COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

In the Matter of:

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

POST-HEARING BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

Filed: June 28, 2016

TABLE OF CONTENTS

I. INTRODUCTION AND RECOMMENDATION TO APPROVE UNANIMOUS SETTLEMENT

The Unanimous Settlement Agreement entered into by the Kentucky Attorney General ("AG"), Kentucky Industrial Utility Customers, Inc. ("KIUC"), Kentucky Utilities Company ("KU"), and Louisville Gas and Electric Company ("LG&E") (LG&E and KU are collectively "Companies") is a fair, just, and reasonable resolution of all the issues in these proceedings. The parties recommend the Commission approve it as resolution of the issues without modification.[1] The issues settled in these proceedings are significant, and the settlement is the product of real compromise. And customers benefit significantly from the reducing rate impacts in the early years of cost recovery of the investment in the facilities required for environmental compliance. For example, a KU residential customer with average energy usage (1,146 kWh per month) will see a bill-impact reduction of $1.96 per month in 2016 under the Settlement Agreement compared to KU's position in its application. Similarly, an LG&E residential customer with average energy usage (976 kWh per month) will see a bill-impact reduction of $0.44 per month in 2016 under the Settlement Agreement compared to LG&E's position in its application.[2] The settlement also includes a unanimous agreement to continue the current-Commission-approved 10.00% return on equity for capital invested in the proposed environmental-compliance projects and recovered through the Companies' environmental-cost-recovery ("ECR") mechanisms. The parties' negotiations and compromises have resulted in a settled outcome that is fair, just, and reasonable in its totality.

The intervenor parties and their settlement are equally as serious and significant as the issues they settled. The AG has a statutory responsibility to represent all customers in

[1] Supplemental Testimony of Robert M. Conroy, Settlement Testimony Exhibit RMC-1.
[2] Supplemental Testimony of Robert M. Conroy, p. 5-6 and Settlement Testimony Exhibit RMC-3.

Commission proceedings, including these proceedings.[3] The KIUC represents some of the Companies' largest industrial customers, which are also some of the most significant employers and businesses in the Commonwealth.[4] Both the AG and KIUC have counsel with many years of experience before this Commission; both are more than capable of advocating their interests; both understand well the issues in these proceedings; both had the assistance of experts with years of experience in utility cases before commissions and the electric utility industry. Kentucky law clearly requires the Commission to base its decisions only on substantial competent evidence.[5] So when these parties agree to settle in proceedings of this magnitude, the settlement agreement is substantial evidence with great credibility and significant probative value. The Commission can approve it with confidence and without modification.

II. STATEMENT OF FACTS AND PROCEDURAL HISTORY

Enacted by the Kentucky General Assembly in 1992, KRS 278.183 allows a utility to recover its costs of complying with federal, state, and local environmental requirements applicable to coal combustion wastes and by-products (commonly referred to as coal ash) from facilities used to produce energy from coal. About 85% of the electricity produced by the Companies' generating units is fueled by coal.[6] The recovery of the environmental compliance costs associated with these generation facilities is achieved through a stand-alone rate mechanism known as the Environmental Cost Recovery or "ECR". The Companies have used

[3] KRS 367.150(8).
[4] KIUC represents large industrial customers generally, and specifically in these proceedings it represents Clopay Plastic Products Co., Inc.; Corning, Inc.; Dow Coming Corporation; Lexmark International, Inc.; North American Stainless; Toyota Motor Manufacturing, Kentucky, Inc.; AAK USA K2, LLC; Carbide Industries LLC; Cemex; and The Chemours Company.
[5] *Big Sandy Community Action Program v. Chaffins*, 502 S.W.2d 526 (Ky. 1973); *Drummond v. Todd County Bd. of Educ.*, 349 S.W.3d 316 (Ky. App. 2011).
[6] Form 10-K PPL CORP – PPL Filed: February 19, 2016 (period: December 31, 2015), p. 10 (https://www.sec.gov/Archives/edgar/data/55387/000092222416000130/form10k.htm).

the ECR with Commission approval to recover their cost of environmental compliance for more than twenty years.

To receive approval from the Commission to recover the environmental compliance costs through the ECR mechanism, KRS 278.183 requires the electric utility to file an application with the Commission containing a plan for complying with the applicable environmental requirements which identifies the particular projects and their associated costs.[7] The compliance plan's costs include a reasonable return on capital expenditures and reasonable operating expenses.[8] The utility can collect the proposed costs from its customers once the Commission approves the compliance plan and calculation of the charges based on the ECR rate formula. At later dates, the Commission then reviews the plan's costs at six-month and two-year intervals, and is authorized to disallow any improper costs.[9] Traditionally, the Commission has a long-standing and well-established practice of setting the utility's return on equity ("ROE") for calculating the return on capital on the proposed ECR Plan, during the utility's base-rate proceedings.[10]

A. Summary of the Companies' Applications

On January 29, 2016, the Companies filed their applications requesting recovery through their ECR mechanisms of the costs of the proposed projects shown in their 2016 ECR Plans.[11] The Companies also asked for authority to construct the projects by requesting certificates of public convenience and necessity pursuant to KRS 278.020 and for certain smaller projects, a declaration that such authority was not required.

---

[7] KRS 278.183(2)
[8] KRS 278.183(1)
[9] KRS 278.183(3)
[10] *In the Matter of: Application of Kentucky Utilities Company for an Adjustment of Base Rates*, Case No. 2008-00251, Order at 7 (Feb. 5, 2009); *In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of Base Rates*, Case No. 2008-00252, Order at 8 (Feb. 5, 2009) ("Typically, an electric utility with an environmental surcharge approved pursuant to KRS 278.183 uses the ROE from its most recent rate case in the return component of the environmental costs included in its surcharge.").
[11] Testimony of John Voyles, Case No. 2016-00026, Exhibit JNV-1; Testimony of John Voyles, Case No. 2016-00027, Exhibit JNV-1.

KU is seeking approval to build seven new projects that will enable the Brown, Ghent, and Trimble County Generating Stations and three inactive generation stations to comply with environmental regulations and recover their total capital cost, estimated to be $677.7 million.[12] LG&E is seeking approval to build three new projects that will enable the Mill Creek and Trimble County Generating Stations to comply with environmental regulations and recover their total capital cost, estimated to be $315.9 million.[13]

Seven of the ten proposed ECR projects involve closing active surface impoundments and constructing new process water systems to allow economical coal-fired generation to continue producing electricity. Many of these projects are necessary to comply with the U.S. Environmental Protection Agency's Coal Combustion Residuals Rule ("CCR Rule"), which became effective October 19, 2015, and provides a comprehensive set of requirements for the safe disposal of CCR from coal-fired power plants.[14] In accordance with the Commission's June 30, 2015 final orders in the Companies' 2014 base-rate cases,[15] the Companies proposed to continue using the approved 10.00% return on equity ("ROE") for their monthly ECR filings reflecting the cost of these new projects.

Consistent with the ratemaking treatment in every KU and LG&E base-rate case since 2003, the Companies proposed in their applications that for ratemaking purposes the CCR storage closure costs be accounted for as cost of removal and charged to the accumulated provision for depreciation reserve. The Companies proposed to recover the CCR-related projects' costs over the remaining life of the generating facility, with the exception of the

[12] KU seeks to recover $667.4 million through the ECR mechanism.
[13] LG&E seeks to recover $313.8 million through its ECR mechanism.
[14] 40 C.F.R.257.53
[15] *In the Matter of: Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates,* Case No. 2014-00371, Order (June 30, 2015); *In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates,* Case No. 2013-00372, Order (June 30, 2015).

inactive generating stations (i.e., KU ECR Project 39: surface-impoundment closures at the Green River, Tyrone, and Pineville Generating Stations), for which KU proposed to recover the impoundment-closure costs over a four-year period. The Companies' proposed cost recovery is in accordance with Commission precedent under KRS 278.183.[16]

Following the filing of applications and direct testimony, the Companies responded to two rounds of data requests from Commission Staff, AG, and KIUC, and provided data and explanations to over 100 data requests. Notably, neither the Commission Staff nor either intervenor requested information concerning the Companies' request to continue use of the 10.00% ROE for purposes of the Companies' monthly environmental surcharge filings.

