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**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

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PUBLIC SERVICE
COMMISSION

In the Matter of:

**APPLICATION OF LOUISVILLE GAS)
AND ELECTRIC COMPANY FOR AN)
ADJUSTMENT OF ITS ELECTRIC)
AND GAS BASE RATES)**

CASE NO. 2009-00549

VOLUME 2 OF 5

**RESPONSE TO FILING REQUIREMENTS listed in 807 KAR 5:001 SECTION 10(6)(l)
through 807 KAR 5:001 SECTION 10(6)(q)**

Filed: January 29, 2010

Louisville Gas and Electric Company
Case No. 2009-00549
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1	Statutory Notice Application Financial Exhibit pursuant to 807 KAR 5:001 Section 6 Table of Contents Response to Filing Requirements listed in 807 KAR 5:001 Section 10(1)(a)1 through 807 KAR 5:001 Section 10(6)(k)
2	Response to Filing Requirements listed in 807 KAR 5:001 Section 10(6)(l) through 807 KAR 5:001 Section 10(6)(q)
3	Response to Filing Requirements listed in 807 KAR 5:001 Section 10(6)(r) through 807 KAR 5:001 Section 10(7)(e)
4	Direct Testimony and Exhibits
5	Direct Testimony and Exhibits

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Vol. No.	Tab No.	Filing Requirement	Description	Sponsoring Witness
1	1	807 KAR 5:001 Section 10(1)(a)1	<i>A statement of the reason the adjustment is required.</i>	Mr. Bellar
1	2	807 KAR 5:001 Section 10(1)(a)2	<i>A statement that the utility's annual reports, including the annual report for the most recent calendar year, are on file with the Commission in accordance with 807 KAR 5:006, Section 3(1).</i>	Mr. Bellar
1	3	807 KAR 5:001 Section 10(1)(a)3	<i>If the utility is incorporated, a certified copy of the utility's articles of incorporation and all amendments thereto or all out-of-state documents of similar import. If the utility's articles of incorporation and amendments have already been filed with the commission in a prior proceeding, the application may state this fact making reference to the style and case number of the prior proceeding.</i>	Mr. Bellar
1	4	807 KAR 5:001 Section 10(1)(a)4	<i>If the utility is a limited partnership, a certified copy of the limited partnership agreement and all amendments thereto or all out-of-state documents of similar import. If the utility's limited partnership agreement and amendments have already been filed with the commission in a prior proceeding, the application may state this fact making reference to the style and case number of the prior proceeding.</i>	Mr. Bellar
1	5	807 KAR 5:001 Section 10(1)(a)5	<i>If the utility is incorporated or a is a limited partnership, a certificate of good standing or certificate of authorization dated within sixty (60) days of the date the application is filed.</i>	Mr. Bellar
1	6	807 KAR 5:001 Section 10(1)(a)6	<i>A certified copy of a certificate of assumed name as required by KRS 365.015 or a statement that such a certificate is not necessary.</i>	Mr. Bellar
1	7	807 KAR 5:001 Section 10(1)(a)7	<i>The proposed tariff in a form which complies with 807 KAR 5:011 with an effective date not less than thirty (30) days from the date the application is filed.</i>	Mr. Bellar
1	8	807 KAR 5:001 Section 10(1)(a)8	<i>The utility's proposed tariff changes, identified in compliance with 807 KAR 5:011, shown either by: (a) Providing the present and proposed tariffs in comparative form on the same sheet side by side; or, (b) Providing a copy of the present tariff indicating proposed additions by italicized inserts or underscoring and striking over proposed deletions.</i>	Mr. Bellar
1	9	807 KAR 5:001 Section 10(1)(a)9	<i>A statement that customer notice has been given in compliance with subsections (3) and (4) of this section with a copy of the notice.</i>	Mr. Bellar

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Vol. No.	Tab No.	Filing Requirement	Description	Sponsoring Witness
1	10	807 KAR 5:001 Section 10(2)	<p><i>Notice of Intent. Utilities with gross annual revenues greater than \$1,000,000 shall file with the commission a written notice of intent to file a rate application at least four (4) weeks prior to filing their application. The notice of intent shall state whether the rate application shall be supported by a historical test period or a fully forecasted test period. This notice shall be served upon the Attorney General, Utility Intervention and Rate Division.</i></p>	Mr. Bellar
1	11	807 KAR 5:001 Section 10(3)	<p><i>Form of notice to customers. Every utility filing an application pursuant to this section shall notify all affected customers in the manner prescribed herein. The notice shall include the following information: (a) The amount of the change requested in both dollar amounts and percentage change for each customer classification to which the proposed rate change will apply; (b) The present rates and the proposed rates for each customer class to which the proposed rates would apply; (c) Electric, gas, water and sewer utilities shall include the effect upon the average bill for each customer class to which the proposed rate change will apply; (d) Local exchange companies shall include the effect upon the average bill for each customer class for the proposed rate change in basic local service; (e) A statement that the rates contained in this notice are the rates proposed by (name of utility); however, the Public Service Commission may order rates to be charged that differ from the proposed rates contained in this notice; (f) A statement that any corporation, association, or person with a substantial interest in the matter may, by written request, within thirty (30) days after publication or mailing of this notice of the proposed rate changes request to intervene; intervention may be granted beyond the thirty (30) day period for good cause shown; (g) A statement that any person who has been granted intervention by the commission may obtain copies of the rate application and any other filings made by the utility by contacting the utility through a name and address and phone number stated in this notice; (h) A statement that any person may examine the rate application and any other filings made by the utility at the main office of the utility or at the commission's office indicating the addresses and telephone numbers of both the utility and the commission; and (i) The commission may grant a utility with annual gross revenues greater than \$1,000,000, upon written request, permission to use an abbreviated form of published notice of the proposed rates provided the notice includes a coupon which may be used to obtain all of the information required herein.</i></p>	Mr. Bellar

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Vol. No.	Tab No.	Filing Requirement	Description	Sponsoring Witness
1	12	807 KAR 5:001 Section 10(4)(a)	<i>Manner of notification. Sewer utilities shall give the required typewritten notice by mail to all of their customers pursuant to KRS 278.185.</i>	Mr. Bellar
1	13	807 KAR 5:001 Section 10(4)(b)	<i>Manner of notification. Applicants with twenty (20) or fewer customers affected by the proposed general rate adjustment shall mail the required typewritten notice to each customer no later than the date the application is filed with the commission.</i>	Mr. Bellar
1	14	807 KAR 5:001 Section 10(4)(c)	<i>Manner of notification. Except for sewer utilities, applicants with more than twenty (20) customers affected by the proposed general rate adjustment shall give the required notice by one (1) of the following methods: 1. A typewritten notice mailed to all customers no later than the date the application is filed with the commission; 2. Publishing the notice in a trade publication or newsletter which is mailed to all customers no later than the date on which the application is filed with the commission; or 3. Publishing the notice once a week for three (3) consecutive weeks in a prominent manner in a newspaper of general circulation in the utility's service area, the first publication to be made within seven (7) days of the filing of the application with the commission.</i>	Mr. Bellar
1	15	807 KAR 5:001 Section 10(4)(d)	<i>Manner of notification. If the notice is published, an affidavit from the publisher verifying the notice was published, including the dates of the publication with an attached copy of the published notice, shall be filed with the commission no later than forty-five (45) days of the filed date of the application.</i>	Mr. Bellar
1	16	807 KAR 5:001 Section 10(4)(e)	<i>Manner of notification. If the notice is mailed, a written statement signed by the utility's chief officer in charge of Kentucky operations verifying the notice was mailed shall be filed with the commission no later than thirty (30) days of the filed date of the application.</i>	Mr. Bellar
1	17	807 KAR 5:001 Section 10(4)(f)	<i>Manner of notification. All utilities, in addition to the above notification, shall post a sample copy of the required notification at their place of business no later than the date on which the application is filed which shall remain posted until the commission has finally determined the utility's rates.</i>	Mr. Bellar
1	18	807 KAR 5:001 Section 10(4)(g)	<i>Manner of notification. Compliance with this subsection shall constitute compliance with 807 KAR 5:051, Section 2.</i>	Mr. Bellar
1	19	807 KAR 5:001 Section 10(5)	<i>Notice of hearing scheduled by the commission upon application by a utility for a general adjustment in rates shall be advertised by the utility by newspaper publication in the areas that will be affected in compliance with KRS 424.300</i>	Mr. Bellar

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Vol. No.	Tab No.	Filing Requirement	Description	Sponsoring Witness
1	20	807 KAR 5:001 Section 10(6)(a)	<i>A complete description and quantified explanation for all proposed adjustments, with proper support for any proposed changes in price or activity levels, and any other factors which may affect the adjustment.</i>	Mr. Rives
1	21	807 KAR 5:001 Section 10(6)(b)	<i>If the utility has gross annual revenues greater than \$1,000,000, the prepared testimony of each witness the utility proposes to use to support its application.</i>	Mr. Bellar
1	22	807 KAR 5:001 Section 10(6)(c)	<i>If the utility has gross annual revenues less than \$1,000,000, the prepared testimony of each witness the utility proposes to use to support its application or a statement that the utility does not plan to submit any prepared testimony.</i>	Mr. Rives
1	23	807 KAR 5:001 Section 10(6)(d)	<i>A statement estimating the effect that the new rates will have upon the revenues of the utility including, at minimum, the total amount of revenues resulting from the increase or decrease and the percentage of the increase or decrease.</i>	Mr. Conroy
1	24	807 KAR 5:001 Section 10(6)(e)	<i>If the utility provides electric, gas, water, or sewer service the effect upon the average bill for each customer classification to which the proposed rate change will apply.</i>	Mr. Conroy
1	25	807 KAR 5:001 Section 10(6)(f)	<i>If the utility is a local exchange company, the effect upon the average bill for each customer class for the proposed rate change in basic local service.</i>	Mr. Bellar
1	26	807 KAR 5:001 Section 10(6)(g)	<i>An analysis of customers' bills in such detail that revenues from the present and proposed rates can be readily determined for each customer class.</i>	Mr. Conroy
1	27	807 KAR 5:001 Section 10(6)(h)	<i>A summary of the utility's determination of its revenue requirements based on return on net investment rate base, return on capitalization, interest coverage, debt service coverage, or operating ratio, with supporting schedules.</i>	Mr. Rives
1	28	807 KAR 5:001 Section 10(6)(i)	<i>A reconciliation of the rate base and capital used to determine its revenue requirement.</i>	Mr. Rives
1	29	807 KAR 5:001 Section 10(6)(j)	<i>A current chart of accounts if more detailed than the Uniform System of Accounts prescribed by the commission.</i>	Ms. Charnas
1	30	807 KAR 5:001 Section 10(6)(k)	<i>The independent auditor's annual opinion report, with any written communication from the independent auditor to the utility which indicates the existence of a material weakness in the utility's internal controls.</i>	Mr. Rives
2	31	807 KAR 5:001 Section 10(6)(l)	<i>The most recent Federal Energy Regulatory Commission or Federal Communication Commission audit reports.</i>	Ms. Scott

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Vol. No.	Tab No.	Filing Requirement	Description	Sponsoring Witness
2	32	807 KAR 5:001 Section 10(6)(m)	<i>The most recent Federal Energy Regulatory Commission Form 1 (electric), Federal Energy Regulatory Commission Form 2 (gas), or Automated Reporting Management Information System Report (telephone) and Public Service Commission Form T (telephone);</i>	Ms. Scott
2	33	807 KAR 5:001 Section 10(6)(n)	<i>A summary of the utility's latest depreciation study with schedules by major plant accounts, except that telecommunications utilities that have adopted the commission's average depreciation rates shall provide a schedule that identifies the current and test period depreciation rates used by major plant accounts. If the required information has been filed in another commission case a reference to that case's number and style will be sufficient.</i>	Ms. Charnas
2	34	807 KAR 5:001 Section 10(6)(o)	<i>A list of all commercially available or in-house developed computer software, programs, and models used in the development of the schedules and work papers associated with the filing of the utility's application. This list shall include each software, program, or model; what the software, program, or model was used for; identify the supplier of each software, program, or model; a brief description of the software, program, or model; the specifications for the computer hardware and the operating system required to run the program.</i>	Ms. Scott
2	35	807 KAR 5:001 Section 10(6)(p)	<i>Prospectuses of the most recent stock or bond offerings.</i>	Mr. Rives
2	36	807 KAR 5:001 Section 10(6)(q)	<i>Annual report to shareholders, or members, and statistical supplements covering the two (2) most recent years from the utility's application filing date.</i>	Mr. Rives
3	37	807 KAR 5:001 Section 10(6)(r)	<i>The monthly managerial reports providing financial results of operations for the twelve (12) months in the test period.</i>	Ms. Scott
3	38	807 KAR 5:001 Section 10(6)(s)	<i>Securities and Exchange Commission's annual report for the most recent two (2) years, Form 10-Ks and any Form 8-Ks issued within the past two (2) years, and Form 10-Qs issued during the past six (6) quarters updated as current information becomes available.</i>	Mr. Rives

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3	39	807 KAR 5:001 Section 10(6)(t)	<i>If the utility had any amounts charged or allocated to it by an affiliate or general or home office or paid any monies to an affiliate or general or home office during the test period or during the previous three (3) calendar years, the utility shall file: 1. A detailed description of the method and amounts allocated or charged to the utility by the affiliate or general or home office for each charge allocation or payment; 2. An explanation of how the allocator for the test period was determined; and 3. All facts relied upon, including other regulatory approval, to demonstrate that each amount charged, allocated or paid during the test period was reasonable;</i>	Ms. Scott
3	40	807 KAR 5:001 Section 10(6)(u)	<i>If the utility provides gas, electric or water utility service and has annual gross revenues greater than \$5,000,000, a cost of service study based on a methodology generally accepted within the industry and based on current and reliable data from a single time period.</i>	Mr. Seelye
3	41	807 KAR 5:001 Section 10(6)(v)	<i>Local exchange carriers with fewer than 50,000 access lines shall not be required to file cost of service studies, except as specifically directed by the commission. Local exchange carriers with more than 50,000 access lines shall file: 1. A jurisdictional separations study consistent with Part 36 of the Federal Communications Commission's rules and regulations; and 2. Service specific cost studies to support the pricing of all services that generate annual revenue greater than \$1,000,000, except local exchange access: a. Based on current and reliable data from a single time period; and b. Using generally recognized fully allocated, embedded, or incremental cost principles.</i>	Mr. Bellar
3	42	807 KAR 5:001 Section 10(7)(a)	<i>Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application: (a) A detailed income statement and balance sheet reflecting the impact of all proposed adjustments;</i>	Ms. Scott

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3	43	807 KAR 5:001 Section 10(7)(b)	<i>Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application: (b) The most recent capital construction budget containing at least the period of time as proposed for any pro forma adjustment for plant additions.</i>	Ms. Charnas
3	44	807 KAR 5:001 Section 10(7)(c)	<i>Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application: (c) For each proposed pro forma adjustment reflecting plant additions provide the following information: 1. The starting date of the construction of each major component of plant; 2. The proposed in-service date; 3. The total estimated cost of construction at completion; 4. The amount contained in construction work in progress at the end of the test period; 5. A schedule containing a complete description of actual plant retirements and anticipated plant retirements related to the pro forma plant additions including the actual or anticipated date of retirement; 6. The original cost, cost of removal and salvage for each component of plant to be retired during the period of the proposed pro forma adjustment for plant additions; 7. An explanation of any differences in the amounts contained in the capital construction budget and the amounts of capital construction cost contained in the pro forma adjustment period; and 8. The impact on depreciation expense of all proposed pro forma adjustments for plant additions and retirements;</i>	Ms. Charnas
3	45	807 KAR 5:001 Section 10(7)(d)	<i>Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application: (d) The operating budget for each period encompassing the pro forma adjustments.</i>	Ms. Scott

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3	46	807 KAR 5:001 Section 10(7)(e)	<p><i>Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application: (e) The number of customers to be added to the test period-end level of customers and the related revenue requirements impact for all pro forma adjustments with complete details and supporting work papers.</i></p>	Mr. Seelye

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**Filing Requirement
807 KAR 5:001 Section 10(6)(I)
Sponsoring Witness: Valerie L. Scott**

Description of Filing Requirement:

The most recent Federal Energy Regulatory Commission or Federal Communication Commission audit reports.

Response:

The most recent Federal Energy Regulatory Commission audit report relating to LG&E's electric business is attached. The Federal Energy Regulatory Commission does not audit LG&E's natural gas business and therefore no such audit reports exist. The Federal Communication Commission does not audit LG&E and, therefore, no such audit reports exist.

FERC Audit Report – July 17, 2006

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. PA05-9-000
July 17, 2006

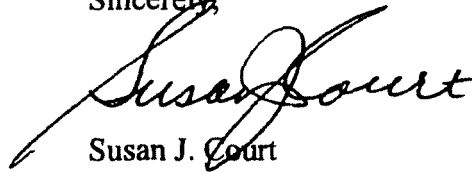
Michael S. Beer
Vice President, Federal Regulation and Policy
LG&E Energy Services, Inc.
220 West Main Street
Louisville, KY 40202

Dear Mr. Beer:

1. The Division of Audits within the Office of Enforcement (OE) has completed the audit of LG&E Energy LLC (LG&E) for the period from January 1, 2003 to December 31, 2005. The enclosed audit report explains our audit findings and recommendations.
2. On June 29, 2006, you notified us that LG&E agreed with our audit findings and recommendations. I hereby approve and direct the recommended corrective actions. A copy of your response is included as an Appendix to this audit report.
3. LG&E should file an implementation plan within 30 days of the date of this letter order and submit quarterly filings describing LG&E's progress completing each corrective action, including dates it has completed each corrective action. The filings should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.
4. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.314 (2006). This letter order constitutes final agency action. Your Company may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713 (2006).
5. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention.

6. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Bryan K. Craig, Director, Division of Audits at (202) 502-8741.

Sincerely,

A handwritten signature in black ink that reads "Susan J. Court". The signature is written in a cursive style with a long, sweeping underline that extends to the left.

Susan J. Court
Director
Office of Enforcement

Enclosure

FEDERAL ENERGY REGULATORY COMMISSION

Audit Period: January 1, 2003 through December 31, 2005

Audit of Code of Conduct, Standards of Conduct, Market-Based Rate Tariff, and MISO's Open Access Transmission Tariff at LG&E Energy LLC



Audit Report

**OFFICE OF ENFORCEMENT
DIVISION OF AUDITS**

Docket No. PA05-9-000

Date: July 17, 2006

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I. EXECUTIVE SUMMARY

A. Overview

The Office of Enforcement (OE)¹ has completed an audit of the operations of LG&E Energy LLC (LG&E).² For purposes of the audit, the relevant parts of LG&E's corporate structure included:

- The two utilities (Louisville Gas & Electric Company and Kentucky Utilities Company), each of which operates a system control center,
- LG&E's service company (LG&E Energy Services, Inc.), and
- LG&E's Marketing and Energy Affiliates, including LG&E's wholesale merchant function (WMF) and its affiliated power marketers³; LG&E's principal affiliated power marketer during the audit period was LG&E Energy Marketing, Inc. (LEM).

The audit covered the period from January 1, 2003 through December 31, 2005, and focused on LG&E's compliance with:

- LG&E's Code of Conduct, which requires the physical, operational, and functional separation of LG&E's WMF and its affiliated power marketers,
- The Commission's Standards of Conduct under Order No. 2004 and 18 C.F.R. Part 358 (2005), which requires the transmission function to operate independently from LG&E's energy marketing operations,
- LG&E's market-based rate tariff, and

¹ On April 16, 2006, the Office of Market Oversight and Investigations changed its name to the Office of Enforcement.

² On December 1, 2005, LG&E Energy LLC announced it changed its name to E.ON US.

