

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

**In the Matter of:**

**THE APPLICATION OF LOUISVILLE GAS AND )**  
**ELECTRIC COMPANY FOR CERTIFICATES )**  
**OF PUBLIC CONVENIENCE AND NECESSITY )**  
**AND APPROVAL OF ITS 2016 COMPLIANCE )** **CASE NO. 2016-00027**  
**PLAN FOR RECOVERY BY ENVIRONMENTAL )**  
**SURCHARGE )**

**LOUISVILLE GAS AND ELECTRIC COMPANY**  
**RESPONSE TO THE**  
**KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.**  
**SECOND SET OF DATA REQUESTS**

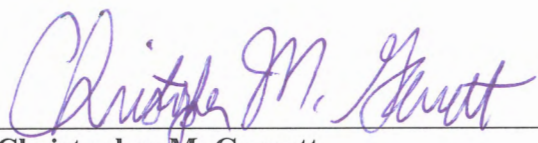
**DATED APRIL 8, 2016**

**FILED: APRIL 20, 2016**

VERIFICATION

COMMONWEALTH OF KENTUCKY )  
 ) SS:  
COUNTY OF JEFFERSON )

The undersigned, **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 10th 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

**LOUISVILLE GAS AND ELECTRIC COMPANY**

**Response to Kentucky Industrial Utility Customers, Inc.**

**Second Set of Data Requests Dated March 8, 2016**

**Case No. 2016-00027**

**Question No. 2-1**

**Witness: Christopher M. Garrett**

Q.2-1 Refer to the Company's response to KIUC 1-3, 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 1-3:  $(35+6*.65)/100$ .
- b. Please confirm that LG&E agreed with KIUC in Case No. 2004-00421 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:

**LG&E 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 LG&E agreed that the gross up factor needed to reflect the impact of the new Internal Revenue Code Section 199 Domestic Manufacturing Deduction and the reduction in the Kentucky corporate income tax rate. LG&E 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 10.39 percent. The Commission finds this is the reasonable rate of return for LG&E'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. 2004-00421.

- 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.2-1 a. For purposes of determining the estimated bill impacts for the 2016 ECR Plan, LG&E utilized the following effective income tax rate formula:  $(35+(6*0.65*0.94))/100$ . LG&E 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 LG&E's response to KIUC 1-3, LG&E 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 LG&E is able to take the Section 199 deduction in a future year, LG&E will appropriately reflect the impact in its future monthly ECR billings. Therefore, LG&E is excluding the Section 199 deduction only in those tax years in which it is unable to utilize the deduction. Current projections indicate LG&E will be unable to take the Section 199 deduction until 2019.
- b. Yes, LG&E agreed to include the Section 199 deduction in the calculation of the effective income tax rate in Case No. 2004-00421. LG&E 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 LG&E's position that the Section 199 deduction should be included only to the extent LG&E in fact is able to use the deduction 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. LG&E exclusion of the Section 199 deduction reflects the fact that LG&E could not use the deduction for the reasons stated above. The Commission approved LG&E's calculations which excluded the Section 199 deduction in Case Nos. 2015-00021, 2015-00222, and 2015-00412.
- d. As discussed above, LG&E 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. LG&E 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.

**LOUISVILLE GAS AND ELECTRIC COMPANY**

**Response to Kentucky Industrial Utility Customers, Inc.**

**Second Set of Data Requests Dated March 8, 2016**

**Case No. 2016-00027**

**Question No. 2-2**

**Witness: Christopher M. Garrett**

- Q.2-2 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.2-2 a. LG&E 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. 2015-00021. Additionally, LG&E 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. 2015-00222. Finally, LG&E 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. 2015-00412.

Furthermore, effective with the February 2016 billing month, LG&E 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. 2015-00222.

