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PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY UTILITIES	)	
COMPANY FOR AN ADJUSTMENT OF	)	Case No. 2009-00548
BASE RATES	)	

And

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY FOR AN	)	Case No. 2009-00549
ADJUSTMENT OF ELECTRIC AND GAS	)	
BASE RATES	)	

ATTORNEY GENERAL'S RENEWED
MOTION TO DISMISS

The Attorney General, by and through his Office of Rate intervention, hereby renews his previous Motion to Dismiss and, again, moves the Public Service Commission to enter an Order dismissing the above-styled actions and states that in view of the announced intent of E.ON AG to sell E.ON U.S. LLC and the pending application for a transfer of KU and LG&E to the PPL Corporation, the test periods utilized by each applicant are no longer sufficient or reasonable for use in setting rates.

1. Ownership of LG&E and KU is Relevant to the Determination of Fair, Just and Reasonable Rates Under KRS Chapter 278.

The Applicants claim that, "the ultimate ownership of LG&E and KU is irrelevant to the determination of fair, just and reasonable rates under KRS Chapter 278."[1] However, the ownership of LG&E and KU is not simply a stale, historical note. It is directly related to the ability of the companies to obtain equity and debt capital. In the Direct Testimonies of William E. Avera, on behalf of LG&E and KU, the companies own witness notes that: "[a]s a wholly-owned subsidiary of E.ON U.S., LGE ***ultimately*** obtains equity capital and most of its debt capital solely from the parent corporation, E.ON AG, whose common stock is included as one of the 30 members of the DAX stock index of major German companies. [emphasis added]"[2] He observes the same for KU.[3] The fact that E.ON U.S. obtains it capital from its parent, E.ON AG, was also noted in the February 12, 2010 Standard & Poor's rating furnished in the companies' responses to the data requests of the Attorney General.[4] This report is attached hereto as Attorney General's Post-Hearing Exhibit "A".

Additionally, the February 12, 2010 report stated that one of the strengths of the companies was the "implicit credit support provided by parent E.ON AG."[5] The report further noted that "Implicit support from ultimate parent Germany-based......E.ON AG

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[1] Joint Response, page 1.
[2] Direct Testimony of Avera, Case No. 2009-00549, page 9.
[3] Direct Testimony of Avera, Case No. 2009-00548, page 8.
[4] AG-1-184(b), February 12, 2010 S&P Analysis, Page 3.
[5] AG-1-184(b), February 12, 2010 S&P Analysis, Page 2.

(A/Stable/A-1) is factored into the ratings analysis."[6] Finally, the report stated that "[t]he stable outlook for E.ON U.S. is based on continued support from parent E.ON AG" and noted that [a]ny change in the parent's attitude toward its U.S. holdings or in Standard & Poor's perception of the parent's support could lead to a ratings change."[7] The fact that E.ON AG is divesting itself of E.ON U.S. clearly will affect the ratings for the companies going forward. This was also noted by Dr. J. Randall Woolridge, the Attorney General's witness at the hearing. At the hearing Dr. Woolridge testified that he was amazed that the material affect upon the companies' as a result of the PPL transfer was not mentioned in any of the companies' rebuttal testimony[8] The companies' witnesses were repeatedly asked at the hearing whether they had supplemented their testimony and/or responses to data requests to indicate changes to the information in light of the pending acquisition, their testimony at the hearing indicated that none had. In fact, Mr. Victor A. Staffieri, the CEO of E.ON U.S. was asked when the negotiations with PPL began and whether any of the witnesses were made aware of the negotiations with PPL and his testimony indicated that the negotiations began around the first of the year and that several of the witnesses were aware and even part of the discussions with PPL. [9]

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[6] AG-1-184(b), February 12, 2010 S&P Analysis, Page 2.
[7] AG-1-184(b), February 12, 2010 S&P Analysis, Page 3.
[8] June 8th Hearing Video, 4:28:35 pm.
[9] June 8th Hearing Video, 1:07 pm.