³ *LG&E Power Mktg., Inc.*, 68 FERC ¶ 61,247 (1994); *modified on other grounds*, 69 FERC ¶ 61,153 (1994). LG&E Power Mktg.'s name was changed to LG&E Energy Marketing Inc. (LEM). See Notice of Name Change, Docket No. ER97-3418-000 (filed June 24, 1997).

- Midwest ISO (MISO) Open Access Transmission Tariff (OATT) §28.6 Restrictions on Use of Service; §30.1 Designation of Network Resources; §30.4 Operation of Network Resources; and §30.7 Limitation on Designation of Network Resources.

B. Summary of Compliance Findings

Our audit findings are based on materials provided by LG&E in response to data requests, interviews with LG&E staff members, site visits, and a review of publicly available documents. LG&E has been very cooperative throughout the audit.

Based on our examination of the Code of Conduct, Standards of Conduct, Market-Based Rate Tariff, and MISO's OATT at LG&E, we identified nine areas of non-compliance.

Code of Conduct Compliance

- *Functional, Physical, and Operational Separation of LG&E's WMF and Affiliated Power Marketer:* LG&E's WMF and its principal affiliated power marketer (LEM) were not functionally, physically, and operationally separate to the maximum extent practical, as required by LG&E's Code of Conduct. Both WMF and LEM functionally reported to the same company officer and LEM shared physical facilities with WMF traders and with mid-office and back-office functions for the WMF. WMF and LEM operationally shared a telephone recording system to capture trading and dispatch conversations.
- *Sharing of Market Information:* LG&E's WMF shared market information with its principal affiliated power marketer (LEM) through presentations at joint staff meetings, in violation of LG&E's Code of Conduct. Also, the password access controls to the shared Energy Management System (EMS) were inconsistent with LG&E's password security policy.
- *Posting of Information on Sales to Affiliates at Market-Based Rates:* LG&E was required to post on an electronic bulletin board (EBB) information on energy sales at market-based rates from its WMF to its affiliated power marketer (LEM). LG&E's Code of Conduct required the price of such sales to be no lower than the rate charged to non-affiliates, and required simultaneous postings on an EBB of WMF's offers to sell to LEM and WMF's actual sales to LEM. Our review of LG&E's archived EBB postings disclosed that LG&E's EBB was not accessible to non-affiliated market participants for a period of time, and the information that LG&E posted on the EBB was not consistent with the requirements in LG&E's Code of Conduct.

Standards of Conduct Compliance

- *Disclosures of Transmission and Customer Information:* LG&E transmission employees improperly disclosed non-public transmission and customer information to employees of its WMF that was not contemporaneously available to the public, and failed to post in a timely manner the information disclosure on OASIS: (1) on at least three occasions, LG&E transmission employees disclosed real-time transmission system status information to LG&E Energy and Marketing affiliate employees during telephone calls concerning generation re-dispatch; (2) on at least one occasion, LG&E made transmission expansion planning information available to marketing employees; and (3) on a monthly basis through February 2005, a transmission employee sent e-mails to a marketing employee containing load data of third-party customers.
- *Standards of Conduct Training:* The scope of LG&E's Standards of Conduct training program was inconsistent with Commission regulations and with LG&E's training implementation plans. More than one year after the effective date of Order No. 2004, LG&E had failed to provide Standards of Conduct training for several hundred of the employees LG&E was required to train.
- *Controls Used to Limit Access to System Control Centers:* LG&E did not follow its posted implementation procedures to control and track access by the employees of its Marketing and Energy Affiliates to LG&E's two system control centers, including the requirement that LG&E marketing employees obtain permission from the Chief Compliance Officer (CCO) before visiting the system control centers.
- *Organizational Charts:* The organizational chart postings failed to include or accurately show: detailed organizational charts for business units engaged in the sales function; the position of LG&E's Marketing and Energy Affiliates within the corporate structure; and all of the business units that are part of LG&E's service company.
- *Shared Facilities:* LG&E did not post a list of the facilities shared by the Transmission Provider and LG&E's Marketing and Energy Affiliates as required by 18 C.F.R. § 358.4(b)(2) (2005).

Market-Based Rate Tariff Compliance

- *Electric Quarterly Report Inaccuracies:* LG&E's Electric Quarterly Report (EQR) filing for the first quarter of 2005 contained inaccurate information. LG&E inaccurately reported several sales transactions from its WMF to its affiliated power marketer (LEM) and reported invalid Data Universal Numbering System (DUNS) numbers for several other customers.

C. Summary of Recommendations

Detailed recommendations are included in Sections III, IV, and V of this Audit Report that describe the compliance findings. Following is a brief summary of those recommendations. We recommend that LG&E:

- Implement its planned actions to ensure that WMF and LEM employees are functionally, physically, and operationally separate to the maximum extent practical.
- Create and implement policies and procedures to ensure that there is no exchange of market information inconsistent with LG&E's Code of Conduct, and to conduct an independent review after implementation of a new EMS system to ensure that market information (and transmission information) is not accessible to employees who should not have access to such information.
- Develop written policies and procedures regarding the use of its EBB, and develop a plan for making the EBB more accessible to non-affiliated market participants.
- Post OASIS notices for all identified disclosures of non-public transmission information. Specific recommendations include creating controls to prevent disclosure of non-public transmission and customer information as part of transmission operations, during meetings attended by transmission and marketing employees, and through e-mail exchanges of information.
- Strengthen the implementation of its training program, specifically, to develop written policies and procedures to ensure that new employees receive training, and conduct periodic reviews to ensure that all of the employees that require training are scheduled for, receive training, and are certified.
- Review and strengthen its system control center access procedures to ensure that LG&E marketing employees do not have access that differs in any way from the access available to other transmission customers.
- Revise its posted organizational charts to show the business units engaged in sales functions, the position of all Marketing and Energy Affiliates within its corporate structure, and sufficient detail to indicate that LG&E's service company is the employment mechanism for the Marketing and Energy Affiliates and the Transmission Provider.
- Revise its shared facilities postings to identify all facilities that LG&E's Marketing and Energy Affiliates share with service employees who have access to non-public transmission or customer information.

- Strengthen its written procedures to ensure that EQR filings are in compliance with Commission regulations, and to refile inaccurate EQR data identified in this Audit Report.

D. Actions Already Taken by LG&E

LG&E has already taken a number of corrective actions in response to our compliance findings to come into compliance with the Standards of Conduct and LG&E's Code of Conduct. These actions are enumerated in detail in Sections III, IV, and V of this Audit Report that describe the compliance findings.

As part of the audit scope, audit staff examined LG&E's use of network integration transmission service (NITS) for the audit period prior to April 1, 2005, the beginning of the MISO Day 2 market. After working with audit staff to perform the review of LG&E's use of NITS, LG&E committed to enhancing its "Before the Purchase System" (BPS) by creating detailed control processes to ensure its compliance with the OATT and the proper use of NITS. LG&E's BPS is a software product that determines when a bi-lateral power purchase can be reasonably expected to serve native load and can be imported using network integration transmission service. LG&E's BPS system provides traders a systematic process for determining if a purchase should be imported using NITS before purchases are made and scheduled. The BPS helps ensure LG&E's compliance with the Commission's approved uses for NITS.

E. Implementation Plan

We recommended that LG&E submit an implementation plan to the audit staff for our approval detailing LG&E's plans to comply fully with the findings and recommendations in this Audit Report. The implementation plan should describe the actions LG&E has already taken, and will take, that are consistent with and complementary to any future structural and organizational changes that LG&E may undertake.

The implementation plan should be submitted within 30 days of issuance of a Final Audit Report in this docket. In addition, LG&E shall make quarterly filings updating the audit staff of its progress on implementing the plan. The filings shall be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

II. INTRODUCTION

A. Objectives

The overall audit objectives were to determine compliance with:

- LG&E's Code of Conduct, which requires the physical, operational, and functional separation of the utilities' WMF and its affiliated power marketers.
- The Commission's Standards of Conduct under Order No. 2004 (and prior to September 22, 2004, under Order No. 889⁴), which requires a Transmission Provider's employees engaged in transmission system operations to function independently from employees of its Marketing and Energy Affiliates.⁵ Standards of Conduct compliance was also evaluated against LG&E's own implementation procedures.⁶

⁴ *Open-Access Same-Time Information System (formerly Real-Time Information Networks) and Standards of Conduct*, Order No. 889, 61 FR 21737 (May 10, 1996), FERC Stats. & Regs., Regulations Preambles ¶ 31,035 (Apr. 24, 1996); *order on reh'g*, Order No. 889-A FR 12484 (March 14, 1997), FERC Stats. & Regs., Regulations Preambles ¶ 31,049 (March 4, 1997).

⁵ *Standards of Conduct for Transmission Providers*, Order No. 2004, 68 FR 69134 (Dec. 11, 2003), FERC Stats. & Regs., Regulations Preambles ¶ 31,155 (Nov. 25, 2003), *order on reh'g*, Order No. 2004-A, 69 FR 23562 (Apr. 29, 2004), FERC Stats. & Regs., Regulations Preambles ¶ 31,161 (April 16, 2004), *order on reh'g*, Order No. 2004-B, 69 FR 48371 (Aug. 10, 2004), FERC Stats. & Regs., Regulations Preambles ¶ 31,166 (Aug. 2, 2004), *order on reh'g*, Order No. 2004-C, 70 FR 284 (Jan. 4, 2005), FERC Stats. & Regs., Regulations Preambles ¶ 31,172 (Dec. 21, 2004), *order on reh'g*, Order No. 2004-D, 110 FERC ¶ 61,320 (2005), *appeal pending*, (D.C. Circuit Docket Nos. 04-1178, et al.)

⁶ "Joint Written Procedures Implementing Standards of Conduct for Transmission Providers as Adopted by the Federal Energy Regulatory Commission in Order No. 2004, Effective September 22, 2004" (hereinafter referred to as LG&E's posted implementation procedures). We found this document on April 5, 2005, posted on http://lgeenergy.com/regulatory/lgeku_compliance_procedures.pdf.

- LG&E's market-based rate tariff.⁷
- The provisions of the MISO OATT.⁸

For purposes of evaluating compliance with the Standards of Conduct, this audit focuses primarily on the period from September 22, 2004, the effective date of Order No. 2004, to December 31, 2005. For purposes of evaluating compliance with Code of Conduct, market-based rate tariff and MISO's OATT requirements, this audit focuses primarily on the period from January 1, 2003 to December 31, 2005.

B. Scope and Methodology

The OE has completed an audit of the operations of LG&E. As part of the audit, OE conducted selective tests on data to determine LG&E's compliance with the Standards of Conduct, Code of Conduct, market-based rate tariff, and MISO's OATT requirements. Selective tests included those necessary to verify the accuracy of required informational postings on LG&E's OASIS, the effectiveness of written procedures and internal controls related to the Standards of Conduct, and compliance with all the provisions of the Standards of Conduct, LG&E's Code of Conduct, LG&E's market-based rate tariff, and the MISO OATT.

Additionally, we reviewed physical and electronic security over transmission operations and information. We discussed with LG&E personnel matters related to the corporate structure, Energy and Marketing Affiliates, local and wide area networks, shared functions, and the Standards of Conduct training received. We reviewed e-mail records and recorded conversations between LG&E's transmission operations and its Energy and Marketing Affiliates.

⁷ *Louisville Gas & Elec. Co.*, 85 FERC ¶ 61,125 (1998) (accepting for filing joint market-based rate tariff of LG&E and KU, FERC Electric Tariff, Original Volume No. 2); *LG&E Operating Cos.* Docket No. ER99-1623-000. Letter Order, Jun. 4, 1999 (accepting revised tariff sheets to Original Volume No. 2 permitting limited sales to certain affiliates); *Louisville Gas & Elec. Co.*, Letter Order, Docket No. ER02-1077-000, Apr. 16, 2002 (accepting "short form" market-based rate tariff as Original Volume No.3).

⁸ *Midwest Independent Transmission System Operator, Inc., et al.*, 84 FERC ¶ 61,231 (1998); *order on reconsideration*, 85 FERC ¶ 61,250 (1998); *order on reh'g*, 85 FERC ¶ 61,372 (1998); *order on compliance filing*, 87 FERC ¶ 61,085 (1999).

III. CODE OF CONDUCT FINDINGS AND RECOMMENDATIONS

1. **Functional, Physical and Operational Separation of LG&E's WMF and Affiliated Power Marketer**

LG&E's WMF and its principal affiliated power marketer (LEM) were not functionally, physically and operationally separate to the maximum extent practical, as required by LG&E's Code of Conduct. The WMF and LEM were functionally within the same LG&E business unit, and reported to the same company officer; the WMF and LEM shared physical facilities without strong controls to prevent information sharing; and the WMF and LEM shared a telephone recording system that provided LEM employees access to operational information such as WMF trading activities.

Pertinent Guidance

Section 3 of LG&E's Code of Conduct states that "(t)o the maximum extent practical, employees of the Utilities [*i.e.*, LG&E's WMF] who operate the Utilities' systems or engage in power purchasing or selling on behalf of the Utilities will be physically, operationally, and functionally separate from employees of the Marketers performing power marketing activities."⁹

Discussion

Collectively, the lack of functional, physical, and operational separation between WMF and LEM precluded LG&E from operating these entities as separate business units to the maximum extent practical as required in Section 3 of LG&E's Code of Conduct.

Functional Separation Between WMF and LEM

LG&E's WMF and its primary affiliated power marketer (LEM) were not functionally separate to the maximum extent practical since they functionally reported to the same company officer, *i.e.*, the Senior Vice President (SVP) of Energy Marketing. The employees of the two trading operations attended periodic meetings together, convened by the SVP of Energy Marketing. As described in the compliance finding "Sharing of Market Information" which follows next in this Audit Report, general market

⁹ *LG&E Power Mktg., Inc.*, 68 FERC ¶ 61,247 (1994); *modified on other grounds*, 69 FERC ¶ 61,153 (1994). LG&E Power Mktg.'s name was changed to LG&E Energy Marketing Inc. (LEM). *See* Notice of Name Change, Docket No. ER97-3418-000 (filed June 24, 1997).

information, as well as specific market information about WMF and LEM trading operations was discussed at these meetings.

According to the job description of the SVP Energy Marketing, the occupant of the position was responsible for establishing the strategic direction and management of the energy marketing, fuel procurement and trading activities for the WMF and also directs the optimization of the corporation's energy-related integrated gross margin. This job description indicates that the SVP Energy Marketing is expected to coordinate WMF and LEM activities to provide a greater return for the LG&E corporate family. This lack of functional separation between WMF and LEM was inconsistent with LG&E's Code of Conduct.

Physical Separation Between WMF and LEM

LG&E lacked sufficient physical barriers to ensure that the WMF's non-public market information was not shared with LEM. WMF operations and LEM operations were both located on the seventh floor of LG&E's headquarters building. Sharing a floor is not a violation of the Code of Conduct, as long as there are sufficient controls to ensure the physical separation of employees and operations. The physical space occupied by WMF operations were secured by a card key access system. However, LEM's operations were not secured by a card key access system, and the workspace of LEM employees (with the exception of the Director of LEM) was arranged in open carrels. WMF employees passed by LEM's workspace on their way to and from a conference room shared by the two trading operations, and the employees shared common facilities such as kitchen and restrooms. WMF and LEM employees frequently held discussions on the LEM trading floor, but LG&E asserted and the employees we interviewed confirmed that the information exchanged between WMF and LEM traders was not prohibited information—it was limited to public information regarding the market and market information about LEM.

The seventh floor also contained LG&E's risk management and energy accounting functions, both of which have access to WMF information. The risk management and energy accounting offices were not protected, e.g., through card key access, against entry by LEM personnel.

Operational Separation with Respect to Recorded Phone Calls

LG&E recorded phone calls of its traders and dispatchers for both the WMF and LEM functions on two RACAL digital tape recorder machines. Each machine recorded calls made by employees of both organizations on digital tapes. Each digital tape contained approximately 60,000 to 75,000 calls or about 21-28 days worth of recorded calls containing conversations made by both WMF employees and LEM employees.

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Each call was identified by date, time, and channel number which corresponded to a person or workstation. A recorded call varied in length from a few seconds to several minutes.

The two RACAL recorder machines and tapes were located on the seventh floor of LG&E's headquarters building in a locked room with access controlled by a LEM administrative employee. The LEM administrative employee provided access to specific tapes when WMF or LEM employees requested access to the tapes. The LEM administrative employee initially set up the machine to a channel, date and time, then instructed the WMF and LEM employees how to operate the machine to find other calls. The listening process involved searching and listening to the tape on a trial and error basis until the call was identified. The LEM administrative person did not remain in the room at all times while the WMF or LEM employees listened to the tapes, and these employees had the opportunity to access the entire contents of a tape containing both WMF and LEM recordings.

Recommendations

We recommend that LG&E:

1. Take all appropriate actions necessary to ensure that WMF employees and LEM employees are functionally and physically separate to the maximum extent practical, as required under LG&E's Code of Conduct.
2. Implement procedures to ensure that authorized access to the tape recordings are properly documented.
3. Implement procedures to separate tape recordings for WMF and LEM channels.
4. Implement controls to provide access to only one tape recording machine when WMF or LEM personnel are authorized to listen to tapes and implement controls to prevent unauthorized access to channels of historical tapes which contain recorded conversations of both WMF and LEM channels.
5. LG&E shall submit all procedures and controls to OE for approval within 30 days of issuance of a Final Audit Report in this docket.

Actions Already Taken by LG&E

After we discussed our concerns with the lack of physical separation between LEM and WMF, LEM physically moved from the seventh floor to the fourth floor of the LG&E building and LEM employees no longer have access to the seventh floor as of March 31, 2006.

LG&E also began maintaining a written log of all access to tapes and revamped its recording system so that now WMF and LEM employee conversations are recorded on separate tapes and machines. We verified that this change had been made during our site visit in October 2005. However, LG&E must still implement access controls to the tapes when WMF or LEM employees listen to tapes containing recorded conversations of both WMF and LEM channels. Also, LG&E must implement physical access controls to the recording machines if WMF or LEM employees are provided access to the secure room to listen to tapes.

The corrective actions do not solve the functional separation problem between WMF and LEM. LG&E will submit a plan to functionally separate WMF and LEM.

2. Sharing of Market Information

LG&E's WMF shared market information with LEM through presentations at joint staff meetings, in violation of LG&E's Code of Conduct. Also, password access controls to the shared Energy Management System (EMS) were insufficient and inconsistent with LG&E's password security policy.

Pertinent Guidance

Section 4 of LG&E's Code of Conduct states that "(n)o employee of the Utilities will share market information with any employee of the Marketers unless all such information is simultaneously made available to the public. The policy will not apply to market information known to be publicly available, or to market information disclosed to employees of the Marketers or the Utilities who are engaged in support functions, including human resources, information resources, data processing, finance, legal, accounting and other support personnel who do not participate in directing, organizing and executing the day-to-day business decisions of the wholesale merchant or generation functions of the Utilities or the Marketers, *provided* that such employees are prohibited from acting as conduits to pass market information obtained from the Utilities to the Marketers."¹⁰ (emphasis in original.)

LG&E's password security policy requires a password for each employee accessing LG&E's Local Area Networks (LAN) and Wide Area Networks (WAN).

Discussion

Joint Staff Meetings Between WMF and LEM

LG&E's WMF shared non-public market information with LEM through presentations at joint staff meetings, in violation of LG&E's Code of Conduct. The monthly trading meetings normally took place during the last week of each calendar month. In addition to the SVP of Energy Marketing, the managers of WMF and LEM attended, as well as staff from WMF and LEM, plus staff from the Market Analysis, Trading Controls, Operations Analysis and Fuels Management sections.

