

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY UTILITIES)
COMPANY FOR CERTIFICATES OF PUBLIC)
CONVENIENCE AND NECESSITY AND)
APPROVAL OF ITS 2016 COMPLIANCE PLAN) **CASE NO. 2016-00026**
FOR RECOVERY BY ENVIRONMENTAL)
SURCHARGE)

KENTUCKY UTILITIES COMPANY
RESPONSE TO THE
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
SECOND SET OF DATA REQUESTS

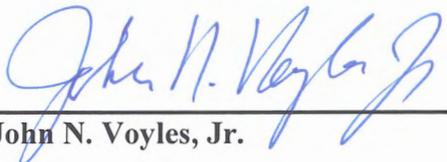
DATED APRIL 8, 2016

FILED: APRIL 20, 2016

VERIFICATION

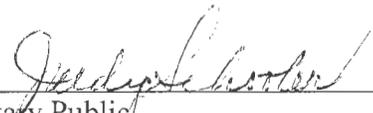
COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **John N. Voyles, Jr.**, being duly sworn, deposes and says that he is the Vice President, Transmission and Generation Services for Louisville Gas and Electric Company and Kentucky Utilities Company and an employee of LG&E and KU Services Company, 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.



John N. Voyles, Jr.

Subscribed and sworn to before me, a Notary Public in and before said County and State,
this 10th day of April 2016.



Notary Public (SEAL)

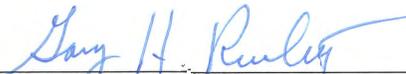
My Commission Expires:

JUDY SCHOULER
Notary Public, State at Large, KY
~~My commission expires July 11, 2018~~
Notary ID # 512743

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Gary H. Revlett**, being duly sworn, deposes and says that he is Director – Environmental Affairs for LG&E and KU Services 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.



Gary H. Revlett

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 20th day of April 2016.



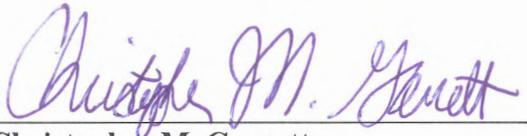
Notary Public (SEAL)

My Commission Expires:
JUDY SCHOOLER
Notary Public, State at Large, KY
My commission expires July 11, 2018
Notary ID # 512743

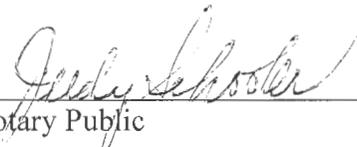
VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Christopher M. Garrett**, being duly sworn, deposes and says that he is Director – Rates for LG&E and KU Services 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.


Christopher M. Garrett

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 20th day of April 2016.


Notary Public (SEAL)

My Commission Expires:
JUDY SCHOOLER
Notary Public, State at Large, KY
My commission expires July 11, 2018
Notary ID # 512743

KENTUCKY UTILITIES COMPANY

Response to Kentucky Industrial Utility Customers, Inc.

Second Set of Data Requests Dated April 8, 2016

Case No. 2016-00026

Question No. 2-1

Witness: John N. Voyles, Jr. / Gary H. Revlett

- Q.2-1 Refer to the Company's responses to KIUC 1-1 and 1-2(a). The responses reference the Company's response to Staff 1-22. The Company's response to Staff 1-22 does not provide a response to KIUC 1-1 or KIUC 1-2(a). The question and response to Staff 1-22 address only the recovery of costs due to future ELG requirements, not present CCR or other requirements. Please provide a response to the two KIUC questions as posed. If there is no legal requirement at present, then please so state. If there presently is a legal requirement, then identify the specific requirement and legal citation relied on for this assertion.
- A.2-1 KU does not agree with the premise set forth in this supplemental request for information, but in the interest of clarity states: KU is not aware of an existing legal requirement mandating the closure of the surface impoundments at Green River, Tyrone, and Pineville as they are being operated today, although there are environmental legal requirements in the state regulations that apply to the closures of those surface impoundments when the closures occur (e.g., 401 KAR 45.110), as KU is proposing to do in this proceeding by December 2018 for Green River and by December 2019 for Pineville and Tyrone. When KU closes these impoundments, it will have to incur costs to comply with applicable environmental regulations (again, e.g., 401 KAR 45:110); KU will not be able to avoid the costs of complying with those regulations. As set forth in detail in KU's response to PSC 1-22 and as addressed in the testimony of John N. Voyles, Jr. and Gary H. Revlett, closing the surface impoundments as proposed is prudent and lowest-reasonable-cost for several reasons. Therefore, because the proposed closures, including the proposed timing of the closures, are prudent and lowest-reasonable-cost, and because the closures will have to comply with state environmental requirements applicable to "coal combustion wastes and by-products from facilities utilized for production of energy from coal" (e.g., 401 KAR 45.110), the closures' costs are recoverable through KU's environmental surcharge mechanism consistent with KRS 278.183.

