an e·on company

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PUBLIC SERVICE COMMISSION

December 8, 2006

Re: The Application of Louisville Gas and Electric Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations – *Case No. 2006-00445*

Dear Ms. O'Donnell:

Enclosed please find an original and five (5) copies of the Response of Louisville Gas and Electric Company (LG&E) to the Commission's Order dated November 29, 2006 in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to contact me.

Sincerely,

Rick E. Lovekamp

Rick E. Lovekamp

C: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE
COMMISSION

In the Matter of:

THE APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR AN ORDER AUTHORIZING THE ISSUANCE OF SECURITIES AND THE ASSUMPTION OF OBLIGATIONS	)))))	CASE NO. 2006-00445

RESPONSE OF
LOUISVILLE GAS AND ELECTRIC COMPANY
TO
COMMISSION'S ORDER
DATED NOVEMBER 29, 2006

FILED: DECEMBER 8, 2006

LOUISVILLE GAS AND ELECTRIC COMPANY

CASE N0. 2006-00445

Response to Commission's Order
Dated November 29, 2006

Question No. 1

Witness: Daniel K. Arbough

Q-1. LG&E's Application, Exhibit 5, presents a financial analysis of its proposed financing. Provide a revised financial analysis that reflects LG&E's proposal in this application and the anticipated issuance of $300 million in new debt over the next five years, assuming LG&E issues 30-year bonds at the interest rate differential discussed in Item No. 5 of LG&E's response to the Commission Staff's information request of November 1, 2006.

A-1. As requested above, a revised financial analysis is attached.

The analysis suggests that there would be a net benefit to the Company of $5.7 million as compared to the initial estimated savings of $1.8 million. The additional interest expense associated with the 30 year loans is more than offset by continuation of the administrative savings for the entire 30 year period. The analysis shows additional periods to reflect the long-term loans maturing through 2040 and the after-tax benefit related to eliminating the preferred stock dividend. However, the assumption that LG&E issues only 30- year secured bonds for all new debt is unreasonable. LG&E's response to the Commission's October 19, 2006 Order, Item No. 5 provided two estimates using prices for ten-year unsecured bonds and thirty-year unsecured bonds for purposes of evaluating whether the Best Rate Method would produce a lower interest rate when compared to issuing debt secured by first mortgage lien. The issuance of only 30-year secured bonds for all of LG&E's debt requirements is not consistent with LG&E's historical practice and is not a prudent business practice. Historically, none of the six LG&E loans obtained from Fidelia have a maturity of 30 years.[1] The Fidelia loans range in maturities of 1 to 10 years.[2] It is the Company's business practice when issuing debt to finance capital needs to utilize a range of

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[1] Until this year, the maximum maturity for both LG&E and KU was 10 years. In June 2006, KU obtained the first 30-year loan from Fidelia.

[2] While LG&E has issued many 30 year tax exempt bonds to take advantage of this low cost funding source for the maximum tenor allowed, these evidences of indebtedness are not comparable to the debt at issue in this proceeding.

Prior to the LG&E/KU merger, taxable first mortgage bonds were issued for a variety of maturities ranging from 10 to 30 years. The Fidelia debt however is the only recent benchmark available because there has not been any other taxable debt issued publicly since the LG&E/KU merger.

maturities and term structures that are reflective of current operating and market conditions and anticipated cash flow requirements. Regardless of the additional interest differential associated with the anticipated borrowings shown through a maturity period of 2040 or the shorter maturity period of 2017 shown in the financial analysis provided in LG&E's Application, Exhibit 5, customers should realize a net benefit.

LG&E acknowledges that the Commission's approval of this application has no implications for ratemaking purposes

