COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	**)**	
COMMISSION OF THE ENVIRONMENTAL	**)**	
SURCHARGE MECHANISM OF KENTUCKY	**)**	**CASE NO.**
UTILITIES COMPANY FOR THE SIX-MONTH	**)**	**2015-00020**
BILLING PERIODS ENDING APRIL 30, 2014	**)**	
AND OCTOBER 31, 2014	**)**	

DIRECT TESTIMONY OF

CHRISTOPHER M. GARRETT
DIRECTOR – ACCOUNTING AND REGULATORY REPORTING
LG&E AND KU SERVICES COMPANY

Filed: February 16, 2015

Q. Please state your name, title, and business address.

A. My name is Christopher M. Garrett. I am the Director – Accounting and Regulatory Reporting for LG&E and KU Services Company, which provides services to Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively "the Companies"). My business address is 220 West Main Street, Louisville, Kentucky, 40202. A complete statement of my education and work experience is attached to this testimony as Appendix A.

Q. Have you previously testified before this Commission?

A. No. However, I previously provided responses to data requests in the Companies' most recent environmental cost recovery ("ECR") surcharge mechanism review case.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss the impact of the 2014 Tax Increase Prevention Act ("Act") and bonus tax depreciation prior to the 2014 tax law change on the ECR periods under review.

Q. Please briefly describe the changes resulting from the 2014 Tax Increase Prevention Act and other bonus tax depreciation provisions in 2014 and their impact on this filing.

A. In December 2014, the Act was passed into law. Included in the Act was an extension of 50% bonus tax depreciation for qualified property placed into service before January 1, 2015. Prior to the law change, only long- production-period property with construction commencing before 2014 was eligible for the 50% bonus tax depreciation deduction in 2014.

As a result of the bonus tax depreciation deduction, KU will incur a tax loss in 2014 and will be unable to take the Internal Revenue Code §199 manufacturing tax deduction. The §199 manufacturing tax deduction is not available to companies that do not have taxable income. The loss of the federal §199 deduction for 2014 results in an increase in KU's 2014 effective income tax rate, thereby, increasing the gross-up revenue factor used in the rate of return calculation. This increase is partially offset by a reduction in the environmental rate base as the deferred income tax liability is increased by the additional bonus tax depreciation.

Q. What is KU's projected tax loss in 2014?

A. KU expects to have a federal taxable loss of approximately $205 million in 2014. The taxable loss is due mainly to $400 million of bonus tax depreciation KU expects to deduct on its 2014 federal income tax return.

Q. What effective income tax rate is KU recommending for use in the gross-up revenue factor for 2013 and 2014?

A. KU recommends using an effective income tax rate of 35.6937% in its December 2013 gross-up revenue factor to be applied to the September through December 2013 expense months and 38.6660% in its February 2014 and August 2014 gross-up revenue factors to be applied to the January through February 2014 and March through August 2014 expense months, respectively. The details and support for the calendar years 2013 and 2014 gross-up revenue factors are shown in the attachments to KU's response to Question No. 1 of the Commission Staff's Request for Information.

Q. What was the impact on the rate of return as a result of the increase in the effective income tax rate?

A. KU recommends an overall rate of return on capital of 10.60% to be applied to the January through February 2014 expense months and 10.52% to be applied to the March through August 2014 expense months. Prior to the increase in the effective income tax rate, the overall rates of return on capital were 10.19% for the January through February 2014 expense months and 10.11% for the March through August 2014 expense months.

Q. Should KU elect to take bonus tax depreciation in 2014 given the resulting increase in the ECR revenue requirement in 2014?

A. Yes, the increase in the deferred income tax liability associated with the bonus tax depreciation deduction in 2014 will continue to reduce the environmental rate base thus lowering the ECR revenue requirement in 2015 and beyond. Additionally, the election to take bonus tax depreciation in 2014 will serve to further reduce base rates as discussed in data response AG 1-27 in the current base rate case proceeding, Case No. 2014-00371.

Q. What effective income tax rate is KU recommending for use in the gross-up revenue factor for 2015?

A. KU recommends using an effective income tax rate of 35.6937% for the gross-up revenue factor in the rate of return calculation for 2015 billing periods. This includes the benefits associated with receiving the §199 manufacturing tax deduction. The use of this lower effective income tax rate results in a rate of return of 10.15%, thereby, lowering the ECR revenue requirement. This approach is consistent with KU's recommendation in the current base rate case proceeding to opt-out of taking bonus tax depreciation in 2015 in order to provide the greatest benefit to customers. The details and support for the calendar year 2015 gross-up revenue factor are shown in the attachments to KU's response to Question No. 5 of the Commission Staff's Request for Information.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned **Christopher M. Garrett**, being duly sworn, deposes and says he is Director – Accounting and Regulatory Reporting for LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Christopher M. Garrett

CHRISTOPHER M. GARRETT

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 16th day of February 2015.

Tammy J. Elzy
(SEAL)
Notary Public

My Commission Expires:

November 9, 2018

APPENDIX A

Christopher M. Garrett
Director, Accounting and Regulatory Reporting
LG&E and KU Services Company
220 West Main Street
Louisville, KY 40202
(502) 627-3328

Professional Memberships:

American Institute of Certified Public Accountants (AICPA)
Kentucky Society of Certified Public Accountants (KSCPA)

Education:

Eastern Kentucky University, Bachelor of Business Administration - Accounting, 1995
- Graduated Magna Cum Laude

Certified Public Accountant, Kentucky, 1999

Previous Positions:

Director, Financial Planning & Controlling	Feb 2010 – Nov 2012
Manager, Financial Planning	Nov 2007 – Feb 2010
Manager, Corporate Accounting	Jan 2006 – Oct 2007
Manager, Utility Tax	May 2002 – Jan 2006
Tax Analyst, various positions	Aug 1995 – May 2002