During the months of August, 2004 through May, 2005, the agendas of the Trading Meetings remained unchanged. The first item on the agenda was a presentation by the Manager of the WMF on the results of Regulated Off-System Sales (OSS) for the month, and how the results compared with the amount budgeted for that item. This

¹⁰ *Id.*

information included reforecast graphs for the calendar year-to-date, the results for the current month-to-date, the factors leading to the results (including such items as purchase power costs and transmission expenses), and a review of the profit-at-risk graph. Following this presentation by the WMF, LEM presented a report on its sales operations for the previous month and its forecasts and plans for the future.¹¹ Following LEM's presentation, the SVP of Energy Marketing dismissed the LEM employees from the meeting after which the WMF made additional reports about its operations and forecasts.

LG&E's Code of Conduct states that no employee of the WMF will share market information with any affiliated power marketer employee unless all such information is simultaneously made available to the public. Based on review of the agendas, and interviews with WMF personnel, we concluded that the WMF Off-System Sales' information presented at the beginning of the monthly meetings by the Manager of the WMF was WMF market information. This information was disclosed to LEM personnel present at the beginning of these meetings, a violation of LG&E's Code of Conduct.

Password Access to EMS Information

LG&E's WMF and LEM both use a shared EMS, partitioned into WMF generation data, LEM generation data, and LG&E transmission data. Password access controls to the shared EMS were insufficient and inconsistent with LG&E's password security policy. Prior to February 2004, LG&E permitted WMF and LEM users to access the EMS using separate group accounts and passwords, rather than using unique user accounts and passwords. The failure to require unique password access was contrary to LG&E's password security policy and increased the risk of inappropriate information access via the EMS. Specifically, group passwords are easier to disseminate and it is not possible to track the identity of individuals that use a group account to ensure that only those with appropriate clearance have accessed the EMS. Because WMF employees and LEM employees used group accounts and passwords, it was not possible to track individual access to specific account information.

¹¹ The information related to Western Kentucky Electric (WKE), LEM's sole remaining customer. In past years the information also related to LEM's contract with Oglethorpe Power Corporation (OPC).

Recommendations

We recommend that LG&E:

6. Create controls consistent with LG&E's Code of Conduct to ensure that there is no exchange of market information stemming from joint trading meetings for WMF and affiliated power marketing personnel.
7. Conduct an independent review by the internal audit department or an outside auditing firm when the new EMS is implemented in 2006 to ensure that there is no improper or unauthorized EMS screen access.
8. LG&E shall submit all controls to OE for approval within 30 days of issuance of a Final Audit Report in this docket. Also, LG&E shall submit the results of the independent review of the EMS to OE within 30 days after implementing its new EMS or issuance of a Final Audit Report in this docket, whichever is later.

Actions Already Taken by LG&E

After we discussed our concerns with LG&E about joint trading meetings between WMF and LEM, LG&E changed the agenda of the monthly trading meetings starting in June 2005. The agenda was altered so that the presentation about WMF's OSS is not made until later in the meeting, after LEM employees have left the meeting. In addition, beginning in December 2005, LG&E adopted certain process changes, including the requirement that the CCO or his designee attend all joint WMF and LEM meetings, and maintain a high-level agenda and/or minutes of each meeting.

LG&E implemented unique user accounts and passwords for its current GE/Harris EMS in February 2004. LG&E is currently developing, installing and testing a new EMS that should be operational in 2006.

3. Posting of Information on Sales to Affiliates at Market-Based Rates

LG&E's EBB was inaccessible to non-affiliated market participants, and the information on the EBB was not consistent with Commission requirements. The EBB would have been difficult for non-affiliate market participants to find, given that for some period of time it was located on a website of an LG&E affiliate that was not a party to affiliate sales. In addition, for some period of time it may not have been accessible over the internet. Moreover, the information and timing on offers to sell and actual sales to affiliates were not consistent with the specific requirements in LG&E's Code of Conduct.

Pertinent Guidance

On January 29, 1999, LG&E petitioned the Commission for blanket authority to authorize the Utilities, *i.e.*, LG&E's WMF, to sell energy at market-based rates to their power marketing affiliates. Acknowledging the Commission's concern about protecting captive ratepayers from subsidizing affiliate marketing operations, LG&E committed to adopt the safeguards the Commission approved in Detroit Edison Company.¹²

To implement these safeguards, LG&E amended its Code of Conduct to add the following requirements: "The Utilities will sell power to the Marketers at a rate that is no lower than the rate the Utilities charge to nonaffiliates; simultaneously with making an offer to sell power to the Marketers, the Utilities will make the same offer to nonaffiliates through a posting on their electronic bulletin board ("EBB"); and simultaneously with the striking of a power sales transaction with the Marketers, the Utilities will post the actual price paid on their EBB."¹³

Discussion

Accessibility of EBB Information to Market Participants

We sought to create a timeline for LG&E's EBB. LG&E's WMF made energy sales at market-based rates to LEM from 1999 through the Spring of 2005, but we could not confirm that the information posted on such sales was accessible to market participants. Based on the documentation provided to us by LG&E:

- From 1999 through December 2003, the sales information was posted on an EBB website for LG&E Power, one of LG&E's affiliated power marketers.

¹² 80 FERC ¶ 61,348 (1997).

¹³ Docket No. ER99-1623-000, Compliance Filing of Louisville Gas and Electric Company and Kentucky Utilities Company, filed March 4, 1999, at 2.

- In December 2003, the EBB containing the sales information migrated from the LG&E Power website to the LG&E Energy website.
- In April 2005, LG&E provided us the website address for the EBB, <http://apps.lgeenergy.com/fercgen/gensales.asp>. When we tried to access the EBB at this address, the page would not display. We subsequently asked LG&E how to access the EBB. On May 4, 2005, the internet address on LG&E Energy's website worked. We asked LG&E when this link to the EBB was made operational; LG&E informed us that it was made operational on May 1, 2005.

LG&E stated that other than LG&E's filing made in 1999 revising its Code of Conduct to post affiliate transactions on an EBB, it could not recall any occasions where it publicized the existence of the EBB. LG&E, however, could not recall a single instance when a market participant had inquired about any posting on the EBB.

Posted Offers to Sell on the EBB

LG&E's Code of Conduct required LG&E to make a simultaneous offer on the EBB to sell to non-affiliates the same product it was offering to sell to its affiliate. We concluded that the posting of offers to sell on the EBB were not consistent with the requirements of LG&E's Code of Conduct.

We reviewed archived EBB data for the audit period. Typically, each month on the first of the month, LG&E's WMF would post on the EBB an offer to sell a block of energy on an hourly basis. This monthly posting was at an asking price of \$12/MWh for virtually every month that a monthly offer was posted. LG&E stated that the asking price was set at \$12/MWh in order to induce counterparties to enter negotiations to purchase from LG&E's WMF.

We reviewed LG&E's variable costs on a generator-by-generator basis. Although prices of coal and other inputs changed over the course of the period that LG&E posted offers on the EBB, we concluded that had LG&E sold energy at \$12/MWh during any hour during which it posted an asking price of \$12/MWh, it would have been selling energy at a price less than its incremental cost. Moreover, our review of the EBB shows that WMF never sold energy to LEM at a price of \$12/MWh or less. LG&E's strategy of posting an asking price of \$12/MWh did not satisfy the Code of Conduct requirements to simultaneously offer hourly energy to non-affiliated market participants at the same price that it would offer such energy to its affiliate.

Prices of Affiliate Sales

We evaluated whether the prices at which WMF sold energy to LEM were consistent with the requirements of LG&E's Code of Conduct, *i.e.*, at a rate that is no lower than the rate that WMF sold to non-affiliated buyers. LG&E had no written procedures or other controls for its WMF traders to follow to determine an appropriate market price at which the WMF would sell to LEM. LG&E's WMF traders established the market price through telephone queries and broker quotes prior to negotiating a next-hour energy sale to LEM. We listened to recorded phone calls during hours in which WMF traders sold energy to LEM. We found no evidence that WMF traders sold energy to LEM at prices less than the market price in accordance with LG&E's Code of Conduct. However, when we reviewed the recorded phone calls, we found that WMF traders did not generally employ strong controls to establish the market price.

EBB Postings in 2001

We had specific concerns whether LG&E was properly using the EBB to post offers and sales from WMF to LEM to support a long-term sales obligation LEM had with Morgan Stanley, specifically affiliate sales in 2001. Based on the data provided to us by LG&E, we found the following EBB posting errors:

- WMF sold to LEM 50 MWh of energy during each off-peak hour during the month of May 2001 without posting offers or transactions on the EBB. We estimated these energy sales in May 2001 to total nearly 20,000 MWh, and to have generated revenues of approximately \$500,000.
- LG&E failed to post on the EBB offers or transactions when WMF sold energy to LEM to support LEM's sales to Morgan Stanley for an additional 10 days during calendar year 2001.

Recommendations

We recommend that LG&E:

9. Develop written procedures regarding the use of its EBB. Specifically, the written procedures should address how LG&E will ensure that the price at which it sells energy to its affiliate is no lower than the price at which it sells to non-affiliates, and how LG&E will post offers and sales on the EBB to make the information available to other market participants to demonstrate that its affiliate sales are at non-preferential prices.

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10. Develop a plan to ensure that the EBB is fully accessible, and that market participants know where to find the EBB on the LG&E website.
11. LG&E shall submit all procedures and plans to OE for approval within 30 days of issuance of a Final Audit Report in this docket.

Actions Already Taken by LG&E

We had numerous discussions with LG&E about the accessibility and effectiveness of its EBB postings. As of January 2006, LG&E had a link from its corporate website to the EBB. In addition, LG&E presented us plans for making the information posted on the EBB consistent with LG&E's Code of Conduct. LG&E has agreed to finalize these plans and to develop written procedures to guide trading staff on the use of the EBB within 30 days of the issuance of a Final Audit Report in this docket.

IV. STANDARDS OF CONDUCT FINDINGS AND RECOMMENDATIONS

4. Disclosures of Transmission and Customer Information

LG&E transmission employees improperly disclosed transmission and customer information to employees of its WMF that was not contemporaneously available to the public, and failed to post the information disclosure on OASIS.

Pertinent Guidance¹⁴

A Transmission Provider must ensure that any employee of the Marketing or Energy Affiliate is prohibited from obtaining information about the Transmission Provider's transmission system through access to information not posted on the OASIS or Internet website or that is not otherwise also available to the general public without restriction.¹⁵

An employee of the Transmission Provider may not disclose to its Marketing or Energy Affiliates any information concerning the transmission system of the Transmission Provider or the transmission system of another through non-public communications conducted off the OASIS or Internet website, through access to information not posted on the OASIS or Internet website that is not contemporaneously available to the public, or through information on the OASIS or Internet website that is not at the same time publicly available.¹⁶

A Transmission Provider may not share any information, acquired from non-affiliated transmission customers or potential non-affiliated transmission customers, or developed in the course of responding to requests for transmission or ancillary service on the OASIS or Internet website, with employees of its Marketing or Energy Affiliates,

¹⁴ Some of the incidents supporting this finding occurred under the former Order No. 889 Standards of Conduct requirements, *i.e.*, Part 37 requirements pre-September 22, 2004, Part 358 requirements thereafter. There are no significant differences in the specific requirements of Part 37 and Part 358 that bear upon the finding that LG&E improperly disclosed transmission and customer load information.

¹⁵ 18 C.F.R. § 358.5(a)(2) (2005).

¹⁶ 18 C.F.R. § 358.5(b)(1) (2005).

except to the limited extent information is required to be posted on the OASIS or Internet website in response to a request for transmission service or ancillary services.¹⁷

If an employee of the Transmission Provider discloses information in a manner contrary to the requirements of sections 358.5(b)(1) and (2), the Transmission Provider must immediately post such information on the OASIS or Internet Web site.¹⁸

Also, LG&E's posted implementation procedures provided that "any person with knowledge or concerns regarding activities that may have resulted, or could result, in a violation of the Standards of Conduct and/or Standards of Conduct Written Procedures is strongly encouraged, expected, and required to report them to the CCO without delay."

Discussion

Disclosures of Transmission Information by Telephone

On at least three occasions, once in May, 2004 and twice in November, 2004 LG&E transmission employees disclosed transmission line loading and operating status information to LG&E generation dispatchers during the course of generation re-dispatch events. LG&E's generation dispatch function is organizationally and functionally within its marketing business unit; therefore generation dispatch personnel are Energy and Marketing Affiliate employees.¹⁹ In each instance, the transmission information was disclosed through non-public communication.

LG&E identified three calls involving the disclosure of non-public transmission information relating to the loading of, line operational status, or redispatch or switching relief options for the 345 kV line Smith – Hardin County; 138 kV line Paddys Run – Paddys West; and 138 kV line Cane Run 6 – Cane Run Switching. LG&E acknowledged that the disclosed transmission information was not otherwise available to market participants through OASIS or other sources at the time that it was disclosed. We

¹⁷ 18 C.F.R. § 358.5(b)(2) (2005).

¹⁸ 18 C.F.R. § 358.5(b)(3) (2005).

¹⁹ The manager of generation dispatch reports to the Director of Trading who reports to the Senior Vice President for Energy Marketing. The generation dispatch desk is on the trading floor, located next to the workstation used by LG&E's real-time traders. Moreover, on occasion, LG&E's generation dispatchers talked to potential energy buyers and sellers on the phone and made trades if no one else on the trading floor was available to do so.

reviewed the disclosed information and determined that its disclosure to generation dispatch personnel was not necessary to ensure reliability and hence is not exempt under 18 C.F.R. § 358.5(b)(6) (2005). LG&E confirmed that the transmission information disclosed was not shared with traders, and there were no trades made by generation dispatchers in the hours subsequent to the disclosure of transmission information.

LG&E's generation dispatchers received Standards of Conduct training, and had available to them LG&E's Standards of Conduct implementation procedures, which required that improper disclosures of non-public transmission information be reported to the CCO. The generation dispatch employee did not disclose the incidents to anyone, including the CCO, so the disclosures were not posted on LG&E's OASIS after they occurred.

Disclosure of Transmission Information at a Meeting Attended by Transmission and Marketing Employees

During the audit period, we identified one meeting in which transmission personnel and marketing personnel were present at which LG&E transmission personnel disclosed non-public information regarding the status of two transmission projects. LG&E did not subsequently post the disclosures on its OASIS. At a Long Term Planning meeting that the SVP of Energy Marketing attended, the Director of Transmission discussed two transmission projects, providing information that was not publicly available in the Midwest ISO Transmission Expansion Plans ("MTEP"). These Projects were a 138/69kV transformer at VA City – Clinch River, which was a new interconnection tie-line between LG&E and American Electric Power Company, Inc., and a 138/69kV transformer at Paris substation, which was a reinforcement of the existing tie-line between LG&E and East Kentucky Power Cooperative. Each of the above two proposed projects would increase the transmission capacity between LG&E and the adjacent control area. LG&E did not post in a timely manner the disclosure on the OASIS after it occurred. We found no evidence that LG&E's Energy or Marketing Affiliates traded on this information.

Disclosure of Customer Load Data by E-Mail

On the first of the month, on a monthly basis through February 2005, a transmission employee e-mailed a marketing employee specific, non-public customer load information and failed to post in a timely manner the disclosures on OASIS.²⁰ Prior

²⁰ In *Allegheny Power Service Corporation et al, (Allegheny)* the Commission stated that the WMF may have access to control area load and not the specific load of third-party transmission customers within the same control area. *See Allegheny*, 84 FERC ¶ 61,131 at 61,729 (1998).

to August 1, 2003, the e-mails identified the date, time and LG&E's control area peak load, and load for the same date and time for LG&E, Hoosier Energy, Owensboro Municipal Utilities, Tennessee Valley Authority, and East Kentucky Power Cooperative. Beginning August 1, 2003 and continuing through February 1, 2005, the e-mails added the customer's monthly energy usage, peak load and load factor.²¹ LG&E acknowledged that this information was not publicly available. Knowledge of specific third-party load information could have been used to the advantage of LG&E's traders, although we found no evidence that this occurred.

Recommendations

We recommend that LG&E:

12. Post OASIS notices for all of the disclosures of non-public transmission information by LG&E's transmission function employees identified in this Audit Report. These postings should include the date, time, type of information disclosed, and other pertinent information.
13. Create and implement controls to prevent prospectively the disclosure of non-public transmission information to marketing employees performing generation dispatch functions and controls to ensure that any subsequent disclosure(s) are posted on OASIS consistent with Commission regulations. Such controls need to emphasize LG&E's policy that all concerns related to the Standards of Conduct should be brought to the attention of the CCO.
14. Create and implement controls to prevent prospectively the disclosure of non-public transmission information during meetings attended by both transmission and marketing employees, and controls to ensure that any subsequent disclosure(s) are posted on OASIS consistent with Commission regulations. Such controls need to emphasize LG&E's policy that all concerns related to the Standards of Conduct should be brought to the attention of the CCO.
15. Perform a review of all transmission and customer information shared through e-mail distribution in order to ensure that such information is not inappropriately shared with LG&E's Marketing and Energy Affiliate employees.

²¹ The load factor represents the ratio of the average load over a designated period of time to the peak load occurring during that period.

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16. LG&E shall submit all controls and the results of its email distribution review to OE for approval within 30 days of issuance of a Final Audit Report in this docket.

Actions Already Taken by LG&E

We discussed our concerns about the disclosure of transmission and customer information. LG&E informed us that it is developing process changes for addressing our concerns on a prospective basis, and that ultimately the process changes would be converted into formal written policies within 30 days of issuance of a Final Audit Report in this docket.

5. Standards of Conduct Training

LG&E's Standards of Conduct training program was inconsistent with Commission regulations and LG&E's own training implementation plans—more than one year after the effective date of Order No. 2004 (*i.e.*, 9/22/04), LG&E had failed to provide Standards of Conduct training for several hundred of the employees LG&E was required to train.

Pertinent Guidance

Order No. 2004 codified the training requirement as follows: “Transmission Providers shall train officers and directors as well as employees with access to transmission information or information concerning gas or electric purchases, sales, or marketing functions. The Transmission Provider shall require each employee to sign a document or certify electronically signifying that s/he has participated in the training.”²² Moreover, training was to be completed by the implementation date of Order No. 2004: “Each Transmission Provider must be in full compliance with the standards of conduct by September 22, 2004.”²³

Order No. 2004 required a Transmission Provider to post its implementation procedures on its OASIS or website, specifically requiring that Transmission Providers “must explain...whether employees have been offered training on the standards of conduct, and whether employees are required to read and sign acknowledgement forms.”²⁴ LG&E's posted implementation procedures have limited detail on its training program. LG&E directed us to an internal company training plan, which states (in part):

- All affected Company Personnel as well as employees of Energy and Marketing Affiliates (*i.e.*...except clerical, maintenance and field personnel) shall receive *Standards of Conduct* training prior to the September 22, 2004 implementation date.
- The initial *Standards of Conduct* training shall be conducted through interactive training programs developed and prepared by the Edison Electric Institute.²⁵

²² 18 C.F.R. § 358.4(e)(5) (2005).

²³ 18 C.F.R. § 358.4(e)(2) (2005).

²⁴ FERC Stats. & Regs, Regulations Preambles ¶ 31,155 at P 136.

²⁵ “FERC Standards of Conduct, Order Nos. 2004, 2004-A, 2004-B, Training plan, August 19, 2004, Overview.”

Discussion

We reviewed LG&E's training program and compared it to the requirements in Order No. 2004, as well as LG&E's training plan. We concluded that LG&E did not provide training to all employees requiring training. As of November 2005, more than one year after the September 22, 2004 implementation date of Order No. 2004, LG&E had not provided training to all employees that fall under the definition of employees who needed to be trained, *i.e.*, "employees with access to transmission information or information concerning gas or electric purchases, sales, or marketing functions."²⁶

We could not determine the exact number of employees that required, but had not received, training. Employees that required Standards of Conduct training but did not receive training included:

- A handful of employees of the service company, *e.g.*, in business units such as Audit Services and Legal;
- Approximately 100 shared service employees, in business units such as Planning & Control;
- As many as 2,000 employees at LG&E-owned transmission and generation facilities, who had no training other than notification that new Standards of Conduct were in effect.²⁷

We discussed with LG&E the need to determine whether the employees in these business units have access to information concerning gas or electric purchases, sales or marketing functions that would trigger a training requirement under 18 C.F.R. § 358.4(e)(5) (2005), and when they do, to ensure that they have Standards of Conduct

²⁶ 18 C.F.R. § 358.4(e)(5) (2005).

