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March 1, 2010

RE: ***REQUEST OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR MODIFICATION AND EXTENSION OF ITS GAS SUPPLY COST PERFORMANCE-BASED RATE-MAKING MECHANSIM - CASE NO. 2009-00550***

Dear Mr. DeRouen:

Enclosed please find an original and ten (10) copies of the Response of Louisville Gas and Electric Company to the Initial Data Request of Commission Staff dated February 18, 2010, in the above-referenced proceeding.

Please contact me if you have any questions concerning this filing.

Sincerely,

Robert M. Conroy

Enclosures

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

REQUEST OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY FOR	)	
MODIFICATION AND EXTENSION OF ITS	)	CASE NO.
GAS SUPPLY COST PERFORMANCE-	)	2009-00550
BASED RATE-MAKING MECHANISM	)	

RESPONSE OF
LOUISVILLE GAS AND ELECTRIC COMPANY
TO THE
INITIAL DATA REQUEST OF COMMISSION STAFF
DATED FEBRUARY 18, 2010

FILED: March 1, 2010

VERIFICATION

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

The undersigned, **J. Clay Murphy**, being duly sworn, deposes and says that he is Director – Gas Management, Planning, and Supply for Louisville Gas and Electric Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

J. Clay Murphy
J. Clay Murphy

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 1st day of March 2010.

Kimberly Brick (SEAL)
Notary Public

My Commission Expires:

October 16, 2012

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Pamela L. Jaynes**, being duly sworn, deposes and says that she is Gas Supply Manager for Louisville Gas and Electric Company, and that she has personal knowledge of the matters set forth in the responses for which she is identified as the witness, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

Pamela Jaynes
Pamela L. Jaynes

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 1st day of March 2010.

______________________(SEAL)
Notary Public

My Commission Expires:

October 16, 2012

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Initial Data Request of Commission Staff
Dated February 18, 2010

Case No. 2009-00550

Question No. 1

Witness: Clay Murphy

Q-1. Provide calculations showing the dollar amount of sharing between LG&E and its customers annually for each year of the report period.

A-1. The calculations to determine the sharing between LG&E (or "the Company") and its customers of any savings or expenses achieved under the gas supply cost PBR mechanism are included in the final report for each PBR Year.

Under the revised sharing mechanism approved by the Commission in its October 26, 2001 Order in Case No. 2001-00017 and as affirmed by the Commission in its May 27, 2005 Order in Case No. 2005-00031, a sliding scale was adopted. Under that sliding scale, LG&E's share in any savings or expenses is 25% for all savings or expenses up to 4.5% of Total Actual Gas Supply Costs ("TAGSC"), which is the sum of Actual Gas Costs ("AGC") and Total Actual Annual Gas Transportation Costs ("TAAGTC"). For savings (or expenses) in excess of 4.5% of TAGSC, LG&E's share is 50%.

PBR Year 9 (12 months ended October 31, 2006): Total savings for PBR Year 9 were $17,132,325, and TAGSC was $280,602,747, which is the sum of $254,243,816 in AGC and $26,358,931 in TAAGTC. Therefore, savings as a percentage of TAGSC were 6.11% ($17,132,325 / $280,602,747). Hence, all of the savings up to $12,627,124 (4.5% x $280,602,747) are shared with 25% allocated to LG&E and the remaining 75% being retained by customers as having already been reflected in LG&E's GSCC. The portion of the savings in excess of that amount, or $4,505,201 ($17,132,325 - $12,627,124), is subject to the 50% sharing tier.

Therefore, the initial tier of the sliding scale is allocated on a 25/75 basis with $3,156,781 (25% x $12,627,124) being allocated to the Company and $9,470,343 (75% x $12,627,124) being allocated to customers. The second tier is subject to sharing on a 50/50 basis with $2,252,600 (50% x $4,505,201) being allocated to the Company and $2,252,601 (50% x $4,505,201) being allocated to customers.

Therefore, the total portion of the savings being retained by customers is $11,722,944 ($9,470,343 + $2,252,601); and the total portion of the savings being allocated to the Company and collected from customers is $5,409,381 ($3,156,781 + $2,252,600). Therefore, the Company Share of the Performance Based Ratemaking Mechanism savings or expenses ("CSPBR") to be collected for the Company from customers by means of the Performance Based Recovery Component ("PBRRC") (as a part of the Gas Supply Cost Component ("GSCC")) is $5,409,381.

PBR Year 10 (12 months ended October 31, 2007): Total savings for PBR Year 10 were $10,222,856, and TAGSC was $272,937,137, which is the sum of $247,276,734 in AGC and $25,660,403 in TAAGTC. Therefore, savings as a percentage of TAGSC were 3.75% ($10,222,856 / $272,937,137). Hence, any savings up to $12,282,171 (4.5% x $272,937,137) are shared with 25% allocated to LG&E and the remaining 75% being retained by customers as having already been reflected in LG&E's GSCC. Because there are no savings in excess of the 4.5% threshold of $12,282,171, none are shared at the 50% sharing tier.

Therefore, the initial tier of the sliding scale is allocated on a 25/75 basis with $2,555,714 (25% x $10,222,856) being allocated to the Company and $7,667,142 (75% x $10,222,856) being allocated to customers. There is no sharing under the second tier which is subject to sharing on a 50/50 basis between Company and customers. Therefore, the total portion of the savings being retained by customers is $7,667,142 ($7,667,142 + $0); and the total portion of the savings being allocated to the Company and collected from customers is $2,555,714 ($2,555,714 + $0). Therefore, the PBRRC to be collected for the Company from customers through the GSCC is $2,555,714.

PBR Year 11 (12 months ended October 31, 2008): Total savings for PBR Year 11 were $11,385,951, and TAGSC was $365,382,839, which is the sum of $339,601,745 in AGC and $25,781,094 in TAAGTC. Therefore, savings as a percentage of TAGSC were 3.12% ($11,385,951 / $365,382,839). Hence, any savings up to $16,442,228 (4.5% x $365,382,839) are shared with 25% allocated to LG&E and the remaining 75% being retained by customers as having already been reflected in LG&E's GSCC. Because there are no savings in excess of the 4.5% threshold of $16,442,228, none are shared at the 50% sharing tier.