- 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/2015-00021/robert.conroy%40lge-ku.com/02162015115625/Garrett\\_Testimony - LGE 2015-00021 FINAL.pdf](http://psc.ky.gov/pscecf/2015-00021/robert.conroy%40lge-ku.com/02162015115625/Garrett_Testimony_-_LGE_2015-00021_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00222/robert.conroy%40lge-ku.com/08122015020450/2-Conroy\\_Testimony - LGE 2015-00222 FINAL.pdf](http://psc.ky.gov/pscecf/2015-00222/robert.conroy%40lge-ku.com/08122015020450/2-Conroy_Testimony_-_LGE_2015-00222_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00412/rick.lovekamp%40lge-ku.com/01152016112315/2 - Rahn Testimony - LGE 2015-00412 Final.pdf](http://psc.ky.gov/pscecf/2015-00412/rick.lovekamp%40lge-ku.com/01152016112315/2_-_Rahn_Testimony_-_LGE_2015-00412_Final.pdf)

Responses to Data Requests:

[http://psc.ky.gov/pscecf/2015-00021/robert.conroy%40lge-ku.com/04022015104612/4-REVISED\\_LGE Formatted 1st DR due 04-02-15 FINAL.pdf](http://psc.ky.gov/pscecf/2015-00021/robert.conroy%40lge-ku.com/04022015104612/4-REVISED_LGE_Formatted_1st_DR_due_04-02-15_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00021/robert.conroy%40lge-ku.com/04022015103615/2-LGE Formatted 2nd DR due 04-02-15 FINAL.pdf](http://psc.ky.gov/pscecf/2015-00021/robert.conroy%40lge-ku.com/04022015103615/2-LGE_Formatted_2nd_DR_due_04-02-15_FINAL.pdf)

[http://psc.ky.gov/pscecf/2015-00222/robert.conroy%40lge-ku.com/08122015020450/3-LGE Responses to Staffs First Data Request filed 08 12 15.pdf](http://psc.ky.gov/pscecf/2015-00222/robert.conroy%40lge-ku.com/08122015020450/3-LGE_Responses_to_Staffs_First_Data_Request_filed_08_12_15.pdf)

[http://psc.ky.gov/pscecf/2015-00222/robert.conroy%40lge-ku.com/09212015022237/2 - LGE Responses to Staffs Second Data Request filed 09212015.pdf](http://psc.ky.gov/pscecf/2015-00222/robert.conroy%40lge-ku.com/09212015022237/2_-_LGE_Responses_to_Staffs_Second_Data_Request_filed_09212015.pdf)

[http://psc.ky.gov/pscecf/2015-00412/derek.rahn%40lge-ku.com/01192016105302/2 - CORRECTED LGE Formatted 1st DR 01-19-16 Final.pdf](http://psc.ky.gov/pscecf/2015-00412/derek.rahn%40lge-ku.com/01192016105302/2_-_CORRECTED_LGE_Formatted_1st_DR_01-19-16_Final.pdf)

Orders:

[http://psc.ky.gov/pscscf/2015%20Cases/2015-00021//20150612\\_PSC\\_ORDER.pdf](http://psc.ky.gov/pscscf/2015%20Cases/2015-00021//20150612_PSC_ORDER.pdf)

[http://psc.ky.gov/pscscf/2015%20Cases/2015-00021//20150622\\_PSC\\_ORDER.pdf](http://psc.ky.gov/pscscf/2015%20Cases/2015-00021//20150622_PSC_ORDER.pdf)

[http://psc.ky.gov/pscscf/2015%20Cases/2015-00222//20151207\\_PSC\\_ORDER.pdf](http://psc.ky.gov/pscscf/2015%20Cases/2015-00222//20151207_PSC_ORDER.pdf)

[http://psc.ky.gov/pscscf/2015%20Cases/2015-00412//20160316\\_PSC\\_ORDER.pdf](http://psc.ky.gov/pscscf/2015%20Cases/2015-00412//20160316_PSC_ORDER.pdf)

Informal Conference:

[http://psc.ky.gov/pscscf/2015%20cases/2015-00021//20150420\\_PSC\\_IC%20Memo.pdf](http://psc.ky.gov/pscscf/2015%20cases/2015-00021//20150420_PSC_IC%20Memo.pdf)

[http://psc.ky.gov/pscscf/2015%20cases/2015-00222//20151201\\_PSC%20IC%20Memo.pdf](http://psc.ky.gov/pscscf/2015%20cases/2015-00222//20151201_PSC%20IC%20Memo.pdf)

[http://psc.ky.gov/pscscf/2015%20cases/2015-00412//20160215\\_PSC%20IC%20Memo.pdf](http://psc.ky.gov/pscscf/2015%20cases/2015-00412//20160215_PSC%20IC%20Memo.pdf)

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

|      |                                       | W/ 6% State<br><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) |