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November 10, 2011

HAND DELIVERED

Jeffrey DeRouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40601

RECEIVED

NOV 10 2011

PUBLIC SERVICE
COMMISSION

RE: *Environmental Surcharge Proceedings*
Case Nos. 2011-00161 and 2011-0162

Dear Mr. DeRouen:

Please find enclosed and accept the filing of two original and fully executed versions of a Settlement Agreement, Stipulation and Recommendation by and among all the parties in these proceedings. Fifteen copies of these documents are enclosed for filing in each case.

Yours very truly,


Kendrick R. Riggs

KRR: jms

Enclosures

Cc: Parties of Record

SETTLEMENT AGREEMENT, STIPULATION, AND RECOMMENDATION

This Settlement Agreement, Stipulation, and Recommendation (“Settlement Agreement”) is entered into this 9th day of November 2011 by and between Kentucky Utilities Company (“KU”); Louisville Gas and Electric Company (“LG&E”) (collectively, the “Companies”); Kentucky Industrial Utility Customers, Inc. (“KIUC”); Attorney General for the Commonwealth of Kentucky, by and through his office of Rate Intervention (“AG”); Community Action Council for Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc. (“CAC”); Lexington-Fayette Urban County Government (“LFUCG”); The Kroger Co. (“Kroger”); Metropolitan Housing Coalition (“MHC”); United States Department of Defense and Other Federal Executive Agencies (“DOD/FEA”); and Rick Clewett, Raymond Berry, Drew Foley, Janet Overman, Gregg Wagner, Sierra Club and the Natural Resources Defense Council (“Environmental Group”) (collectively, the “Intervenors”) in the proceedings involving KU and LG&E, which proceedings are the subject of this Settlement Agreement as set forth below:

WITNESSETH:

WHEREAS, KU filed on June 1, 2011, with the Kentucky Public Service Commission (“Commission”) its Application and Testimony in *The Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge*, and the Commission has established Case No. 2011-00161 to review KU’s application;

WHEREAS, LG&E filed on June 1, 2011, with the Commission its Application and Testimony in *The Application of Louisville Gas and Electric Company for a Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge*, and the Commission has established Case No. 2011-00162 to review LG&E’s application;

WHEREAS, the Commission issued deficiency letters to LG&E and KU concerning their applications on June 14, 2011, which deficiencies LG&E and KU subsequently cured, and the Commission, by Order dated June 21, 2011, accepted the applications as filed on June 16, 2011;

WHEREAS, KIUC filed petitions to intervene in both proceedings on May 18, 2011, and was granted intervention by the Commission in both proceedings on May 23, 2011;

WHEREAS, AG filed petitions to intervene in both proceedings on May 25, 2011, and was granted intervention by the Commission in both proceedings on June 3, 2011;

WHEREAS, CAC filed a petition to intervene in only Case No. 2011-00161 on June 3, 2011, and was granted intervention by the Commission on June 16, 2011;

WHEREAS, LFUCG filed a petition to intervene in only Case No. 2011-00161 on June 8, 2011, and was granted intervention by the Commission on June 16, 2011;

WHEREAS, Kroger filed petitions to intervene in both proceedings on June 14, 2011, and was granted intervention by the Commission in both proceedings on June 16, 2011;

WHEREAS, MHC filed a petition to intervene in only Case No. 2011-00162 on June 15, 2011, and was granted intervention by the Commission in both proceedings on June 23, 2011;

WHEREAS, Rick Clewett, Raymond Berry, Sierra Club, and the Natural Resources Defense Council filed a petition to intervene in Case No. 2011-00161 on June 16, 2011, and were granted intervention by the Commission on July 27, 2011; and Drew Foley, Janet Overman, Gregg Wagner, Sierra Club, and the Natural Resources Defense Council filed a petition to intervene in Case No. 2011-00162 on June 16, 2011, and were granted intervention by the Commission on July 27, 2011;

WHEREAS, DOD/FEA filed a petition to intervene in only Case No. 2011-00162 on July 6, 2011, and was granted intervention by the Commission on July 15, 2011;

WHEREAS, an informal conference for the purpose of reviewing the status of the case and discussing the possible settlement of issues, attended in person or by phone by representatives of the Intervenors, the Commission Staff, and the Companies, took place on November 4, 7, and 9, 2011, at the offices of the Commission;