Therefore, the initial tier of the sliding scale is allocated on a 25/75 basis with $2,846,488 (25% x $11,385,951) being allocated to the Company and $8,539,463 (75% x $11,385,951) being allocated to customers. There is no sharing under the second tier which is subject to sharing on a 50/50 basis between Company and customers. Therefore, the total portion of the savings being retained by customers is $8,539,463 ($8,539,463 + $0); and the total portion of the savings being allocated to the Company and collected from customers is $2,846,488 ($2,846,488 + $0). Therefore, the PBRRC to be collected for the Company from customers through the GSCC is $2,846,488.

PBR Year 12 (12 months ended October 31, 2009): Total savings for PBR Year 12 were $6,981,170, and TAGSC was $188,487,751, which is the sum of $163,384,089 in AGC and $25,103,662 in TAAGTC. Therefore, savings as a percentage of TAGSC were 3.70% ($6,981,170 / $188,487,751). Hence, any savings up to $8,481,949 (4.5% x $188,487,751) are shared with 25% allocated to LG&E and the remaining 75% being retained by customers as having already been reflected in LG&E's GSCC. Because there are no savings in excess of the 4.5% threshold of $8,481,949, none are shared at the 50% sharing tier.

Therefore, the initial tier of the sliding scale is allocated on a 25/75 basis with $1,745,292 (25% x $6,981,170) being allocated to the Company and $5,235,878 (75% x $6,981,170) being allocated to customers. There is no sharing under the second tier which is subject to sharing on a 50/50 basis between Company and customers. Therefore, the total portion of the savings being retained by customers is $5,235,878 ($5,235,878 + $0); and the total portion of the savings being allocated to the Company and collected from customers is $1,745,292 ($1,745,292 + $0). Therefore, the PBRRC to be collected for the Company from customers through the GSCC is $1,745,292.

Attached are tables summarizing the calculations described herein.

Louisville Gas And Electric Company
Summary of Gas Supply Cost Performance-Based Ratemaking Savings/(Expenses)

12 Months Ended October 31	Year	Total Savings (Expenses) *	Customer Portion	Shareholder Portion	AGC	TAAGTC	TAGSC	Percentage
2002	5	$5,994,221	$4,495,666	$1,498,555	$117,371,041	$27,895,137	$145,266,178	4.13%
2003	6	$13,570,936	$9,610,649	$3,960,287	$224,956,761	$26,170,439	$251,127,200	5.40%
2004	7	$8,980,737	$6,735,553	$2,245,184	$220,159,259	$26,648,595	$246,807,854	3.64%
Total	5 - 7	$28,545,894	$20,841,868	$7,704,026	$562,487,061	$80,714,171	$643,201,232	4.44%
2005	8	$10,806,867	$8,105,150	$2,701,717	$316,248,284	$26,289,056	$342,537,340	3.15%
Total	5 - 8	$39,352,761	$28,947,018	$10,405,743	$878,735,345	$107,003,227	$985,738,572	3.99%
2006	9	$17,132,325	$11,722,944	$5,409,381	$254,243,816	$26,358,931	$280,602,747	6.11%
2007	10	$10,222,856	$7,667,142	$2,555,714	$247,276,734	$25,660,403	$272,937,137	3.75%
2008	11	$11,385,951	$8,539,463	$2,846,488	$339,601,745	$25,781,094	$365,382,839	3.12%
2009	12	$6,981,170	$5,235,878	$1,745,292	$163,384,089	$25,103,662	$188,487,751	3.70%
Total	9 - 12	$45,722,302	$33,165,427	$12,556,875	$1,004,506,384	$102,904,090	$1,107,410,474	4.13%

* Savings/Expenses are shared 25% to Company and 75% to Customer up to 4.5% of benchmarked costs; above 4.5% savings are shared 50%/50%.

Louisville Gas and Electric Company
Customer / Company Allocation Under Gas Supply Cost Performance-Based Ratemaking Mechanism
12 Months Ended October 31, 2006
Year 9

Total PBR Results -- Savings (Expenses)	TPBRR		$17,132,325
Actual Gas Costs	AGC	$254,243,816	
Actual Transportation Costs	TAAGTC	$26,358,931	
Total Actual Gas Supply Costs	TAGSC		$280,602,747
Percentage	(TPBRR / TAGSC)		6.11%

	Total PBR Results (TPBRR)	Company Sharing Company	Customer Sharing Percentage	Customer Portion	Company Portion (CSPBR)
25/75 Company/Customer Sharing Up to 4.5% of TAGSC	$12,627,124	25%	75%	$9,470,343	$3,156,781
50/50 Company/Customer Sharing in Excess of 4.5% of TAGSC	$4,505,201	50%	50%	$2,252,601	$2,252,600
Total	$17,132,325			$11,722,944	$5,409,381

Louisville Gas and Electric Company
Customer / Company Allocation Under Gas Supply Cost Performance-Based Ratemaking Mechanism
12 Months Ended October 31, 2007
Year 10

Total PBR Results -- Savings (Expenses)	TPBRR		$10,222,856
Actual Gas Costs	AGC	$247,276,734	
Actual Transportation Costs	TAAGTC	$25,660,403	
Total Actual Gas Supply Costs	TAGSC		$272,937,137
Percentage	(TPBRR / TAGSC)		3.75%

	Total PBR Results (TPBRR)	Company Sharing Company	Customer Sharing Percentage	Customer Portion	Company Portion (CSPBR)
25/75 Company/Customer Sharing Up to 4.5% of TAGSC	$10,222,856	25%	75%	$7,667,142	$2,555,714
50/50 Company/Customer Sharing in Excess of 4.5% of TAGSC	$0	50%	50%	$0	$0
Total	$10,222,856			$7,667,142	$2,555,714

Louisville Gas and Electric Company
Customer / Company Allocation Under Gas Supply Cost Performance-Based Ratemaking Mechanism
12 Months Ended October 31, 2008
Year 11

Total PBR Results -- Savings (Expenses)	TPBRR		$11,385,951
Actual Gas Costs	AGC	$339,601,745	
Actual Transportation Costs	TAAGTC	$25,781,094	
Total Actual Gas Supply Costs	TAGSC		$365,382,839
Percentage	(TPBRR / TAGSC)		3.12%

