**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

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| **JOINT APPLICATION OF PPL CORPORATION,<br>PPL SUBSIDIARY HOLDINGS, LLC, PPL<br>ENERGY HOLDINGS, LLC, LG&E AND KU<br>ENERGY LLC, LOUISVILLE GAS AND<br>ELECTRIC COMPANY AND KENTUCKY<br>UTILITIES COMPANY FOR APPROVAL OF AN<br>INDIRECT CHANGE OF CONTROL OF<br>LOUISVILLE GAS AND ELECTRIC COMPANY<br>AND KENTUCKY UTILITIES COMPANY** | **)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)** | **CASE NO. 2017-00415** |

**DIRECT TESTIMONY OF**
**KENT W. BLAKE**
**CHIEF FINANCIAL OFFICER**
**LG&E AND KU ENERGY LLC**

**Filed: March 13, 2018**

1 **Q. Please state your name, position and business address.**

2 A. My name is Kent W. Blake. I am the Chief Financial Officer of Louisville Gas and
3 Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively,
4 the "Companies"), and an employee of LG&E and KU Services Company. My
5 business address is 220 West Main Street, Louisville, Kentucky 40202.

6 **Q. Please describe your educational and professional background.**

7 A. A complete statement of my work experience and education is contained in the
8 Appendix attached to my testimony.

9 **Q. Have you previously testified before this Commission?**

10 A. Yes, I have testified before the Public Service Commission ("Commission") on
11 numerous occasions for many years. Most recently, I testified for the Companies in
12 their last base rate cases,[1] and the case involving the effects of the Tax Cuts and Jobs
13 Act on the Companies' rates.[2]

14 **Q. What is the purpose of your testimony?**

15 A. I am filing testimony in response to the Commission's February 22, 2018 Order. In
16 my testimony, I will discuss the challenges and benefits associated with a potential
17 merger of the legal entities LG&E and KU, including whether there have been any
18 formal or informal studies or evaluations conducted to assess the merits of such a
19 merger.

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[1] *Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates and Certificates of Public Convenience and Necessity*, Case No. 2016-00370, and *Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates and Certificates of Public Convenience and Necessity*, Case No. 2016-00371.

[2] *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company and Louisville Gas and Electric Company*, Case No. 2018-00034.

1 **Q. Have the Companies recently conducted any formal or informal studies or**
2 **evaluations to assess the merits of a merger of the LG&E and KU legal entities?**
3 A. The Companies have informally considered the legal merger of LG&E and KU from
4 time to time, but have not documented such considerations in the form of any formal
5 or informal studies. Informal considerations of a potential merger of the two entities
6 have always resulted in a conclusion that the challenges of a legal merger would
7 outweigh the benefits of a legal merger. As a result, the Companies have prudently
8 not invested more time and resources to document more formally the merits of a legal
9 merger.
10 **Q. Will you please describe the change of control of the Companies that occurred in**
11 **1998?**
12 A. Yes. In May of 1997, the boards of directors of KU Energy Corporation, KU, LG&E
13 Energy Corp. and LG&E approved a merger between KU Energy Corporation and
14 LG&E Energy Corp and other related transactions. Following the filing of their
15 application and investigation in September of 1997, the Commission approved the
16 merger of KU Energy Corporation with LG&E Energy Corp. and the resulting
17 transfer of control of KU and LG&E.[3] Under the merger, the holding company for
18 LG&E acquired all of the outstanding shares of KU Energy Corporation, the then
19 holding company for KU. After the merger, the KU holding company was dissolved
20 and the LG&E holding company, now known as LG&E and KU Energy LLC,
21 became the holding company for both LG&E and KU. While both utilities remained

[3] *In the Matter of: Application of Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of a Merger Under KRS 278.020*, Case No. 97-300, Order (Ky. PSC Sept. 12, 1997).

1 separate corporations after the merger was completed in 1998, their utility operations
2 integrated into a single joint utility system over time.

