

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

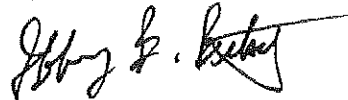
**In the Matter of:**

<b>Application Of Kentucky Power Company For:</b>	)	
<b>(1) A General Adjustment Of Its Rates For Electric</b>	)	
<b>Service; (2) An Order Approving Its 2014</b>	)	
<b>Environmental Compliance Plan; (3) An Order</b>	)	<b>Case No. 2014-00396</b>
<b>Approving Its Tariffs And Riders; And (4) An</b>	)	
<b>Order Granting All Other Required Approvals</b>	)	
<b>And Relief</b>	)	

**REBUTTAL TESTIMONY OF**  
**JEFFREY B. BARTSCH**  
**ON BEHALF OF KENTUCKY POWER COMPANY**

**VERIFICATION**

The undersigned, Jeffrey B. Bartsch, being duly sworn, deposes and says he is the Director, Tax Accounting and Regulatory Services for American Electric Power Service Corporation and that he has personal knowledge of the matters set forth in the forgoing testimony and the information contained therein is true and correct to the best of his information, knowledge and belief.



\_\_\_\_\_  
Jeffrey B. Bartsch

STATE OF OHIO


)

) Case No. 2014-00396

COUNTY OF FRANKLIN

)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by Jeffrey B. Bartsch, this the 27 day of April 2015.

  
\_\_\_\_\_  
Notary Public

My Commission Expires: 12/14/15

**REBUTTAL TESTIMONY OF  
JEFFREY B. BARTSCH, ON BEHALF OF  
KENTUCKY POWER COMPANY  
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY**

**I. INTRODUCTION**

1 **Q. PLEASE STATE YOUR NAME.**

2 A. My name is Jeffrey B. Bartsch.

3 **Q. ARE YOU THE SAME JEFFREY B. BARTSCH WHO OFFERED**  
4 **DIRECT TESTIMONY IN THIS PROCEEDING?**

5 A. Yes.

**II. PURPOSE OF REBUTTAL TESTIMONY**

6 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**  
7 **PROCEEDING?**

8 A. The purpose of my rebuttal testimony is to rebut the testimony of KIUC witness  
9 Lane Kollen regarding the Section 199 Manufacturing Deduction and the  
10 amortization period of the Mitchell Plant ADSIT. In addition, I will discuss the  
11 accounting impacts of the extension of Federal bonus tax depreciation.

12 **Q. ARE YOU SPONSORING ANY REBUTTAL EXHIBITS?**

13 A. Yes. I am sponsoring the following Rebuttal Exhibits:

14 Rebuttal Exhibit JBB-R1 – Historical Stand-Alone Section 199 Deduction

15 Rebuttal Exhibit JBB-R2 – Reconciliation of Book Income to QPAI

16 Rebuttal Exhibit JBB-R3 – Analysis of KIUC Proposed Revenue Adjustments

17 Rebuttal Exhibit JBB-R4 – Analysis of Potential Section 199 Deduction

**III. SECTION 199 MANUFACTURING DEDUCTION**

1 **Q. MR. KOLLEN RECOMMENDS THAT THE SECTION 199**  
2 **MANUFACTURING DEDUCTION BE INCLUDED IN THE GROSS**  
3 **REVENUE CONVERSION FACTOR (GRCF). DO YOU AGREE?**

4 A. No. As I stated in my Direct Testimony, this is inappropriate because the  
5 Company has not been able to claim the deduction on most of its Federal Income  
6 Tax Returns since this provision was added to the Internal Revenue Tax Code  
7 effective in the 2005 tax year. The Company has offered historical tax return  
8 evidence that cannot be disputed. Mr. Kollen's approach assumes that the  
9 Company will always get a permanent tax benefit from Section 199.

10 **Q. HOW DOES MR. KOLLEN PROPOSE TO CALCULATE THE SECTION**  
11 **199 MANUFACTURING DEDUCTION BENEFIT FOR PURPOSES OF**  
12 **THIS PROCEEDING?**

13 A. Mr. Kollen bases his calculation of the Section 199 deduction on the Revenue  
14 Requirement (-ie- Return) on Common Equity as shown in Section VI of page 2  
15 of his Exhibit LK-9. This amount represents the theoretical Pre-Tax Book  
16 Income that the Company would earn in this rate proceeding assuming all of the  
17 KIUC adjustments are accepted by the Commission. He applies a Gross Revenue  
18 Conversion Factor, which contains an adjustment for the Section 199 deduction  
19 related to production plant (based on a Percent of Production Assets to Total  
20 Assets), to the total company return in order to calculate a revenue requirement  
21 assuming that the Company would be able to claim a Section 199 deduction. The  
22 difference between this calculation and the revenue requirement that he calculates

1 in Section V of page 2 of his Exhibit LK-9 represents his theoretical impact of the  
2 Section 199 deduction on the revenue requirement.