	Total PBR Results (TPBRR)	Company Sharing Company	Customer Sharing Percentage	Customer Portion	Company Portion (CSPBR)
25/75 Company/Customer Sharing Up to 4.5% of TAGSC	$11,385,951	25%	75%	$8,539,463	$2,846,488
50/50 Company/Customer Sharing in Excess of 4.5% of TAGSC	$0	50%	50%	$0	$0
Total	$11,385,951			$8,539,463	$2,846,488

Louisville Gas and Electric Company
Customer / Company Allocation Under Gas Supply Cost Performance-Based Ratemaking Mechanism
12 Months Ended October 31, 2009
Year 12

Total PBR Results -- Savings (Expenses)	TPBRR		$6,981,170
Actual Gas Costs	AGC	$163,384,089	
Actual Transportation Costs	TAAGTC	$25,103,662	
Total Actual Gas Supply Costs	TAGSC		$188,487,751
Percentage	(TPBRR / TAGSC)		3.70%

	Total PBR Results (TPBRR)	Company Sharing Company	Customer Sharing Percentage	Customer Portion	Company Portion (CSPBR)
25/75 Company/Customer Sharing Up to 4.5% of TAGSC	$6,981,170	25%	75%	$5,235,878	$1,745,292
50/50 Company/Customer Sharing in Excess of 4.5% of TAGSC	$0	50%	50%	$0	$0
Total	$6,981,170			$5,235,878	$1,745,292

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Initial Data Request of Commission Staff
Dated February 18, 2010

Case No. 2009-00550

Question No. 2

Witness: Clay Murphy

Q-2. For each year of the report period, provide details of annual expenses associated with the Performance Based Ratemaking ("PBR") Mechanism.

A-2. The PBR mechanism requires that LG&E exclude labor-related or other expenses typically classified as O&M expenses from the determination of any savings or expenses under the PBR mechanism. LG&E is required to report on a quarterly basis any costs required to implement the PBR mechanism. Inasmuch as such costs cannot be shared between Company and Customer, LG&E has sought to minimize incremental costs. LG&E has not incurred any significant quantifiable costs during the period covered by this report for activity under the PBR mechanism.

Incurrence of Non-Quantifiable Expenses Under the PBR Mechanism:

LG&E has incurred no significant quantified expenses in connection with activity under this PBR report. However, LG&E does incur expenses associated with managing LG&E's risks under the PBR mechanism. Those expenses include labor-related expenses and other operating and maintenance expenses that are typically not considered to be out-of-pocket. These expenses would not likely be incurred by LG&E absent the gas supply cost PBR mechanism.

For example, LG&E's Gas Supply Department analyzes and develops strategies to achieve savings under the PBR mechanism, evaluates risks related to potential strategies, and implements strategies and actions to manage risks, maximize savings, and mitigate expenses under the PBR mechanism. Other departments within LG&E also provide support in these processes. For example, the development and evaluation of strategies that rely upon LG&E's on-system storage capabilities also requires analytical support from LG&E's Gas Control Department. The management of credit risks related to strategies that involve off-system sales transactions requires input from LG&E's Credit Department. LG&E's regulatory counsel also assists LG&E in identifying various potential regulatory developments that may impact the pipeline services purchased by LG&E and its ability to achieve savings under the PBR mechanism.

The Gas Supply Department must also administer the PBR mechanism, which includes calculating benchmarks, tracking PBR mechanism results, and preparing regulatory and other reports related to the PBR mechanism. These administrative functions assist LG&E in determining the extent to which its risk of incurring expenses is increasing or decreasing as the PBR Year progresses.

It is not possible to quantify these expenses because LG&E does not track specific hours related to the development of PBR strategies, the implementation of those strategies, or the administrative functions related to the PBR mechanism. However, absent the PBR mechanism, there would have been no need for LG&E to undertake these kinds of activities.

Incurrence of Risk Under the PBR Mechanism:

Importantly, LG&E does assume risk in the operation of the PBR mechanism. If LG&E does not successfully manage that risk, it shares in any expenses incurred under the mechanism. If LG&E successfully manages that risk, it shares in any savings under the mechanism. For this reason the gas supply cost PBR mechanism acts as an incentive mechanism to avoid expenses (including out-of-pocket expenses) and to achieve savings.

On page 3 of its Application, LG&E sets forth certain risks it has assumed in order to achieve savings under its gas supply cost PBR mechanism. Those mentioned include contracting risks, storage management risks, supply management risks, transportation management risks, and credit risks. Absent the mechanism, LG&E would not have undertaken these risks and would not have been exposed to these risks.

While LG&E has assumed additional risks in order to achieve savings under its PBR mechanism, LG&E does not assumed those risks without first determining that it can manage those risks. LG&E's paramount goal, irrespective of any incentive mechanism is to ensure reliable service to customers. LG&E does not take actions that would jeopardize the reliability of its system regardless of the potential savings that might be achieved under the PBR mechanism. LG&E recognizes that it has an obligation to reliably serve its retail gas customers and that the cost it would incur to correct any failure to serve its customers would substantially outweigh any savings that might be produced under the PBR mechanism.

LG&E evaluates and assumes those risks for which it will be rewarded under the PBR mechanism as it develops and establishes its gas supply strategies, as it develops its gas supply portfolio, as it sets up its monthly gas supply activities, and as it manages and evaluates the gas supply activities that it must undertake to provide reliable service to its customers. LG&E's willingness to undertake these risks is derived from the potential rewards which it can receive through the sharing mechanism.

LOUISVILLE GAS AND ELECTRIC COMPANY

Response to the Initial Data Request of Commission Staff
Dated February 18, 2010

Case No. 2009-00550

Question No. 3

Witness: Clay Murphy / Pam Jaynes

Q-3. Compare the levels of savings realized from each of the PBR components from November 1, 2005 through October 31, 2009 to the November 1, 2001 through October 31, 2004 period covered by its last report in Case No. 2005-00031. Specifically address the higher savings realized through the Gas Acquisition Index Factor as opposed to the Transportation Index Factor in the current report period as compared to the last, as well as the steep decline in the Off-System Sales Index Factor. Include a discussion of market factors that may have impacted these results.