²⁷ LG&E designated these employees as field and maintenance personnel and as such did not provide training to them. But the training requirement in Order No. 2004 does not hinge on whether employees are designated as field and maintenance personnel, but rather whether an employee has access to non-public transmission information or information concerning gas or electric purchases, sales or marketing functions. LG&E told us it did not make this determination with respect to its field and maintenance personnel. As such, we could not determine how many of these employees should have received training. LG&E did not assert that these employees did not have access to non-public transmission information or information concerning gas or electric purchases, sales or marketing functions.

training. LG&E agreed to review its training program, specifically to identify the additional employees that should have received training.

Recommendations

We recommend that LG&E:

17. Strengthen the implementation of its training program to ensure that on a going-forward basis, its training program is consistent with Commission requirements and its internal training plans.
18. Develop written procedures to ensure that new employees, and transferring employees that require training, receive training.
19. Conduct a review to ensure that all of the employees that have “access to transmission information or information concerning gas or electric purchases, sales, or marketing functions...” are scheduled for training, have received training, and are certified.
20. LG&E shall submit all changes to the implementation of its training program and procedures developed to OE for approval within 30 days of issuance of a Final Audit Report in this docket. Also, LG&E shall submit the results of its review of employee access to information within 30 days after issuance of a Final Audit Report in this docket.

Actions Already Taken by LG&E

We discussed LG&E’s training program with the CCO, and other LG&E officials. On November 10, 2005, LG&E submitted a letter to us outlining an enhanced training program. We reviewed LG&E’s plan and found it to be consistent with the requirements of Order No. 2004, the audit findings, and our recommended remedies.

LG&E proposed to require training for all LG&E employees who fall within the definition in 18 C.F.R. § 358.4(e)(5) (2005). LG&E proposed to use the EEI computer-based Training Program, including the certification of training completion. For employees without internet access, a paper version of the training program will be used for the training. LG&E informed us on January 11, 2006, that as of that date, it had increased the number of LG&E employees who had received training by 80%, from approximately 600 employees to approximately 1100 employees.

6. Controls Used to Limit Access to System Control Centers

LG&E did not follow its posted implementation procedures to control and track access of its marketing employees to LG&E's two system control centers, including the requirement that LG&E marketing employees obtain permission from the CCO before visiting the system control centers.

Pertinent Guidance

Order No. 2004 requires that a Transmission Provider's employees engaged in transmission system operations "must function independent from employees of its Marketing and Energy Affiliates."²⁸ Specifically, a Transmission Provider is prohibited from permitting the employees of its Marketing or Energy Affiliates from "having access to the system control center or similar facilities used for transmission operations or reliability functions that differs in any way from the access available to other transmission customers."²⁹

LG&E's posted implementation procedures provide that LG&E marketing employees must obtain permission from the CCO before visiting the system control centers: "The Chief Compliance Officer shall maintain a written record of each such decision for inspection upon request by the Commission."³⁰

LG&E's posted implementation procedures also prescribe access control to the system control centers.

The Companies shall maintain a written log book at each Transmission System Operating Center for purposes of documenting the instances in which a transmission customer, whether an employee(s) of an Energy and/or Marketing Affiliate or a representative(s) of an unaffiliated third-party, visited these facilities. The written log book should contain the: (1) name of the transmission customer; (2) the date and time of the visit; and (3) the Transmission Function Employee(s)

²⁸ 18 C.F.R. § 358.2(a) (2005).

²⁹ 18 C.F.R. § 358.4(a)(3)(ii) (2005).

³⁰ "Joint Written Procedures Implementing Standards of Conduct for Transmission Providers as Adopted by the Federal Energy Regulatory Commission in Order No. 2004, Effective September 22, 2004" Section IV.A.2.b.

or other Company Personnel hosting the transmission customer; (4) whether the transmission customer is an affiliate; and (5) purpose for the visit.³¹

Discussion

LG&E operates two separate system control centers. One control center, called Waterside, is located in Louisville, KY, in a building approximately two blocks from the LG&E corporate headquarters. The other control center, called Dix Dam, is located in Burgin, KY, at the site of the Dix Dam generating facility.

LG&E used card key access to restrict direct access to its system control centers. However, we found a number of problems with the controls employed to track access of visitors (including LG&E marketing employees) to LG&E's system control centers.

CCO Permission to Visit the System Control Centers

LG&E's posted implementation procedures provide that LG&E marketing employees should submit a written request to the CCO prior to visiting either one of the system control centers. Based on our review of the Waterside log sheets, on at least five occasions, two LG&E employees with marketing or marketing-related responsibilities visited the Waterside facility after September 22, 2004.³² The CCO told us that there was no record that marketing employees had sought permission to enter the control centers, and no record of CCO approval of such requests.

Controls on Visitors Entering the System Control Centers

The written log books controlling visitors to the system control centers were inconsistent with LG&E's posted implementation procedures. The logs did not collect some pertinent information that LG&E's implementation procedures required. Many of the entries on the log sheets were unintelligible to us, and some of these entries were unintelligible to LG&E personnel as well. As a result, we could not determine the full extent to which LG&E marketing employees (and non-affiliated transmission customers) had access to the system control centers and could not determine whether LG&E

³¹ *Id.*

³² One of the employees was the manager of the generation dispatch function, which staff established was part of the marketing function. The other was the manager of market policy—the position description for this individual said his department was responsible for monitoring and analyzing emerging electric markets and educating Energy Marketing staff on the implications of new market operations.

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marketing employees had access in any way that differed from the access provided to non-affiliated transmission customers.

Access to Transmission Information Once Inside the System Control Centers

At both the Waterside and Dix facilities, a visitor standing at the door to the control centers had a line of sight into the control room, and was able to see transmission status information. This concern is heightened because of the relatively large number of LG&E marketing employees that visited a system control center. For example, our review of log sheets indicated that in the two year period prior to implementation of Order No. 2004, LG&E marketing employees may have made as many as 50 separate visits to the Waterside facility.

Recommendations

We recommend that LG&E:

21. Review and strengthen its system control center access procedures to ensure that its control procedures: (a) adhere to its own posted implementation procedures as it relates to CCO permission to visit control centers and maintenance of log books; (b) are followed by LG&E employees including the CCO and CCO designees; and (c) are certified in compliance with Order No. 2004 and LG&E's posted implementation procedures. LG&E shall submit all procedures to OE for approval within 30 days of issuance of a Final Audit Report in this docket.
22. Ensure that the entrances into the Waterside control room and Dix Dam control room are such that a visitor that enters the Waterside and Dix Dam facilities does not have a line of sight into the control rooms or to any workstations displaying data on transmission status.

Actions Already Taken by LG&E

LG&E informed us that on January 10, 2006, it revised its website to notify LG&E marketing employees that require access to the system control centers to seek written permission before each visit from the CCO. In addition, LG&E indicated that no later than January 13, 2006, the log books would be updated to conform to LG&E's posted implementation procedures, and temporary covers would be installed on all windows and doors that allow a line of sight into the system control centers.

7. Organizational Charts

LG&E's posted corporate and functional organizational charts (as of April 2005) failed to include or accurately show: detailed organizational charts for business units engaged in the sales function; the position of its Marketing and Energy Affiliates within the corporate structure; and sufficient detail to indicate that LG&E's service company is the employment mechanism for the Marketing and Energy Affiliates and the Transmission Provider.

Pertinent Guidance

The Order No. 2004 requirements for posting organizational charts provide that:

- (3) A Transmission Provider must post comprehensive organizational charts showing:
 - (i) The organizational structure of the parent corporation with the relative position in the corporate structure of the Transmission Provider, Marketing and Energy Affiliates;
 - (ii) For the Transmission Provider, the business units, job titles and descriptions, and chain of command for all positions, including officers and directors, with the exception of clerical, maintenance, and field positions. The job titles and descriptions must include the employee's title, the employee's duties, whether the employee is involved in transmission or sales, and the name of the supervisory employees who manage non-clerical employees involved in transmission or sales.

Further, Order Nos. 2004-A and 2004-B requires:

If a corporation uses a service company as the employment mechanism for the Transmission Provider and its Marketing or Energy Affiliates, the organizational charts should clearly specify those circumstances. Similarly, if a corporation uses both functional and structural organizational charts for its management, the organizational charts must accurately reflect its operations....³³

With respect to whether a detailed organizational chart is also required for a service company, the answer depends on the functions that the service company is

³³ FERC Stats. & Regs, Regulations Preambles ¶ 31,161 at P 163.

performing. If the service company is performing transmission functions, additional detail is required.³⁴

Discussion

LG&E's posted several organizational charts on its website at <http://lgeenergy.com/regulatory/soc.asp>³⁵ which showed a high-level organizational structure, including the holding company which owns LG&E Energy LLC, and the legal entities under LG&E Energy LLC, including notably: the operating companies (Kentucky Utilities Company and Louisville Gas and Electric Company); the service company (LG&E Energy Services, Inc.); and an LG&E marketing affiliate (LG&E Energy Marketing Inc., or LEM).

Additional posted organizational charts showed some—but not all—of the business units of the service company. The organizational charts showed a Senior Vice President (SVP) for Energy Services, with the following direct reports: Director of Transmission; SVP for Energy Marketing; VP for Regulated Generation; and VP Power Operations for Western Kentucky Energy.

However, the only business unit for which detailed organizational charts, job titles, chains of command, and job descriptions were posted was the Director of Transmission. Such detailed information was not posted for the sales functions, *i.e.*, the SVP for Energy Marketing, VP for Regulated Generation, and VP Power Operations for Western Kentucky Energy. The sales functions under the SVP for Energy Marketing included the following business units: Director of Trading; Director of Market Analysis & Valuation; Director of Non-Utility Marketing; Manager of Operations Analysis and System Implementation; Director of Corporate Fuels & By-Products; and Director of Business Information.

In addition, the posted organizational charts did not show the relative position in the corporate structure of all of LG&E's Marketing and Energy affiliates and did not clearly indicate that LG&E's service company is the employment mechanism for its Marketing and Energy Affiliates and Transmission Provider. For example:

- LG&E's postings showed one of LG&E's Marketing and Energy Affiliates, *i.e.*, LG&E Energy Marketing Inc. (LEM), as a separate corporate entity, but did not clearly indicate that LEM employees are in the service company along with transmission function employees; and

³⁴ FERC Stats. & Regs, Regulations Preambles ¶ 31,166 at P 79.

³⁵ We reviewed the organization charts on April 5, 2005.

- LG&E's postings failed to show what position another Marketing and Energy Affiliate, LG&E Power Services LLC, occupied within the corporate structure.

Recommendations

We recommend that LG&E:

23. Post organizational charts and employee information showing the required information for all of the business units engaged in the sales function.
24. Revise its organizational chart postings to show the position of all Energy and Marketing Affiliates within the corporate structure.
25. Revise its organizational chart posting to clearly show that LG&E uses its service company as the employment mechanism for the Transmission Provider and its Energy and Marketing Affiliates. All postings shall be made within 7 business days of the issuance of a Final Audit Report in this docket, consistent with 18 C.F.R. § 358.4(b)(3)(iv) (2005).

Actions Already Taken by LG&E

After discussions with us, LG&E updated its posted organizational charts. We reviewed LG&E's organizational charts in January 2006, and found the revised organizational charts included more, but not all, of the information required under 18 C.F.R. § 358.4(b)(3) (2005).

8. Shared Facilities

LG&E did not post a list of the facilities shared by the Transmission Provider and LG&E's Marketing and Energy Affiliates as required by 18 C.F.R. § 358.4(b)(2) (2005).

Pertinent Guidance

The Commission's regulations state: "A Transmission Provider must post on its OASIS or Internet website, as applicable, a complete list of the facilities shared by the Transmission Provider and its Marketing and Energy Affiliates, including the types of facilities shared and their addresses."³⁶ This requires that when a Transmission Provider's Marketing and Energy Affiliates share facilities with any function of the Transmission Provider whose employees have access to transmission information, those shared facilities must be posted.³⁷

Discussion

LG&E's Order No. 2004 information posted on its internet website in April 2005 stated: "At this time, no facilities are shared between the Transmission Provider and its Marketing and Energy Affiliates".

LG&E believed that it was required to post a list of shared facilities only if its transmission function shares facilities with its Marketing and Energy Affiliates. Since LG&E's transmission function is housed in two buildings (the Waterside control center and the Dix Dam control center) that otherwise do not house other LG&E business units, LG&E informed us that it did not believe it had any shared facilities that required posting.

³⁶ 18 C.F.R. § 358.4(b)(2) (2005).

³⁷ Transmission Provider is defined as follows in 18 C.F.R. § 358.3 (2005):

(a) Transmission Provider means:

(1) Any public utility that owns, operates or controls facilities used for the transmission of electric energy in interstate commerce; or

(2) Any interstate natural gas pipeline that transports gas for others pursuant to subpart A of part 157 or subparts B or G of part 284 of this chapter.

(3) A Transmission Provider does not include a natural gas storage provider authorized to charge market-based rates that is not interconnected with the jurisdictional facilities of any affiliated interstate natural gas pipeline, has no exclusive franchise area, no captive rate payers and no market power.

Virtually all of LG&E's shared service employees (many of whom have access to transmission information) occupied the same building as LG&E's two primary Marketing and Energy Affiliates, *i.e.*, LG&E's WMF, and LG&E's principal affiliated power marketer (LEM). When we pointed out to LG&E that shared service employees with access to transmission information and the Marketing and Energy affiliate employees share facilities which trigger a posting requirement, LG&E agreed to revise its posting to ensure that it is consistent with 18 C.F.R. § 358.4(b)(2) (2005).

Recommendation

We recommend that LG&E:

26. Revise its shared facilities posting to include all facilities that LG&E's Marketing and Energy Affiliates share with service employees who have access to non-public transmission information.

Actions Already Taken by LG&E

After discussions with us, LG&E revised its posting with respect to shared facilities on December 13, 2005. We reviewed the revised posting in January 2006 and found that the revised posting is not consistent with the Commission's requirements. Specifically, LG&E has not identified the facilities its Marketing and Energy Affiliates share with other LG&E functions that have access to non-public transmission information.

V. MARKET-BASED RATE TARIFF FINDING AND RECOMMENDATIONS

9. Electric Quarterly Report Inaccuracies

LG&E's Electric Quarterly Report (EQR) filing for the first quarter of 2005 contained inaccurate information for its market-based rate sales. LG&E inaccurately reported several sales transactions from its WMF to its affiliated power marketer (LEM) and reported invalid Data Universal Numbering System (DUNS) numbers for several other customers.

Pertinent Guidance

Order No. 2001³⁸ provided field names for the specified information required to be filed for the EQR: transaction begin date and transaction end date fields are provided for reporting the date and hour the transaction began and ended, increment peaking name field for reporting full period (FP), Peak (P), and Off-peak (OP), and class name field for reporting non-firm (NF) and firm (FP) power sales. Order No. 2001 also required the reporting of DUNS numbers for all customers in the EQR, making the power sale and the transmission reporting requirements consistent and reducing possible confusion among similarly named, but different, providers of service.

Discussion

We reviewed a sample of LG&E's EQR filing specifically for the first quarter of 2005. We found that LG&E inaccurately reported sales transactions to LEM and reported invalid Data Universal Numbering System (DUNS) numbers for several other customers.

LG&E reported two "around the clock" sales to LEM on February 24, 2005 (transaction_unique_identifier 2005003000) and February 25, 2005 (transaction_unique_identifier 2005003080). LG&E sold 52 megawatts to LEM in each hour in Transaction 2005003000 for \$47.00 during the peak period and \$31.00 during the off-peak period. LG&E sold 104 megawatts to LEM in each hour in Transaction

³⁸ *Revised Public Utility Filing Requirements*, Order No. 2001, FERC Stats. & Regs., Regulations Preambles, ¶ 31,127 (2002), *order on reh'g*, Order No. 2001-A, 100 FERC ¶ 61,074 (2002), *order on reconsideration and clarification*, Order No. 2001-B, 100 FERC ¶ 61,342 (2002); Order No. 2001-C, 101 FERC ¶ 61,314 (2002); Order No. 2001-D, 102 FERC ¶ 61,334 (2003); Order No. 2001-E, 105 FERC ¶ 61,352 (2003); Order No. 2001-F, 106 FERC ¶ 61,060 (2004).

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2005003080 for \$51.50 during the peak period and \$31.50 during the off-peak period. LG&E reported the off-peak period of both transactions as beginning at 12:00 AM and ending at 11:59 PM and assigned the increment peaking name as "FP" or full period rather than "OP" or off-peak. LG&E reported the peak period of these transactions as beginning at 7:00 AM and ending at 10:59 PM and assigned the increment peaking name as "FP" or full period rather than "P" or peak.

LG&E's EQR filing included 34 unique transaction identifiers where it sold energy to LEM and reported the class name of the energy sold as "NF" or non-firm. LG&E's Code of Conduct also required these sales to LEM to be posted on an EBB where LG&E reported these same sales transactions as system firm sales. When we asked LG&E to explain the discrepancy, it explained that the EQR data showing the sales as non-firm was incorrect.

LG&E reported 10 invalid DUNS numbers in its EQR for the 1st quarter 2005 for the following customers: Barbourville Water & Electric, Bardstown Municipal Light & Water, Bardwell City Utilities, Benham Electric System, City of Madisonville, City of Paris Combines Utilities, El Paso Merchant Energy L.P., El Paso Merchant Energy, LP, Owensboro Municipal Utilities, and Rainbow Energy Marketing Corp..

Recommendations

We recommend that LG&E:

27. Strengthen its written procedures to ensure all data reported in future EQR filings are in compliance with Commission regulations and reflect the correction of the errors and inconsistencies identified in this Audit Report.
28. Implement procedures to validate all customer DUNS numbers.
29. Refile all EQR reports from inception to correct the increment peaking name and the class name of power it sold to LEM.
30. LG&E shall submit all procedures to OE for approval within 30 days of issuance of a Final Audit Report in this docket.

Actions Already Taken by LG&E

LG&E advised us that it would be making corrections to its EQR filings, and that such corrections were made on January 31, 2006. We expect that the revised written procedures on EQR filings will be addressed by LG&E in its implementation plan in response to this Audit Report.

VI. IMPLEMENTATION PLAN

We recommended that LG&E submit an implementation plan to the audit staff for our approval detailing LG&E's plans to comply fully with the findings and recommendations in this Audit Report. The implementation plan should describe the actions LG&E has already taken, and will take, that are consistent with and complementary to any future structural and organizational changes that LG&E may undertake.

The implementation plan should be submitted within 30 days of issuance of a Final Audit Report in this docket. In addition, LG&E shall make quarterly filings updating the audit staff of its progress on implementing the plan. The filings shall be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.



Michael S. Beer

June 29, 2006

Mr. Bryan Craig, Director
Division of Audits
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

RE: *Louisville Gas and Electric Company, Kentucky Utilities Company*
Docket No. PA05-9-000

Dear Mr. Craig:

This letter sets forth the response of Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively, the "Companies") to the draft audit report issued by the Federal Energy Regulatory Commission's ("FERC" or the "Commission"), Office of Enforcement, Division of Audits ("FERC Audit Staff") on June 14, 2006, in the above referenced docket ("Draft Audit Report"). As requested, this response addresses: (1) whether the Companies agree or disagree with each finding and recommendation set forth in the Draft Audit Report; and (2) the corrective actions planned, or taken, and target completion dates.