Dr. Woolridge further testified that, as cost of capital is a forward-looking concept, the pending acquisition by PPL potentially would affect the companies' cost of obtaining capital going forward along with potential impacts to the companies' capital structure.[10] He also testified that the parent E.ON AG was the "main driver" of the companies' credit rating and that E.ON AG has an "A" credit rating whereas PPL's credit rating is "BBB."[11] His conclusion was that the change in ownership would have a material effect on the cost of capital going forward.[12]

Therefore, contrary to the position of the applicants, ownership of the companies is certainly relevant to ability of LG&E and KU to attract capital and that ability will clearly be affected by the pending transfer. The Commission seems to acknowledge the importance of where and how the companies obtain capital as it has inquired the companies on this very point.[13] In fact, at the hearing, Staff asked Dr. Woolridge whether an increase in the cost of capital would cause the companies to require additional revenue and his response was that it was possible.[14] Conversely, Dr. William Avera, the witness for the companies', noted that the companies' cost of debt was actually lower[15] since the companies are issuing asset-backed debt going forward.[16] This

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[10] June 8th Hearing Video, 4:28:50 pm.
[11] June 8th Hearing Video, 4:29:15 pm.
[12] June 8th Hearing Video, 4:29:45 pm.
[13] See, for example, Item 50 (a) of Commission Staff's 2nd Request for Information in Case No. 2009-00548, Order dated 1 March 2010 (in which Staff asks Avera how E.ON AG obtains capital) and Item 50 (a) of Commission Staff's 2nd Request for Information in Case No. 2009-00549, Order dated 1 March 2010.
[14] June 8th Hearing Video, 4:56:00 pm.
[15] June 8th Hearing Video, 5:15:29 pm.
[16] June 8th Hearing Video, 5:15:15 pm.

would seem to indicate the "mirror image" to the situation proposed by staff, wherein the lower capital costs noted by Dr. Avera, mean the companies would need less revenue going forward.

Although the exact effect on the companies is unknown, clearly the companies' have previously enjoyed the benefits of obtaining private capital from a much larger parent without needing to access the public capital markets. Therefore a change in ownership that affects this ability will obviously affect the business risk, financial risk, credit profile and growth opportunities of each utility going forward. Yet, the Companies insist that the "signed" agreement between E.ON AG and PPL Corporation transferring ownership of KU and LG&E is irrelevant to these proceedings. This is simply not true; as ownership has been actively "in-play" since the Companies filed their rate applications. Simply stated, as the instant proceedings request changes in the companies' rates on a ***prospective*** basis, the change in the ownership of the companies is materially relevant.

2. The Requirement that Adjustments to the Test Year Period be "Known and Measurable" Framework Underscores the Problem with the Situation.

The purpose of a test period is to justify the reasonableness of a proposed general increase in rates.[17] As noted in the Attorney General's previous Motion to Dismiss, when an item in the test period does not reflect reasonably expected, normal operations

[17] KRS 278.192 (1).

going-forward, then adjustments may be appropriate.[18] However, there are limits to the ability to adjust a test period. One limit is that the adjustment must be "known and measurable." It appears that, at least on this point, the Attorney General and the companies agree.[19]

The Attorney General's disagreement concerns what happens in a scenario, such as presented in these proceedings, in which post-test period developments cause the historical test periods to become unreliable ***and*** when the use of the "known and measurable" adjustment process cannot be applied to render the test periods reflective of normal, going-forward operations.

It appears that the Companies simply want to ignore the post-test period developments concerning the change in ownership of the companies simply because the nature and the extent of the agreement with PPL Corporation with regard to LG&E and KU are not yet well-defined or capable of exact quantification. However, the purpose of the test year is to justify the reasonableness of the proposed increase in ***prospective*** rates. Therefore, when there is a post-test year development that renders the test year unreliable for the purpose of setting ***prospective*** rates, the test year must either be adjusted so that it reflects normal, going-forward operations, or it must be disregarded. Here, it simply cannot be adjusted and the Attorney General does not agree that it is

[18] Motion to Dismiss, page 4.
[19] Joint Response, page 3. "The relevant Commission regulation allows for adjustments to be made to a utility's historical test year data, but only when such adjustments are 'known and measurable.'"

proper to characterize the development relating to the companies' ownership as irrelevant. Likewise, he cannot agree to term ownership of the companies as immaterial or of no consequence to the reliability of the test periods being utilized to justify the reasonableness of companies' future rates.

3. The Burden of Proof that a Proposed Increase in Rate or Charge is Just and Reasonable is upon the Companies.

The Commission's Order of June 8, 2010 recognized that the burden of proof to show that a proposed increase in a rate or charge is just and reasonable is upon the utility and that there is no presumption that the information set forth in an application for a change in rates is reasonable for setting rates.