3 **Q. DO YOU AGREE WITH THIS APPROACH?**

4 A. No. In the first place, the Section 199 deduction is determined on an annual basis  
5 based on facts and circumstances and is more closely aligned with taxable income.  
6 Mr. Kollen's calculation assumes that the book return on production activities will  
7 approximate the Qualified Production Activities Income (QPAI) which would be  
8 used in calculating the Section 199 manufacturing deduction. As indicated on  
9 Rebuttal Exhibit JBB-R2, the two will not be the same and in fact are quite different.

10 **Q. PLEASE EXPLAIN WHY THESE AMOUNTS WOULD BE DIFFERENT.**

11 A. The primary reason for the difference between book income and QPAI is that  
12 QPAI is derived from taxable income associated with generation related activities  
13 only. Thus, by using book income, Mr. Kollen is excluding the impact of all  
14 book/tax temporary differences in his computation of the Section 199 impact on  
15 revenues.

16 **Q. DO YOU HAVE ANY CONCERNS REGARDING MR. KOLLEN'S**  
17 **EXHIBIT LK-9?**

18 A. Yes. The source of the production plant balances used in the development of his  
19 production percentage for calculating the Section 199 impact is not correct. Mr.  
20 Kollen has corrected his production factor and subsequent calculations and revenue  
21 adjustments that are impacted by Section 199 in the KIUC Response to Kentucky  
22 Power Company's First Set of Data Requests.

1 **Q. DO YOU HAVE ANY OTHER CONCERNS REGARDING MR.**  
2 **KOLLEN'S CALCULATION OF THE SECTION 199 BENEFITS?**

3 A. Yes. Despite the fact that the Company claimed minimal, if any Section 199  
4 deductions on a stand-alone basis over the past 4 tax years as indicated in Rebuttal  
5 Exhibit JBB-R1, Mr. Kollen believes that the Company will be able to claim a  
6 Section 199 base rate Schedule M deduction of approximately \$1,900,000 even  
7 though he is recommending a base rate decrease of \$35,702,000 as revised in the  
8 KIUC Response to Kentucky Power Company's First Set of Data Requests. Mr.  
9 Kollen has also recommended Section 199 Schedule M deductions of  
10 approximately \$1,800,000 related to the Big Sandy Retirement Rider and the  
11 Mitchell FGD Environmental Surcharge for a Total Company Section 199  
12 Schedule M deduction of approximately \$3,700,000. The largest Section 199  
13 Schedule M deduction that the Company has ever been able to claim on a stand-  
14 alone basis over the past 9 years is \$330,833.

15 **Q. THE REVENUE RIDERS RELATED TO THE BIG SANDY**  
16 **RETIREMENT AND THE MITCHELL FGD ENVIRONMENTAL**  
17 **SURCHARGE RECOVERY HAVE CONSIDERABLE REVENUE**  
18 **INCREASES, WOULDN'T THOSE AMOUNTS CONTRIBUTE TO THE**  
19 **SECTION 199 DEDUCTION?**

20 A. Yes, but only marginally. A large portion of the revenues associated with these  
21 riders are offset with expenses, so only the book income associated with those riders  
22 would contribute to the computation of any Section 199 benefit. As a result, the  
23 revenues associated with the Big Sandy Unit 1 Operations Rider would not

1 contribute anything to net income or QPAI for purposes of computing a Section 199  
2 deduction. Mr. Kollen acknowledges this as he has not proposed any Section 199  
3 adjustments to this Revenue Rider. Moreover, although the Big Sandy Retirement  
4 Rider and the Mitchell FGD Environmental Surcharge do have some earnings  
5 associated with them that would contribute to QPAI, it is much less than calculated  
6 by Mr. Kollen.