B. The Attorney General and KIUC

The Attorney General did not file any testimony. Only the KIUC filed testimony, which did not contest the need for, or costs of, any of the Companies' proposed 2016 ECR Plan

[16] *In the Matter of: The Application of Louisville Gas and Electric Company for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend Its Environmental Surcharge Tariff,* Case No. 2000-386, Order (April 18, 2001), Order Granting Rehearing (May 14, 2001), Order on Rehearing (Aug. 30, 2001); *In the Matter of: The Application of Kentucky Utilities Company for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend Its Environmental Surcharge Tariff,* Case No. 2000-439, Order (April 18, 2001), Order Granting Rehearing (May 14, 2001), Order on Rehearing (Aug. 30, 2001); *In the Matter of: The Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00421, Order (June 20, 2005), Amended Order (July 19, 2005), Order Denying Rehearing (July 22, 2005); *In the Matter of: The Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct Flue Gas Desulfurization Systems and Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge*, Case No. 2004-00426, Order (June 20, 2005), Order Denying Rehearing (July 22, 2005); *In the Matter of: Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of Its 2009 Compliance Plan for Recovery by Environmental Surcharge,* Case No. 2009-00197, Order (Dec. 23, 2009); *In the Matter of: Application of Louisville Gas and Electric Company for Certificates of Public Convenience and Necessity and Approval of Its 2009 Compliance Plan for Recovery by Environmental Surcharge,* Case No. 2009-00198, Order (Dec. 23, 2009); *In the Matter of: Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge,* Case No. 2011-00161, Order (Dec. 15, 2011); *In the Matter of: Application of Louisville Gas and Electric Company for Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge,* Case No. 2009-00162, Order (Dec. 15, 2011).

projects.[17] KIUC's witness Mr. Kollen essentially disputed the Companies' proposed use of depreciation to recover the costs of the projects, disputed KU's ability to recover through its ECR mechanism the costs of surface impoundment closures at KU's retired generating stations (the Green River, Pineville, and Tyrone Generating Stations), and asked the Commission to reject the Companies' position. Mr. Kollen advocated the Commission require the costs of the proposed ECR projects be amortized rather than depreciated over time for recovery purposes.

Mr. Kollen recommended that the Commission direct the Companies to include the federal Section 199 tax deduction as soon as it is available to them on a standalone tax return basis, asserting that deduction likely will be available for the Companies in the future.

Finally, Mr. Kollen advocated the Commission condition any approval of the construction of certain impoundment-closure projects such that the Companies would be required to seek additional Commission approval for any material modifications in the scope of work or any change of 10% or more in cost estimates.

C. Summary of Companies' Rebuttal Testimony

The Companies filed testimony rebutting KIUC's testimony. Specifically, the Companies demonstrated that the ECR statute provides ECR cost recovery for the cost of complying with environmental requirements applicable to CCR and since KU's surface-impoundment closures at inactive generating stations (ECR Project 39: Green River, Pineville, Tyrone) must comply with the requirements of 401 KAR Chapter 45, it is therefore eligible for ECR cost recovery. The Companies' rebuttal testimony further showed why their proposal is reasonable, and how Mr. Kollen's recommendations regarding amortization for projects at active generating stations are

[17] This is true even for KU ECR Project 39, which concerns surface-impoundment closures at generating stations that have ceased generation operations; KIUC's witness Mr. Kollen argued against ECR cost recovery for the project, but he provided no testimony or other evidence concerning the need for, or cost of, the project. And although Mr. Kollen suggested a different means of recovery for KU Project 39 or a different means of calculating ECR recovery for the surface-impoundment-related projects, KIUC's witness did not contest the fundamental need for, or the projected costs of, the projects.

both inconsistent with accounting practice and fail to address the recovery of capital costs on the unamortized closure cost balance. The Companies fully rebutted KIUC's federal Section 199 tax deduction argument by proving the Commission's six-month and two-year review proceedings fully address the issue regarding whether the Section 199 deduction is included or excluded. Finally the Companies' rebuttal testimony explained how their long-standing practice of refining and reevaluating their engineering and cost estimates to ensure they comply with the applicable requirements at the lowest reasonable cost will continue, together with their long-standing practice of advising the Commission of any significant material changes through the Commission's meeting process negates any reason to condition any approval the Commission grants in these proceedings.

D. Unanimous Settlement Agreement

On June 9, 2016, an informal conference was held at the Commission to discuss the issues in and possible settlement of the cases. Commission Staff and representatives of the AG, KIUC and the Companies attended. During this informal conference, the parties negotiated the Unanimous Settlement Agreement which resolves all issues in these cases. During those discussions—and for the first time in these proceedings—Commission Staff "noted that the proposal to the current Commission-approved 10 percent return on equity for the proposed 2016 Environmental Compliance Plans would need to be further examined during the formal hearing on these cases scheduled for June 14, 2016… ."[18]

On June 13, 2016, the Companies filed the Unanimous Settlement Agreement, supported by the supplemental testimony of Robert M. Conroy. Article I provides that the Companies will amortize on a non-levelized basis over 25 years their actual surface-impoundment-closure costs for KU Projects 40, 41, and 42, and LG&E Projects 29 and 30, and amortize on a non-levelized

[18] Intra-Agency Memorandum to the Case File from Staff Counsel Dated June 17, 2016, p, 1, filed June 20, 2016.

basis over 10 years KU's actual surface-impoundment-closure costs for Project 39 (a significant departure from the Companies' proposal to include projected costs and recover them in the form of depreciation over four years for Project 39 and over the life of the facilities for the remaining projects). As explained in Mr. Conroy's testimony, a KU residential customer with average energy usage (1,146 kWh per month) will see a bill-impact reduction of $1.96 per month in 2016 under the Settlement Agreement compared to KU's position in its application, and an LG&E residential customer with average energy usage (976 kWh per month) will see a bill-impact reduction of $0.44 per month in 2016 under the Settlement Agreement compared to LG&E's position in its application.[19]

Article II provides that the Companies will continue to review the use of the Section 199 deduction during the Companies' six-month and two-year ECR review proceedings.

Article III commits the Companies to continue their existing practice of updating the Commission if and when material changes occur to the scope or cost of approved ECR projects, thereby alleviating KIUC's concerns regarding material changes in scope or cost.

Article IV contains the parties' agreement that all other requested relief be approved, including the current Commission-approved 10.00% ROE for use in the Companies' ECR billings.

E. Hearing on Settlement

On June 14, 2016, the Commission held a hearing to examine the terms of the Unanimous Settlement Agreement. Notably, then-Commissioner Cicero questioned the Companies' assertion that no CPCNs are required for the surface-impoundment closures at KU's inactive generating stations (Green River, Pineville, Tyrone).[20] The Commission Staff cross

[19] Supplemental Testimony of Robert M. Conroy, at 9-10 (June 13, 2016).
[20] Commissioner Cicero was subsequently appointed Vice-Chairman of the Commission.

examined the Companies' witness, Robert M. Conroy, regarding the parties' recommendation to continue using the currently-Commission-approved 10.00% ROE for the 2016 ECR Plan. The Commission Staff inquired of Mr. Conroy concerning ROEs awarded to other electric utilities in 2015, and the first quarter of 2016, as reported in the January 14, 2016, and April 15, 2016, editions of Regulatory Research Associates' ("RRA") Regulatory Focus reports.[21] In addition, the Commission Staff questioned whether the Companies' had ever been subjected to cost disallowances during a six-month or two-year review, and whether the lack of cost disallowances allowed utilities to earn their authorized rate of return ("ROE"), including the authorized ROE.

III. ISSUES FOR RESOLUTION

Whether the Commission should approve the written unanimous settlement agreement between and recommended by the AG, KIUC and the Companies as the fair, just and reasonable disposition of the issues in these cases?

IV. ARGUMENT

A. The Unanimous Settlement Agreement Represents a Fair, Just and Reasonable Resolution of All Issues in these Proceedings

The Unanimous Settlement Agreement represents significant compromise by the parties, and should be approved by the Commission. The intervenor parties to the agreement have seasoned counsel, their own outside experts, long experience in Commission proceedings generally and ECR cases in particular, and a proven ability to advocate their own interests and contest matters at hearing when needed. Therefore, the bare fact that the AG, who has a statutory responsibility to represent all customers in Commission proceedings,[22] and the KIUC, which represents the Companies' largest customers, customers who are among the largest

[21] Hearing Exhibits 3 and 4, filed June 21, 2016.
[22] KRS 367.150(8).

employers and most significant economic interests in the Commonwealth,[23] have both signed on to the Unanimous Settlement Agreement in these proceedings commends the agreement to the Commission for approval without modification. Certainly the Commission is not bound to accept the agreement and must exercise its own judgment in evaluating the evidence and law in these proceedings. But the Commission has historically congratulated parties for reaching settlements in proceedings where issues are contested,[24] and has generally looked favorably on settled outcomes.[25] The Commission's view of settlement is well-grounded in Kentucky's basic jurisprudence: "It is a universal rule that compromises between individuals of their contentions

[23] KIUC represents large industrial customers generally, and specifically in these proceedings it represents Clopay Plastic Products Co., Inc.; Corning, Inc.; Dow Coming Corporation; Lexmark International, Inc.; North American Stainless; Toyota Motor Manufacturing, Kentucky, Inc.; AAK USA K2, LLC; Carbide Industries LLC; Cemex; and The Chemours Company.