The applications and records submitted by the companies omit any discussion of the consequence of the agreement between E.ON AG and PPL Corporation to sell KU and LG&E. With that being the case, the record is insufficient to determine whether the post-test period developments regarding the pending transfer case are irrelevant or immaterial. Simply stated, it is difficult to understand how the Commission could reasonably make such a finding in the absence of discovery.

4. The Agreement with PPL Corporation itself is a Material Change Requiring Dismissal of the Instant Cases.

That E.ON AG intends to divest itself of E.ON U.S. LLC is not hypothetical.[20] It is a fact that is manifest in the agreement through which PPL Corporation has agreed to acquire E.ON U.S., and is evident in the transfer case filed with this Commission on May 28th, 2010. While the Attorney General does not suggest that the transfer will be, or even that it should be, approved.[21] It is the position of the Attorney General that if the transfer is approved it will result in a material change to both KU and LG&E. The extent of this change is not known at this point and because the records in the rate applications are barren with regard to the possible impacts due to the agreement with PPL Corporation, the record is insufficient to determine prospective rates for the companies. The point is not whether the transfer of ownership from E.ON AG to PPL Corporation will be approved, but that companies are before this Commission requesting approval of the transaction in the transfer case, while asking the Commission to ignore its request for approval of the transfer in the rate proceedings. While the parties to the PPL transaction have discussed the impact of the transaction to the normal, going-forward operations of KU and LG&E to their audience in the investment community, they have been silent in this case as to the impact of the transaction on KU and LG&E's expected prospective operations should the transfer be approved.

[20] Joint Response, page 10. In an attempt to distance themselves from the natural, logical consequences of the stated intent of E.ON AG, the Joint Response speaks in terms of a "hypothetical merger." "Pending merger" is a far better description.
[21] Motion to Dismiss, page 3.

THERFORE, in consideration of the above, the Attorney General respectfully moves the Commission to dismiss the instant cases.

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Jeff Derouen, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail, postage pre-paid, to:

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all on this ~~25th~~ 29th day of June, 2010.

Assistant Attorney General

STANDARD
&POOR'S

February 12, 2010

E.ON U.S. LLC

Primary Credit Analyst:
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Exhibit A

E.ON U.S. LLC

Major Rating Factors

BBB+/Stable/--

Strengths:

- The implicit credit support provided by parent E.ON AG.;
- Stable and relatively predictable regulated utility operations and associated cash flows;
- Constructive regulatory environment in Kentucky; and
- Competitive rates and high customer satisfaction rankings in the region.

Weaknesses:

- Little fuel diversity, virtually all coal-fired;
- Heavy construction program to meet environmental requirements and for new generating capacity.
- Rate relief needs during at time of unusual economic weakness.

Rationale

The ratings on E.ON U.S. are based primarily on the credit profile of its two operating utilities in Kentucky--Louisville Gas & Electric Co. (LG&E; BBB+/Stable/--) and Kentucky Utilities Co. (KU; BBB+/Stable/A-2)--and the company's focus on operating the fully integrated utilities. Implicit support from ultimate parent Germany-based integrated power and gas utility E.ON AG (A/Stable/A-1) is factored into the ratings analysis.

E.ON U.S.'s consolidated business risk profile is viewed as 'excellent' (business risk profiles are categorized as 'excellent' to 'vulnerable') and its financial profile is considered to be aggressive (financial profiles are ranked from 'minimal' to 'highly leveraged'). The company's business risk profile is supported by relatively low-risk, regulated vertically integrated electric and natural gas distribution operations, a stable and credit supportive regulatory environment in Kentucky, efficient generation facilities that allow for competitive rates, consistently high customer satisfaction rankings, and effective cost containment. The company's electric operations benefit from a fuel and purchased power (energy only) adjustment clause, an environmental cost recovery surcharge and other timely cost recovery mechanisms, while its smaller gas operations benefit from a gas supply clause. These strengths are tempered by the lack of fuel diversity (nearly all coal-fired), a heavy construction program, and rate relief needs at a time of unusual economic weakness. Construction outlays focus on the company's 75% ownership share in the 750 MW Trimble County Unit 2 coal-fired facility, slated for completion later this year, ongoing environmental requirements and other project betterments.

On July 16, 2009, termination of the power plant lease arrangement between E.ON U.S.'s subsidiary Western Kentucky Energy Corp. and Big Rivers Electric Corp. was completed. While unwinding of the contract required a large one-time cash payment of $575 million and other concessions, it significantly reduces E.ON U.S.'s dependence on riskier unregulated activities, and enhances the company's business risk profile within the "excellent category."