WHEREAS, the Companies and the Intervenors hereto desire to settle issues pending before the Commission in the above-referenced proceedings;

WHEREAS, the adoption of this Settlement Agreement will eliminate the need for the Commission and the parties to expend significant resources litigating these proceedings, and eliminate the possibility of, and any need for, rehearing or appeals of the Commission's final orders herein;

WHEREAS, the Intervenors and the Companies agree that this Settlement Agreement, viewed in its entirety, is a fair, just, and reasonable resolution of all the issues in the above-referenced proceedings;

WHEREAS, it is understood by the parties hereto that this Settlement Agreement is subject to the approval of the Commission insofar as it constitutes an agreement by the parties to the proceedings for settlement; and

WHEREAS, it is the position of the parties hereto that this Settlement Agreement is supported by sufficient and adequate data and information, and should be approved by the Commission.

NOW, THEREFORE, for and in consideration of the premises and conditions set forth herein, the parties hereto stipulate and agree as follows:

SECTION 1. Overall Recommendation. The parties to this Settlement Agreement recommend the Commission approve the respective applications of LG&E and KU in the above-captioned cases filed on June 1, 2011 (accepted for filing on June 16, 2011), and grant the relief requested therein as amended by the terms of this Settlement Agreement, and as more specifically stated below, by entering orders on or before December 16, 2011, approving LG&E's and KU's applications in their entirety except as described in the following Sections.

SECTION 1.01 All parties to this agreement except the Environmental Intervenors stipulate and support KU's 2011 Environmental Cost Recovery ("ECR") Compliance Plan, as amended herein, and LG&E's 2011 ECR Compliance Plan as reasonable and cost-effective for purposes of KRS 278.183; parties recommend the Compliance Plans be approved and Certificates of Public Convenience and Necessity ("CPCNs") for requested projects in KU's application, as amended, and LG&E's application be granted; and ECR surcharge recovery of the costs for the 2011 ECR Compliance Plans, as amended by the terms of this Settlement Agreement, be approved.

SECTION 1.02 Environmental Intervenors do not support KU's plans to retrofit the Ghent power plant, and LG&E's plans to retrofit the Mill Creek and Trimble power plant; however, Environmental Intervenors agree not to challenge the reasonableness or cost-effectiveness for purposes of KRS 278.183 of KU's ECR Compliance Plan, as amended, and LG&E's Compliance Plan or CPCNs for requested projects in KU's application, as amended and LG&E's application, or ECR surcharge recovery of the costs for the 2011 ECR Compliance plans, as modified by the terms of this settlement. The Environmental Intervenors' main motivation for not opposing the

CPCNs and the Companies' 2011 ECR Compliance Plans is to support their low-income housing advocate allies.

SECTION 2. Removing E.W. Brown Units 1 and 2 from the KU 2011 ECR Compliance Plan and Withdrawing KU's Related Request for a Certificate of Public Convenience and Necessity.

SECTION 2.01 KU agrees to withdraw from its application the portion of Project No. 34 in KU's 2011 ECR Compliance Plan concerning the proposed "Particulate Matter Control System," defined as a pulse-jet fabric filter or "baghouse" to capture particulate matter, a Powdered Activated Carbon injection system to capture mercury, a lime injection system to protect the baghouses from the corrosive effects of sulfuric acid mist ("SAM") and other balance-of-plant support system changes such as ash collection and transport systems and fans, to serve each of Brown Units 1 and 2, except the SAM mitigation equipment consisting of sorbent injection systems on Brown Units 1 and 2 that are independent of the lime injection systems associated with the baghouses. The SAM mitigation systems for Brown Units 1 and 2 are necessary to meet the Title V SAM emissions requirement for Brown that arose from a U.S. Environmental Protection Agency ("EPA") enforcement action.

SECTION 2.02 KU agrees to withdraw the portion of its application requesting a CPCN to permit the construction of a Particulate Matter Control System to serve Brown Units 1 and 2.

SECTION 2.03 The foregoing notwithstanding, KU will continue to dispatch, operate, and maintain Brown Units 1 and 2 as part of its generation fleet as long

as, and to the extent to which, it is reasonable and cost-effective to do so while complying with all applicable environmental regulations.