[24] *See, e.g.*, Case No. 2011-00161, Order at 22 and Case No. 2011-00162, Order at 17 ("The Commission is very encouraged by the scope and breadth of the terms of the Settlement Agreement and we compliment the parties to this matter on the results they were able to achieve."); *In the Matter of: Joint Application of PPL Corporation, E.ON AG, E.ON US Investments Corp., E.ON U.S. LLC, Louisville Gas and Electric Company, and Kentucky Utilities Company for Approval of an Acquisition of Ownership and Control of Utilities*, Case No. 2010-00204, Order (Sep. 30, 2010) ("The Commission has thoroughly reviewed the Settlement Agreement and finds that it truly does represent diverse interests and divergent points of view, as stated in the agreement. We are very encouraged by the scope and breadth of the terms of the Settlement Agreement and wish to compliment the Applicants and intervenors on the results they were able to achieve."); *In the Matter of: Joint Application of Duke Energy Corporation, Cinergy Corp., Duke Energy Ohio, Inc., Duke Energy Kentucky, Inc., Diamond Acquisition Corporation, and Progress Energy, Inc., for Approval of the Indirect Transfer of Control of Duke Energy Kentucky, Inc.*, Case No. 2011-00124, Order (Aug. 2, 2011) ("The Commission has thoroughly reviewed the Settlement Agreement and we compliment the Applicants and the AG on the results they achieved.").

[25] *See, e.g., In the Matter of: Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates*, Case No. 2012-00221, Order at 7 (Dec. 20, 2012) ("Our analysis indicates that a reasonable range for KU's ROE is 9.6 percent to 10.6 percent, with a mid-point of 10.1 percent. The 10.25 percent ROE agreed upon by the parties to the Settlement falls within this ROE range."); *In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates, a Certificate of Public Convenience and Necessity, Approval of Ownership of Gas Service Lines and Risers, and a Gas Line Surcharge*, Case No. 2012-00222, Order at 9 (Dec. 20, 2012) ("Our analysis indicates that a reasonable range for LG&E's ROE is 9.6 percent to 10.6 percent, with a mid-point of 10.1 percent. The 10.25 percent ROE agreed upon by the parties to the Settlement falls within this ROE range."); *See also*, *In the Matter of: An Adjustment of the Gas and Electric Rates, Terms, and Conditions of Louisville Gas and Electric Company*, Case No. 2003-00433, Order at 69 (June 30, 2004); *In the Matter of: An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company*, Case No. 2003-00434, Order at 60 (June 30, 2004); Case No. 2008-00251, Order at 9-10 (Feb. 5, 2009); Case No. 2008-00252, Order at 10 (Feb. 5, 2009); *In the Matter of: Application of Kentucky Utilities Company for an Adjustment of Base Rates*, Case No. 2009-00548, Order at 33(July 30, 2010); *In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of Electric and Gas Base Rates*, Case No. 2009-00549, Order at 35(July 30, 2010); Case No. 2014-00371, Order at 7 (June 30, 2015); Case No. 2014-00372, Order at 7-8 (June 30, 2015).

affecting their legal rights are favored by the law."[26] The Companies respectfully submit the Commission should similarly look favorably upon the current settlement and approve it.

In addition to the inherent credibility of an agreement reached among sophisticated parties—and particularly when those parties include representatives of customers with a significant financial stake in the outcome—there are strong substantive reasons for the Commission to approve the settlement without modification. Most notably, the settlement addresses and resolves all of the issues in this proceeding, including the issue of greatest contention between the parties, namely the appropriate cost-recovery methodology for the costs of the Companies' proposed surface-impoundment closures and related post-closure costs. The Companies had proposed to depreciate those costs over the remaining lives of the facilities for the active generating stations, and to use the same depreciation approach for the inactive generating stations but over a four-year recovery term. KIUC opposed that approach and proposed amortizing actually incurred costs over the average remaining service lives of the generating stations for the active generating stations, and opposed ECR recovery of the inactive-generating-stations projects entirely, though it asked for a ten-year amortization approach if the Commission approved ECR recovery of the project's costs. The settlement agreement contains a resolution of this significant dispute that is fair, just, and reasonable in the context of the entire settlement, namely that each of the Companies will amortize on a non-levelized basis over 25 years its actual surface-impoundment-closure costs incurred to comply with the CCR Rule (including groundwater monitoring costs) of each project; 25 years is roughly the average of the remaining lives currently used for depreciating the related generating assets, making the settled

[26] *Lincoln-Income Life Ins. Co. v. Kraus*, 132 S.W.2d 318, 320 (Ky. 1939).

25-year amortization period reasonable.[27] The parties further unanimously agreed that the actually incurred costs of the surface-impoundment closures at the inactive generating stations (Green River, Pineville, and Tyrone), should be recovered through KU's ECR mechanism by amortizing those costs on a non-levelized basis over ten years. Also, each of the Companies will include the unamortized balance of its actual costs incurred for the non-process-water portions of these projects in its ECR rate base, allowing the Companies to recover the full cost of capital applicable to ECR rate base on all such unamortized balances. This compromise will result in a bill-impact reduction for a KU residential customer with average energy usage (1,146 kWh per month) of $1.96 per month in 2016 compared to KU's proposed depreciation approach.[28] Similarly, an LG&E residential customer with average energy usage (976 kWh per month) will see a bill-impact reduction of $0.44 per month in 2016 under the agreed amortization approach compared to LG&E's proposed depreciation approach.[29] KU and LG&E's commercial and industrial customers will see a comparable relative bill-impact reduction per month in 2016.[30] This bill-impact reduction in the early years of cost recovery for these projects is valuable consideration for which the AG and KIUC negotiated on behalf of their clients. It represents real and significant compromise by all parties, and is a strong reason to approve the agreement without modification.

The Unanimous Settlement Agreement further addresses the only other issues raised as points of potential disagreement by the only intervenor testimony filed in these proceedings, namely the Companies' practice concerning the Section 199 federal tax deduction as it applies to

[27] *See* Case No. 2016-00026, Testimony of John J. Spanos at Exhibit JJS-2 (showing an average composite remaining life of 21.8 years for relevant generating assets); Case No. 2016-00027, Testimony of John J. Spanos at Exhibit JJS-2 (showing an average composite remaining life of 26 years for relevant generating assets).
[28] Settlement Testimony Exhibit RMC-3 at 1.
[29] *Id.* at 2.
[30] *Id.* at 1-2.

the Companies' ECR mechanisms and the extent to which the Companies should have an obligation to report to the Commission concerning 2016 Plan developments. Concerning the Section 199 issue, the settlement agreement states the Companies will continue their current practice concerning the Section 199 federal tax deduction as it applies to their ECR mechanisms by reviewing the use of the deduction and determining whether the deduction should be reflected in prospective ECR rates in the Companies' six-month and two-year ECR review proceedings.

Concerning updates to the Commission concerning developments related to the 2016 Plan projects, the Companies committed in the settlement agreement to continue their existing practice of updating the Commission if and when material changes occur to the scope or cost of approved ECR projects, a practice the Companies have followed for years. The Companies further committed to notify the AG and KIUC reasonably soon after notifying the Commission of such changes, and to make reasonable efforts to invite the AG and KIUC to attend any meetings the Companies have with the Commission or Commission Staff to provide updates concerning any 2016 Plan projects. As Mr. Conroy noted during the public hearing in these proceedings, though the Companies do not believe formal reporting in addition to ECR review proceedings is necessary, they will report as the Commission reasonably directs even though such a requirement is not part of the Unanimous Settlement Agreement.

With the above-described points of contention resolved, all parties agreed that, except as modified in the Unanimous Settlement Agreement and its exhibits, all of the relief the Companies requested in their filings in these proceedings (as corrected by their Errata and other filings) should be approved as filed. That includes, without limitation, approving the Companies' 2016 Plans for ECR cost recovery including the Companies' requested use of the current Commission-approved 10.00% ROE for use in the Companies' 2016 ECR billings,

granting the requested CPCNs, and declaring that no CPCN is required for any portion of the surface-impoundment closures at KU's inactive generating stations.

All of the items described above are the total consideration for the Unanimous Settlement Agreement in these proceedings. Again, sophisticated parties with decades of experience in these matters arrived at the settlement agreement as a fair, just, and reasonable resolution of all matters in these proceedings. They arrived at this agreement with due care and consideration, balancing the Companies' legitimate need for the projects proposed in the 2016 Plans with customers' desire for more gradual rate increases to provide the necessary cost recovery for the projects. It is an agreement worthy of the Commission's approval without modification.

B. The Commission Should Approve the Continued Use of a 10.00% Return on Equity for All of the Companies' ECR Plans, Including the 2016 Plans

Less than 12 months ago on June 30, 2015, the Commission entered orders that approved the use of a 10.00% ROE when it approved the unanimous settlement agreement in the Companies' 2014 rate cases.[31] That settlement agreement provides:

> 1.3. Environmental Cost Recovery Mechanism Return on Equity. The Parties agree that, effective as of the expense month that includes July 1, 2015, the return on equity that shall apply to the Utilities' recovery under their environmental cost recovery ("ECR") mechanism is 10.00% for *all* environmental compliance plans.