Currently pending before the Kentucky Public Service Commission are rate applications for a $94.6 million (12.1%) electric rate hike and a $22.6 million (7.7%) natural gas rate increase for LG&E and a $135 million (11.5%)

electric rate hike for KU. The rate requests are predicated upon an 11.50% return on equity. Commission orders are expected this summer. Higher rates are needed to recover the utilities' investment in Trimble County, damage costs related to severe storms and higher costs. The fact that the state regulators will be reviewing rate hike requests at a time of unusual economic weakness is a credit concern. Therefore, the company's ability to manage regulatory risk will be critical to credit quality.

E.ON U.S.'s consolidated financial metrics have declined somewhat owing primarily to its heavy construction program. However, with well controlled operating and maintenance expenses, continued efficient operations, responsive regulatory treatment and credit supportive actions by management, bondholder protection parameters should strengthen to levels more commensurate with the current rating level.

Liquidity

Standard & Poor's expects consolidated capital spending at E.ON U.S. to exceed cash flow from operations primarily because of significant environmental expenditures and outlays to complete the Trimble County Unit 2 station. The steady internal cash flow generated by KU's and LG&E's regulated operations will not be enough to meet these obligations, thus creating a reliance on outside capital. Such funding is expected to be concentrated at parent E.ON AG, which will also provide support in the case of short-term liquidity needs. (A cross-default clause in E.ON's credit facility protects E.ON U.S. as long as it is a "material subsidiary".) An E.ON-related entity provides a credit facility to E.ON U.S. to ensure funding availability for its money pool.

Outlook

The stable outlook on E.ON U.S. is based on continued support from parent E.ON AG and a corporate strategy that maintains a primarily low-risk, utility-based business risk profile. The ratings and outlook on E.ON U.S. and its subsidiaries are loosely linked to those on E.ON AG. However, the significance of E.ON's U.S. operations to its group strategy remains a factor in the ratings on E.ON U.S. Any change in the parent's attitude toward its U.S. holdings or in Standard & Poor's perception of the parent's support could lead to a rating change. Ratings stability on E.ON AG reflects our expectation that it will maintain a financial profile commensurate with the ratings, especially consolidated FFO coverage of debt on an adjusted basis of more than 20%. Given the deterioration in E.ON AG's financial profile and its substantial investment program, there is no upside ratings potential. The ratings could be lowered if E.ON AG were not to maintain credit metrics commensurate with the ratings. This could, in particular, occur if the group were not to deliver on its disposal program.

Accounting

The financial statements of E.ON U.S. are provided to Standard & Poor's, conform to U.S. GAAP, and are audited by PricewaterhouseCoopers LLP. The separate financial statements of the company's interests in two Argentine gas utilities are not part of that audit, but do not represent a material part of either the company's overall financial picture or its credit profile. With U.S. business activity consisting mainly of electric utility operations and to a lesser degree natural gas distribution, most of the financials are subject to regulatory accounting under SFAS No. 71.

E.ON U.S. is a private company and does not release financial information publicly.

E.ON U.S. LLC	
Corporate Credit Rating	BBB+/Stable/--
Corporate Credit Ratings History	
04-Aug-2003	BBB+/Stable/--
12-Sep-2002	A-/Stable/--
09-Apr-2001	BBB+/Watch Pos/--
Business Risk Profile	Excellent
Financial Risk Profile	Aggressive
Related Entities	
Central Networks East PLC	
Issuer Credit Rating	A/Stable/A-1
E.ON AG	
Issuer Credit Rating	A/Stable/A-1
Commercial Paper	A-1
Senior Unsecured (52 Issues)	A
Short-Term Debt (1 Issue)	A-1
E.ON Energy Ltd.	
Issuer Credit Rating	A/Stable/A-1
E.ON International Finance B.V.	
Commercial Paper	
Local Currency	A-1
E.ON U.K. PLC	
Issuer Credit Rating	A/Stable/A-1
Senior Unsecured (1 Issue)	A
Kentucky Utilities Co.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured (3 Issues)	BBB+
Senior Unsecured (4 Issues)	BBB+/A-2
Louisville Gas & Electric Co.	
Issuer Credit Rating	BBB+/Stable/NR
Senior Unsecured (8 Issues)	BBB+
Senior Unsecured (4 Issues)	BBB+/A-2
Powergen (East Midlands) Investments	
Issuer Credit Rating	A/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.