SECTION 2.04 KU further agrees that, in any applications filed under KRS 278.020 or KRS 278.183 seeking a CPCN to permit the construction of a Particulate Matter Control System to serve Brown units 1 and 2 or approval of cost recovery for such equipment and related costs through the ECR mechanism, it will not ask the Commission to issue an order granting the requested relief before January 1, 2014, and will not file such request before July 1, 2013, unless finalized changes in the proposed utility MACT rules, future finalized ambient air quality standards, or other regulations finalized after the date of this agreement establish new environmental requirements for Brown Units 1 or 2. The parties acknowledge that KU projects that it would need two years from the date of Commission approval to complete the construction of the retrofit project.

SECTION 2.05 Nothing contained herein shall prohibit any party to this agreement from seeking to intervene in any future proceeding or challenge any application filed by the Companies for the retrofitting of Brown Units 1 and 2, except that the recovery of additional costs resulting from the delay in deciding whether to retrofit Brown Units 1 and 2, including, but not limited to, fuel costs, purchase power, and construction costs, will not be challenged by any party to this Settlement Agreement. Subject to the foregoing restriction, any other challenge to such an application may include the argument that the cost of retrofitting the units is not reasonable or cost effective pursuant to KRS Chapter 278.

SECTION 3. Financing

SECTION 3.01 Each of KU and LG&E will seek to increase its short-term borrowing limit to \$500 million, subject to approval by the Federal Energy Regulatory Commission (“FERC”).

SECTION 3.02 KU and LG&E will use short term debt as the first form of financing for capital projects. The Companies expect to allow their short-term debt balances to accumulate to approximately \$250 million at each company, at which time first mortgage bonds would be issued in a minimum size of \$250 million. Market conditions may accelerate or delay the timing of the long-term debt issuances or increase the size of such issuances.

SECTION 3.03 KU and LG&E will evaluate the cost-effectiveness, reasonableness, and feasibility of issuing tax-exempt pollution control bonds in connection with long-term debt financings.

SECTION 3.04 In the six-month and two-year review proceedings under KRS 278.183(3), KU and LG&E will calculate the short-term debt rate using average daily balances and daily interest rates, and will calculate the long-term debt rate using daily balances and daily interest rates in connection with the ECR true-up calculations for the actual weighted average cost of capital.

SECTION 4. Return on Equity

SECTION 4.01 The return on equity to be used concerning all projects and items contained in KU’s and LG&E’s 2009, 2006, and 2005 ECR Compliance Plans, the costs of which KU and LG&E currently recover through their respective ECR

mechanisms, shall remain at the current level of 10.63% unless prospectively changed by a future Commission order.

SECTION 4.02 The return on equity to be used concerning all projects and items contained in KU's and LG&E's 2011 ECR Compliance Plans, the costs of which KU and LG&E will recover through their respective ECR mechanisms, shall be 10.10% unless prospectively changed by a future Commission order.

SECTION 4.03 The parties acknowledge the Commission's jurisdiction under KRS Chapter 278 to regulate the Companies' rates and service. The parties further acknowledge the AG's statutory right pursuant to KRS 367.150 to act as an advocate for customers in proceedings before the Commission, including the right to file a rate complaint pursuant to KRS 278.260.

SECTION 5. Revenue Allocation

SECTION 5.01 Each utility's current ECR revenue allocation methodology, which uses total utility revenues to allocate ECR revenues between rate classes, will continue to be used as modified by the two-step methodology described in Section 5.

SECTION 5.02 Each utility's total ECR revenues to be collected will be allocated between each rate class on a total-revenues basis.

SECTION 5.03 The total amount of ECR revenues to be collected from each of following LG&E rate classes will be determined on a total-revenues basis: RS Residential Service, VFD Volunteer Fire Department Service, LS Lighting Service, RLS Restricted Lighting Service, LE Lighting Energy Service, TE Traffic Energy Service,

DSK Dark Sky Friendly, LEV Low Emission Vehicle Service, and RRP Residential Responsive Pricing Service. The total amount of ECR revenues to be collected from each of following KU rate classes will be determined on a total-revenues basis: RS Residential Service, VFD Volunteer Fire Department Service, AES All Electric School, ST. LT. Street Lighting Service, P.O. LT. Private Outdoor Lighting, LE Lighting Energy Service, TE Traffic Energy Service, DSK Dark Sky Friendly, and LEV Low Emission Vehicle Service.