(Emphasis added.) In doing so, the Commission observed that it was not simply deferring to the parties' agreement, but was exercising its own independent judgment in approving the agreement based upon an extensive record.[32] And the Commission was clearly aware of the provision of

[31] Case No. 2014-00371, Order (June 30, 2015); Case No. 2014-00372, Order (June 30, 2015).
[32] Case No. 2014-00371, Order at 7 (June 30, 2015); Case No. 2014-00372, Order at 7-8 (June 30, 2015).

the agreement concerning the 10.00% ROE to be applied to ECR calculations going forward, as the Commission explicitly listed that provision when reciting the terms of the agreement.[33]

The record supporting the Commission's June 30, 2015 Orders is significant for at least two reasons. First, the matter of an appropriate ROE was the subject of extensive expert testimony by four different witnesses, representing the respective interests of the Companies and their residential, commercial and industrial customers. Each witness presented an analysis identifying risk-comparable firms and analytical methodologies such as the discounted cash flow and capital asset pricing models. Each witness did so to be consistent with sound regulatory economics and the standards set forth in the United States Supreme Court's *Bluefield* and *Hope* decisions.[34] The parties and Commission Staff conducted significant discovery. Secondly, in addition to the Companies, the parties to those proceedings were 12 diverse intervenors with widely varying interests.[35] These intervenors represented residential, commercial, industrial, governmental, low-income, and environmental interests. As Mr. Conroy explained, "Through vigorous and lengthy settlement negotiations, the 12 intervenors and the Companies reached a Unanimous Settlement Agreement. The consideration involved in the agreement ranged from revenue requirements to items not available through a litigated outcome, including donations by the Companies' shareholders to various charitable causes. One of the items of consideration included in the Unanimous Settlement Agreement that could not have been achieved by litigation in those proceedings was [the ROE of '10.00% for all environmental compliance plans.']."[36]

[33] Case No. 2014-00371, Order at 3 (June 30, 2015); Case No. 2014-00372, Order at 4 (June 30, 2015).
[34] *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923); *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591 (1944).
[35] The parties were the AG; KIUC; Lexington-Fayette Urban County Government; The Kroger Company; Community Action Council of Lexington-Fayette, Bourbon, Harrison, and Nicholas Counties, Inc.; Kentucky Cable Telecommunications Association; Kentucky School Boards Association; Sierra Club, Alice Howell, Carl Vogel and Wallace McMullen; Wal-Mart Stores East, LP and Sam's East, Inc.; United States Department of Defense and All Other Executive Agencies; Association of Community Ministries, Inc.; and Metropolitan Housing Coalition.
[36] Supplemental Testimony of Robert M. Conroy, at 9-10 (June 13, 2016).

Notably, the settled ECR ROE of 10.00% was a negotiated decrease from the then-applicable ECR ROE of 10.25%,[37] a decrease that was part of the consideration the Companies gave in settling the rate cases on the expressed term the settled 10.00% ROE would indeed continue to apply to all their ECR plans after the Commission approved it.

And the orders in the Companies' rate cases were not unique. On June 22, 2015, a few days before the Commission approved the Unanimous Settlement Agreement in the Companies' 2014 base-rate cases, the Commission approved a settlement agreement for Kentucky Power Company in its 2014 base-rate case that included setting a 10.25% ROE for use in its environmental surcharge mechanism,[38] as well as for use in two other riders related to Kentucky Power's Big Sandy Generating Station.[39] The Commission did so in the context of finding that 9.80% was a reasonable ROE generally, and that there was a range of reasonable ROEs that spanned from 9.30% to 10.30%.[40]

Then—less than four months ago—the Commission affirmed the ongoing reasonableness of applying its previously approved 10.00% ROE to the Companies' ECR mechanisms. Following an almost three-month investigation and review of the Companies' environmental surcharge mechanisms for the six-month billing period ending October 31, 2015, the Commission entered orders on March 16, 2016 expressly approving the overall weighted average

[37] *See* Case No. 2016-00026, KU Response to Information Requested at Hearing No. 2 (June 21, 2016); Case No. 2016-00027, LG&E Response to Information Requested at Hearing No. 2 (June 21, 2016); *In the Matter of: Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates*, Case No. 2014-00371, Order at 4 (June 30, 2015); *In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates*, Case No. 2013-00372, Order at 4 (June 30, 2015).

[38] *In the Matter of: Application of Kentucky Power Company for: (1) A General Adjustment of Its Rates for Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief*, Case No. 2014-00396, Order at 72 (June 22, 2015).

[39] *Id*. at 47-48.

[40] *Id*. at 42.

cost of capital, including the 10.00% ROE in calculating the ECR charges.[41] In doing so, the Commission's order expressly described the 10.00% ROE as the "currently approved 10 percent return on equity."[42] In each Order the Commission made specific determinations that the Companies' respective calculations of the weighted average cost of capital, containing the 10.00% ROE "was reasonable for the Compliance Plans and should be approved."[43]

This Commission was not alone in determining it was reasonable to apply a 10.00% ROE to the Companies' operations. In a February 2016 order concerning base rates for KU's Virginia operations, the Virginia State Corporation Commission ("VSCC") approved using an ROE range of 9.50% to 10.50% for KU's Annual Informational Filings ("AIFs").[44] Ten percent is the midpoint of this range. AIFs are annual filings KU must make in Virginia to demonstrate its earned ROE is not outside the range of reasonableness established by the VSCC.[45] It is therefore noteworthy that the VSCC established a reasonable-ROE range with a midpoint—not a ceiling—of 10.00% for KU. And it did so free of the statutory ROE constraints and adders that apply to other investor-owned electric utilities in Virginia; unlike all other electric utilities in Virginia, KU has an explicit statutory exemption from the Virginia Electric Utility Regulation Act which constrains the VSCC's ROE analysis and requires the VSCC to then award additional basis points the VSCC must apply to other investor-owned electric utilities.[46] Therefore, this Commission can have confidence in the reasonableness and comparability of the VSCC's

[41] *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Period Ending October 31, 2015*, Case No. 2015-00411, Order (March 16, 2016); *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company for the Six-Month Billing Period Ending October 31, 2015*, Case No. 2015-00412, Order (March 16, 2016).
[42] Case No. 2015-00411, Order at 3 (March 16, 2016); Case No. 2015-00412, Order at 3 (March 16, 2016).
[43] *Id*.
[44] *Application of Kentucky Utilities Company d/b/a Old Dominion Power Company for An Adjustment of Electric Base Rates*, Case No. PUE-2015-00063, Order at 5 (Va. State Corp. Comm'n Feb. 2, 2016).
[45] 20 VAC 5-201-30. Annual informational filings.
[46] Code of Virginia at § 56-580(G).

determination less than five months ago that the reasonable range of ROEs for evaluating KU's operations included a midpoint of 10.00% and a ceiling of 10.50%.

1. The 10.00% ROE for ECR purposes the Commission approved less than a year ago and affirmed less than four months ago continues to be within a range of reasonable ROEs

A concept evident in the Commission's Kentucky Power order and in the VSCC order concerning KU discussed above, as well as in numerous other Commission rate orders, is that there is not a single ROE that is the only reasonable ROE at a given time; rather, there is a range of ROEs that is reasonable at any particular time for a particular utility, and certainly across time a range of ROEs, not a single ROE, is reasonable for a given utility.[47] Indeed the Commission has approved ROEs in settlement agreements that were higher than the ROE the Commission would have chosen when the settlement ROE was within the Commission's range of reasonable ROEs.[48] The VSCC's February 2016 order concerning KU supports a range of reasonable ROEs applicable today that includes the 10.00% ROE for the Companies' ECR purposes. Indeed, the VSCC's order shows 10.00% is the midpoint of the range it found reasonable for KU less than five months ago based on a record consistent with the standards set forth in the United States Supreme Court's *Bluefield* and *Hope* decisions.[49]

[47] *See, e.g., In the Matter of: An Adjustment of Rates of General Telephone Co.,* Case No. 9678, Order on Rehearing at 17-18 (Oct. 19, 1987) ("The Commission in its determination of ROE relies heavily on analytical techniques and evidence that are less than perfect and that yield imprecise answers. The Commission is forced to determine a range of reasonable returns based on the evidence in the case. The selection of a specific ROE can only be determined as a result of reviewing the same evidence that was used in selecting the range of returns and applying the Commission's judgment in selecting the specific ROE.") *See also, e.g.,* Case No. 2003-00433, Order at 66 (June 30, 2004); Case No. 2003-00434, Order at 61 (June 30, 2004); Case No. 2009-00548, Order at 31 (July 30, 2010): Case No. 2009-00549, Order at 33 (July 30, 2010).

[48] Case No. 2012-00221, Order at 6 (Dec. 20, 2012) ("Our analysis indicates that a reasonable range for KU's ROE is 9.6 percent to 10.6 percent, with a midpoint of 10.1 percent. The 10.25 percent ROE agreed upon by the parties to the Settlement falls within this ROE range"); Case No. 2012-00222, Order at 8 (Dec. 20, 2012) ("Our analysis indicates that a reasonable range for LG&E's ROE is 9.6 percent to 10.6 percent, with a mid-point of 10.1 percent. The 10.25 percent ROE agreed upon by the parties to the Settlement falls within this ROE range.").