A-3. When LG&E implements a strategy to create savings under the PBR mechanism, there is no guarantee that the strategy will in fact produce savings under the mechanism. Some strategies have proven successful during some months, but have not been successful in all the months in which the strategy was implemented. Other strategies are currently successful, but may not continue to be successful in the future. There is no single purchasing strategy that can be successful in any and all potential market scenarios. Therefore, LG&E undertakes a variety of purchasing strategies which enable it to achieve savings for customers under a variety of market conditions because it does not know what market conditions will ultimately materialize and be used to measure its performance. LG&E's overall strategy, however, has generally proven to be successful.

Importance of Comparing Same Number of Years: In making a comparison of savings levels achieved for each component of the PBR, it is important to note that the Report provided to the Commission in this proceeding (Case No. 2009-00550) ("the Current PBR Report") summarizes four years of PBR results (PBR Years 9, 10, 11, and 12) while the Report provided to the Commission in Case No. 2005-00031 ("the Previous PBR Report") summarizes three years of PBR results (PBR Years 5, 6, and 7). The Current PBR Report includes an additional year of results for each PBR component because it is associated with a five-year Commission extension of the PBR mechanism, while the Previous PBR Report is associated with a four-year Commission extension of the PBR mechanism.

When comparing the Previous PBR Report to the Current PBR Report, the table included in response to Commission Question No. 1 illustrates that results (savings) from the Previous PBR Report (covering 3 years) are only very slightly higher than the Current PBR Report (covering 4 years) when expressed as a percentage of the Total Actual Gas Supply Costs ("TAGSC"). (The TAGSC is the total of the Actual Gas Costs ("AGC") and the Total Annual Actual Gas Transportation Costs ("TAAGTC")). This comparison shows that (expressed as a percentage) the results (savings) for both the Current and Previous PBR Reports were about 4% of TAGSC (4.44% of TAGSC for PBR Years 5, 6, and 7 and 4.13% of TAGSC for PBR Years 9, 10, 11, and 12).

However, when comparing the same number of years, the results are even more similar. When comparing PBR Years 5, 6, 7, and 8 to PBR Years 9, 10, 11, and 12, the results (savings) for PBR Years 5, 6, 7, and 8 are 3.99% of TAGSC compared to the results for PBR Years 9, 10, 11, and 12, which are 4.13% of TAGSC. Recall that savings below the 4.5% of the TAGSC level are shared on a 25/75 basis between Company and Customer, and savings above the 4.5% sharing level is shared on a 50/50 basis.

GAS ACQUISITION INDEX FACTOR ("GAIF")

Components of the GAIF: The savings or expenses achieved by LG&E under the GAIF component of the PBR mechanism are calculated by comparing the total annual Benchmark Gas Costs ("BGC") for the PBR Year to the total annual Actual Gas Costs ("AGC") for the same period. The BGC is made up of two cost components. The first component is Total Annual Benchmarked Gas Commodity Costs ("TABMGCC"), and the second component is Historical Reservation Fees ("HRF"). The TABMGCC is determined by applying the applicable price indices to all gas commodity purchases on Texas Gas and Tennessee and the HRF is the average of the actual reservation fees for the prior two years.

Factors Impacting Performance: The factors that influence the level of savings or expenses achieved under the Gas Acquisition Index Factor ("GAIF") are reflected in the ability of LG&E's gas supply strategies to respond effectively to a variety of exogenous factors, including on-system loads, price behavior, and supply reservation fees. When comparing the results under the GAIF from one PBR Year to another, or one series of PBR years to another, it is important to recognize that the factors influencing performance under the GAIF are not constant from one PBR Year to another PBR Year. Consequently, comparing the results of one PBR Year to another, or one series of PBR years to another is not meaningful except insofar as they demonstrate the risks inherent in the PBR mechanism itself. This is also true for the other two components (the TIF and the OSSIF) of the gas supply cost PBR mechanism. These components are discussed in detail further below.

The number of PBR years included in each report significantly impacts the total savings reported. This is particularly true for the Gas Acquisition Index Factor ("GAIF") component of the mechanism which benchmarks natural gas commodity costs. In order to reflect the different number of years included in each PBR report, the following comparison focuses on average savings/(expenses) achieved per year for the Current PBR Report and the Previous PBR Report. See Table 1.

Breaking Down the GAIF Components by PBR Report: In order to explain why the savings achieved by LG&E under the GAIF of the PBR mechanism were higher on average for the four PBR Years ended October 31, 2009, than for the three PBR Years ended October 31, 2004, it is important to analyze the savings achieved by LG&E under each of the GAIF components (gas commodity and HRF). See Table 1.

The average savings per year achieved under each of these components is set forth below in Table 1 for each PBR Report:

TABLE 1

PBR Report	Average Gas Commodity Savings/ (Expenses)	Average Reservation Fees (HRF) Savings/ (Expenses)	Average Total GAIF Savings/ (Expenses)
Current	$7,782,996	($325,190)	$7,457,806
Previous	$4,826,956	($1,327,694)	$3,499,262

Gas Commodity Costs

The gas commodity cost savings set forth above reveal that the average commodity savings included in the Current PBR Report are $2,956,040 ($7,782,996 - $4,826,956) higher than the average savings included in the Previous PBR Report.

Impact of PBR Year 9 on Performance During the Current PBR Report: The higher commodity cost savings achieved by LG&E in the Current PBR Report can be attributed to the ability of LG&E's gas supply strategies to respond to external factors (such as purchase requirements and price behavior), particularly during PBR Year 9 (November 2005 through October 2006) when LG&E