7 **Q. HAVE YOU PERFORMED AN ANALYSIS OF THE KIUC'S**  
8 **RECOMMENDED REVENUE ADJUSTMENTS AND THE POTENTIAL**  
9 **IMPACT IT MAY HAVE ON THE SECTION 199 DEDUCTION?**

10 A. Yes, as shown in Rebuttal Exhibit JBB-R3, it appears that even though the KIUC is  
11 recommending an overall revenue increase (including the revenue riders) of  
12 \$26,782,000 (as revised), the estimated impact on production activity book income  
13 is only about \$11,000,000. Using Mr. Kollen's approach of using book income  
14 rather than QPAI to calculate the Section 199 deduction, this would indicate that the  
15 Company might receive a Section 199 manufacturing deduction of \$348,000 on its  
16 tax returns as a result of the KIUC's proposed changes to revenues (See Rebuttal  
17 Exhibit JBB-R4). This would equate to an approximate reduction of \$544,000 in the  
18 Company's revenue requirement and not the \$2,147,000 proposed by KIUC.

19 **Q. WOULDN'T THERE BE AN EXPECTATION THAT A RATE INCREASE**  
20 **RESULTING FROM THIS CASE WOULD INCREASE THE COMPANY'S**  
21 **TAXABLE INCOME, WHICH WILL IN TURN INCREASE THE**  
22 **LIKELIHOOD OF THE COMPANY BEING ABLE TO CLAIM THE**  
23 **SECTION 199 DEDUCTION?**

1 A. While one would assume that an increase in revenues would increase the QPAI on  
2 which the Section 199 deduction is calculated, it is nothing more than an  
3 assumption. It is important to note that any change in the Section 199 deduction  
4 would be dependent on more than the amount of the revenue increase that impacts  
5 generation activities. As indicated on Rebuttal Exhibit JBB-R2, there is no direct  
6 link between book income and QPAI due to the differences in the reporting of  
7 revenues and expenses for book and tax purposes.

8 **Q. MR. KOLLEN STATES THAT BOTH KENTUCKY UTILITIES AND**  
9 **LOUISVILLE GAS AND ELECTRIC HAVE REFLECTED THE**  
10 **SECTION 199 DEDUCTION IN THE GRCF FOR THEIR RECENT BASE**  
11 **RATE CASES. DOES THAT MEAN KENTUCKY POWER SHOULD DO**  
12 **LIKEWISE?**

13 A. No. Each Company is different and has its own set of facts and circumstances. I  
14 am not familiar with these companies, but it appears that they may in fact be  
15 enjoying the benefits of being able to claim a Section 199 deduction on their tax  
16 returns. The fact that one company can claim a deduction does not mean that  
17 another company would also be able to claim the deduction.

18 **Q. MR. KOLLEN CLAIMS THAT THE COMPANY HAS NOT OFFERED**  
19 **PROOF THAT IT WILL NOT BE ABLE TO CLAIM THE SECTION 199**  
20 **DEDUCTION IN THE FUTURE. DO YOU AGREE WITH THAT**  
21 **ASSERTION?**

22 A. No; it is quite the opposite. Rebuttal Exhibit JBB-R1 clearly demonstrates that  
23 the Company has been able to claim this deduction only infrequently, and



1 certainly not to the magnitude that Mr. Kollen believes that it will be able to claim  
2 in this filing. On the other hand, Mr. Kollen has not proven that the Company  
3 will be able to claim this deduction in the future. As demonstrated above, the  
4 revenue increases that may be granted in this case are not expected to contribute  
5 much if anything towards generating additional QPAI which would drive a  
6 Section 199 deduction on the tax return.

7 **WHAT IS THE COMPANY'S POSITION ON THE AMOUNT OF THE**  
8 **SECTION 199 DEDUCTION THAT SHOULD BE INCLUDED IN THE**  
9 **TAX CALCULATION FOR THIS RATE PROCEEDING?**

10 A. The Section 199 deduction for this rate case should be based on historical  
11 information and reasonable expectations. The deduction should not be based on  
12 some theoretical calculation that does not bear any relation to reality. It would not  
13 be proper to include in rates a tax benefit that cannot realistically be expected to be  
14 realized. For purposes of this proceeding, I recommend using a Section 199  
15 deduction amount based on the historical stand-alone deductions that could have  
16 actually been claimed on the Company's stand-alone Federal income tax returns.

**IV. AMORTIZATION OF MITCHELL PLANT ADSIT**

17 **Q. MR. KOLLEN RECOMMENDS THAT THE ADSIT RELATED TO THE**  
18 **MITCHELL PLANT ACQUISITION BE AMORTIZED OVER A THREE**  
19 **YEAR PERIOD RATHER THAN THE 23.59 YEARS PROPOSED BY THE**  
20 **COMPANY. DO YOU AGREE WITH HIS RECOMMENDATION?**

1 A. No. As discussed in my direct testimony, the Company believes that this ADSIT  
2 benefit should be recognized over the estimated remaining life of the plant since it  
3 was the Mitchell plant that gave rise to the liability.