I. INTRODUCTION.

The Companies agree with the findings and recommendations set forth in the Draft Audit Report. Further, the Companies appreciate the opportunity to respond to the Draft Audit Report. Encouraging, facilitating, and maintaining on-going compliance with Commission's regulatory initiatives and requirements is of the highest priority to the Companies and consistent with the core values and behaviors of E.ON U.S. LLC and its parent, E.ON AG. The operational audit of the Companies' compliance with the Standards of Conduct, the Companies' Market-Based Rate Tariffs, Market-Based Rate Tariff Code of Conduct ("LG&E Code of Conduct"), and the Open Access Transmission Tariff of the Midwest Independent Transmission System Operator, Inc. (collectively, "Audit Items") has been beneficial for the Companies as the audit process revealed several areas in which the Companies could improve their existing processes and methods.

During the course of the audit, and as discussed here, the Companies have taken and will continue to take substantial steps to improve their compliance. The Companies are committed to implementing and maintaining a comprehensive internal FERC compliance program as suggested in the

recent *Policy Statement on Enforcement*.¹¹⁾ One of the core behaviors that defines the global E.ON corporate family is the “drive for excellence.” In this regard, the Companies are committed to driving for excellence in the area of FERC regulatory compliance by implementing, monitoring, and periodically evaluating the effectiveness and efficiency of existing measures designed to ensure for full compliance.

In this regard and to clearly demonstrate the Companies’ commitment to compliance, the Chairman, President, and Chief Executive Officer of the Companies has expanded the responsibilities of the Standards of Conduct Chief Compliance Officer (“CCO”) to include the LG&E Code of Conduct and the Market-Based Rate Tariffs under which the Companies and any affiliates may be operating. The CCO has been further directed to prepare and implement a detailed, comprehensive compliance program that encompasses the full range of FERC regulatory obligations, and to develop and implement a strategy for enhanced training, monitoring, and auditing the effectiveness of the overall internal FERC compliance process. The Companies’ ongoing commitment to compliance has the full support of the entire senior management team of E.ON U.S. LLC, as well as their commitment to support the development and the implementation of the broader FERC compliance program.

As noted in the *Policy Statement on Enforcement*, a thorough commitment to compliance must be ingrained in corporate culture. Such a commitment is established at the senior most levels of any organization and must flow down from management to front-office employees engaged in day-to-day operations. As noted above, E.ON U.S. LLC senior management is strongly committed to ensuring compliance with all applicable FERC regulatory obligations. The Companies believe that the establishment of a detailed and comprehensive internal FERC compliance program will demonstrate this commitment throughout the E.ON U.S. LLC corporate family and also to the Commission. Simply put, compliance with the letter and spirit of applicable FERC regulatory obligations is encouraged, expected, and required at all levels of our organization. Therefore, as the audit process concludes, E.ON U.S. LLC reiterates our commitment to strengthening and maintaining an effective and open culture of compliance. This commitment is an integral part of our corporate identity and reflects our core values and behaviors.

¹¹⁾ *Enforcement of Statutes, Orders, Rules and Regulations*, 113 FERC ¶ 61,068 (2005) (“*Policy Statement on Enforcement*”).

II. RESPONSE TO PROPOSED FINDINGS AND RECOMMENDATIONS.

The Companies sincerely appreciate FERC Audit Staff's willingness to work with our employees and, where possible, provide guidance to help strengthen our overall compliance with the Audit Items. Prior to addressing specific comments on the proposed findings and recommendations, the Companies would like to highlight their cooperation with FERC Audit Staff as the audit progressed. We believe that the spirit in which the revised procedures for the Before-the-Purchase System were developed, as well as the guidance regarding Standards of Conduct training and for strengthening compliance with the Code of Conduct Electronic Bulletin Board ("EBB") posting requirements, are positive examples of how the operational audit process can work. The Companies look forward to working with FERC Audit Staff to finalize and implement post operational audit compliance plans in accordance with the process described in the Draft Audit Report.

As noted in Section I, above, the Companies agree with the findings and recommendations set forth in the Draft Audit Report. As discussed in Section I, above, the Companies and their parent, E.ON U.S. LLC, are committed to ensuring on-going compliance with the Audit Items, as well as other applicable FERC regulatory initiatives and requirements. The Companies were frankly unsettled by the number of non-compliance findings identified by FERC Audit Staff. We trust that our willingness to act without delay to address the identified non-compliance issues and take the necessary steps to strengthen and broaden their overall compliance program is, in fact, evidence of the priority the Companies give to compliance. These priorities will not change following the conclusion of the audit. Finally, the Companies would like to emphasize the importance of the absence of findings of intent to violate applicable rules or tariffs regarding the identified areas of non-compliance.

III. UPDATE OF CORRECTIVE ACTIONS TAKEN OR PLANNED AND TARGET COMPLETION DATES.

The Companies agree to submit an implementation plan within 30 days of the issuance of the final audit report. The implementation plan will set forth the distinct steps that the Companies have taken, and will take, to fully comply with the findings and recommendations set forth in the final audit report. In the interim, the Companies provide the following status report on the steps that they have taken during the course of the audit to comply with the findings and recommendations of FERC Audit Staff.

A. CODE OF CONDUCT FINDINGS AND RECOMMENDATIONS.

1. Functional, Physical, and Operational Separation of LG&E's Wholesale Merchant Function and Affiliated Power Marketer.

The Draft Audit Report directs the Companies to take all appropriate actions necessary to ensure that wholesale merchant function employees ("WMF") are functionally, physically, and operationally separated to the maximum extent practical, as required under the LG&E Code of Conduct, from their affiliated power marketer, LG&E Energy Marketing Inc. ("LEM"). Draft Audit Report at 8-11. As discussed below, the Companies have already implemented, or propose to implement, corrective measures designed to satisfy these requirements. While the final details of the steps taken by the Companies to achieve the appropriate degree of functional, physical and operational separation required

by the LG&E Code of Conduct will be set forth in their implementation plan, the Companies provide the following update.

a. Functional Separation Concerns.

The Draft Audit Report states that the functional separation between WMF and LEM is not consistent with the LG&E Code of Conduct. Draft Audit Report at 8-9. The Draft Audit Report cites two examples of the lack of appropriate functional separation between WMF and LEM. *Id.* at 8-9. The first example concerns meetings jointly attended by WMF and LEM personnel and the Senior Vice President, Energy Marketing (“SVP Energy Marketing”) at which certain market information about WMF and LEM trading operations was discussed. *Id.* The second example addresses certain aspects of the job description for the SVP Energy Marketing’s indicating “that the SVP Energy Marketing is expected to coordinate WMF and LEM activities to provide a greater return for the LG&E corporate family.” *Id.* at 9. The Companies agree with the findings made in the Draft Audit Report regarding the functional separation between WMF and LEM and agree to implement post-audit corrective measures to improve their compliance with the LG&E Code of Conduct functional separation requirements.

In order to ensure clear and full compliance with the functional separation requirements of the LG&E Code of Conduct, the Companies propose to implement the following corrective measures. First, the Companies propose to revise the job description of the SVP Energy Marketing. All language in the current job description indicating that SVP Energy Marketing is expected to “coordinate WMF and LEM activities to provide a greater return for the LG&E corporate family” will be deleted. As revised, the job description will require the SVP Energy Marketing to exercise his corporate oversight and management responsibilities for WMF and LEM in a manner that ensures that WMF and LEM: (1) are treated as separate and distinct businesses in accordance with the functional separation requirements of the LG&E Code of Conduct; and (2) will produce the greatest return for the E.ON U.S. corporate family on an independent and stand-alone basis. Further, the revised job description will acknowledge the SVP Energy Marketing’s obligation to comply with the No Conduit Rule set forth in the LG&E Code of Conduct.

Second, as discussed in Section III.A.1.b, below, the SVP Energy Marketing has discontinued holding monthly trading meetings that are jointly attended by WMF and LEM staff. Concurrent with the physical relocation of LEM to an enclosed work space on the Fourth (4th) Floor West section of the E.ON U.S. LLC Building located at 220 W. Main Street in Louisville, Kentucky (“E.ON Center”), the SVP Energy Marketing has implemented a process change and now meets with WMF and LEM separately on a monthly basis to discuss relevant business issues. Further, as noted in Section III.A.2.a, below, the Companies have implemented a process change that requires the CCO or his designee to attend any business meetings where both WMF and LEM staff are present. This process change squarely covers any meeting where the SVP Energy Marketing also may be present with both WMF and LEM staff.

Third, per prior discussions with FERC Audit Staff on or about February 6, 2006, the Companies commit to adhere to the chain of command for WMF and LEM in order to maintain separation between the SVP Energy Marketing and the execution of day-to-day WMF and LEM activities consistent with the SVP Energy Marketing’s status as one of most senior executives in the E.ON U.S. LLC corporate family and the Companies’ existing delegations of corporate authorities.

Together with the corrective measures designed to ensure proper physical and operational separation discussed in Sections III.A.1.b and c, below, the Companies respectfully submit that, given the relatively small size of E.ON U.S. LLC regulated and unregulated trading operations, these corrective measures will provide the functional separation required by the LG&E Code of Conduct (from both a substantive and optical perspective). The Companies will submit the specific measures for ensuring full compliance with the LG&E Code of Conduct functional separation requirements as part of their post-audit implementation plan.

b. Physical Separation Concerns.

The Draft Audit Report states that the physical separation between WMF and LEM is not consistent with the LG&E Code of Conduct. Draft Audit Report at 9. The Companies agree with the findings regarding physical separation concerns and, as discussed below, have implemented a number of corrective measures that assure that the physical separation of WMF and LEM is consistent with the LG&E Code of Conduct.

As a follow-up to the discussion regarding the physical proximity of WMF and LEM in their letter to FERC Audit Staff dated January 11, 2006 ("January 11 Letter"), the Companies hereby confirm that as of March 31, 2006, LEM has been physically relocated to an enclosed work space on the 4th Floor West section of E.ON Center. The enclosed LEM work space on the 4th Floor West section of the E.ON Center is secured by a card-key reader that only permits access to LEM personnel and a limited group of support personnel that may be shared consistent with requirements of the LG&E Code of Conduct, such as the CCO and designees, internal legal counsel, Energy Marketing Accounting, Trading Controls, and Operations Analysis/System Implementation.

Neither the 4th Floor of the E.ON Center nor the enclosed LEM workspace located thereon can be accessed by WMF personnel. Conversely, neither the 7th Floor of the E.ON Center nor the enclosed WMF workspace located thereon can be accessed by LEM personnel.

A full description of the specifics regarding the key card access restrictions to the enclosed LEM work space on the 4th Floor West section, and to the WMF work space on the 7th Floor North section, of the E.ON Center will be provided in the Companies' post-audit implementation plan. Further, written procedures governing the access to the WMF and LEM workspaces for authorized E.ON U.S. LLC employees and other permitted persons will be adopted by the Companies as part of comprehensive Code of Conduct compliance program.

c. Operational Separation Concerns with Respect to Recorded Phone Calls.

The Draft Audit Report states that the operational separation between WMF and LEM with respect to recorded phone calls on two (2) RACAL digital tape recorders is not consistent with the LG&E Code of Conduct. Draft Audit Report at 9-10. The Companies agree with these findings as set forth in the Draft Audit Report and have already undertaken measures to ensure compliance with the operational separation requirements of the LG&E Code of Conduct as it relates to recorded phone conversations. Further, as discussed below, the Companies propose to implement additional measures to ensure compliance with this aspect of the operational separation requirement.

In their January 11 Letter, the Companies proposed to implement certain internal controls to ensure appropriate operational separation under the LG&E Code of Conduct with respect to WMF and LEM trader telephone conversations using RACAL digital tape recorders. January 11 Letter at 5. The Companies continue to pursue the implementation of the corrective measures outlined in the January 11 Letter. However, the Companies hereby inform FERC Audit Staff that, on or about December 14, 2005, the RACAL digital tape recorders were replaced by two (2) NiceCall Focus III voice recording systems that contain technology that permit the “desktop review” of previously recorded conversations. One NiceCall Focus III machine is dedicated exclusively for use by LEM. The second machine is dedicated for use exclusively by WMF. The Companies believe that their investment in separate voice recording machines for LEM and WMF that contain “desktop review” technology is a substantial step towards achieving the operational separation required by the LG&E Code of Conduct with respect to recorded calls.

Distinct from the RACAL recorders, the NiceCall Focus III voice recording systems are operated on a stand-alone basis and are not interconnected in any way, physically or operationally. As noted above, these machines contain technology that allows traders to engage in desktop review of prior recorded calls. As discussed in greater detail in the Companies’ post-audit implementation plan, traders for WMF and LEM are assigned specific channels on the NiceCall Focus III machine assigned to their business unit and are only permitted access to those channels.^[4] In order to provide appropriate risk management and corporate oversight of trading activities, supervisory personnel within LEM and WMF are also permitted to access the recorded conversations of traders assigned to their business unit.^[5] Limited access to recorded conversations is permitted by certain “shared support” personnel that are subject to the No Conduit Rule under the LG&E Code of Conduct, such as internal legal counsel, Trading Controls, Energy Accounting, Contract Administration, and the CCO and his designees.

In two distinct respects, the Companies believe that the use of the separate NiceCall Focus III machines with “desktop review” technology will help ensure on-going compliance with the operational separation requirements of the LG&E Code of Conduct. First, “desktop review” technology eliminates the need for WMF and LEM personnel to have physical access to the work space where these machines are currently stored. Second, because different NiceCall Focus III machines are used by WMF and LEM, taken together with the fact that WMF and LEM have been physically separated as described in Section III.A.1.b, above, there is no risk of personnel from one operation gaining indirect, remote access to non-public market information on the other operation’s recorded lines.

As discussed in greater detail in their post audit implementation plan, the Companies propose to adopt a comprehensive set of written procedures designed to facilitate on-going compliance with LG&E Code of Conduct operational separation requirements as applied to recorded calls for both the new NiceCall Focus III machines and for historic conversations recorded on the RACAL tapes. The Companies will adopt these written procedures as part of comprehensive Code of Conduct compliance

^[4] Because separate NiceCall Focus III machines are used by LEM and WMF, traders for LEM may only access assigned channels on the NiceCall Focus III machine that is dedicated for use exclusively by LEM. Similarly, WMF traders may only access assigned channels on the NiceCall Focus III that is dedicated for use exclusively by WMF.

^[5] LEM supervisory personnel may only access voice recordings on the NiceCall Focus III machine dedicated for use exclusively by LEM. Similarly, WMF supervisory personnel may only access voice recordings on the NiceCall Focus III machine dedicated exclusively for use by WMF.

program. With regard to historic conversations recorded on the RACAL tapes, the Companies propose to implement internal controls consistent with those outlined in their January 11 Letter.

In that regard, the January 11 Letter proposed to implement a policy or set of procedures designed to ensure that: (1) trading personnel of one operation (whether WMF or LEM) will not have access to RACAL tapes of recorded conversations of the other; and (2) that anyone requesting access to RACAL tapes of recorded conversations must listen to such tapes in a location that does not permit access to phone conversations of the other group (*i.e.*, in their assigned work spaces). Specifically, the Companies proposed to develop a log book or another form of written record to document requests for access to historic conversations recorded on the RACAL tapes that requires the following information:

- The name of the person(s) seeking access to the RACAL tapes containing the recorded phone conversations;
- The name of their business unit (*e.g.*, WMF, LEM, legal or regulatory);
- A brief description of the recorded conversations on the RACAL tapes for which access to the tapes is sought;
- A brief description of the reasons for reviewing the recorded conversations on the RACAL tapes (*e.g.*, contract dispute, incorrect trade confirmation).

Finally, the Companies propose to include written procedures to provide for the periodic review by the CCO or his designee of the RACAL tape log book or other written record. These written procedures will be adopted as part of a comprehensive Code of Conduct compliance program

2. Sharing of Market Information.

a. Joint Staff Meetings Between WMF and LEM.

The Draft Audit Report states that the WMF shared marketing information through presentations at joint staff meetings in violation of the LG&E Code of Conduct. Draft Audit Report at 12-13. The Companies agree with these findings regarding joint staff meetings between WMF and LEM as set forth in the Draft Audit Report. As discussed below, the Companies have already undertaken significant measures to ensure compliance with the information sharing restrictions in the LG&E Code of Conduct and propose to formalize these measures in their post-audit implementation plan.

In June 2005, the Companies revised the agenda of the monthly trading meetings jointly attended by WMF and LEM personnel, as well as the SVP Energy Marketing and staff from Market Analysis, Trading Controls, Operations Analysis, and Fuels Management to address concerns raised by FERC Audit Staff regarding the sharing of WMF historical off-system sales (“OSS”) summary information during these meetings. *See* Draft Audit Report at 14. From the period June 2005 through March 31, 2006, the Companies altered the agenda so that the presentation regarding WMF’s OSS was not made until LEM employees were dismissed from the meeting. Since December 2005, the Companies have adopted certain process changes, including the requirement to have the CCO or his designee attend all

business meetings jointly attended by WMF and LEM personnel. The CCO or his designee maintains a high-level agenda and/or minutes of such joint meetings.

Please note that beginning on or about April 1, 2006, the SVP Energy Marketing discontinued scheduling and holding monthly trading meetings that are jointly attended by WMF and LEM staff. The monthly trading meetings are now held by the SVP Energy Marketing with WMF and LEM staff separately. These separate meetings are also attended by staff from Market Analysis, Trading Controls, Operations Analysis, and Fuels Management, who are shared support staff under the LG&E Code of Conduct and subject to the No Conduit Rule. In accordance with the No Conduit Rule, non-public WMF or LEM market information discussed during meeting with one business unit (*i.e.*, WMF) is not shared in meetings with the other business unit (*i.e.*, LEM) and vice versa.

As discussed in greater detail in their post-audit implementation plan, the Companies propose to adopt the process changes as part of a comprehensive Code of Conduct compliance program. In addition, the Companies propose to memorialize as part of a comprehensive Code of Conduct compliance program that monthly trading meetings discussed in the Draft Audit Report are held separately with WMF and LEM staff.

b. Password Access to EMS Information.

The Draft Audit Report states that Companies password access controls to the shared Energy Management System (“EMS”) were insufficient and inconsistent with the Companies’ password security policy. Draft Audit Report at 13. Prior to February 2004, the Companies permitted WMF and LEM users to access the EMS using separate group accounts and passwords, rather than using unique user accounts and passwords. *Id.* As a consequence, the Draft Audit Report states that failure to require unique password access was contrary to the Companies’ password security policy and increased the risk of inappropriate information access via the EMS. *Id.* The Companies agree with the findings regarding password access to EMS information as set forth in the Draft Audit Report and have already taken corrective measures to address these concerns.

As noted in the Draft Audit Report, in February 2004, the Companies have implemented individual user-ids and passwords for its current GE/Harris EMS. As required by GE/Harris vendor support requirements, a common user-id still exists solely and exclusively for maintenance purposes. However, the WMF and LEM EMS users do not have access to the vendor required common user-id and may only access the EMS through their own unique user-id and password.

The Companies are in the process of installing a new Open Systems International (“OSI”) EMS. It is anticipated that the OSI EMS will become fully operational on or about December 31, 2006. As part of their post-audit operational plan, the Companies will provide an update on the status of the installation of the new OSI EMS and on a quarterly basis thereafter until the OSI EMS becomes fully operational. In addition, the Companies agree to conduct an independent review by their internal audit department or an outside audit firm when the OSI EMS is implemented to ensure that there is no unauthorized EMS screen access by WMF and LEM staff. Finally, a requirement mandating the periodic review of EMS access requirements will be adopted as part of the Companies’ existing Standards of Conduct compliance program and the proposed comprehensive Code of Conduct compliance program.