LOUISVILLE GAS AND ELECTRIC

Date	Increase in Interest Charges and Ins Premium (1)	Interest on New Debt Replacing Preferred Stk (2)	Additional Debt Expense Amortization (3)	Interest Differential on Anticipated Borrowings (4)	Administrative Savings	Underwriting, Call Premium and Issue Expenses (5)	Taxes	After-Tax Return on Additional Equity (6)	After-Tax Elimination of Pfd Stk Dividend (7)	Net Periodic (Cost) or Savings	Present Value Factor	Present Value SAVINGS
01-Jan-07	$ -	$ -	$ -	$ -	$ -	($3,318,561)	$ -			$ (3,318,561)	1.0000	($3,318,561)
01-Jan-08	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (13,350)	$ 334,975		$ 2,056,881	$ (960,825)	$ 4,783,892	$ 661,494	0.9326	$616,899
01-Jan-09	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (34,200)	$ 345,024		$ 2,061,083	$ (960,825)	$ 4,783,892	$ 654,895	0.8697	$569,570
01-Jan-10	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (52,950)	$ 355,375		$ 2,064,350	$ (960,825)	$ 4,783,892	$ 649,763	0.8111	$527,009
01-Jan-11	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (71,700)	$ 366,036		$ 2,067,497	$ (960,825)	$ 4,783,892	$ 644,821	0.7564	$487,742
01-Jan-12	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (79,200)	$ 377,017		$ 2,066,143	$ (960,825)	$ 4,783,892	$ 646,948	0.7054	$456,360
01-Jan-13	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (79,200)	$ 388,328		$ 2,061,743	$ (960,825)	$ 4,783,892	$ 653,859	0.6578	$430,140
01-Jan-14	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (79,200)	$ 399,978		$ 2,057,211	$ (960,825)	$ 4,783,892	$ 660,977	0.6135	$405,509
01-Jan-15	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (79,200)	$ 411,977		$ 2,052,543	$ (960,825)	$ 4,783,892	$ 668,308	0.5721	$382,365
01-Jan-16	$ (582,220)	$ (4,957,859)	$ (69,159)	$ (79,200)	$ 424,336		$ 2,047,736	$ (960,825)	$ 4,783,892	$ 675,860	0.5336	$360,617
01-Jan-17	$ (540,038)	$ (4,957,859)	$ (51,870)	$ (79,200)	$ 437,066		$ 2,019,649	$ (960,825)	$ 4,783,892	$ 702,685	0.4976	$349,654
01-Jan-18	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 450,178		$ 1,961,688	$ (960,825)	$ 4,783,892	$ 741,855	0.4641	$344,258
01-Jan-19	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 463,684		$ 1,956,435	$ (960,825)	$ 4,783,892	$ 750,106	0.4328	$324,620
01-Jan-20	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 477,594		$ 1,951,023	$ (960,825)	$ 4,783,892	$ 758,606	0.4036	$306,166
01-Jan-21	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 491,922		$ 1,945,450	$ (960,825)	$ 4,783,892	$ 767,360	0.3764	$288,820
01-Jan-22	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 506,680		$ 1,939,709	$ (960,825)	$ 4,783,892	$ 776,377	0.3510	$272,514
01-Jan-23	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 521,880		$ 1,933,796	$ (960,825)	$ 4,783,892	$ 785,664	0.3273	$257,182
01-Jan-24	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 537,537		$ 1,927,706	$ (960,825)	$ 4,783,892	$ 795,230	0.3053	$242,764
01-Jan-25	$ (456,020)	$ (4,957,859)	$ -	$ (79,200)	$ 553,663		$ 1,921,433	$ (960,825)	$ 4,783,892	$ 805,083	0.2847	$229,203
01-Jan-26	$ (439,307)	$ (4,957,859)	$ -	$ (79,200)	$ 570,273		$ 1,908,470	$ (960,825)	$ 4,783,892	$ 825,443	0.2655	$219,156
01-Jan-27	$ (369,968)	$ (4,957,859)	$ -	$ (79,200)	$ 587,381		$ 1,874,842	$ (960,825)	$ 4,783,892	$ 878,263	0.2476	$217,460
01-Jan-28	$ (294,666)	$ (4,957,859)	$ -	$ (79,200)	$ 605,002		$ 1,838,695	$ (960,825)	$ 4,783,892	$ 935,039	0.2309	$215,909
01-Jan-29	$ (294,666)	$ (4,957,859)	$ -	$ (79,200)	$ 623,152		$ 1,831,635	$ (960,825)	$ 4,783,892	$ 946,129	0.2153	$203,742
01-Jan-30	$ (254,494)	$ (4,957,859)	$ -	$ (79,200)	$ 641,847		$ 1,808,736	$ (960,825)	$ 4,783,892	$ 982,096	0.2008	$197,229
01-Jan-31	$ (198,831)	$ (4,957,859)	$ -	$ (79,200)	$ 661,102		$ 1,779,592	$ (960,825)	$ 4,783,892	$ 1,027,872	0.1873	$192,506
01-Jan-32	$ (181,171)	$ (4,957,859)	$ -	$ (79,200)	$ 680,935		$ 1,765,008	$ (960,825)	$ 4,783,892	$ 1,050,779	0.1747	$183,529
01-Jan-33	$ (95,737)	$ (4,957,859)	$ -	$ (79,200)	$ 701,363		$ 1,723,827	$ (960,825)	$ 4,783,892	$ 1,115,461	0.1629	$181,692
01-Jan-34	$ -	$ (4,957,859)	$ -	$ (79,200)	$ 722,404		$ 1,678,401	$ (960,825)	$ 4,783,892	$ 1,186,813	0.1519	$180,281
01-Jan-35	$ -	$ (4,957,859)	$ -	$ (79,200)	$ 744,076		$ 1,669,970	$ (960,825)	$ 4,783,892	$ 1,200,054	0.1417	$170,003
01-Jan-36	$ -	$ (4,957,859)	$ -	$ (79,200)	$ 766,399		$ 1,661,287	$ (960,825)	$ 4,783,892	$ 1,213,693	0.1321	$160,344
01-Jan-37	$ -	$ (4,957,859)	$ -	$ (79,200)	$ 789,391		$ 1,652,343	$ (960,825)	$ 4,783,892	$ 1,227,741	0.1232	$151,265
01-Jan-38	$ -	$ -	$ -	$ (52,500)	$ 813,072		$ (295,863)	$ (960,825)	$ -	$ (496,116)	0.1149	($57,004)
01-Jan-39	$ -	$ -	$ -	$ (37,500)	$ 837,464		$ (311,186)	$ (960,825)	$ -	$ (472,047)	0.1072	($50,582)
01-Jan-40	$ -	$ -	$ -	$ (15,000)	$ 862,588		$ (329,712)	$ (960,825)	$ -	$ (442,949)	0.0999	($44,264)
	($11,557,013)	($148,735,762)	($674,304)	($2,336,400)	$18,449,700	($3,318,561)	$ 56,348,120	$ (31,707,236)	$ 143,516,756	$20,659,603		$5,654,096