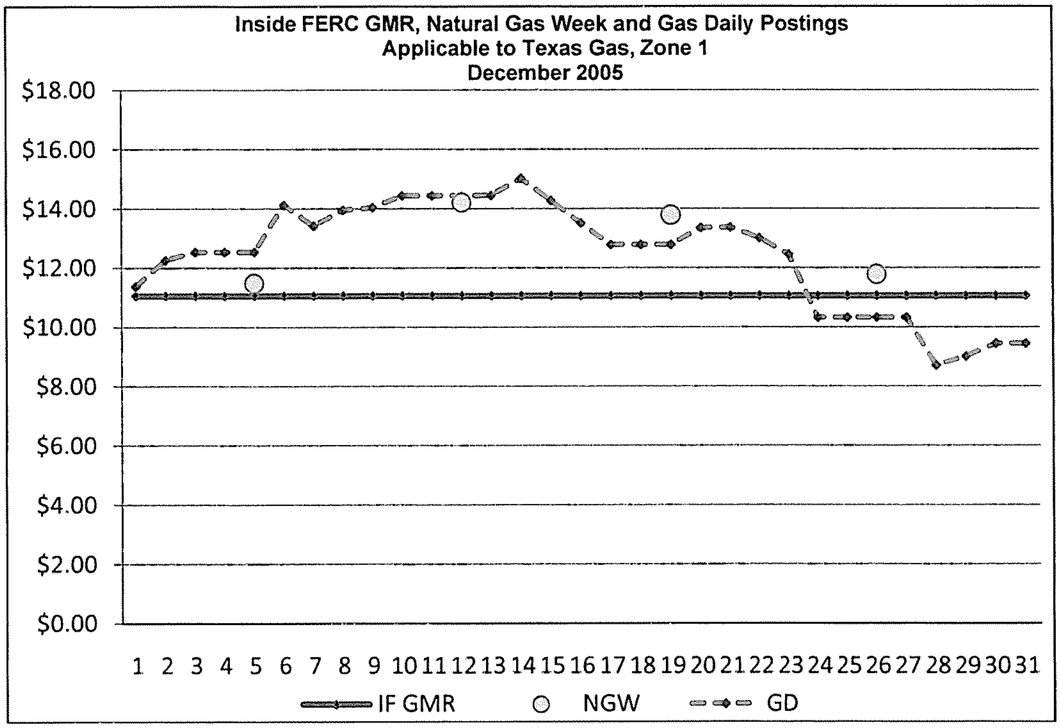
achieved savings under the gas commodity component of the PBR of $13,285,188.

At the beginning of PBR Year 9 (November 2005), natural gas market prices were near $14 per MMBtu. This high market price reflected market concerns about the adequacy of natural gas supplies following the extensive damage caused by Hurricanes Katrina and Rita to natural gas supply infrastructure (production, processing and pipeline facilities).

LG&E's gas supply strategies were particularly successful in mitigating customer exposure to periods of rising prices that occurred during PBR Year 9, and in particular during the Winter Season of 2005/2006. Specifically, those strategies were very successful during December of 2005 when LG&E achieved savings under the gas commodity component of the mechanism of $6,641,462. This one month represents about 50% ($6,641,462 / $13,285,188) of the gas commodity savings reported in PBR Year 9 and about 21% ($6,641,462 / $31,131,982) of the total gas commodity savings reported in the Current PBR Report for PBR Years 9 through 12.

Several factors contributed to LG&E's performance in December 2005. The weather in December 2005 was nearly 14% colder-than-normal in Louisville causing LG&E's supply purchase requirements to exceed 5 Bcf (the highest December level in PBR Years 5 through 12). Additionally, there were several periods of rising prices during December 2005. For example, at the beginning of December 2005 the market price was about $12 per MMBtu and by mid-December the price had risen to about $15 per MMBtu. LG&E successfully managed the risk associated with its supply portfolio for December 2005 in a manner that significantly mitigated the impact of higher market prices on its customers.

Below is a graph that illustrates the behavior of market prices during December 2005 for gas purchased in Texas Gas Zone 1 as reflected in a first-of-month price posting (*Inside F.E.R.C.--Gas Market Report,* a weekly price posting (*Natural Gas Week*) and a daily price posting (*Gas Daily*). While this chart focuses on the movement of gas prices in Texas Gas Zone 1, similar price behavior was experienced for Texas Gas Zone SL, Tennessee Zone 0, and Tennessee Zone 1 during December 2005.



<u>Impact of PBR Year 5 on Performance During the Previous PBR Report</u>: Contrasted with the results from PBR Year 9 of the Current PBR Report, PBR Year 5 greatly contributed to the lower average commodity costs savings achieved for PBR Years 5 through 7 of the Previous PBR Report.

During PBR Year 5, LG&E achieved $1,539,237 in commodity savings (exclusive of the HRF impact). This was the lowest AGC savings achieved for PBR Years 5 through 12 of the PBR Mechanism. One factor that contributed significantly to the total level of commodity savings achieved for PBR Year 5 is the expense of ($760,597) that LG&E incurred under the gas commodity component of the GAIF in November 2001.

During PBR Year 5, LG&E also experienced expenses under the GAIF component of the PBR Mechanism not only in November 2001, but also in December 2001, January 2002, and February 2002. Expenses achieved under the HRF component of the mechanism in each of these months contributed to the net expenses achieved under the GAIF for those months. These expenses illustrate the risk of exposure to expenses under the PBR Mechanism. (Please see a more specific discussion of the HRF component of the PBR Mechanism below.)

When analyzing the commodity cost savings achieved for PBR Year 5, it is important to take into consideration that LG&E's ability to achieve savings under the GAIF for that PBR Year was reduced by the fact that LG&E did not receive a Commission Order in Case No. 2001-00017 to renew the PBR mechanism until October 26, 2001. In order to ensure reliable supply for its customers, LG&E had already entered into supply contracts by that date that would be in effect during the PBR Year beginning November 1, 2001. By October 26, 2001, LG&E was unable to adjust its supply portfolio to respond to the revised incentives under the PBR Mechanism which began November 1, 2001 (PBR Year 5).

Specifically, the PBR mechanism approved in Case No. 97-00171 included two first-of-month price indices (*Inside F.E.R.C.--Gas Market Report* and *NYMEX*) and two mid-month price indices (*Gas Daily* and *Natural Gas Week*). The October 26, 2001 Commission Order in Case No. 2001-00017 removed *NYMEX* from the indices used to calculate the GAIF benchmark. That same Order also altered the sharing mechanism from a 50/50 Company/Customer sharing to a sliding scale with a 25/75 sharing mechanism covering savings up to 4.5% of benchmarked gas costs and a 50/50 sharing above that level. Even though that Order substantially changed the benchmarks and incentives under the GAIF, LG&E could not incorporate those revisions into its gas supply strategies until the following year. This contributed to LG&E achieving lower savings under the commodity costs component of the GAIF and higher expenses under the HRF component of the GAIF for PBR Year 5.

Historical Reservation Fees ("HRF")

Illustrative of one of the risks that LG&E has taken under the GAIF component is the fact that LG&E has achieved expenses, not savings, under the HRF component of the GAIF in 9 of the 12 years that it has operated under a PBR mechanism.