KENTUCKY UTILITIES COMPANY

Response to Kentucky Industrial Utility Customers, Inc.

Second Set of Data Requests Dated April 8, 2016

Case No. 2016-00026

Question No. 2-2

Witness: Christopher M. Garrett

Q. 2-2 Refer to the Company's response to KIUC 1-3, which provides the expenditures used in the Company's calculations of AROs. Please provide a citation to the legal requirement that mandates impoundment closures as proposed by the Company by December 2018 for Green River and December 2019 for Tyrone and Pineville.

A.2-2 See the response to Question No. 2-1. But note that a legal requirement to retire an asset by a date certain is not a requirement for Asset Retirement Obligations ("ARO"); rather, for an ARO there must be legal requirements attaching to the retirement activities when an asset retires, as there will be for KU's proposed impoundment closures at Green River, Pineville, and Tyrone.¹ Because KU will have to comply with applicable environmental legal requirements to close the impoundments as proposed, KU's ARO calculations based on the dates cited are appropriate.

¹ See, e.g., A.S.C. 410-20-25-13 ("If a current law, regulation, or contract requires an entity to perform an asset retirement activity when an asset is dismantled or demolished, there is an unambiguous requirement to perform the retirement activity even if that activity can be indefinitely deferred. At some time deferral will no longer be possible, because no tangible asset will last forever (except land). Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement.").

KENTUCKY UTILITIES COMPANY

Response to Kentucky Industrial Utility Customers, Inc.

Second Set of Data Requests Dated April 8, 2016

Case No. 2016-00026

Question No. 2-3

Witness: Christopher M. Garrett

- Q.2-3 Refer to the Company's response to KIUC 1-3. Please describe any penalty that the Company will incur if it does not complete the impoundment closures as proposed by the Company by December 2018 for Green River and December 2019 for Tyrone and Pineville. Cite to and provide a copy of all authorities relied on for your response.
- A.2-3 See the response to Question No. 2-1. KU has not asserted that it will incur penalties, and is not aware of any penalties under current law it will incur, if it does not close the surface impoundments at Green River, Pineville, and Tyrone as proposed. But the threat of a penalty is not a requirement for AROs, and the current lack of a penalty threat does not make KU's proposed closures any less prudent nor does it alter KU's lowest-reasonable-cost conclusion.

KENTUCKY UTILITIES COMPANY

Response to Kentucky Industrial Utility Customers, Inc.

Second Set of Data Requests Dated April 8, 2016

Case No. 2016-00026

Question No. 2-4

Witness: Christopher M. Garrett

Q.2-4 Refer to the Company's response to KIUC 1-5, which indicates that the Company does not intend to reflect the Section 199 deduction in the income tax rate used to calculate income tax expense on the proposed projects.

- a. Please confirm that the Company proposes to use the following calculation of the income tax rate to calculate the income tax expense for the proposed projects as shown in the spreadsheet attachment to the response to KIUC 1-5: $(35+6*.65)/100$.
- b. Please confirm that KU agreed with KIUC in Case No. 2004-00426 to include the Section 199 deduction in the calculation of the income tax rate and that this was memorialized by the Commission in its Order in that proceeding as follows:

KU has noted the need to recognize a "gross up" of the cost rates for its preferred stock and common equity to reflect the effects of income taxes. KIUC and KU agreed that the gross up factor should reflect the impact of the new Internal Revenue Code Section 199 Domestic Manufacturing Deduction and the reduction in the Kentucky corporate income tax rate. KU recalculated the gross up factor to reflect these tax changes, resulting in a gross up factor of 61.5558 percent.

Applying this gross up factor to the weighted average costs of preferred stock and common equity results in an overall rate of return on capital of 11.00 percent. The Commission finds this is the reasonable rate of return for KU's entire environmental compliance Rate Base as of the date of this Order. (Footnotes omitted).

- c. Please confirm that the elimination or reduction of the Section 199 deduction in the calculation of the income tax rate used to calculate income tax expense for the proposed projects is a change in methodology from that previously ordered by the Commission in prior proceedings. If this is not the case, then please identify and cite the relevant provisions of each Commission order that specifically revised the methodology adopted in Case No. 2004-00426.