Assumptions

(1) Reflects an increase in interest charges related to the non-insured floating rate debt of $246.2 million and insurance premium related to insured debt of $288.1 million through maturity.

	Rate	Amount	Maturity	Increase	
Interest Increase		$ 35,200,000	9/1/2017	$ 35,200	
		$ 31,000,000	9/1/2017	$ 31,000	
		$ 60,000,000	9/1/2017	$ 60,000	
		$ 22,500,000	9/1/2026	$ 22,500	
		$ 27,500,000	9/1/2026	$ 27,500	
		$ 35,000,000	11/1/2027	$ 35,000	
		$ 35,000,000	11/1/2027	$ 35,000	
	0.100%	$ 246,200,000		246,200	annually
Insurance Increase	0.125%	$ 25,000,000	5/1/2027	$ 31,250	
	0.100%	$ 10,104,000	9/1/2027	$ 10,104	
	0.115%	$ 83,335,000	8/1/2030	$ 95,835	
	0.170%	$ 41,665,000	10/1/2032	$ 70,831	
	0.100%	$ 128,000,000	10/1/2033	$ 128,000	
		$ 288,104,000		$ 336,020	annually

(2) Interest on New Debt replacing Preferred Stock:
90% of preferred stock would be replaced by new debt at a rate of **6.02%**

(3) Reflects the additional debt amortization related to the $126.2 million refunding through maturity September 1, 2017.

(4) Interest differential on the anticipated borrowings (less the borrowings related to preferred redemption) over the next 5 years assuming borrowings occur at the half year point: 0.03%

	2007	2008	2009	2010	2011	Thereafter	Total
L-T Borrowings	$ 89,000,000	$ 50,000,000	$ 75,000,000	$ 50,000,000	$ -		$ 264,000,000
Cumulative Interest	$ 13,350	$ 34,200	$ 52,950	$ 71,700	$ 79,200	$ 79,200	

MISCELLANEOUS

Amortized Debt Expense	$737,700
Administrative Savings	$334,975
Annual Inflation Rate	3.00%
From January 1, 2007 to Maturity	128.0
Tax rate	38.900%
Discount rate	7.00%

(5) Underwriting, Call Premium and Issuance Costs:
Call Premium - Preferred Shares $ 2,580,861

New Bond Issuance		$ 126,200,000
Bond Issue Costs		0.58%
Underwriting	$ 441,700	0.35%
Bond Counsel	$ 80,000	0.06%
Company Counsel	$ 70,000	0.06%
Underwriters Counsel	$ 44,000	0.03%
Ratings	$ 40,000	0.03%
Printing	$ 10,000	0.01%
Trustee Counsel	$ 6,000	0.00%
Accountants	$ 40,000	0.03%
Trustee	$ 6,000	0.00%
Bond Insurance	$ -	0.00%
Issuance costs	$ 296,000	0.23%

(6) After-tax Return on Additional Equity:
10% of preferred stock would be replaced by common equity with an assumed 10.5% equity return

(7) After-tax savings derived from the elimination of the preferred stock dividend