HRF Expenses: As set forth in Table 1 above, LG&E has experienced average annual expenses of ($325,190) for the four PBR years in the Current PBR Report and average annual expenses of ($1,327,694) for the three PBR years in the Previous PBR Report. Reservation fees are the charges assessed by gas suppliers to hold gas available to meet the demands of the gas purchaser according to the contract specifications. Like gas prices, reservation fees are impacted by market conditions.

One reason that LG&E achieved greater savings under the GAIF in the Current PBR Report is that it has taken actions since the Previous PBR Report that reduced the expenses under the HRF component by an average of $1,002,504 per year ($1,327,694 in expenses from the Previous PBR Report less $325,190 in expenses from the Current PBR Report). (See Table 1.) This fact alone accounts for 25% [$1,002,504 / ($7,457,806 - $3,499,262)] of the increase in average GAIF savings included in the Current PBR Report as compared to the Previous PBR Report.

Efforts to Mitigate HRF Expenses: LG&E has taken several actions over the years to mitigate the impact of increasing gas supply reservation fees, such as minimizing the monthly volume change flexibility required under its supply agreements priced at first-of-month indices (which agreements command higher supply reservation fees), reducing supply contracts incorporating first-of-month pricing during shoulder months (in order to lower overall reservation fees), and relying more on the use of pricing provisions that are tied to daily price indices (which agreements command lower supply reservation fees).

Continued Applicability of Mechanism: The overall structure of the GAIF component of the PBR mechanism continues to provide appropriate incentives to LG&E to manage its gas supply portfolio in ways which reduce costs to customers, specifically by encouraging LG&E to purchase reliable gas supplies at the lowest prevailing price.

TRANSPORTATION INDEX FACTOR ("TIF")

Components of the TIF: The savings or expenses achieved by LG&E under the TIF component of the PBR mechanism are calculated by comparing the Total Annual Benchmark Monthly Gas Transportation Costs ("TABMGTC") for the PBR Year to the Total Annual Actual Gas Transportation Costs ("TAAGTC") for the same period. The TABMGTC is determined by applying the tariffed pipeline transportation rates to the billed demand and volumetric quantities under contract to LG&E from its interstate pipeline transportation providers.

Factors Impacting Performance: When comparing the total savings achieved by LG&E under the TIF component of the PBR mechanism during one PBR Year to those achieved during another PBR Year, it is important to take into account that the factors that influence performance are not constant from year to year. The most significant factor driving the results of the Transportation Index Factor ("TIF") of the gas supply cost PBR mechanism has been the decline in transportation capacity held by LG&E. LG&E required less capacity to meet its sales requirements, and, as a result, began exercising pipeline capacity reduction options as they became available beginning in PBR Year 9. With the decline in transportation capacity held by LG&E on interstate pipelines, there has been a decline in LG&E's opportunity to secure pipeline transportation discounts for that capacity.

Narrative of Capacity Reductions and Impact on Discounts Achieved: Following is a narrative of the capacity changes implemented by LG&E beginning with PBR Years 9 through 12, the years incorporated in the Current PBR Report.

PBR Year 9: Effective November 1, 2005

- Reduction in January–only Capacity Under Texas Gas's Rate STF by 15,000 MMBtu/day: This capacity reduction resulted in a decrease in savings for PBR Year 9 when compared to PBR Year 8 of approximately $129,177.

- Reduction in Summer Season Capacity Under Texas Gas's Rate FT by 18,000 MMBtu/day: This capacity reduction resulted in a decrease in savings for PBR Year 9 when compared to PBR Year 8 of approximately $752,625.

Therefore, the total estimated reduction in savings under the TIF component for PBR Year 9 as compared to PBR Year 8 is approximately $881,802.

PBR Year 10: Effective November 1, 2006

- Reduction in Annual Capacity Under Texas Gas's Rate FT by 8,000 MMBtu/day: This capacity reduction resulted in a decrease in savings for PBR Year 10 when compared to PBR Year 9 of approximately $272,146.

PBR Year 11: Effective November 1, 2007

- There were no changes in capacity for PBR Year 11 as compared to PBR Year 10.

PBR Year 12: Effective November 1, 2008

- Reduction in Winter Season Capacity Under Texas Gas's Rate FT by 18,000 MMBtu/day: This capacity reduction resulted in a decrease in savings for PBR Year 12 when compared to PBR Year 11 of approximately $29,652.

- Conversion of Summer Season Capacity of 18,000 MMBtu/day from Texas Gas's Rate FT to Rate STF: The conversion of this capacity from Texas Gas's Rate FT (which was discounted) to Texas Gas's Rate STF (which is not discounted) resulted in a decrease in savings for PBR Year 12 when compared to PBR Year 11 of approximately $596,173.

Therefore, the total estimated reduction in savings under the TIF component for PBR Year 12 as compared to PBR Year 11 is approximately $625,825.

Table 2 below shows the performance in the TIF component for each year of the Current PBR Report and compares those results to the prior year.

TABLE 2

	TIF Savings	Change in Savings From Prior Year	Reduction in Discounts Resulting from Capacity Reductions	Impacts of Other Factors
PBR Year 9	$3,854,805	($900,871)	($881,802)	($19,069)
PBR Year 10	$3,540,781	($314,024)	($272,146)	($41,878)
PBR Year 11	$3,587,862	$47,081	$0	$47,081
PBR Year 12	$2,950,497	($637,365)	($625,825)	($11,540)
Total		($1,805,179)	($1,779,773)	($25,406)

As illustrated, the reduced opportunity to achieve discounts accounts for about 99% ($1,779,773 / $1,805,179) of the decrease in TIF savings included in the Current PBR Report. Other factors which contribute in a lesser degree to any differences in the TIF savings included in the Current PBR Report compared to the Previous PBR Report include the volumes transported, the mix in pipeline transportation quantities, and capacity release activity.

Continued Applicability of Mechanism: Despite lower savings in the TIF component of the PBR mechanism, the overall structure of the TIF component of the PBR mechanism continues to provide appropriate incentives to LG&E to manage its gas transportation portfolio in ways which reduce costs to customers, including negotiating discounts, releasing capacity, or by other means.