4 **Q. MR. KOLLEN STATES IN HIS TESTIMONY THAT THIS ADSIT**  
5 **LIABILITY IS MORE AKIN TO A REGULATORY LIABILITY,**  
6 **THEREFORE IT IS SIMPLY AN AMOUNT DUE TO THE COMPANY'S**  
7 **CUSTOMERS AND THE COMMISSION HAS THE DISCRETION TO**  
8 **AMORTIZE THE BALANCE OVER A SHORTER PERIOD OF TIME.**  
9 **DO YOU AGREE WITH THIS STATEMENT?**

10 A. Although true in the abstract, amortizing the ADSIT balance over the 23.59 year  
11 remaining life of the unit giving rise to the benefit ensures that the customers  
12 paying for the unit during its operational life receive the benefit of the ADSIT  
13 liability and not just by the Company's customers during the arbitrary three year  
14 amortization period suggested by Mr. Kollen.

#### V. FEDERAL BONUS DEPRECIATION

15 **Q. PLEASE DESCRIBE THE 50% FEDERAL BONUS TAX DEPRECIATION**  
16 **THAT WAS EXTENDED IN DECEMBER 2014?**

17 A. As the Company stated in its response to KIUC 1-27, in December 2014, the  
18 Federal 50% bonus tax depreciation deduction was extended for the entire 2014  
19 year. Under Internal Revenue Code Section 168(k), the bonus allowance is only  
20 available for new property ("original use" must begin with the taxpayer) which is  
21 depreciable under MACRS and has a recovery period of 20 years or less and  
22 computer software depreciable over three years under IRC Sec 167(f). The assets

1 must be placed in service before January 1, 2015, unless the property qualifies as  
2 “long production property.” This is defined as property that (a) is subject to IRC  
3 Sec 263A uniform capitalization rules, (b) has a production period greater than  
4 one year and a cost exceeding \$1 million, and (c) has a MACRS recovery period  
5 of at least 10 years. If these additional requirements are met and the asset is  
6 placed in service in 2015, then the pre-2015 expenditures will qualify for bonus  
7 depreciation in 2015.

8 **Q. DID THE COMPANY REFLECT THE ADDITIONAL TAX**  
9 **DEPRECIATION AND ADIT AS A REDUCTION TO CAPITALIZATION**  
10 **IN ITS FILING?**

11 A. No. As the Company responded to KIUC 1-30, if the retroactive 50% bonus  
12 depreciation extension had been signed into law in time to include in the rate  
13 filing, the Company would have included its impacts on the ADIT balances as of  
14 September 30, 2014.

15 **Q. IF THE COMPANY WERE TO ADJUST THE SEPTEMBER 2014**  
16 **FINANCIAL STATEMENTS TO REFLECT THE EXTENSION OF THE**  
17 **50% FEDERAL BONUS TAX DEPRECIATION, WHAT WOULD BE THE**  
18 **IMPACT ON THE INCOME STATEMENT FOR THE 12 MONTHS**  
19 **ENDED SEPTEMBER 30, 2014 AND THE BALANCE SHEET AS OF**  
20 **SEPTEMBER 30, 2014?**

21 A. If the Company had reflected the additional 50% federal bonus tax depreciation  
22 on the Company’s September books, current income tax expense on the income  
23 statement would have been reduced and deferred income tax expense would have

1           been increased by an equal and offsetting amount resulting in no change in  
2           income tax expense for income statement purposes. For balance sheet purposes  
3           the Company would have reduced current federal income taxes payable and  
4           increased accumulated deferred federal income taxes by an equal and offsetting  
5           amount resulting in no change to the total assets or total liabilities. Reflecting the  
6           change in 50% federal bonus tax depreciation on the Company's September 2014  
7           books could possibly have resulted in an increase in net cash from operations of  
8           the Company had the legislation been enacted before the close of the quarter.  
9           Since the legislation was not signed into law until December 19, 2014, cash flows  
10          could not have been impacted as estimated tax payments had already been made  
11          for the year. Company witness Wohnhas informs me that an adjustment to reflect  
12          the change in the 50% federal bonus tax depreciation would have had no effect on  
13          the Company's capitalization for rate making purposes.

14   **Q.    DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?**

15   A.    Yes.