SECTION 5.04 Each utility's total ECR revenues from the remaining rate classes will be reallocated from the remaining rate schedules on the basis of non-fuel revenues (i.e., total revenues less fuel revenues). For purposes of Section 5.04, the ECR revenues allocated in the second step of the allocation process will be reallocated among the following LG&E rate classes on the basis of non-fuel revenues: GS General Service, PS Power Service, ITODS Industrial Time-of-Day Secondary Service, CTODS Commercial Time-of-Day Secondary Service, ITODP Industrial Time-of-Day Primary Service, CTODP Commercial Time-of-Day Primary Service, RTS Retail Transmission Service, FLS Fluctuating Load Service, GRP General Responsive Pricing Service, and special contracts. For purposes of Section 5.04, the ECR revenues allocated in the second step of the allocation process will be reallocated among the following KU rate classes on the basis of non-fuel revenues: GS General Service, PS Power Service, TODS Time-of-Day Secondary Service, TODP Time-of-Day Primary Service, RTS Retail Transmission Service, FLS Fluctuating Load Service, and special contracts.

SECTION 5.05 Each utility will use the two-step ECR revenue allocation methodology described in Sections 5.01 through 5.04 unless prospectively changed by

future Commission orders. Each utility shall address the impact of this change in revenue allocation in the next two future environmental surcharge two-year reviews or ECR compliance plan proceedings and, if appropriate, present recommendations after consulting with the AG, KIUC, Kroger, and DOD/FEA.

SECTION 5.06 If the Commission approves this Settlement Agreement, the Companies will forthwith submit evidence in Case Nos. 2011-00231 and 2011-00232 to effectuate the roll-in at issue in those proceedings consistent with Sections 5.01-5.04 of this Settlement Agreement, and will request that the Commission issue orders granting the appropriate relief by January 31, 2012. The Companies will continue to use the existing total revenue allocation methodology in the Companies' monthly ECR filings until the Commission issues orders in Case Nos. 2011-00231 and 2011-00232 to effectuate the base-rate roll-ins described above. The purpose of this provision is to effectuate the base-rate roll-ins consistent with the methodology contained in Sections 5.01-5.04.

SECTION 6. Low-Income Items

SECTION 6.01 KU's and LG&E's shareholders will make two additional annual contributions totaling \$500,000 to the Companies' Home Energy Assistance ("HEA") programs, consisting of a shareholder contribution of \$250,000 in each of 2011 and 2012. These contributions will be split evenly between the KU and LG&E HEA Programs.

SECTION 6.02 Effective January 1, 2012, the Companies' HEA charges will increase from 15 cents to 16 cents, and will remain at the 16-cent level until the next change in the Companies' base rates. The Companies estimate this 1-cent HEA charge

increase will produce \$115,000 of additional HEA funds each year. The proceeds resulting from this increase will be allocated consistent with LG&E's and KU's existing HEA Programs. Nothing in this Settlement Agreement precludes any party from seeking the continuation or expansion of the HEA Programs in any future proceeding.

SECTION 6.03 The applications of LG&E and KU in these cases contain evidence supporting their positions that they are obligated to comply with the pending and impending regulations of the Environmental Protection Agency. The Attorney General cannot state, suggest, infer, or otherwise imply that LG&E and KU should fail to comply with the Environmental Protection Agency's regulations, which have been duly enacted after public participation in the rule-making process, regardless of any argument that the regulations are flawed or unfair.

SECTION 7. Miscellaneous Provisions

SECTION 7.01 Each party waives all cross-examination of the other parties' witnesses unless the Commission disapproves this Agreement, and each party further stipulates and recommends that the Notice of Intent, Notice, Application, testimony, pleadings, and responses to data requests filed in this proceeding be admitted into the record. The parties stipulate that after the date of this Settlement Agreement they will not otherwise contest the Companies' proposals, as modified by this Settlement Agreement, in the hearing of the above-referenced proceedings regarding the subject matter of the Settlement Agreement, and that they will refrain from cross-examination of the Companies' witnesses during the hearing, except insofar as such cross-examination is in support of the Settlement Agreement.

SECTION 7.02 The signatories hereto agree that making this Settlement Agreement shall not be deemed in any respect to constitute an admission by any party hereto that any computation, formula, allegation, assertion, or contention made by any other party in these proceedings is true or valid.

SECTION 7.03 The signatories hereto agree that the foregoing stipulations and agreements represent a fair, just, and reasonable resolution of the issues addressed herein and request the Commission to approve the Settlement Agreement.