3. Posting Information on Sales to Affiliates at Market-Based Rates.

a. Accessibility of EBB Information to Market Participants.

The Draft Audit Report raised a number of concerns regarding the accessibility of the Companies EBB to market participants. Draft Audit Report at 15-16. The Companies agree with the findings regarding the accessibility of EBB information to market participants.

As noted in the Companies' January 11 Letter, as of January 2006, a link to the EBB, entitled "LEM Transactions" was posted on the left-hand column of regulatory page of the E.ON U.S. LLC Internet site. January 11 Letter at 6 n.2. The regulatory page of the E.ON U.S. LLC Internet site can be accessed at the following web address: <http://www.eon-us.com/regulatory.asp>. Subsequently, to ensure the easiest possible ratepayer and market participant access to the EBB, the Companies posted an additional EBB link, entitled "LEM Transactions EBB," on the lower right-hand corner of the homepage of E.ON U.S. LLC Internet site. The homepage of the E.ON U.S. LLC Internet site can be accessed at the following web address: <http://www.eon-us.com/home.asp>. Accordingly, as of the date hereof, there are two (2) separate and easily accessible links on the E.ON U.S. LLC Internet site for interested parties to view the EBB.

A copy of the regulatory page and the home page of the E.ON U.S. LLC Internet site containing the existing links to the Companies' EBB on are appended hereto as Attachment A.

b. Posted Offers to Sell on the EBB.

The Draft Audit Report states that Companies' efforts to post offers to sell to LEM on the EBB were not consistent with posting requirements set forth in Paragraphs 7 and 8 of the LG&E Code of Conduct. Draft Audit Report at 16-17. The Companies agree with the findings regarding posted offers to sell on the EBB as set forth in the Draft Audit Report. As noted in their January 11 Letter, the Companies proposed to develop process changes to facilitate significantly stronger compliance with the posting requirements set forth Paragraphs 7 and 9¹ of the LG&E Code of Conduct.

A presentation generally outlining the proposed process changes was made and submitted to FERC Audit Staff on December 16, 2005. The process changes proposed in the presentation and described below are based on the Companies' understanding of existing Commission precedent addressing the need for implementing the EBB requirement when regulated utilities engage in market-based sales with unregulated affiliates. Specifically, Commission precedent is clear that when traditional public utilities engage in power sales to an affiliated power marketer, public utilities may have an incentive to favor their affiliated marketer to the detriment of captive ratepayers.^[6] Such behavior can take place when a public utility and its affiliated power marketer transact in ways that result in a

^[6] The paragraphs in the currently effective LG&E Code of Conduct originally accepted for filing by the Commission in Docket No. ER99-1623 were incorrectly numbered. There are a total of nine (9) paragraphs. The eighth and ninth paragraph of the LG&E Code of Conduct are incorrectly labeled paragraphs 9 and 10.

^[7] See *Detroit Edison Co., et al.*, 80 FERC ¶ 61,348 at 62,198 (1997); see also *Aquila, Inc.*, 101 FERC ¶ 61,331 at P 8 (2002); *FirstEnergy Corp. et al.*, 94 FERC ¶ 61,182 at 61,630 (2001); *Alliant Services Co.*, 85 FERC ¶ 61,344 at 62,335 (1998).

diversion of benefits from the public utility (and its captive ratepayers) to the affiliated power marketer (and its shareholders).^[7]

To avoid the diversion of benefits from captive ratepayers to shareholders, the Commission requires that utilities engaging in power sales to affiliated marketers must price such transactions at a rate no lower than the rate the utilities charge to non-affiliates.^[8] The requirement to “simultaneously” post offers to, and executed sales with, an affiliate marketer on an EBB is intended to provide transparency to this affiliate sales process. The purpose for providing such transparency is to allow interested third-parties (*i.e.*, ratepayers and market participants), as well as the Commission itself, to independently verify whether such affiliate transactions were priced in accordance with this standard.

As a practical business and operational matter, it is extremely difficult, if at all possible, to comply with the literal language set forth in Paragraphs 7 and 9 of the LG&E Code of Conduct, *i.e.*, mandating the simultaneous posting of: (1) offers to LEM; and (2) executed affiliate power sales transactions. Due to the pace of modern trading operations, transactions are negotiated and executed within minutes. Traders in the WMF cannot in such a short period of time: (1) survey the market and develop a credible picture of the prevailing market price for a given product; (2) negotiate with several counterparties to obtain the best sales price possible; (3) execute trades; and (4) post offers to, and executed sales with, LEM at the same time they take place.

The proposed EBB posting process changes discussed with FERC Audit Staff are intended to reflect the practical realities of engaging in real-time trading activities within a small organization. More importantly, the Companies believe that the process changes discussed with FERC Audit Staff are consistent with both the intent and spirit of the Commission’s existing precedent and policies designed to prevent affiliate abuse and self-dealing described above.

The Companies believe that addressing these operational realities in a practical manner must have been considered by the Commission when it established the simultaneous posting requirements codified in Paragraphs 7 and 9 of the LG&E Code of Conduct. Further, the Companies believe that these operational realities must have been intended when Paragraphs 7 and 9 were written. As proposed to FERC Audit Staff, the EBB posting process changes will provide ratepayers, market participants, and the Commission with a workable, easily accessible, and transparent mechanism for monitoring on a real-time basis whether sales by the Companies to LEM may result in an improper diversion of benefits from ratepayers due to the failure to price such transactions in a manner that complies with the LG&E Code of Conduct.

The Companies recognize the complexities of this particular issue and look forward to working with FERC Audit Staff to finalize these process changes as part of their post-audit implementation plan. The final process changes for posting offers to sell on the EBB will be adopted as part of a comprehensive Code of Conduct compliance program. As discussed in greater detail in the Companies’ post-audit implementation plan, E.ON U.S. LLC senior management will supervise the formal roll-out sessions for implementing the final EBB posting process changes. Specifically, the roll out and subsequent training sessions will not only discuss the purpose and application of the EBB posting

^[8] *Id.*

^[9] *Id.*

process, they will also emphasize the importance of this process and the need to vigilantly assure compliance therewith. After the initial roll out, the Companies propose to conduct periodic internal reviews and follow-up training to ensure on-going compliance.

c. Prices of Affiliate Sales.

The Draft Audit Report states that the Companies did not have any written procedures or other controls for WMF traders to determining whether sales to LEM were consistent with the affiliate pricing provisions set forth in Paragraph 6 of the LG&E Code of Conduct. Draft Audit Report at 17. The Draft Audit Report notes that the WMF traders established the market price for next-hour energy sales to LEM through telephone queries with potential counterparties and through broker quotes. *Id.* The Draft Audit Report further states that, although no evidence that WMF traders transacted with LEM at less than market price, WMF traders did not generally employ strong controls to establish the market prices. *Id.* The Companies agree with the findings relating to the pricing of affiliate sales as set forth in the Draft Audit Report.

The process changes for posting offers to sell on the EBB discussed in Section III.A.3.b, above, were addressed in the presentation presented to FERC Audit Staff on December 16, 2005. In relevant part, the process changes outline the steps by which WMF traders must determine whether posted offers to sell to LEM hourly or daily energy are priced no lower than prevailing market prices for each product. These procedures provide for a specific period after an offer to sell to LEM is posted on the EBB during which WMF traders must exercise commercially reasonable efforts (*i.e.*, due diligence) to survey the market and determine whether non-affiliates have any interest in pursuing an opportunity equivalent to that being offered to LEM. The WMF traders may not transact with LEM until after the specified posting period has expired. If, at the expiration of such period, an offer to sell to LEM posted on the EBB is the best and highest price available (*i.e.*, no lower than the price offered or sold to non-affiliates), the Companies may execute the sale to LEM.

As discussed in greater detail in the Companies' post-audit implementation plan, these procedures will be adopted as part of a comprehensive Code of Conduct compliance program.

d. EBB Postings in 2001.

The Draft Audit Report identifies certain concerns that took place in 2001 relating to whether, for a period of time, the EBB was properly used to post offers and sales from WMF to LEM to support a long-term sales obligation that LEM had with Morgan Stanley. Draft Audit Report at 17. The Companies agree with the findings regarding the EBB postings in 2001 as set forth in the Draft Audit Report. E.ON U.S. LLC senior management is deeply committed to ensuring that the Companies use the EBB to properly post offers and sales to LEM in accordance with the LG&E Code of Conduct requirements.

E.ON U.S. LLC has and will continue to commit the time and resources necessary to internal compliance measures designed to facilitate an enhanced understanding of, and compliance with, the EBB posting requirements set forth in the LG&E Code of Conduct. As discussed with FERC Staff at length and proposed in the Companies' December 16, 2005 presentation, E.ON U.S. LLC management believes that significantly enhanced compliance with the EBB posting requirements may be achieved through:

- Implementing a revised user friendly EBB offer matrix that contains key deal parameters and clearly articulates appropriate definitions and user guidelines;
- Providing formal employee training regarding the purpose, application and importance of the EBB posting process (including potential ramifications for non-compliance -- both internally and externally);
- Implementing additional internal controls designed to ensure that, when offers to LEM are made and sales are executed, all required EBB postings are timely made and consistent with the LG&E Code of Conduct; and
- Providing periodic follow-up training and reviewing the revised EBB posting process periodically to ensure that it is operating correctly.

As will be discussed in greater detail in the Companies post-audit implementation plan, because a true culture of compliance flows down from the top of corporate organizations, the Companies propose that the process changes for the EBB posting process will be formally rolled out by current E.ON U.S. LLC management. Senior management will ensure proper oversight of employee training sessions regarding the scope, application and importance of the EBB posting process. In addition, management will ensure that appropriate resources are dedicated to conduct periodic internal reviews and follow-up training to ensure on-going compliance with the EBB posting requirements.

B. STANDARDS OF CONDUCT FINDINGS AND RECOMMENDATIONS.

As discussed in Section I above, as part of their post-audit implementation plan, the Companies propose to undertake a comprehensive review of their Standards of Conduct Written Procedures (“SCWP”) posted on the E.ON U.S. LLC Internet site, and revise and update the SCWP as necessary. The comments below respond to the specific findings and recommendations set forth in the Draft Audit Report.

1. Disclosure of Transmission and Customer Information.
 - a. Disclosure of Transmission Information by Telephone.

The Draft Audit Report identifies three instances where transmission function employees of the Companies disclosed non-public transmission information to regulated generation dispatchers during the course of reliability-related Transmission Line Loading Relief/generation redispatch events (“Generation Redispatch Events”). Draft Audit Report at 20-21. Because the Companies regulated generation dispatchers are organizationally and functionally housed in the WMF business unit (an Energy Affiliate), the identified transmission information was disclosed through non-public communications. *Id.* at 17. The Companies agree with the factual findings regarding the disclosure of transmission information by telephone as set forth in the Draft Audit Report, subject to the following factual clarification. The identified disclosures of transmission information occurring by telephone during Generation Dispatch Events were posted on the Standards of Conduct Page of the E.ON U.S. LLC Internet site on January 13, 2006. The posting can be found at: http://www.eon-us.com/regulatory/disclosure_of_information.pdf.

In their January 11 Letter, the Companies proposed to develop certain process changes to ensure that any information disclosed by transmission function employees or by a third-party Transmission Provider are promptly reported to the CCO for evaluation and, where necessary, posted on the OASIS or the E.ON U.S. LLC Internet site. January 11 Letter at 8-9. In the intervening period, the process changes outlined below have been implemented by the Companies. These process changes govern the behavior of both transmission function employees and regulated generation dispatchers during Generation Redispatch Events and include the following concepts:

- During Generation Redispatch Events, transmission function employees are only to provide specific redispatch instructions.
- Absent emergency circumstances affecting system reliability, transmission function employees may not provide regulated generation dispatchers with information regarding the cause of the Generation Redispatch Event.
- Transmission function employees and regulated generation dispatchers are required to document and provide prompt notice to the CCO or his designee of any instance in which non-public transmission information is disclosed to regulated generation dispatchers, whether by transmission function employees or any other third party (including, but not limited to, a security coordinator or reliability authority, or another Transmission Provider).
- In the event of any disclosures of non-public transmission information by a third-party (including, but not limited to, a security coordinator or reliability authority, or another Transmission Provider), apart from notifying the CCO, transmission function employees and regulated generation dispatchers will comply with the No Conduit Rule.
- Regulated generation dispatchers should not trade on any non-public transmission information improperly disclosed to them.

As will be described in greater detail in the Companies' post-audit compliance plans, the process changes outlined above will be converted into written procedures and incorporated into the Companies' existing SCWPs and future Standards of Conduct training programs sponsored by the Companies.

b. Disclosure of Transmission Information at a Meeting Attended by Transmission and Marketing Employees.

The Draft Audit Report identifies one meeting in which transmission personnel and marketing personnel were present at which the Companies' transmission personnel disclosed non-public information regarding the status of two transmission projects. Draft Audit Report at 21. The Draft Audit Report notes that the disclosure was not posted on the OASIS in a timely manner. *Id.* As noted in the Draft Audit Report, no evidence was found that Companies' Energy or Marketing Affiliates traded on this information. *Id.* The Companies agree with the findings regarding the disclosure of transmission information at a meeting attended by transmission and marketing employees as set forth in the Draft Audit Report.

The Companies posted the non-public transmission information disclosed in the meeting identified in the Draft Audit Report on the E.ON U.S. LLC Internet site at: http://www.eon-us.com/regulatory/disclosure_of_information.pdf on March 31, 2006. Further, beginning in April 2005, the Companies adopted certain process changes in response to concerns raised by FERC Audit Staff that cross-functional business meetings between transmission function employees and employees of Energy or Marketing Affiliates (“C/F Meetings”) create the potential for the sharing of non-public transmission information. Since April 2005, the CCO or his designee has attended all identified C/F Meetings. The CCO or his designee maintains a high-level agenda and/or minutes for each meeting. The C/F Meetings include not only senior level staff meetings but also meetings attended by line level Transmission Function Employees and employees of Energy Affiliates.

In addition, the Companies propose to continue to conduct periodic “function specific” training sessions, including those with E.ON U.S. LLC senior management, to ensure that employees at all levels of the E.ON U.S. LLC organization fully understand the scope and application of the Standards of Conduct restrictions on the sharing of non-public transmission information, including the requirements to post disclosures of non-public transmission information. As discussed in greater detail in their post-audit implementation plan, the Companies propose to: (1) adopt procedures detailing the need for the CCO or his designee to be present at all C/F Meetings as described above and incorporate such procedures into its SCWPs; and (2) will provide additional information about the “function specific” training sessions.

c. Disclosure of Customer Load Data by E-Mail.

The Draft Audit Report states that a transmission function employee e-mailed a marketing employee specific, non-public customer load information on a monthly basis through February 2005. Draft Audit Report at 21. The Draft Audit Report notes that the Companies failed to post these disclosures on the OASIS in a timely manner. *Id.* The Companies agree with the findings regarding the disclosure of customer load data by e-mail as set forth in the Draft Audit Report.

As noted in the posted disclosure, the customer information at issue involved after-the-fact, monthly historic peak transmission load information. This information is used by the Midwest ISO to invoice the Companies for their Schedule 10 charges under the Midwest ISO’s Open Access Transmission Tariff (or Module B of the Day 2 TEMT). The WMF is responsible for budgeting, approving and paying the Midwest ISO invoice. The non-public customer load data disclosed via e-mail to marketing employee identified in the Draft Audit Report was posted on the E.ON U.S. LLC Internet site on March 31, 2006 at: http://www.eon-us.com/regulatory/disclosure_of_information.pdf.

Since February 2005, the Companies have implemented process changes to ensure that transmission function employees no longer provide non-public customer load information to Energy or Marketing Affiliate employees. As will be discussed in greater detail in their post-audit compliance plan, these process changes will be memorialized and incorporated into the Companies’ SCWPs. In addition, the Companies agree to perform a review of all transmission and customer information shared through e-mail distribution in order to ensure that such information is not inappropriately shared with Energy or Marketing Affiliate employees. The Companies further propose to implement new written procedures that require the periodic review of such e-mail distributions to ensure ongoing compliance with the Standards of Conduct.

2. Standards of Conduct Training.

The Draft Audit Report states that the Companies' Standards of Conduct training program was inconsistent with the Commission's regulations and the Companies' SCWP and implementation plans. Draft Audit Report at 24. During the audit, FERC Audit Staff discussed the Companies' training with the CCO, his designees and other E.ON U.S. LLC officials. Subsequently, on November 10, 2005, the Companies submitted a letter outlining an enhanced Standards of Conduct training program. *Id.* FERC Audit Staff found the proposed compliance plan to be consistent with Order No. 2004 and proposed findings and recommendations. *Id.* The Companies accept the findings regarding Standards of Conduct training as set forth in the Draft Audit Report.

The 2005 edition of the Companies' Standards of Conduct training took place from November 17, 2005 through December 31, 2005. The 2005 training program required the participation of all employees in the E.ON U.S. LLC corporate family at the manager level and above, as well as employees with the words or phrases "supervisor," "team leader," or "group leader" in their job title.^[9] In addition, the Companies trained all employees in the following lines of business: (1) the Companies' Transmission Function; (2) All Energy Marketing Personnel (regulated and unregulated); (3) Information Technology; (4) Accounting and Finance; (5) Corporate Communications; (6) Legal; and (7) Regulatory. These functional areas of responsibility were selected because employees in such areas have or may have access to non-public transmission information through the Companies' financial books of account, records or contracts or real-time, day-to-day operations.

As noted in the Draft Audit Report, in 2005, the Companies significantly increased the number of employees who have received the Edison Electric Institute ("EEI")-developed, electronic Standards of Conduct training program by eighty percent (80%), from approximately 610 to approximately 1,100. The Companies are committed to further strengthening their training program to ensure that on a going-forward basis it remains consistent with Commission requirements and internal training plans. As part of this process, the Companies will memorialize new process changes for ensuring that new employees and transfers receive the appropriate Standards of Conduct training. The Companies' future Standards of Conduct training plans will be discussed in greater detail in their post-audit implementation plan.

^[10] Included within the group of employees described above are certain field personnel in the Companies' distribution function, such as managers and supervisors of substation construction crews which respond to outages that can affect the Companies integrated transmission and distribution systems. In addition, this group of employees included all managers, supervisors or above higher ranking personnel that are employed by Energy Affiliates that operate generation facilities on behalf of other investor-owned utilities

3. Controls Used to Limit Access to the System Control Centers.

a. CCO Permission to Visit the System Control Centers.

The Draft Audit Report states the Companies did not follow Section IV.A.2.b of their posted SCWP to control and track access of its marketing employees to their Waterside and Dix Dam system control centers. Draft Audit Report at 27. The Companies agree with the findings regarding CCO permission to visit the system control centers as set forth in the Draft Audit Report. Below the Companies discuss certain corrective measures that have already been undertaken to address concerns identified by FERC Audit Staff.

As noted in the Draft Audit Report, on January 10, 2005, the Companies revised the Standards of Conduct page of the E.ON U.S. LLC website to include a link titled, "Request for Access to Transmission Control Center." The link can be found at: http://www.eon-us.com/regulatory/soc_request_access.asp. The link provides instructions for the submission of written, electronic requests by employees of Energy and Marketing seeking access to the Transmission Control Centers. Consistent with Section IV.A.2.b of the Companies' SCWP, the link directs Energy or Marketing Affiliate employees to submit the following information to the CCO as part of a request for access to the to the Transmission Control Centers:

- The proposed time and date that access to the Transmission Control Centers is required; and
- A verifiable and legitimate business purpose for seeking access to such facilities.

Consistent with Section IV.A.2.b of SCWP, the link states that the CCO shall: (1) review such requests and approve or deny them; and (2) maintain electronic copies of all forms submitted and his decision to approve or deny such requests for a period of three (3) years.