- d. Please identify where, in the Company's application and/or its witness' testimony in this proceeding, the Company identified and requested the change in methodology described in part (c) of this question.
- A.2-4. a. For purposes of determining the estimated bill impacts for the 2016 ECR Plan, KU utilized the following effective income tax rate formula: $(35+(6*0.65*0.94))/100$. KU included the impact of the 6% Kentucky domestic production activities deduction in the formula but excluded the impact of the Federal Section 199 domestic production activities deduction in the formula. As discussed in KU's response to KIUC 1-5, KU does not anticipate being able to take the Section 199 deduction for the next few years as a result of tax losses attributable to bonus depreciation and thus has excluded the impact of the Section 199 deduction in the effective tax rate used in the gross-up factor. However, to the extent KU is able to take the Section 199 deduction in a future year, KU will appropriately reflect the impact in its future ECR monthly billings. Therefore, KU is excluding the Section 199 deduction only in those tax years in which it is unable to utilize the deduction. Current projections indicate KU will be unable to take the Section 199 deduction until 2018.
- b. Yes, KU agreed to include the Section 199 deduction in the calculation of the effective income tax rate in Case No. 2004-00426. KU was able to utilize the Section 199 deduction in 2005 unlike its current tax position where it has incurred significant tax losses in 2014 and 2015 due to large bonus depreciation deductions. It is KU's position that the Section 199 deduction should be included only to the extent KU in fact is able to use and record the deduction on its books and records.
- c. The exclusion of the Section 199 deduction in the calculation of the income tax rate for the proposed projects is not a change in methodology from that previously ordered by the Commission in prior proceedings. KU's exclusion of the Section 199 deduction reflects the fact that KU could not use the deduction for the reasons stated above. The Commission approved KU's calculations which excluded the Section 199 deduction in Case Nos. 2015-00020, 2015-00221, and 2015-00411.
- d. As discussed above, KU will appropriately reflect the impact of the Section 199 deduction in its effective income tax rate used in the gross-up factor as part of its ECR monthly billings to the extent it is able to use and record the deduction on its books and records. KU will continue to provide updates on its ability to use the Section 199 deduction in future ECR review cases consistent with the Company's approach in the most recent review cases listed in part c. of the response.

KENTUCKY UTILITIES COMPANY

Response to Kentucky Industrial Utility Customers, Inc.

Second Set of Data Requests Dated April 8, 2016

Case No. 2016-00026

Question No. 2-5

Witness: Christopher M. Garrett

- Q.2-5 Please indicate whether the Company has eliminated or reduced the Section 199 deduction in the calculation of the income tax rate used to calculate income tax expense on projects presently or previously included in the surcharge. If so, please provide the following:
- a. Each month in which the Company eliminated or reduced the Section 199 deduction in the calculation of the income tax rate used to calculate income tax expense on projects presently or previously included in the surcharge.
 - b. In each such month, the calculation of the income tax rate used to calculate income tax expense on projects presently or previously included in the surcharge.
 - c. A copy of each request submitted to the Commission to eliminate or reduce the Section 199 deduction in the calculation of the income tax rate used to calculate income tax expense on projects presently or previously included in the surcharge.
 - d. A copy of each notice provided to the Commission that the Company had eliminated or reduced or proposed to eliminate or reduce the Section 199 deduction in the calculation of the income tax rate used to calculate income tax expense on projects presently or previously included in the surcharge.
 - e. All authorities relied on by the Company as authorization from the Commission to eliminate or reduce the Section 199 deduction in the calculation of the income tax rate used to calculate income tax expense on projects presently or previously included in the surcharge.
- A.2-5 a. KU did not include the Section 199 deduction in the calculation of the effective income tax rate used in the gross-up factor for the expense months January through August 2014 for the reasons previously discussed. The Commission approved this calculation in Case No. 2015-00020. Additionally, KU did not include the Section 199 deduction for the expense months of September 2014 through February 2015 for the reasons discussed. The Commission approved this calculation in Case No. 2015-00221. Finally, KU did not include the Section 199 deduction for the expense months of March

2015 through August 2015 for the reasons discussed. The Commission approved this calculation in Case No. 2015-00411.

Furthermore, effective with the February 2016 billing month, KU received Commission approval of the rate of return excluding the Section 199 deduction to be used in the calculation of the monthly billing factors in Case No. 2015-00221.

- b. See attached for the effective income tax rate calculation excluding the Section 199 deduction.
- c,d,e. See the following links for testimony and responses to data requests provided by the Company in the cases referenced above regarding the exclusion of the Section 199 deduction from the effective income tax rate and the corresponding Commission orders and memos in those cases.