OFF-SYSTEM SALES INDEX FACTOR ("OSSIF")

Components of the OSSIF: The savings or expenses achieved by LG&E under the OSSIF component of the PBR mechanism are calculated by comparing the Off-System Sales Revenues ("OSREV") for the PBR Year to the Out-of-Pocket Costs ("OOPC").

LG&E makes off-system sales when it can purchase natural gas under its contracts which incorporate first-of-month pricing and then sell that gas to a credit-worthy counterparty at a price that is higher than the first-of-month price that LG&E is contracted to pay for the gas. LG&E does not make off-system sales of natural gas when such gas is required to meet on-system requirements, or when making such sales could reduce LG&E's flexibility to increase or decrease the volume it can purchase under a contract in order to meet on-system load requirements later in the month. Because LG&E's PBR mechanism appropriately provides for symmetrical sharing of savings achieved across all PBR components (GAIF, TIF, and OSSIF), LG&E is not incented to make off-system sales of natural gas in lieu of using such supply to meet on-system requirements.

Table 3 below sets forth a summary of savings/(expenses) included in the Current PBR Report and the Previous PBR Report.

TABLE 3

Current PBR Report PBR Year	OSSIF Savings/ (Expenses)	Previous PBR Report PBR Year	OSSIF Savings/ (Expenses)
Year 9	$ 4,927	Year 5	$2,170,618
Year 10	$1,262,877	Year 6	$1,187,553
Year 11	$ 689,331	Year 7	$1,342,433
Year 12	$ 0		
Report Total	$1,957,135	Report Total	$4,700,604

Savings achieved by LG&E under the OSSIF component of the PBR mechanism averaged $489,284 ($1,957,135 / 4) per year in the Current PBR Report, while in the Previous PBR Report, savings under this component were on average $1,566,868 ($4,700,604 / 3) per year – approximately $1,077,584 ($1,566,868 - $489,284) higher in the Previous PBR Period than in the Current PBR Period.

Factors Impacting Performance: Low off-system sales volumes in PBR Year 9 and PBR Year 12 of the mechanism contributed significantly to the lower average savings achieved under the OSSIF component in the Current PBR Report. Market price behavior combined with reduced reliance on contracts incorporating first-of-month pricing contributed to lower performance found in the Current PBR Report as compared to the Previous PBR Report.

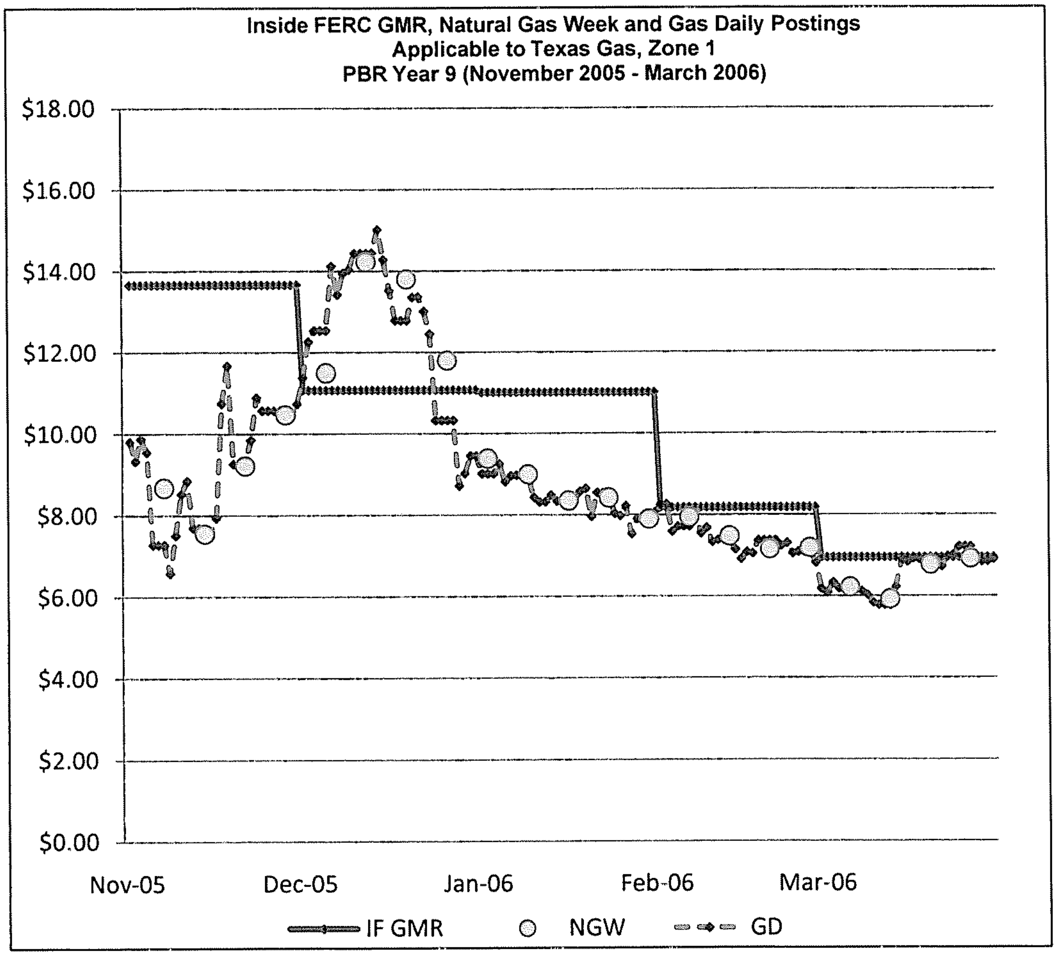
Decreased Reliance on Supply Contracts With First-of-Month Pricing: The reduction in OSSIF reflected in the Current PBR Report was, in part, caused by LG&E's reduced reliance over time on contracts incorporating both first-of-month pricing and volume change flexibility which reduction impacted LG&E's opportunities to make off-system sales. For example, in PBR Year 5, the first year included in the Previous PBR Report, LG&E had 8 gas supply contracts (totaling 167,000 MMBtu per day) that incorporated first-of-month pricing for January. By contrast, in PBR Year 9, the first year included in the Current PBR

Report, LG&E had 6 gas supply contracts (totaling 138,000 MMBtu/day) for January.