Subsequently, on February 2, 2006, the Companies posted an announcement on the E.ON U.S. LLC Intranet site prominently announcing the new "Request for Access to Transmission Control Center" link on the Standards of Conduct section of Regulatory page of the E.ON U.S. LLC Internet site. The announcement of the "Request for Access to Transmission Control Center" link was made available to all E.ON U.S. LLC employees as part of the daily "News Transmission" published on the E.ON U.S. LLC Intranet site. In addition, an e-mail blast was distributed to all employees highlighting the "Request for Access to Transmission Control Center" link as a headline story in the "News Transmission" items for February 2, 2006.

As will be discussed in greater detail in their post-audit implementation plan, the Companies will further review and strengthen its system control center access procedures as directed in the Draft Audit Report. Further, the Companies commit to internally announce on a periodic basis the "Request for Access to Transmission Control Center" link on the Standards of Conduct section of Regulatory page of the E.ON U.S. LLC Internet site.

b. Controls on Visitors Entering the System Control Centers.

The Draft Audit Report states that the written log books documenting visitors' access to the Waterside and Dix Dam system control centers were inconsistent with Companies' SCWPs. Draft Audit Report at 28. Specifically, the written log books did not collect some pertinent information that was required in Section IV.A.2.b of the SCWPs. *Id.* The Companies accept the findings regarding controls on visitors entering the system control centers as set forth in the Draft Audit Report

The Companies confirm that by January 13, 2006, the log books located at the Waterside and Dix Dam system control centers were in place and updated to contain the same fields of inquiry set forth in Section IV.A.2.b of the SCWP, which include the following:

- The name of the transmission customer;
- Date and time of the visit;
- The name of the Transmission Function Employee or other Company Personnel (as that term is defined in the SCWP) hosting the transmission customer;
- Whether the transmission customer is an affiliate; and
- The purpose of the visit.

The update of the logbooks to include these fields of inquiry ensures consistency with the Companies' existing SCWP procedures and creates an audit trail that allows for independent verification regarding whether the Companies' Energy and Marketing Affiliate employees had access to system control centers in any way that differed from non-affiliate transmission customers. The Companies agree to the recommendations set forth in the Draft Audit Report and will provide greater detail regarding additional corrective measures (if any are required) in their post-audit implementation plan.

c. Access to Transmission Information Once Inside the System Control Center.

The Draft Audit Report raises concerns that non-transmission function employee visitors to Waterside and Dix Dam system control centers could gain access through a direct, external line of sight to certain non-public transmission information posted on monitors and boards within these facilities actual transmission system control rooms. Draft Audit Report at 29. The Companies agree with the findings regarding access to transmission information once inside the system control centers as set forth in the Draft Audit Report.

In their January 11 Letter, the Companies committed to install by January 13, 2006 certain temporary, but effective, covers on all windows on doors, or windows that serve as partitions or walls for purposes of impeding a direct view into the control rooms at Waterside and Dix Dam. The Companies hereby confirm that such temporary covers were in fact installed by January 13, 2006. Further, the Companies committed to implement a permanent solution through the use of frosted glass or another similar technique by the end of the first quarter of 2006. By this letter, the Companies hereby confirm that, prior to the end of the first quarter of 2006, permanent window frosting treatment covers were

installed all windows on doors, or windows that serve as partitions or walls for purposes of impeding a direct view into the control rooms at Waterside and Dix Dam.

4. Organizational Charts.

The Draft Audit Report states that Companies have not properly posted certain organizational charts showing: (1) employee information required for all business units in the sales function; (2) the position of all Energy and Marketing Affiliates with the E.ON U.S. LLC family corporate structure; and (3) that the Companies use a service company as an employment mechanism for the Transmission Provider and for its Energy and Marketing Affiliates. Draft Audit Report at 30-32. The Companies agree with the findings regarding the posting of organizational charts as set forth in the Draft Audit Report.

On Friday, June 16, 2006, the Companies and FERC Audit Staff held a conference call for purposes of ensuring that the Companies fully satisfied the organizational chart posting requirements and concerns articulated in the Draft Audit Report. The Companies appreciate FERC Audit Staff's cooperation and help in this process. As will be discussed in greater detail in their post-audit implementation plan, the Companies will post revised organizational charts in accordance with the directives and guidance provided by FERC Audit Staff on the June 16th call.

5. Shared Facilities.

The Draft Audit Report states that the Companies did not post a list of facilities Shared by the Transmission Provider and the Companies' Energy and Marketing Affiliates. Draft Audit Report at 33. Further, the Draft Audit Report notes that virtually all of the Companies shared service Employees occupied the same building as their two primary Marketing and Energy Affiliates -- WMF and LEM. *Id.* at 34. When FERC Audit Staff pointed out that the shared services employees with access to transmission information and the Marketing and Energy Affiliate shared facilities which trigger a posting requirement, the Companies agreed to revise its posting to ensure that it is consistent with 18 C.F.R. § 358.4(b)(2) (2005). The Companies agree with the findings regarding shared facilities as set forth in the Draft Audit Report and corrected the posting.

C. MARKET-BASED RATE TARIFF FINDING AND RECOMMENDATIONS.

The Draft Audit Report states that, for the first quarter of 2005, the Companies' Electric Quarterly Reports ("EQRs") contained inaccurate information for its sales made pursuant to their joint market-based rate tariff. Draft Audit Report at 35. Specifically, the Companies inaccurately reported several sales transactions from its WMF to LEM and reported invalid Data Universal Numbering System ("DUNS") numbers for several other customers. The Companies accept the findings regarding EQRs as set forth in the Draft Audit Report.

As noted in the Draft Audit Report, on January 31, 2006, the Companies made certain corrections to its EQR filings. The Companies agree to implement the proposed recommendations set forth in the Draft Audit Letter regarding: (1) strengthening the Companies' written procedures to ensure that all data reported in future EQR filings are in compliance with Commission regulations and reflect the correction of errors and inconsistencies identified in the Draft Audit Report; (2) implementing procedures to

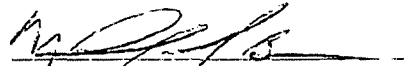
validate all customer DUNS numbers; and (3) refiling all EQR reports from inception to correct the incremental peaking name and class name of power sold to LEM. The refiling referenced in subsection (3) above has been completed.

The proposed corrective measures designed ensure the accuracy and sufficiency of the Companies' EQR reports and ensure compliance with their joint market-based rate tariff will be submitted with the Companies' post-audit implementation plan.

IV. CONCLUSION.

On behalf of E.ON U.S. LLC, I would like to thank the FERC Audit Staff for their time, effort and commitment to ensuring that the Companies are in full compliance with the Audit Items. I would like to again affirm E.ON U.S. LLC's commitment to meeting its obligations under the Standards of Conduct, the Code of Conduct, its Market-Based Rate Tariff and all other applicable FERC imposed regulatory obligations.

Sincerely,



Michael S. Beer
Vice President, Federal Regulation and Policy and
Standards of Conduct Chief Compliance Officer
E.ON U.S. LLC

on behalf of
Louisville Gas and Electric Company &
Kentucky Utilities Company

cc: Carl Coscia
Lyle Hanagami
Eliot Wessler
FERC, Office of Enforcement, Division of Audits

Steven D. Phillips
E.ON U.S. LLC

R. Michael Sweeney, Jr.
Hunton & Williams LLP

ATTACHMENT A

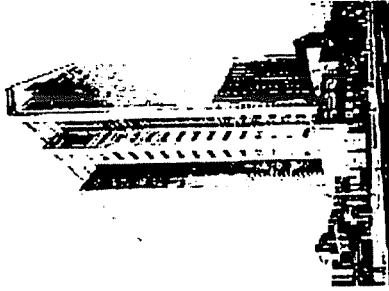
search

10/1/06



After more than three successful years as part of the E.ON family, LG&E Energy, the parent company of Louisville Gas and Electric Company, Kentucky Utilities Company and Western Kentucky Energy, is now E.ON U.S.

LG&E, KU, and WKE — the companies that customers are most familiar with — will continue to operate under their current identities. more



06.28.2006

LG&E Coal Ash Recycled; Land to be used for Green Space

LG&E

For the Home
For the Business

06.27.2006

E.ON U.S. Capital Corp. Announces Pricing Of Tender Offer and Consent Solicitation

KU/ODP

For the Home
For the Business

06.20.2006

LG&E Announces Regular Dividends On Preferred Stock

E.ON U.S.

E.ON U.S. - Regulatory - LG&E/KU Standards of Conduct

[Company Customer Services](#)[Media Careers](#)

[www.eon.com/SitemapContactE.ON World search](#)

[Company Profile](#)
[Management Team](#)
[Chairman's Message](#)
[Investor Information](#)
[Mailing Addresses](#)
[Social Responsibility](#)
[Environment](#)
[Diversity](#)
[Service Territory](#)
[History](#)
[Regulatory](#)
[LG&E/KU Code of Ethics](#)

[LEM Transactions](#)
[SEC Filings - LG&E Energy](#)
[SEC Filings - LG&E](#)
[SEC Filings - KU](#)
[LG&E Electric Rates](#)
[LG&E Gas Rates](#)
[KU Electric Rates](#)
[Community](#)

LG&E/KU Standards of Conduct

Effective September 22, 2004, E.ON U.S. and other U.S. energy companies must comply with new Federal Energy Regulatory Commission ("FERC") orders requiring organizational separation between transmission and energy and marketing affiliates.

Collectively, the new orders are referred to as the Standards of Conduct and are fundamentally based on two guiding principles. First, a Transmission Provider's employees engaged in transmission system operations must function independent from the employees of its Marketing and Energy Affiliates. Secondly, a Transmission Provider must treat all transmission customers, affiliated and non-affiliated, on a non-discriminatory basis and must not operate

its transmission system to preferentially benefit its marketing or energy affiliates. The Final Rule requires organizational separation of all energy and marketing affiliates, including natural gas marketing affiliates, from the electric transmission function.

The Standards of Conduct require that a Transmission Provider must post certain information on its corporate website or its OASIS. Links to all of the requisite information, whether residing here or on the LG&E/KU page of the MISO OASIS, are provided below. Please contact the Chief Compliance Officer if you have any questions.

- [How to Report a Potential Violation of the Standards of Conduct](#)
- [Request for Access to Transmission Control Center](#)
- [FERC Orders - Standard of Conduct Regulation \(PDF\)](#)
- [FERC Orders - Order No. 2004 \(PDF\)](#)
- [FERC Orders - Order No. 2004-A \(PDF\)](#)
- [FERC Orders - Order No. 2004-B \(PDF\)](#)
- [LG&E/KU Compliance Procedures \(PDF\)](#)
- [LG&E/KU February 2004 Compliance Filing \(PDF\)](#)
- [Chief Compliance Officer](#)
- [Marketing & Energy Affiliate Listing \(PDF\)](#)
- [Shared Facilities Listing](#)
- [Notices of Employee Transfers \(PDF\)](#)
- [Organizational Charts - Overall Corporate Structure \(PDF\)](#)
- [Organizational Charts - Chain of Command \(PDF\)](#)
- [Organizational Charts - Transmission Chain of Command](#)
- [Organizational Charts - Energy Marketing Chain of Command](#)
- [Organizational Charts - Job Titles & Descriptions \(PDF\)](#)
- [Potential Merger Partners as Affiliates \(none at this time\)](#)
- [Disclosure of Information \(PDF\)](#)
- [Voluntary Consent to Disclose Information \(none at this time\)](#)
- [Log of Tariff Administration Matters and Discounts](#)
- [MISO OASIS](#)
- [LG&E/KU page of MISO OASIS](#)

E.ON U.S. - Regulatory - LG&E/KU Standards of Conduct

[Download PDF \(103K\)](#)

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[Terms of Use](#) [Contractor Health and Safety Site](#) [Wellness Site](#)

Louisville Gas and Electric Company
Case No. 2009-00549
Historical Test Period Filing Requirements

Filing Requirement
807 KAR 5:001 Section 10(6)(m)
Sponsoring Witness: Valerie L. Scott

Description of Filing Requirement:

The most recent Federal Energy Regulatory Commission Form 1 (electric), Federal Energy Regulatory Commission Form 2 (gas), or Automated Reporting Management Information System Report (telephone) and Public Service Commission Form T (telephone);

Response:

The below-listed documents are provided. Please note that by an order dated July 12, 2007 in Docket No. CP07-232-000, LG&E was granted a Section (7) exemption by the FERC under the Natural Gas Act, and as a part of that exemption LG&E was granted "a waiver of reporting and accounting requirements", which includes the filing of Form 2 with FERC. In addition, on February 15, 2008, the Commission issued an order granting LG&E's request to cease the annual filing of the FERC Form 2. In lieu of filing a FERC Form 2 with the Commission, LG&E was ordered to file a paper copy of the annual report information that it files with the Commission electronically and include with such copy a paper copy of the notes to its financial statements that LG&E had previously filed as part of its FERC Form 2.

- FERC Form 1 - December 31, 2008
- KPSC Annual Report for Major Natural Gas Companies - December 31, 2008
- FERC Form 2 - December 31, 2006

LG&E FERC Form 1 – December 31, 2008

THIS FILING IS	
Item 1: <input type="checkbox"/> An Initial (Original) Submission	OR <input type="checkbox"/> Resubmission No. _____

Form 1 Approved
 OMB No. 1902-0021
 (Expires 7/31/2008)
 Form 1-F Approved
 OMB No. 1902-0029
 (Expires 6/30/2007)
 Form 3-Q Approved
 OMB No. 1902-0205
 (Expires 6/30/2007)



FERC FINANCIAL REPORT
FERC FORM No. 1: Annual Report of
Major Electric Utilities, Licensees
and Others and Supplemental
Form 3-Q: Quarterly Financial Report

Public Service Commission
of
Kentucky

These reports are mandatory under the Federal Power Act, Sections 3, 4(a), 304 and 309, and 18 GFR 141.1 and 141.400. Failure to report may result in criminal fines, civil penalties and other sanctions as provided by law. The Federal Energy Regulatory Commission does not consider these reports to be of confidential nature

Exact Legal Name of Respondent (Company)	Year/Period of Report
Louisville Gas and Electric Company	End of 2008/Q4

LOUISVILLE GAS AND ELECTRIC COMPANY

PUBLIC SERVICE COMMISSION OF KENTUCKY

**PRINCIPAL PAYMENT AND INTEREST INFORMATION
FOR THE YEAR ENDING DECEMBER 31, 2008**

1. Amount of Principal Payment during calendar year \$ 0.00

2. Is Principal current? (Yes) X (No) _____

3. Is Interest current? (Yes) X (No) _____

**SERVICES PERFORMED BY
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT**

Are your financial statements examined by a Certified Public Accountant?

(Yes) X (No) _____

If yes, which service is performed?

Audit X

Compilation _____

Review _____

Please enclose a copy of the accountant's report with annual report.

Louisville Gas and Electric Company
 Supplemental Electric Information
 Revenues, Customers and KWH Sales
 For Reporting Year 2008

	Revenues	KWHs Sold	Customers
440 Residential	\$ 301,021,844	4,206,410,526	353,173
442 Commercial & Industrial Sales			
Small (or Commercial)	\$ 248,375,431	3,723,171,070	41,483
Large (or Industrial)	\$ 138,314,832	2,850,830,033	383
444 Public St. & Highway Lighting	\$ 6,896,924	61,974,931	3,344
445 Other Sales to Public Authorities	\$ 68,992,558	1,240,681,990	2,316
446 Sales to Railroads and Railways	\$ -	-	-
448 Interdepartmental Sales	\$ -	-	-
TOTAL Sales to Ultimate Customers	\$ 763,601,589	12,083,068,550	400,699
447 Sales for Resale	\$ 241,984,634	7,883,759,000	19
TOTAL Sales of Electricity	\$1,005,586,223	19,966,827,550	400,718

THIS PAGE MUST BE COMPLETED AND RETURNED WITH THE ANNUAL REPORT

**LOUISVILLE GAS AND ELECTRIC COMPANY
NUMBER OF ELECTRIC DEPARTMENT EMPLOYEES
SUPPLEMENTAL INFORMATION TO 2008 ANNUAL REPORT**

NUMBER OF ELECTRIC DEPARTMENT EMPLOYEES	
<p>1. The data on number of employees should be reported for the payroll period ending nearest to October 31, or any payroll period ending 60 days before or after October 31.</p> <p>2. If the respondent's payroll for the reporting period includes any special construction personnel, include such employees on line 3, and show the number of such special construction employees in a footnote.</p>	<p>¹The number of employees assignable to the electric department from joint functions of combination utilities may be determined by estimate, on the basis of employee equivalents. Show the estimated number of equivalent employees attributed to the electric department from joint functions.</p>
1. Payroll Period Ended (Date)	12/31/2008
2. Total Regular Full-Time Employees	688
3. Total Part-Time and Temporary Employees	11
4. Total Employees	699

Additional Requested Information

Utility Name Louisville Gas & Electric Company

FEIN# (Federal Employer Identification Number)

6	1	-	0	2	6	4	1	5	0
---	---	---	---	---	---	---	---	---	---

Contact Person Mimi Kelly

Contact Person's E-Mail Address mimi.kelly@eon-us.com

Utility's Web Address www.eon-us.com

Please complete the above information, if it is available.

If there are multiple staff who may be contacts please include their names and e-mail addresses also.

THIS FILING IS	
Item 1: <input checked="" type="checkbox"/> An Initial (Original) Submission	OR <input type="checkbox"/> Resubmission No. _____

Form 1 Approved
OMB No. 1902-0021
(Expires 2/29/2009)
Form 1-F Approved
OMB No. 1902-0029
(Expires 2/28/2009)
Form 3-Q Approved
OMB No. 1902-0205
(Expires 2/28/2009)



FERC FINANCIAL REPORT

FERC FORM No. 1: Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report

These reports are mandatory under the Federal Power Act, Sections 3, 4(a), 304 and 309, and 18 CFR 141.1 and 141.400. Failure to report may result in criminal fines, civil penalties and other sanctions as provided by law. The Federal Energy Regulatory Commission does not consider these reports to be of confidential nature

Exact Legal Name of Respondent (Company) Louisville Gas and Electric Company	Year/Period of Report End of <u>2008/Q4</u>
--	---

Report of Independent Auditors

To the Board of Directors and Management of Louisville Gas and Electric Company:

We have audited the accompanying balance sheets of Louisville Gas and Electric Company (the "Company") as of December 31, 2008 and 2007 and the related statements of income, retained earnings and cash flows for the years then ended, included on pages 110 through 123.46 of the accompanying Federal Energy Regulatory Commission Form 1. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, these financial statements were prepared in accordance with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases, which is a comprehensive basis of accounting other than generally accepted accounting principles in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Louisville Gas and Electric Company as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in accordance with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases.

This report is intended solely for the information and use of the board of directors and management of Louisville Gas and Electric Company and for filing with the Federal Energy Regulatory Commission and should not be used for any other purpose.

PricewaterhouseCoopers LLP

March 24, 2009

INSTRUCTIONS FOR FILING FERC FORM NOS. 1 and 3-Q

GENERAL INFORMATION

I. Purpose

FERC Form No. 1 (FERC Form 1) is an annual regulatory requirement for Major electric utilities, licensees and others (18 C.F.R. § 141.1). FERC Form No. 3-Q (FERC Form 3-Q) is a quarterly regulatory requirement which supplements the annual financial reporting requirement (18 C.F.R. § 141.400). These reports are designed to collect financial and operational information from electric utilities, licensees and others subject to the jurisdiction of the Federal Energy Regulatory Commission. These reports are also considered to be non-confidential public use forms.

II. Who Must Submit

Each Major electric utility, licensee, or other, as classified in the Commission's Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject To the Provisions of The Federal Power Act (18 C.F.R. Part 101), must submit FERC Form 1 (18 C.F.R. § 141.1), and FERC Form 3-Q (18 C.F.R. § 141.400).