[49] *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923); *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591 (1944).

And the RRA reports the Commission Staff introduced at hearing do not show that a 10.00% ROE is an outlier or outside the bounds of reasonableness; reported ROE awards of 10.00% or more appear 14 times for electric utilities in the Commission-Staff-provided RRA reports, and with those awards made by the utility commissions of Virginia, Michigan, and Wisconsin. As discussed below, the Indiana Utility Regulatory Commission also recently found a 10.00% ROE reasonable as the midpoint of a 9.70% to 10.30% ROE range.[50] Therefore, the evidence of what this Commission and other utility commissions have recently approved supports approving continuing to apply a 10.00% ROE to the Companies' ECR mechanisms as being within a range of reasonable ROEs. That is in addition to what is arguably the most compelling evidence in this proceeding, namely that the AG and KIUC have agreed a 10.00% ROE is reasonable in the context of the Unanimous Settlement Agreement in these proceedings.

2. RRA-reported average ROEs have not changed materially since the Commission issued its June 30, 2015 order approving use of a 10.00% ROE for the Companies' ECR mechanisms

Nothing in the RRA reports the Commission Staff introduced at hearing indicates a change in average awarded ROEs supporting a departure from the 10.00% ROE for ECR purposes the Commission approved less than a year ago and affirmed for ongoing ECR use less than four months ago. Indeed, the RRA reports introduced at hearing indicate a 10.00% ROE for ECR purposes is at least as appropriate now as it was when the Commission approved it on June 30, 2015. For example, according to the "Major Rate Case Decisions—Calendar 2015" RRA report, the average awarded ROE for the second quarter of 2015 for electric utilities was 9.73%

[50] *In the Matter of: Petition of Indianapolis Power & Light Company ("IPL") for Authority to Increase Rates and Charges for Electric Utility Service and for Approval of: (1) Accounting Relief, Including Implementation of Major Storm Damage Restoration Reserve Account; (2) Revised Depreciation Rates; (3) The Inclusion in Basic Rates and Charges of the Costs of Certain Previously Approved Qualified Pollution Control Property; (4) Implementation of New or Modified Rate Adjustment Mechanisms to Timely Recognize for Ratemaking Purposes Lost Revenues from Demand-Side Management Programs and Changes in (A) Capacity Purchase Costs; (B) Regional Transmission Organization Costs; and (C) Off System Sales Margins; and (5) New Schedule of Rates, Rules and Regulations for Service*, Cause No. 44602, Order at 42 (In. Util. Reg. Auth. Mar. 16, 2016).

(including Virginia-awarded ROEs).[51] But according to the most recent RRA report, "Major Rate Case Decisions—January-March 2016," the average awarded ROE for the first quarter of 2016 for electric utilities was 10.26% (including Virginia-awarded ROEs)—an increase of 53 basis points from the second quarter of 2015.[52] In other words, according to the Commission Staff's own evidence, the RRA-reported average ROE trend from the second quarter of 2015 to the first quarter of 2016 is up, not down, adding support to maintaining the ROE the Commission awarded less than a year ago for ECR purposes, and which the Commission has approved less than four months ago in two separate ECR review cases.[53]

Excluding Virginia-awarded ROEs from the RRA averages does not change the upward trend in ROEs from the second quarter of 2015 to the first quarter of 2016. Excluding the one Virginia-awarded ROE from the ROE awards RRA reported for the second quarter of 2015 results in an average ROE award of 9.51%.[54] Excluding the Virginia-awarded ROEs from the ROE awards RRA reported for the first quarter of 2016 results in an average ROE award of 9.68%—an increase of 17 basis points from the second quarter of 2015.[55] Again, the RRA-reported average ROE trend is up, not down, from the second quarter of 2015 to the first quarter of 2016.

3. The Companies' ECR rate of return on capitalization, which includes the Companies' debt cost and equity return, is lower than many utilities, which is a benefit for the Companies' customers and supports the continuing use of a 10.00% ROE for the Companies' ECR mechanisms.

It is vitally important for the Commission to bear in mind as it considers whether to approve the Unanimous Settlement Agreement in these proceedings, including continuing the

[51] Hearing Exhibit 3, filed June 21, 2016.
[52] Hearing Exhibit 4, filed June 21, 2016.
[53] Case No. 2015-00411, Order (March 16, 2016); Case No. 2015-00412, Order (March 16, 2016).
[54] Hearing Exhibit 3, filed June 21, 2016.
[55] Hearing Exhibit 4, filed June 21, 2016.

repeatedly-Commission-approved 10.00% ROE for ECR purposes, a crucial fact easy to overlook: it is a utility's weighted average cost of capital (or rate of return, "ROR") that determines the total financing costs customers pay for capital deployed in a utility's operations, not ROE alone. And the Companies' current ROR for ECR is markedly lower than many of the RORs reported in the RRA reports provided by the Commission Staff at hearing.[56]

In particular, the Commission Staff introduced at hearing an RRA document concerning a June 3, 2016 order of the Maryland Public Service Commission.[57] That order granted Baltimore Gas and Electric Company ("BG&E") an electric rate increase based on an ROE of 9.75%.[58] But the RRA report shows the Maryland Commission further approved an ROR of 7.28% (before grossing up for taxes).[59] That ROR is 36 basis points higher than KU's ROR for ECR reviewed and approved by this Commission in KU's most recent ECR review case,[60] and is more than 53 basis points higher than LG&E's ROR for ECR reviewed and approved by this Commission in LG&E's most recent ECR review case.[61] Therefore, for KU to have an ROR for ECR purposes that equals the 7.28% ROR approved for BG&E, KU's ECR ROE would have to increase to 10.68%, not decrease.[62] Likewise, for LG&E to have an ROR for ECR purposes that equals the 7.28% ROR approved for BG&E, LG&E's ECR ROE would have to increase to 11.00%.[63] Thus, the RRA document the Commission Staff introduced at hearing concerning BG&E actually supports continuing the Commission-approved 10.00% ROE for the Companies' ECR mechanisms.

[56] Hearing Exhibits 3-6, filed June 21, 2016.
[57] Hearing Exhibit 6, filed June 21, 2016.
[58] *Id.* at 1.
[59] *Id.*
[60] Case No. 2015-00411, Order at 3 (March 16, 2016).
[61] Case No. 2015-00412, Order at 4 (March 16, 2016).
[62] 10.68% ROE * 53.58% Equity = 5.72% WACE + 1.56% WACD = 7.28% WACC
[63] 11.00% ROE * 53.07% Equity = 5.84% WACE + 1.44% WACD = 7.28% WACC

Similarly, the Commission Staff introduced at hearing an RRA document concerning an April 29, 2016 order of the Massachusetts Department of Public Utilities ("DPU"), which order granted Fitchburg Gas and Electric Company ("Fitchburg") an electric rate increase based on an ROE of 9.8%.[64] But the RRA report shows the Massachusetts DPU further approved an ROR of 8.46% (before grossing up for taxes).[65] That ROR is 154 basis points higher than KU's ROR for ECR reviewed and approved by this Commission in KU's most recent ECR review case,[66] and is 171 basis points higher than LG&E's ROR for ECR reviewed and approved by this Commission in LG&E's most recent ECR review case.[67] Therefore, for KU to have an ROR for ECR purposes that equals the 8.46% ROR approved for Fitchburg, KU's ECR ROE would have to increase to 12.88%, not decrease.[68] Likewise, for LG&E to have an ROR for ECR purposes that equals the 8.46% ROR approved for Fitchburg, LG&E's ECR ROE would have to increase to 13.23%.[69] Thus, the RRA document the Commission Staff introduced at hearing concerning Fitchburg strongly supports continuing the Commission-approved 10.00% ROE for the Companies' ECR mechanisms.

What these two documents show is the value to customers of the Companies having a well-balanced capital structure, exceptional debt-cost management, and a competitive and consistent ROE. These factors result in lower overall RORs, which in turn benefit customers through lower total financing costs. The Companies therefore respectfully submit that the RRA reports the Commission Staff introduced at hearing, and particularly the documents concerning BG&E and Fitchburg, support continuing to apply the 10.00% ROE that the Commission has

[64] Hearing Exhibit 5, filed June 21, 2016.
[65] *Id.* at 3.
[66] Case No. 2015-00411, Order at 3 (March 16, 2016).
[67] Case No. 2015-00412, Order at 4 (March 16, 2016).
[68] 12.88% ROE * 53.58% Equity = 6.90% WACE + 1.56% WACD = 8.46% WACC
[69] 13.23% ROE * 53.07% Equity = 7.02% WACE + 1.44% WACD = 8.46% WACC

repeatedly approved for use in the Companies' ECR mechanisms and that the parties to these proceedings explicitly agreed to as part of the Unanimous Settlement Agreement reached in these proceedings.