Testimony:

[http://psc.ky.gov/pscecf/2015-00020/robert.conroy%40lge-ku.com/02162015115119/Garrett_Testimony - KU 2015-00020 FINAL.pdf](http://psc.ky.gov/pscecf/2015-00020/robert.conroy%40lge-ku.com/02162015115119/Garrett_Testimony_-_KU_2015-00020_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00221/robert.conroy%40lge-ku.com/08122015020256/2-Conroy_Testimony - KU 2015-00221_FINAL.pdf](http://psc.ky.gov/pscecf/2015-00221/robert.conroy%40lge-ku.com/08122015020256/2-Conroy_Testimony_-_KU_2015-00221_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00411/rick.lovekamp%40lge-ku.com/01152016111654/2 - Rahn Testimony - KU 2015-00411_Final.pdf](http://psc.ky.gov/pscecf/2015-00411/rick.lovekamp%40lge-ku.com/01152016111654/2_-_Rahn_Testimony_-_KU_2015-00411_Final.pdf)

Responses to Data Requests:

[http://psc.ky.gov/pscecf/2015-00020/robert.conroy%40lge-ku.com/02162015115119/KU Formatted 1st DR due 02-16-15 FINAL.pdf](http://psc.ky.gov/pscecf/2015-00020/robert.conroy%40lge-ku.com/02162015115119/KU_Formatted_1st_DR_due_02-16-15_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00020/robert.conroy%40lge-ku.com/04022015103328/2-KU Formatted 2nd DR due 04-02-15_FINAL.pdf](http://psc.ky.gov/pscecf/2015-00020/robert.conroy%40lge-ku.com/04022015103328/2-KU_Formatted_2nd_DR_due_04-02-15_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00221/robert.conroy%40lge-ku.com/08122015020256/3-KU Responses to Staffs First Data Request filed 08 12 15.pdf](http://psc.ky.gov/pscecf/2015-00221/robert.conroy%40lge-ku.com/08122015020256/3-KU_Responses_to_Staffs_First_Data_Request_filed_08_12_15.pdf)

[http://psc.ky.gov/pscecf/2015-00221/robert.conroy%40lge-ku.com/09212015022028/2 - KU Responses to Staffs Second Data Request filed 09212015.pdf](http://psc.ky.gov/pscecf/2015-00221/robert.conroy%40lge-ku.com/09212015022028/2_-_KU_Responses_to_Staffs_Second_Data_Request_filed_09212015.pdf)

[http://psc.ky.gov/pscecf/2015-00411/derek.rahn%40lge-ku.com/01192016104642/2 - CORRECTED KU Formatted 1st DR 01-19-16.pdf](http://psc.ky.gov/pscecf/2015-00411/derek.rahn%40lge-ku.com/01192016104642/2_-_CORRECTED_KU_Formatted_1st_DR_01-19-16.pdf)

Orders:

http://psc.ky.gov/pscscf/2015%20Cases/2015-00020//20150612_PSC_ORDER.pdf

http://psc.ky.gov/pscscf/2015%20Cases/2015-00221//20151207_PSC_ORDER.pdf

http://psc.ky.gov/pscscf/2015%20Cases/2015-00411//20160316_PSC_ORDER.pdf

Informal Conference:

http://psc.ky.gov/pscscf/2015%20cases/2015-00020//20150420_PSC_IC%20Memo.pdf

http://psc.ky.gov/pscscf/2015%20cases/2015-00221//20151201_PSC%20IC%20Memo.pdf

http://psc.ky.gov/pscscf/2015%20cases/2015-00411//20160215_PSC%20IC%20Memo.pdf

**ECR - Gross-up Revenue Factor &
Composite Income Tax Calculation
Excluding Federal Section 199 deduction**

	W/ 6% State <u>Tax Rate Included</u>	
(1) Assume pre-tax income of	\$ 100.0000	
(2)		
(3) State income tax (see below)	<u>5.6400</u>	(40)
(4)		
(5) Taxable income for Federal income tax		
(6) before production credit	94.3600	(1)-(3)
(7) a. Production Rate	0%	
(8) b. Allocation to Production Income	100%	
(9) c. Allocated Production Rate (a x b)	0.00%	
(10)		
(11) Less: Production tax credit	<u>-</u>	(6)*(9)
(12)		
(13) Taxable income for Federal income tax	94.3600	(6)-(11)
(14)		
(15) Federal income tax	<u>\$ 33.0260</u>	(13)*35%
(16)		
(17)		
(18) Total State and Federal income taxes	<u>\$ 38.6660</u>	(3)+(15)
(19)		
(20) Gross-up Revenue Factor	<u><u>\$ 61.3340</u></u>	100-(18)
(21)		
(22) Therefore, the composite rate is:		
(23) Federal	33.0260%	(15)/100
(24) State	<u>5.6400%</u>	(3)/100
(25) Total	<u><u>38.6660%</u></u>	(23)+(24)
(26)		
(27)		
(28)		
(29)		
(30)		
(31) <u>State Income Tax Calculation</u>		
(32) Assume pre-tax income of	\$ 100.0000	
(33)		
(34) Less: Production tax credit @ 6%	<u>6.0000</u>	
(35)		
(36) Taxable income for State income tax	94.0000	(32)-(34)
(37)		
(38) State Tax Rate	<u>6.0000%</u>	
(39)		
(40) State Income Tax	<u><u>\$ 5.6400</u></u>	(36)*(38)