Note: Major means having, in each of the three previous calendar years, sales or transmission service that exceeds one of the following:

- (1) one million megawatt hours of total annual sales,
- (2) 100 megawatt hours of annual sales for resale,
- (3) 500 megawatt hours of annual power exchanges delivered, or
- (4) 500 megawatt hours of annual wheeling for others (deliveries plus losses).

III. What and Where to Submit

(a) Submit FERC Forms 1 and 3-Q electronically through the forms submission software. Retain one copy of each report for your files. Any electronic submission must be created by using the forms submission software provided free by the Commission at its web site: <http://www.ferc.gov/docs-filing/eforms/form-1/elec-subm-soft.asp>. The software is used to submit the electronic filing to the Commission via the Internet.

(b) The Corporate Officer Certification must be submitted electronically as part of the FERC Forms 1 and 3-Q filings.

(c) Submit immediately upon publication, by either eFiling or mail, two (2) copies to the Secretary of the Commission, the latest Annual Report to Stockholders. Unless eFiling the Annual Report to Stockholders, mail the stockholders report to the Secretary of the Commission at:

Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

(d) For the CPA Certification Statement, submit within 30 days after filing the FERC Form 1, a letter or report (not applicable to filers classified as Class C or Class D prior to January 1, 1984). The CPA Certification Statement can be either eFiled or mailed to the Secretary of the Commission at the address above.

The CPA Certification Statement should:

- a) Attest to the conformity, in all material aspects, of the below listed (schedules and pages) with the Commission's applicable Uniform System of Accounts (including applicable notes relating thereto and the Chief Accountant's published accounting releases), and
- b) Be signed by independent certified public accountants or an independent licensed public accountant certified or licensed by a regulatory authority of a State or other political subdivision of the U. S. (See 18 C.F.R. §§ 41.10-41.12 for specific qualifications.)

<u>Reference Schedules</u>	<u>Pages</u>
Comparative Balance Sheet	110-113
Statement of Income	114-117
Statement of Retained Earnings	118-119
Statement of Cash Flows	120-121
Notes to Financial Statements	122-123

- e) The following format must be used for the CPA Certification Statement unless unusual circumstances or conditions, explained in the letter or report, demand that it be varied. Insert parenthetical phrases only when exceptions are reported.

"In connection with our regular examination of the financial statements of _____ for the year ended on which we have reported separately under date of _____, we have also reviewed schedules _____ of FERC Form No. 1 for the year filed with the Federal Energy Regulatory Commission, for conformity in all material respects with the requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases. Our review for this purpose included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Based on our review, in our opinion the accompanying schedules identified in the preceding paragraph (except as noted below) conform in all material respects with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases."

The letter or report must state which, if any, of the pages above do not conform to the Commission's requirements. Describe the discrepancies that exist.

- (f) Filers are encouraged to file their Annual Report to Stockholders, and the CPA Certification Statement using eFiling. To further that effort, new selections, "Annual Report to Stockholders," and "CPA Certification Statement" have been added to the dropdown "pick list" from which companies must choose when eFiling. Further instructions are found on the Commission's website at <http://www.ferc.gov/help/how-to.asp>.

- (g) Federal, State and Local Governments and other authorized users may obtain additional blank copies of FERC Form 1 and 3-Q free of charge from <http://www.ferc.gov/docs-filing/eforms/form-1/form-1.pdf> and <http://www.ferc.gov/docs-filing/eforms.asp#3Q-gas>.

IV. When to Submit:

FERC Forms 1 and 3-Q must be filed by the following schedule:

- a) FERC Form 1 for each year ending December 31 must be filed by April 18th of the following year (18 CFR § 141.1), and
- b) FERC Form 3-Q for each calendar quarter must be filed within 60 days after the reporting quarter (18 C.F.R. § 141.400).

V. Where to Send Comments on Public Reporting Burden.

The public reporting burden for the FERC Form 1 collection of information is estimated to average 1,144 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data-needed, and completing and reviewing the collection of information. The public reporting burden for the FERC Form 3-Q collection of information is estimated to average 150 hours per response.

Send comments regarding these burden estimates or any aspect of these collections of information, including suggestions for reducing burden, to the Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426 (Attention: Information Clearance Officer); and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503 (Attention: Desk Officer for the Federal Energy Regulatory Commission). No person shall be subject to any penalty if any collection of information does not display a valid control number (44 U.S.C. § 3512 (a)).

GENERAL INSTRUCTIONS

- I. Prepare this report in conformity with the Uniform System of Accounts (18 CFR Part 101) (USofA). Interpret all accounting words and phrases in accordance with the USofA.
- II. Enter in whole numbers (dollars or MWH) only, except where otherwise noted. (Enter cents for averages and figures per unit where cents are important. The truncating of cents is allowed except on the four basic financial statements where rounding is required.) The amounts shown on all supporting pages must agree with the amounts entered on the statements that they support. When applying thresholds to determine significance for reporting purposes, use for balance sheet accounts the balances at the end of the current reporting period, and use for statement of income accounts the current year's year to date amounts.
- III. Complete each question fully and accurately, even if it has been answered in a previous report. Enter the word "None" where it truly and completely states the fact.
- IV. For any page(s) that is not applicable to the respondent, omit the page(s) and enter "NA," "NONE," or "Not Applicable" in column (d) on the List of Schedules, pages 2 and 3.
- V. Enter the month, day, and year for all dates. Use customary abbreviations. **The "Date of Report" included in the header of each page is to be completed only for resubmissions (see VII. below).**
- VI. Generally, except for certain schedules, all numbers, whether they are expected to be debits or credits, must be reported as positive. Numbers having a sign that is different from the expected sign must be reported by enclosing the numbers in parentheses.
- VII. For any resubmissions, submit the electronic filing using the form submission software only. Please explain the reason for the resubmission in a footnote to the data field.
- VIII. Do not make references to reports of previous periods/years or to other reports in lieu of required entries, except as specifically authorized.
- IX. Wherever (schedule) pages refer to figures from a previous period/year, the figures reported must be based upon those shown by the report of the previous period/year, or an appropriate explanation given as to why the different figures were used.

Definitions for statistical classifications used for completing schedules for transmission system reporting are as follows:

FNS - Firm Network Transmission Service for Self. "Firm" means service that can not be interrupted for economic reasons and is intended to remain reliable even under adverse conditions. "Network Service" is Network Transmission Service as described in Order No. 888 and the Open Access Transmission Tariff. "Self" means the respondent.

FNO - Firm Network Service for Others. "Firm" means that service cannot be interrupted for economic reasons and is intended to remain reliable even under adverse conditions. "Network Service" is Network Transmission Service as described in Order No. 888 and the Open Access Transmission Tariff.

LFP - for Long-Term Firm Point-to-Point Transmission Reservations. "Long-Term" means one year or longer and "firm" means that service cannot be interrupted for economic reasons and is intended to remain reliable even under adverse conditions. "Point-to-Point Transmission Reservations" are described in Order No. 888 and the Open Access Transmission Tariff. For all transactions identified as LFP, provide in a footnote the

termination date of the contract defined as the earliest date either buyer or seller can unilaterally cancel the contract.

OLF - Other Long-Term Firm Transmission Service. Report service provided under contracts which do not conform to the terms of the Open Access Transmission Tariff. "Long-Term" means one year or longer and "firm" means that service cannot be interrupted for economic reasons and is intended to remain reliable even under adverse conditions. For all transactions identified as OLF, provide in a footnote the termination date of the contract defined as the earliest date either buyer or seller can unilaterally get out of the contract.

SFP - Short-Term Firm Point-to-Point Transmission Reservations. Use this classification for all firm point-to-point transmission reservations, where the duration of each period of reservation is less than one-year.

NF - Non-Firm Transmission Service, where firm means that service cannot be interrupted for economic reasons and is intended to remain reliable even under adverse conditions.

OS - Other Transmission Service. Use this classification only for those services which can not be placed in the above-mentioned classifications, such as all other service regardless of the length of the contract and service FERC Form. Describe the type of service in a footnote for each entry.

AD - Out-of-Period Adjustments. Use this code for any accounting adjustments or "true-ups" for service provided in prior reporting periods. Provide an explanation in a footnote for each adjustment.

DEFINITIONS

I. Commission Authorization (Comm. Auth.) -- The authorization of the Federal Energy Regulatory Commission, or any other Commission. Name the commission whose authorization was obtained and give date of the authorization.

II. Respondent -- The person, corporation, licensee, agency, authority, or other Legal entity or instrumentality in whose behalf the report is made.

EXCERPTS FROM THE LAW

Federal Power Act, 16 U.S.C. § 791a-825r

Sec. 3. The words defined in this section shall have the following meanings for purposes of this Act, to with:

(3) 'Corporation' means any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, or a receiver or receivers, trustee or trustees of any of the foregoing. It shall not include 'municipalities, as hereinafter defined;

(4) 'Person' means an individual or a corporation;

(5) 'Licensee, means any person, State, or municipality Licensed under the provisions of section 4 of this Act, and any assignee or successor in interest thereof;

(7) 'municipality means a city, county, irrigation district, drainage district, or other political subdivision or agency of a State competent under the Laws thereof to carry and the business of developing, transmitting, unitizing, or distributing power;

(11) "project' means. a complete unit of improvement or development, consisting of a power house, all water conduits, all dams and appurtenant works and structures (including navigation structures) which are a part of said unit, and all storage, diverting, or fore bay reservoirs directly connected therewith, the primary line or lines transmitting power there from to the point of junction with the distribution system or with the interconnected primary transmission system, all miscellaneous structures used and useful in connection with said unit or any part thereof, and all water rights, rights-of-way, ditches, dams, reservoirs, Lands, or interest in Lands the use and occupancy of which are necessary or appropriate in the maintenance and operation of such unit;

"Sec. 4. The Commission is hereby authorized and empowered

(a) To make investigations and to collect and record data concerning the utilization of the water 'resources of any region to be developed, the water-power industry and its relation to other industries and to interstate or foreign commerce, and concerning the location, capacity, development -costs, and relation to markets of power sites; ... to the extent the Commission may deem necessary or useful for the purposes of this Act."

"Sec. 304. (a) Every Licensee and every public utility shall file with the Commission such annual and other periodic or special* reports as the Commission may be rules and regulations or other prescribe as necessary or appropriate to assist the Commission in the -proper administration of this Act. The Commission may prescribe the manner and FERC Form in which such reports salt be made, and require from such persons specific answers to all questions upon which the Commission may need information. The Commission may require that such reports shall include, among other things, full information as to assets and Liabilities, capitalization, net investment, and reduction thereof, gross receipts, interest due and paid, depreciation, and other reserves, cost of project and other facilities, cost of maintenance and operation of the project and other facilities, cost of renewals and replacement of the project works and other facilities, depreciation, generation, transmission, distribution, delivery, use, and sale of electric energy. The Commission may require any such person to make adequate provision for currently determining such costs and other facts. Such reports shall be made under oath unless the Commission otherwise specifies*.10

"Sec. 309. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, and rescind such orders, rules and regulations as it may find necessary or appropriate to carry out the provisions of this Act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this Act; and may prescribe the FERC Form or FERC Forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed..."

General Penalties

The Commission may assess up to \$1 million per day per violation of its rules and regulations. *See* FPA § 316(a) (2005), 16 U.S.C. § 825o(a).

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**FERC FORM NO. 1/3-Q:
REPORT OF MAJOR ELECTRIC UTILITIES, LICENSEES AND OTHER**

IDENTIFICATION		
01 Exact Legal Name of Respondent Louisville Gas and Electric Company		02 Year/Period of Report End of 2008/Q4
03 Previous Name and Date of Change (if name changed during year) / /		
04 Address of Principal Office at End of Period (Street, City, State, Zip Code) 220 W. Main Street, P.O. Box 32010, Louisville, KY 40232		
05 Name of Contact Person Mimi Kelly		06 Title of Contact Person Mgr - Regulatory Acct & Reprt
07 Address of Contact Person (Street, City, State, Zip Code) P.O. Box 32010, Louisville, KY 40232		
08 Telephone of Contact Person, including Area Code (502) 627-2482	09 This Report Is (1) <input checked="" type="checkbox"/> An Original (2) <input type="checkbox"/> A Resubmission	10 Date of Report (Mo, Da, Yr) / /
ANNUAL CORPORATE OFFICER CERTIFICATION		
<p>The undersigned officer certifies that:</p> <p>I have examined this report and to the best of my knowledge, information, and belief all statements of fact contained in this report are correct statements of the business affairs of the respondent and the financial statements, and other financial information contained in this report, conform in all material respects to the Uniform System of Accounts.</p>		
01 Name S. Bradford Rives	03 Signature S. Bradford Rives	04 Date Signed (Mo, Da, Yr) 03/24/2009
02 Title Chief Financial Officer		
<p>Title 18, U.S.C. 1001 makes it a crime for any person to knowingly and willingly to make to any Agency or Department of the United States any false, fictitious or fraudulent statements as to any matter within its jurisdiction.</p>		

Name of Respondent Louisville Gas and Electric Company		This Report Is: (1) <input checked="" type="checkbox"/> An Original (2) <input type="checkbox"/> A Resubmission	Date of Report (Mo, Da, Yr) / /	Year/Period of Report End of 2008/Q4
LIST OF SCHEDULES (Electric Utility)				
Enter in column (c) the terms "none," "not applicable," or "NA," as appropriate, where no information or amounts have been reported for certain pages. Omit pages where the respondents are "none," "not applicable," or "NA".				
Line No.	Title of Schedule (a)	Reference Page No. (b)	Remarks (c)	
1	General Information	101		
2	Control Over Respondent	102		
3	Corporations Controlled by Respondent	103	None	
4	Officers	104		
5	Directors	105		
6	Important Changes During the Year	108-109		
7	Comparative Balance Sheet	110-113		
8	Statement of Income for the Year	114-117		
9	Statement of Retained Earnings for the Year	118-119		
10	Statement of Cash Flows	120-121		
11	Notes to Financial Statements	122-123		
12	Statement of Accum Comp Income, Comp Income, and Hedging Activities	122(a)(b)		
13	Summary of Utility Plant & Accumulated Provisions for Dep, Amort & Dep	200-201		
14	Nuclear Fuel Materials	202-203	None	
15	Electric Plant in Service	204-207		
16	Electric Plant Leased to Others	213	None	
17	Electric Plant Held for Future Use	214		
18	Construction Work in Progress-Electric	216		
19	Accumulated Provision for Depreciation of Electric Utility Plant	219		
20	Investment of Subsidiary Companies	224-225	None	
21	Materials and Supplies	227		
22	Allowances	228-229		
23	Extraordinary Property Losses	230	None	
24	Unrecovered Plant and Regulatory Study Costs	230	None	
25	Transmission Service and Generation Interconnection Study Costs	231	None	
26	Other Regulatory Assets	232		
27	Miscellaneous Deferred Debits	233		
28	Accumulated Deferred Income Taxes	234		
29	Capital Stock	250-251		
30	Other Paid-in Capital	253		
31	Capital Stock Expense	254		
32	Long-Term Debt	256-257		
33	Reconciliation of Reported Net Income with Taxable Inc for Fed Inc Tax	261		
34	Taxes Accrued, Prepaid and Charged During the Year	262-263		
35	Accumulated Deferred Investment Tax Credits	266-267		
36	Other Deferred Credits	269		

Name of Respondent Louisville Gas and Electric Company		This Report Is: (1) <input checked="" type="checkbox"/> An Original (2) <input type="checkbox"/> A Resubmission	Date of Report (Mo, Da, Yr) / /	Year/Period of Report End of 2008/Q4
LIST OF SCHEDULES (Electric Utility) (continued)				
Enter in column (c) the terms "none," "not applicable," or "NA," as appropriate, where no information or amounts have been reported for certain pages. Omit pages where the respondents are "none," "not applicable," or "NA".				
Line No.	Title of Schedule (a)	Reference Page No. (b)	Remarks (c)	
37	Accumulated Deferred Income Taxes-Accelerated Amortization Property	272-273	None	
38	Accumulated Deferred Income Taxes-Other Property	274-275		
39	Accumulated Deferred Income Taxes-Other	276-277		
40	Other Regulatory Liabilities	278		
41	Electric Operating Revenues	300-301		
42	Sales of Electricity by Rate Schedules	304		
43	Sales for Resale	310-311		
44	Electric Operation and Maintenance Expenses	320-323		
45	Purchased Power	326-327		
46	Transmission of Electricity for Others	328-330		
47	Transmission of Electricity by ISO/RTOs	331	None	
48	Transmission of Electricity by Others	332		
49	Miscellaneous General Expenses-Electric	335		
50	Depreciation and Amortization of Electric Plant	336-337		
51	Regulatory Commission Expenses	350-351		
52	Research, Development and Demonstration Activities	352-353		
53	Distribution of Salaries and Wages	354-355		
54	Common Utility Plant and Expenses	356		
55	Amounts included in ISO/RTO Settlement Statements	397		
56	Purchase and Sale of Ancillary Services	398		
57	Monthly Transmission System Peak Load	400		
58	Monthly ISO/RTO Transmission System Peak Load	400a	None	
59	Electric Energy Account	401		
60	Monthly Peaks and Output	401		
61	Steam Electric Generating Plant Statistics	402-403		
62	Hydroelectric Generating Plant Statistics	406-407		
63	Pumped Storage Generating Plant Statistics	408-409	None	
64	Generating Plant Statistics Pages	410-411	None	
65	Transmission Line Statistics Pages	422-423		
66	Transmission Lines Added During the Year	424-425	None	

Name of Respondent Louisville Gas and Electric Company	This Report Is: (1) <input checked="" type="checkbox"/> An Original (2) <input type="checkbox"/> A Resubmission	Date of Report (Mo, Da, Yr) / /	Year/Period of Report End of <u>2008/Q4</u>
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LIST OF SCHEDULES (Electric Utility) (continued)

Enter in column (c) the terms "none," "not applicable," or "NA," as appropriate, where no information or amounts have been reported for certain pages. Omit pages where the respondents are "none," "not applicable," or "NA".

Line No.	Title of Schedule (a)	Reference Page No. (b)	Remarks (c)
67	Substations	426-427	
68	Footnote Data	450	
	<p>Stockholders' Reports Check appropriate box:</p> <p><input type="checkbox"/> Four copies will be submitted</p> <p><input checked="" type="checkbox"/> No annual report to stockholders is prepared</p>		

Name of Respondent Louisville Gas and Electric Company	This Report Is: (1) <input checked="" type="checkbox"/> An Original (2) <input type="checkbox"/> A Resubmission	Date of Report (Mo, Da, Yr) / /	Year/Period of Report End of <u>2008/Q4</u>
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GENERAL INFORMATION

1. Provide name and title of officer having custody of the general corporate books of account and address of office where the general corporate books are kept, and address of office where any other corporate books of account are kept, if different from that where the general corporate books are kept.

S. Bradford Rives, Chief Financial Officer
 220 West Main Street
 Louisville, KY 40202

2. Provide the name of the State under the laws of which respondent is incorporated, and date of incorporation. If incorporated under a special law, give reference to such law. If not incorporated, state that fact and give the type of organization and the date organized.

Kentucky - July 2, 1913

3. If at any time during the year the property of respondent was held by a receiver or trustee, give (a) name of receiver or trustee, (b) date such receiver or trustee took possession, (c) the authority by which the receivership or trusteeship was created, and (d) date when possession by receiver or trustee ceased.

Not Applicable

4. State the classes or utility and other services furnished by respondent during the year in each State in which the respondent operated.

Respondent furnishes electric and gas services in the City of Louisville and adjacent territory in Kentucky.

5. Have you engaged as the principal accountant to audit your financial statements an accountant who is not the principal accountant for your previous year's certified financial statements?

- 1) Yes...Enter the date when such independent accountant was initially engaged:
- 2) No