4. RRA reports are at best hearsay, and neither they nor any other evidence in the record of these proceedings is sufficient to support changing the 10.00% ROE for ECR purposes agreed upon in the Companies' 2014 base-rate cases, which were contested proceedings with expert testimony on ROE, and in which the settled 10.00% ROE was negotiated among sophisticated parties obtaining consideration not available outside settlement context and approved by the Commission

On June 30, 2015, the Commission approved a Unanimous Settlement Agreement achieved in the Companies' 2014 base-rate cases. That agreement was reached by 12 diverse intervenors (including the AG and KIUC), and included continuing to use for the Companies' ECR the 10.00% ROE. The 10.00% ROE was not proposed, or found reasonable by the Commission, solely because it appeared consistent with a few examples of approved ROEs summarized in an RRA report. Rather, the ROE approved in the 2014 base-rate cases was the subject of considerable analysis, expert testimony, and discovery by the Companies, AG and KIUC. Such analysis is required to satisfy the financial analysis mandated by the United States Supreme Court in the *Bluefield* and *Hope* decisions.[70] These fundamental decisions require that public utilities charge rates sufficient to earn a return "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties"[71] and a return on equity "commensurate with returns on investments in other enterprises having corresponding risks [and] sufficient to assure confidence in the financial integrity of the enterprise, so as to

[70] *Bluefield*, 262 U.S. 679; *Hope*, 320 U.S. 591.
[71] *Bluefield*, 262 U.S. at 692.

maintain its credit and to attract capital."[72] The expert testimony, analysis, and discovery conducted in the Companies' 2014 base-rate cases provided precisely the kind of record required to satisfy the *Bluefield* and *Hope* criteria when addressing possible changes to ROEs previously established via evidence sufficient to satisfy the *Bluefield* and *Hope* criteria.[73]

Producing the kind and quantity of evidence sufficient to satisfy those criteria is expensive and time consuming. Perhaps for that very reason the Commission has made a standard practice of applying the ROE established in a utility's most recent base-rate case to the utility's environmental surcharge (or ECR) calculations until the utility's next base-rate case. The Commission explicitly acknowledged its established practice in its final orders in the Companies' 2008 base-rate cases: "Typically, an electric utility with an environmental surcharge approved pursuant to KRS 278.183 uses the ROE from its most recent rate case in the return component of the environmental costs included in its surcharge."[74] It is therefore entirely consistent with the Commission's established practice that the Companies proposed to continue using the 10.00% ROE unanimously agreed to by the Companies and 12 intervenors in the Companies' 2014 base-rate cases, approved by the Commission less than a year ago in its final orders in those cases, affirmed by the Commission less than four months ago in the Companies' most recent six-month ECR review proceedings, and agreed to yet again by the AG and KIUC as part of the Unanimous Settlement Agreement in these proceedings.

What is entirely inconsistent with the Commission's established practice concerning ECR ROEs, as well as the *Bluefield* and *Hope* standards, is what appears to be an attempt to justify establishing a new ROE for ECR purposes on the basis of nothing more than a handful of RRA

[72] *Hope*, 320 U.S. at 603.
[73] *Big Sandy Community Action Program v. Chaffins*, 502 S.W.2d 526 (Ky. 1973); *Drummond v. Todd County Bd. of Educ.*, 349 S.W.3d 316 (Ky. App. 2011).
[74] Case No. 2008-00251, Order at 7; Case No. 2008-00252, Order at 8.

reports first introduced into the record of these proceedings at the public hearing, and of which none of the parties to these proceedings had any notice until the informal settlement conference held a mere five days before the public hearing. Those RRA reports, which are hearsay under Kentucky's Rules of Evidence, do not begin to constitute substantive evidence, and certainly not sufficient evidence to overturn an ROE established explicitly for use in the Companies' ECR mechanisms in proceedings where substantive and sufficient evidence from four different experts, including three intervenor experts, was in the record and had been the subject of discovery and analysis.

Moreover, if the Commission desires to change its long-established practices and turn every ECR proceeding into a full *Bluefield* and *Hope* satisfying ROE case, basic principles of due process require the Commission to provide notice of such a dramatic change more than two business days before the public hearing.[75]

Due process and evidentiary infirmities aside, the imprecise and undifferentiated nature of RRA reports make them woefully insufficient evidence for overturning a well-established and repeatedly Commission-approved ROE. RRA reports have their place; they can be useful to obtain a basic understanding of ROEs approved by various commissions for various utilities. But they should not be relied upon by any commission as the sole source for determining the appropriate ROE for any utility for at least two reasons.

First, RRA reports, when viewed in isolation, fail to provide the information needed for the type of financial analysis mandated by the *Bluefield* and *Hope* decisions. When commissions

[75] *See, e.g., Utility Regulatory Comm'n v. Ky. Water Service Co.*, 642 S.W.2d 591, 593 (Ky. App. 1982) ("It has been said that no hearing in the constitutional sense exists where a party does not know what evidence is considered and is not given an opportunity to test, explain or refute."); *Public Service Comm'n v. Warren County Water Dist.*, 642 S.W.2d 594, 595 (Ky. App. 1982) (finding that Warren County Water District had the right to a meaningful opportunity to be heard as to the issue of the allowance for depreciation expense on contributed property); *Ky. American Water Co. v. Commonwealth*, 847 S.W.2d 737, 741 (Ky. 1993) ("Under Due Process, he AG and the City were entitled to know what evidence is being considered and are entitled to an opportunity to test, explain and/or refute that evidence.").

determine ROEs, they generally look at the unique characteristics and circumstances of a utility to identify factors that affect the ROE needed for that specific utility to attract investors and obtain necessary capital. These characteristics and circumstances are not identified in a short RRA report, making them potentially misleading. For example, Commission Staff pointed to a May 13, 2016 RRA Regulatory Focus report, which reported a 9.8% ROE for Fitchburg Gas and Electric Company.[76] Fitchburg is a distribution-only electric utility; unlike the Companies, it owns no generation or transmission facilities, making it inherently less financially risky from an equity-investment perspective than vertically integrated utilities like the Companies. In addition, it is in no other material respect comparable to the Companies: it has an electric rate base slightly over $50 million compared to the Companies' combined electric capitalization of approximately $9 billion; it has a cost of debt nearly twice as high as the Companies' cost of debt; and perhaps most dissimilarly, it has a revenue-decoupling mechanism, largely insulating it from revenue fluctuations due to changes in customers' usage levels. In other words, other than having a somewhat-similar debt-to-equity ratio, there is no way in which Fitchburg is comparable to the Companies.

Similarly, Commission Staff pointed to an RRA Alert regarding the June 3, 2016 order of the Maryland Commission, which order granted BG&E an electric rate increase based on an ROE of 9.75%.[77] But the Maryland Commission expressly acknowledged that BG&E "continues to constitute a low-risk investment" because it "does not own generating facilities, which lowers its risk and it enjoys other risk-reducing attributes such as the ERI initiative [and] the BSA decoupling mechanism."[78] The ERI (Electric Reliability Initiative) allows BG&E to

[76] Hearing Exhibit 5, filed June 21, 2016.
[77] Hearing Exhibit 6, filed June 21, 2016.
[78] *In the Matter of the Application of Baltimore Gas and Electric Company for Adjustments to Its Electric and Gas Base Rates*, Case No. 9406, Order at 154-155 (Md. Pub. Serv. Comm'n June 3, 2016).

collect a monthly charge from its customers to fund distribution-system upgrades.[79] The BSA (Bill Stabilization Adjustment) decouples BG&E's revenues from its sales.[80] Thus, like Fitchburg, BG&E simply is not comparable to the Companies. Thus, the Fitchburg and BG&E decisions fall short of the *Bluefield* and *Hope* standards, which require an analysis of comparable entities with corresponding risks. And the RRA reports concerning the Fitchburg and BG&E orders show how RRA reports can be misleading and cannot be relied upon to establish an ROE.

And another clear example of the kinds of notable errors and omissions RRA reports contain is the reported 9.85% ROE for Indianapolis Power and Light Company ("IPL"). The April 15, 2016 RRA Report introduced by Commission Staff at hearing reports a 9.85% ROE awarded to IPL by the Indiana Utility Regulatory Commission ("IURC") in IPL's most recent base-rate proceeding. What the RRA report fails to mention is that the IURC determined that a reasonable ROE for IPL was 10.00%, the midpoint of a 9.70% to 10.30% range of reasonable ROEs. But the IURC determined that the ROE it approved for IPL should be reduced to the 9.85% midpoint of the lower end of the reasonable ROE range to provide IPL's management an "incentive" to address certain electrical-network improvements and to participate constructively in a collaborative effort established by the IURC.[81] The clear implication of the IURC's order was that IPL could regain the 15 docked basis points if its management addressed the issues the IURC wanted it to address.[82] Notably, no claims of mismanagement have been raised against the

[79] *In the Matter of the Application of Baltimore Gas and Electric Company for Adjustments to Its Electric and Gas Base Rates*, Case No. 9326, Order at 3 (Md. Pub. Serv. Comm'n Dec. 13, 2013).
[80] *In the Matter of the Application of Baltimore Gas and Electric Company for Adjustments to Its Electric and Gas Base Rates*, Case No. 9406, Order at 154 n.2 (Md. Pub. Serv. Comm'n June 3, 2016).
[81] Cause No. 44602, Order at 42 (In. Util. Reg. Auth. Mar. 16, 2016).
[82] *Id.*

Companies in these proceedings.[83] Regardless, none of this important background information about the IURC's ROE determination for IPL, and particularly its finding that a 10.00% ROE would have been appropriate for IPL absent the IURC's 15-basis-point penalty, can be found in the RRA report introduced at hearing.