SECTION 7.04 The signatories hereto agree that, following the execution of this Settlement Agreement, the signatories shall cause the Settlement Agreement to be filed with the Commission by November 10, 2011, together with a request to the Commission for consideration and approval of this Settlement Agreement.

SECTION 7.05 The signatories hereto agree that this Settlement Agreement is subject to the acceptance of and approval by the Kentucky Public Service Commission. The signatories hereto further agree to act in good faith and to use their best efforts to recommend to the Commission that this Settlement Agreement be accepted and approved.

SECTION 7.06 The signatories hereto agree that if the Commission does not accept and approve this Settlement Agreement in its entirety, then: (a) this Settlement Agreement shall be void and withdrawn by the parties hereto from further consideration by the Commission and none of the parties shall be bound by any of the provisions herein, provided that no party is precluded from advocating any position contained in this Settlement Agreement; and (b) neither the terms of this Settlement Agreement nor any

matters raised during the settlement negotiations shall be binding on any of the signatories to this Settlement Agreement or be construed against any of the signatories.

SECTION 7.07 If the Commission issues an order adopting this Settlement Agreement in its entirety and without additional conditions, each of the parties agrees that it shall file neither an application for rehearing with the Commission, nor an appeal to the Franklin Circuit Court with respect to such order.

SECTION 7.08 The signatories hereto agree that this Settlement Agreement shall inure to the benefit of, and be binding upon, the parties hereto and their successors and assigns.

SECTION 7.09 The signatories hereto agree that this Settlement Agreement constitutes the complete agreement and understanding among the parties hereto, and any and all oral statements, representations, or agreements made prior hereto or contemporaneously herewith shall be null and void and shall be deemed to have been merged into this Settlement Agreement.

SECTION 7.10 The signatories hereto agree that, for the purpose of this Settlement Agreement only, the terms of the Settlement Agreement are based upon the independent analysis of the parties to reflect a fair, just, and reasonable resolution of the issues herein and are the product of compromise and negotiation.

SECTION 7.11 The signatories hereto agree that neither the Settlement Agreement nor any of the terms shall be admissible in any court or commission except insofar as such court or commission is addressing litigation or an administrative action arising out of the implementation of the terms herein or the approval of this Settlement

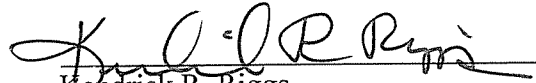
Agreement. This Settlement Agreement shall not have any precedential value in this or any other jurisdiction.

SECTION 7.12 The signatories hereto warrant that they have informed, advised, and consulted with the respective parties hereto in regard to the contents and significance of this Settlement Agreement and, based upon the foregoing, are authorized to execute this Settlement Agreement on behalf of the parties hereto.

SECTION 7.13 The signatories hereto agree that this Settlement Agreement is a product of negotiation among all parties hereto, and no provision of this Settlement Agreement shall be strictly construed in favor of or against any party.

SECTION 7.14 The signatories hereto agree that this Settlement Agreement may be executed in multiple counterparts.

IN WITNESS WHEREOF, the parties have hereunto affixed their signatures:



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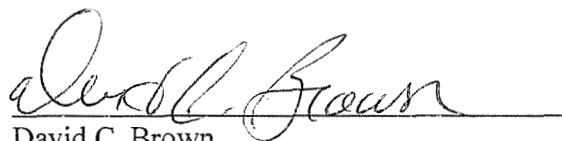
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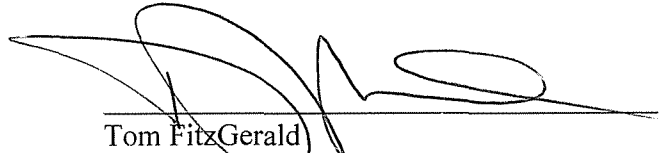
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A handwritten signature in cursive script, reading "David C. Brown", is positioned above a horizontal line.

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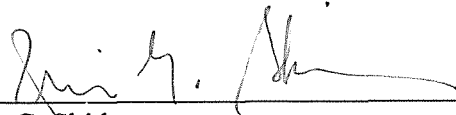
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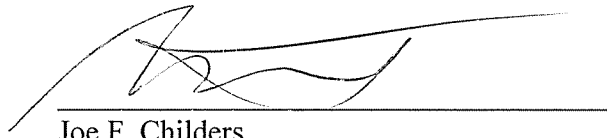
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