

LG&E Energy LLC, Louisville, KY

- Dec 2000 – Sep 2003, Senior Vice President, Finance and Controller
- Feb 1999 – Dec 2000 – Senior Vice President, Finance and Business Development
- Mar 1996 – Feb 1999 – Vice President, Finance and Controller
- Jan 1996 – Mar 1996 – Vice President, Finance, Non Utility Business
- Mar 1995 – Dec 1995 – Vice President, Controller and Treasurer (LG&E Power)
- Jun 1994 – Mar 1995 – Vice President and Treasurer (LG&E Power)
- Jan 1994 – Jun 1994 – Associate General Counsel
- Jan 1993 – Dec 1993 – Director, Business Development
- Feb 1992 – Dec 1992 – Assistant Treasurer
- Oct 1991 – Feb 1992 – Director, Corporate Finance

Louisville Gas and Electric Company, Louisville, KY

- 1990-1991 – Director, Corporate Finance
- 1989-1990 – Director, Corporate Tax
- 1985-1989 – Manager, Tax Accounting
- 1983-1985 – Assistant Manager, Tax Accounting

Arthur Andersen and Company, Louisville, KY

- 1982-1983 – Audit Senior
- 1980-1982 – Audit Staff