In addition, RRA reports are not an exhaustive review of commission-approved ROEs. For example, RRA reports do not report many ROEs reached via settlement. For example, the April 15, 2016 RRA Report introduced by Commission Staff that purports to cover ROE results for the first quarter of 2016 does not report KU's settled 10.00% ROE as the midpoint of the range the VSCC found reasonable for KU's Annual Informational Filings in Virginia.

But to the extent the Commission does look to RRA reports to obtain a general sense of a reasonable range of ROEs, it must not exclude certain commissions' ROE awards simply because those commissions establish ROEs differently than does this Commission. Any such exclusion would ignore the reality of investor choice in capital markets. Investors are not limited to certain jurisdictions; rather, they have the discretion to take their investment to any jurisdiction. Therefore, it is imperative to include all approved ROEs, not just non-Virginia ROEs, because these are the entities with which the Companies compete for capital. Indeed, the Commission has acknowledged that investment capital is fungible and seeks the best risk-weighted returns, and that this extends to utilities and non-utilities: "[I]nvestors are always looking for the best investment opportunity and that a utility is in competition with unregulated firms."[84] This reality requires the Commission to take into account all ROEs in the RRA reports

[83] Even if they were, the Supreme Court of Kentucky has held, and this Commission has recognized, that the Commission is prohibited from using ROE either to reward or to punish a utility's management. *South Cent. Bell Tel. Co. v. Utility Regulatory Com.*, 537 S.W.2d 649, 653-654 (Ky. 1982); Case No. 2003-00433, Order at 65-66 (June 30, 2004); Case No. 2003-00434, Order at 57 (June 30, 2004).
[84] Case No. 2009-00548, Order at 31(July 30, 2010); Case No. 2009-00549, Order at 33(July 30, 2010).

when using those reports for their proper purpose, namely to provide a general sense of ROEs being awarded.

The Commission has historically viewed RRA Reports as a guidepost of reasonableness, as opposed to dispositive evidence which meets the *Bluefield* and *Hope* standards. Because uncorroborated reliance on RRA reports is fraught with peril, it is unsurprising that as recently as June 2015 the Commission repeated its position that it does not rely on returns awarded in other states in determining the appropriate ROE for Kentucky jurisdictional utilities.[85] But this does not mean that the Commission disregards RRA reports; rather, the Commission has historically used RRA reports as an indication of whether the ROE recommendations from parties are within the general realm of reasonableness of recently approved ROEs.[86] It is appropriate to use RRA reports not as dispositive evidence based on the economic standards required by the United State Supreme Court in the *Bluefield* and *Hope* decisions, but rather as a "reasonableness check" when evaluating the dispositive evidence required by the *Bluefield* and *Hope* decisions, precisely because the Commission finds it "reasonable to expect that other state commissions, each with their own attributes, are evaluating expert witness testimony which uses the same or similar cost-of-equity models and reaching conclusions based on the data provided in the records of individual cases."[87] Thus, it is the testimony, models, and evaluation that satisfy the utility-specific financial mandates of the *Bluefield* and *Hope* decisions and determine the appropriate ROE for a specific utility under specific circumstances, not the RRA report that is merely used as a general representation of reasonableness. This type of evidence is traditionally presented

[85] Case No. 2014-00396, Order at 43; *In the Matter of: Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Case No. 2013-00148, Order at 28 (April 22, 2014); *In the Matter of: Application of Delta Natural Gas Company, for an Adjustment of Rates*, Case No. 2010-00116, Order at 22 (Oct. 21, 2010); Case No. 2003-00433, Order at 66; Case No. 2003-00434, Order at 57.
[86] Case No. 2003-00433, Order at 66; Case No. 2003-00434, Order at 57.
[87] Case No. 2014-00396, Order at 43; Case No. 2013-00148, Order at 28.

during a utility's base-rate proceeding, which supports the Commission's long-standing practice of setting ROEs for ECR purposes during base-rate proceedings precisely because it allows the Commission to examine the utility's enterprise in its entirety. To depart from the Commission's historical practice would require utility's to satisfy the financial mandates of the *Bluefield* and *Hope* decisions outside the context of base-rate proceedings wherein proper ROR and ROE analysis is best suited.

The extensive and thorough testimony, cost-of-equity models, and discovery that resulted in the 10.00% ROE for ECR purposes in the 2014 base-rate case settlement agreement satisfy the financial mandates of the *Bluefield* and *Hope* decisions and continue to support the use of the 10.00% ROE. Moreover, the RRA reports provided at hearing show that 10.00% is well within the general realm of reasonableness of recently approved ROEs.

5. The Companies' next base-rate cases will include testimony from multiple expert witnesses on ROE

As discussed above, the appropriate forum in which to address a possible change to an established, Commission-approved ROE is a base-rate case, not an ECR proceeding. The Commission itself has said that is its established practice: "Typically, an electric utility with an environmental surcharge approved pursuant to KRS 278.183 uses the ROE from its most recent rate case in the return component of the environmental costs included in its surcharge."[88] For the reasons discussed above, it is a sensible practice: in base-rate cases, all parties anticipate addressing the appropriate ROE to use not only for base-rates but also for ECR. The Companies, AG, and KIUC typically present expert testimony and analyses to support their ROE positions in such cases, and the parties and Commission Staff conduct thorough discovery concerning that evidence, providing the Commission a well-developed record to support any ROE changes.

[88] Case No. 2008-00251, Order at 7; Case No. 2008-00252, Order at 8.

Another reason it is profoundly sensible to follow the Commission's practice of setting ROEs for base-rates and environmental surcharge mechanisms in base-rate proceedings is that equity investors do not invest in one mechanism or another when investing in a utility; rather, they invest in the entire utility. So although a utility might have a particular cost-recovery mechanism with a reasonable ROE, such as the 10.00% ROE the Commission has approved for the Companies' ECR mechanisms, it does not follow that the utility is earning a reasonable ROE overall, the kind of ROE that will attract capital investment necessary to support the utility's overall operations in accordance with the *Bluefield* and *Hope* standards. The Commission has appeared to recognize that reality, as when it approved the settlement agreement for Kentucky Power Company in its 2014 base-rate case that included setting a 10.25% ROE for use in its environmental surcharge mechanism,[89] as well as for use in two other riders related to Kentucky Power's Big Sandy Generating Station,[90] all in the context of finding that 9.80% was a reasonable ROE generally.[91]

The Companies anticipate filing base-rate applications within the next 12 months. The proceedings concerning those applications will provide the appropriate forum and evidentiary record for addressing ROE changes, not only for base rates but also for ECR cost recovery. The Companies therefore respectfully suggest to the Commission that, in accordance with the Commission's own established practice, the record of these proceedings does not contain evidence to support an ROE other than the 10.00% ROE the Commission approved less than a year ago in the Companies' most recent base-rate cases and in two ECR review cases since then,

[89] *In the Matter of: Application of Kentucky Power Company for: (1) A General Adjustment of Its Rates for Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief,* Case No. 2014-00396, Order at 72 (June 22, 2015).
[90] *Id.* at 47-48.
[91] *Id.* at 42.

and which the parties to this proceeding have agreed upon as fair, just, and reasonable in the context of the Unanimous Settlement Agreement submitted to the Commission. The Commission should therefore approve the unanimous settlement in its entirety and without modification, knowing that in no more than 12 months the Commission will likely have applications presented to it that will permit the development of the robust record necessary to change ROEs.