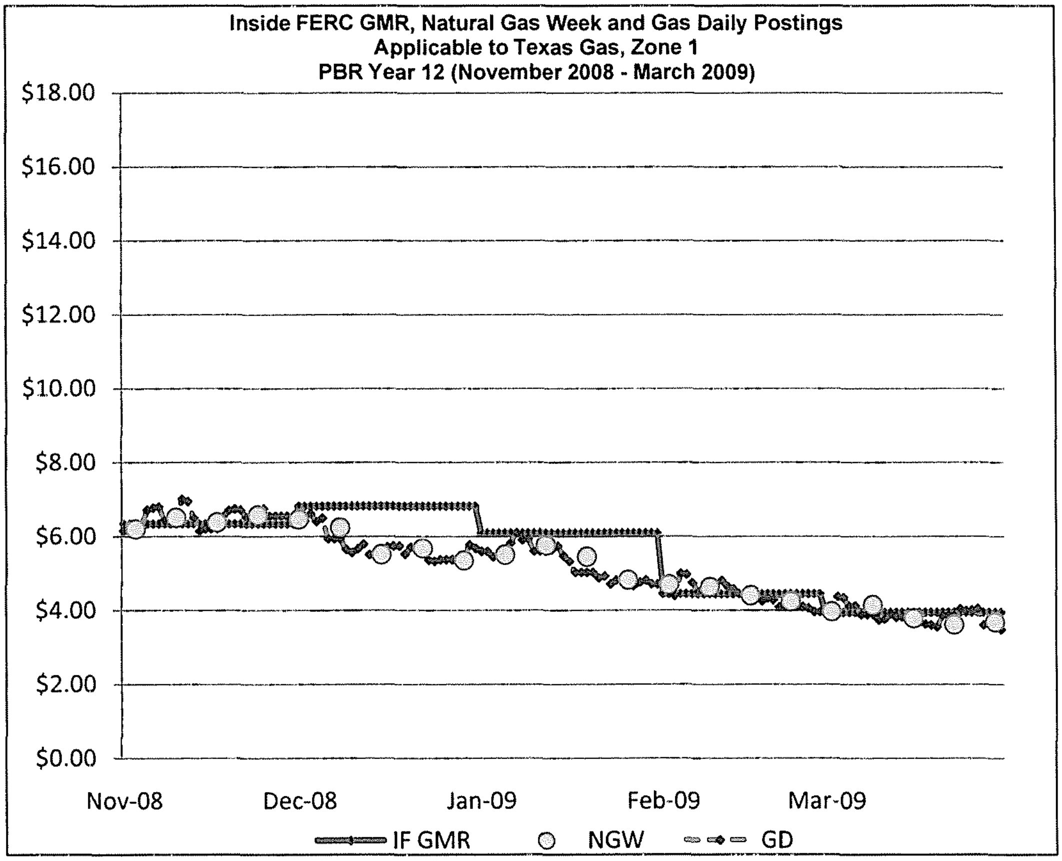
As discussed above with respect to "Efforts to Mitigate HRF Expenses" under the GAIF component, one reason that LG&E made such changes in its gas supply strategies was to reduce expenses caused by rising reservation fees under the HRF. Supply contracts which enable LG&E to call on gas at first-of month prices generally have higher reservation fees. LG&E determined that the risk of incurring known higher reservation fees outweighed the potential for exploiting unknown but potential off-system sales opportunities.

Market Price Behavior: A closer look at market price behavior and LG&E's on-system requirements during the Winter Seasons of PBR Year 9 and PBR Year 12 of the mechanism are helpful in understanding the reasons for low off-system sales volumes for these two PBR years. (This discussion focuses on the Winter Season because the majority of off-system sales occur during the Winter Season when LG&E has the greatest ability to purchase natural gas under contracts that both incorporate first-of-month pricing and mid-month volume purchase flexibility.)

The chart below illustrates that -- except for the month of December 2005 -- market prices during the Winter of 2005/2006 (PBR Year 9) generally trended downward from the start of each month to the end of each month. As a result, LG&E did not have an opportunity to make off-system sales during the months of November 2005, January 2006, February 2006, and March 2006. LG&E did make some off-system sales during the month of December 2005 because market conditions and on-system requirements supported such off-system sales. However, additional off-system sales were not possible during the month of December 2005 because the supply that could have been purchased to make such off-system sales was instead being purchased by LG&E to meet on-system requirements. (Please see the discussion above regarding substantial savings achieved under the GAIF component during December 2005 entitled "Impact of PBR Year 9 on Performance During the Current PBR Report".)



Similarly, during the Winter of 2008/2009 (PBR Year 12), LG&E did not have meaningful opportunities to make off-system sales because market prices generally remained flat or trended downward throughout the Winter Season. The chart below illustrates that except for the month of November 2008, market prices during the Winter of 2008/2009 (PBR Year 12) generally trended downward from the start of each month to the end of each month.



In making any off-system sale, not only is LG&E presented with counter-party credit risks, but there is also a risk that an off-system sale could create expenses under the OSSIF component of the PBR mechanism. Additionally, there is a risk that an off-system sale could reduce LG&E's purchasing flexibility for the remainder of the month under one or more supply contracts making it difficult to respond to changes in system supply requirements.

While daily market prices may have supported off-system sales during some periods of November 2008, LG&E did not make off-system sales because the supply that could have been purchased to make such sales was instead being purchased by LG&E to meet on-system requirements. Price movements and load conditions did not present LG&E with an opportunity to make off-system sales during the months of December 2008 and January 2009. Daily market prices may have supported off-system sales for a few days in early February 2009 and early March 2009. However, given the general downward price trend during the months leading into February and March, and the fact that market prices did not rise substantially above first-of-month prices in February or March for any duration, making off-system sales presented unacceptable risks to LG&E. Additionally, LG&E used a portion of its contracts that incorporate first-of-month pricing to meet on-system requirements in February and March.

<u>Continued Applicability of Mechanism</u>: Despite reductions in the OSSIF component of the PBR mechanism, the overall structure of the OSSIF component of the PBR mechanism continues to provide appropriate incentives to LG&E to manage its gas supply portfolio in ways which reduce costs to customers, specifically by allowing LG&E to share in any savings achieved for customers as a result of off-system sales activity.