6. The authority to recover current costs pursuant to KRS 278.183 does not justify lowering the Companies' ROE from that found reasonable in their most recent base-rate proceedings

At hearing, Commission Staff acknowledged that KRS 278.183(3) authorizes the Commission to disallow improper costs during its six-month and two-year review proceedings. Commission Staff then questioned whether (1) the Companies had ever been subjected to such cost disallowances, to which the Companies answered in the negative, and (2) the absence of cost disallowances allows the Companies to earn the authorized ROR, including the authorized ROE, to which the Companies answered in the affirmative. This line of questioning implies that because the Companies have historically recovered their ECR plan costs, the ROE should be discounted to account for the diminished risk of cost disallowance. The Companies object to this implication on two primary grounds. First, that the Companies have not been subjected to cost disallowances during six-month and two-year reviews does not mean that the risk of cost disallowance does not exist or that the Companies are guaranteed their approved rate of return; the Commission has on multiple occasions shown its willingness to disallow recovery of ECR plan costs. For example, in Case Nos. 95-060 and 96-290, the Commission required KU and LG&E to exclude a portion of the ECR costs associated with off-system sales from their

respective ECR mechanisms.[92] In Case No. 95-550, the Commission held that Big Rivers Electric Corporation could not recover environmental-recovery costs on customer bills issued more than two months after the month of incurring the cost.[93] And in Case No. 2013-000325, the Commission denied Kentucky Power's request to increase its total jurisdictional environmental surcharge amount by a one-time adjustment of $3,518,900, determining that a settlement agreement reached in a prior proceeding required Kentucky Power to set its environmental-surcharge factor to zero until the next base-rate proceeding.[94] Therefore, the Companies and their investors have no reason to believe the Commission would hesitate to disallow unreasonable or improper costs in future ECR-review proceedings. That the Companies have not been subjected to such disallowances merely shows that the Companies have prudently managed their ECR programs, not that their ECR mechanisms are "guaranteed" or risk-free.

Second, it is important to remember that, as discussed above, equity investors do not invest solely in a single utility recovery mechanism; rather, they invest in the totality of the enterprise. The Companies do not engage in project financing. Thus, it is a utility's enterprise-level ROE that must be analyzed, including the risk applicable to the enterprise as a whole. For example, according to the "Major Rate Case Decisions—January-March 2016" RRA report, the VSCC awarded Virginia Electric and Power Company five different ROEs in the first quarter of 2016 for different rate mechanisms, four of which the VSCC established on the same day.[95] The

[92] *In the Matter of: An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company as Billed from August 1, 1994 to January 31, 1995,* Case No. 95-060, Order (Aug. 22, 1995); *In the Matter of: An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas and Electric Company as Billed from November 1, 1995 to April 30, 1996,* Case No. 96-290, Order (Nov. 12, 1996).
[93] *In the Matter of: Application of Big Rivers Electric Corporation for Recovery of July 1995 Environmental Compliance Costs,* Case No. 95-550, Order (April 29, 1996).
[94] *In the Matter of: An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Two-Year Billing Period Ending June 30, 2013,* Case No. 2013-00325, Order (April 29, 2014), Order Denying Rehearing (June 4, 2014).
[95] Hearing Exhibit 4, filed June 21, 2016.

ROEs ranged from 9.60% to 11.60%, with an average of 10.60%; that 10.60% average, not the ROE for a particular rate mechanism, is what investors look for when making investment decisions and is what is material when considering whether awarded ROEs meet the *Bluefield* and *Hope* standards.[96] As described above, that is one of the reasons why the Commission's established practice of subjecting ROEs to extensive review, modeling, and expert analysis in the context of base-rate proceedings and then applying the ROE so established to environmental-surcharge mechanisms like the Companies' ECR mechanisms is so sensible; it takes into account all the relevant factors investors consider, not just factors applicable to a single cost-recovery mechanism.

C. No CPCN Should Be Required to Close Any Surface Impoundment at a Retired Generating Station Because All Such Closures Are in the Ordinary Course of Business and None Is Financially Material

The surface-impoundment closures at Green River, Pineville, and Tyrone represent an ordinary extension in the usual course of business that will not materially affect the financial condition of KU. Therefore, neither KRS 278.020 nor 807 KAR 5:001 Section 15 requires the Companies to obtain a CPCN to conduct these surface-impoundment closures. In pertinent part, KRS 278.020 requires a utility to obtain a CPCN prior to constructing any plant, equipment, property, or facility for furnishing utility service to the public; but KRS 278.020 does not require CPCNs for ordinary extensions of existing systems in the usual course of business. 807 KAR 5:001 Section 15 further provides that no CPCN is required for extensions that (i) do not create wasteful duplication of plant, equipment, property, or facilities; or (ii) conflict with the existing certificates or service of other utilities operating in the same, general, or contiguous area; and (iii) do not involve sufficient capital outlay to materially affect the existing financial condition of the utility involved. The Commission has historically interpreted the materiality criterion of 807

[96] *Id.*

KAR 5:001 Section 15(3) to contemplate a comparison of the capital outlay involved to the value of the utility's net utility plant.

Closing surface impoundments is entirely in the ordinary course of conducting and then ceasing active operations at generating stations with coal-fired units. KU has now ceased all existing electric generating operations at Green River, Pineville, and Tyrone, and closing the surface impoundments is an entirely ordinary part of each generating station's life-cycle in the usual course of business. The closures will not be a wasteful duplication of plant, equipment, property, or facilities, and will likely improve the landscape by replacing open surface impoundments with vegetated hills. Also, there is no facility or other utility with which the closed surface impoundments will compete. Moreover, the total capital outlay involved with the closures will not materially affect the financial condition of KU. The total projected capital cost of the closures is $77.9 million, which represents approximately 1.4% of KU's net rate base of $5.3 billion. By generating station, the projected costs of the surface-impoundment closures represent approximately 1.0% (Green River), 0.15% (Pineville), and 0.24% (Tyrone) of KU's net rate base. Therefore, the closures do not meet the CPCN financial materiality criterion of 807 KAR 5:001 Section 15(3) as the Commission has historically interpreted it.[97] In addition, the AG and KIUC agreed as part of the Unanimous Settlement Agreement that no CPCN should be required for any of the surface-impoundment closures at Green River, Pineville, or Tyrone.

[97] *See* Conroy Direct Testimony at 15, citing *In the Matter of: Tariff Filing of Warren County Water District To Establish the Rockfield School Sewer Capital Recovery Fee*, Case No. 2012-00269 (Nov. 19, 2012); *In the Matter of: Application of Big Rivers Electric Corporation for Approval of an Interconnection Agreement with Kentucky Utilities Company*, Case No. 2007-00058 (Apr. 16, 2007); *In the Matter of: Application of Southern Madison Water District to Issue Securities in the Approximate Amount of $860,000 for the Purpose of Refunding an Outstanding Revenue Bond of the District and Finance Certain System Improvements Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001*, Case No. 99-310 (Sept. 1, 1999).

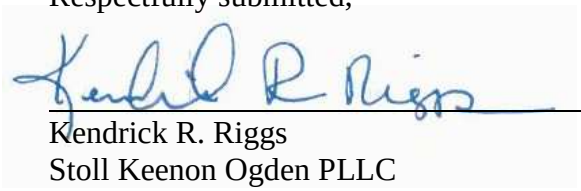
V. CONCLUSION

Taken in its entirety, the Unanimous Settlement Agreement reached by the AG, KIUC, and the Companies is a fair, just, and reasonable resolution of all the issues presented in these proceedings. It is a settlement entered into by arguably the two most sophisticated intervenor parties that appear before this Commission, parties whose counsel have combined experience of decades in the utility field in Kentucky; they do not enter lightly into settlements involving the recovery from those they represent of nearly $1 billion of new capital expenditures. They are parties that would not hesitate to walk away from the settlement table if they thought the terms of the entire Unanimous Settlement Agreement, including continuing to use the Commission-approved 10.00% ROE for ECR purposes, were anything other than fair, just, and reasonable in their totality. The Commission can therefore have confidence in approving the Unanimous Settlement Agreement in its entirety and without modification.

For these reasons, Kentucky Utilities Company and Louisville Gas and Electric Company ask the Commission to issue final orders by July 29, 2016, approving the Unanimous Settlement Agreement as the reasonable disposition of the issues in these cases without modification of any kind.

Dated: June 28, 2016

Respectfully submitted,



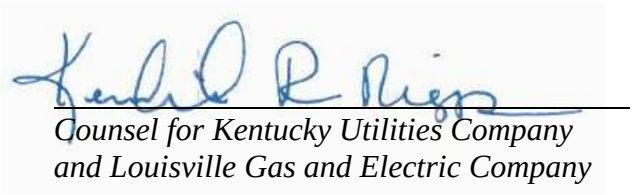
Kendrick R. Riggs
Stoll Keenon Ogden PLLC
2000 PNC Plaza
500 West Jefferson Street
Louisville, KY 40202-2828
Telephone: (502) 333-6000
Email: kendrick.riggs@skofirm.com

Allyson K. Sturgeon
Senior Corporate Attorney
LG&E and KU Energy LLC
220 West Main Street
Louisville, KY 40202
Telephone: (502) 627-2088
Email: allyson.sturgeon@lge-ku.com

Counsel for Kentucky Utilities Company
and Louisville Gas and Electric Company

CERTIFICATE OF SERVICE

This is to certify that Kentucky Utilities Company's and Louisville Gas and Electric Company's June 28, 2016 electronic filing of the Post-Hearing Brief is a true and accurate copy of the same document being filed in paper medium; that the electronic filing has been transmitted to the Commission on June 28, 2016; that there are currently no parties that the Commission has excused from participation by electronic means in these proceedings; and that an original, in paper medium, of the Brief is being mailed by first class U.S. mail, postage prepaid, to the Commission on June 28, 2016.



Counsel for Kentucky Utilities Company
and Louisville Gas and Electric Company