3 **Q. How does the 1998 merger differ from the type of merger the Commission**
4 **requests the Companies to consider now?**

5 A. The 1998 merger involved the merger of the holding companies, but retained the two
6 separate operating utility corporate entities. The Commission now requests the
7 Companies to consider the merits of merging the two utilities into one entity. Such a
8 merger would largely be legal in nature – the Companies already operate as and
9 consider themselves a single integrated utility system.[4]

10 **Q. At the time of the 1998 merger, was a legal merger of LG&E and KU into one**
11 **entity considered?**

12 A. Yes. In Case No. 97-300, Commission Staff asked whether, given the savings
13 expected from the consolidation of activities, any consideration was given to merging
14 LG&E and KU and possibly achieving more savings. Joint Applicants responded as
15 follows:

16 Witnesses Van den Berg/Staffieri/Hewett

17 21. The testimony of Mr. Van den Berg discusses the various savings
18 expected from the proposed merger due to the consolidation or central
19 coordination of activities previously handled separately. Given this
20 background, was any consideration given to merging LG&E and KU, and
21 possibly achieving more savings? Describe what consideration was given to
22 this possibility.
23

[4] *In the Matter of: Application of Powergen PLC, To Acquire Louisville Gas and Electric Company and Kentucky Utilities Company*, Case No. 2000-095, Response to Commission's Order Dated April 5, 2000, Item 38, Page 1 of 1.

1 Yes. Senior management did consider the possibility of merging LG&E and
2 KU, but concluded that from a legal and financial standpoint such a merger
3 would not under existing circumstances produce any identifiable savings in
4 addition to the savings that could be accomplished through the merger of
5 LG&E Energy and KU Energy. The common borders of the service territories
6 are very limited and therefore further savings could not be reasonably
7 expected to be achieved. Combining generation and transmission operations
8 and planning functions as provided in the Power Supply and Coordination
9 Agreements are expected to achieve substantial savings. As explained by Mr.
10 Hewett in his testimony, further savings and efficiencies through the
11 combination of distribution operations could not reasonably be expected to be
12 achieved. Senior management also considered the benefits of avoiding
13 customer confusion and dissatisfaction that would result in the merger of
14 LG&E and KU and concluded that the benefits of maintaining the separate
15 existence of the two utilities were greater than the possible benefits of
16 merging the two utilities.

17 **Q. Describe the savings that resulted from the integration of the Companies.**

18 A. The non-fuel savings from the 1998 merger and integration of the Companies are
19 described in detail in the testimony of A. Joseph Van den Berg, a consultant with
20 Deloitte & Touche Consulting Group, LLC, filed in support of the merger in Case
21 No. 97-300. Mr. Van den Berg explained that the merger of the parent companies of
22 LG&E and KU would enable the Companies to "realize substantial benefits in the
23 form of economies, efficiencies and operating effectiveness."[5] His analysis
24 recognized three different types of savings: created savings, enabled savings, and
25 developed savings. Created savings are the most significant, as they are the savings
26 directly related to the completion of a merger that could not be obtained absent the
27 merger. The created savings include the following:

28 • <u>Corporate and Operations Labor</u>: Position reductions related to redundancies
29 with corporate, administrative, and technical support functions;

[5] Case No. 97-300, Testimony of A. Joseph Van den Berg at 10.

1 • Facilities Integration: Consolidation of headquarters, neighboring business
2 offices, or service centers and facilities;
3 • Corporate and Administrative Programs: Reductions in non-labor programs
4 and expenses, resulting from economies of scale and cost avoidance, including
5 advertising, administrative and general overhead, benefits, directors' fees,
6 insurance, information systems, professional services, shareholder services,
7 etc.;
8 • Purchasing Economies: Aggregation of materials and supplies volumes and
9 service contracts to increase purchasing power and to reduce standardized
10 inventory levels and associated carrying costs; and
11 • Capacity Deferral: Savings resulting from deferral of costs associated with the
12 building of new generation or purchasing firm generating capacity created by
13 diversity of system peaks and a joint reduction in reserve margin.
14 The Companies achieved these created savings and other enabled and developed
15 savings after the 1998 merger. The Companies shared a portion of the non-fuel
16 savings resulting from the 1998 merger via the Merger Surcredit mechanism, which
17 provided LG&E customers with $145.7 million and KU customers with $143.4
18 million over a 10-year period.[6] Subsequent savings initiatives labeled "One Utility"
19 and "Value Delivery Team" identified incremental savings. The Companies shared
20 savings with customers via the "VDT Surcredit" mechanism which provided LG&E
21 customers with approximately $47 million and KU customers with approximately $18

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[6] *In the Matter of: The Plan of Louisville Gas and Electric Company for the Future Disposition of the Merger Surcredit Mechanism*, *The Plan of Kentucky Utilities Company for the Future Disposition of the Merger Surcredit Mechanism*, Case No. 2007-00562, 2007-00563, Order at 3 (Ky. PSC June 26, 2008).

1 million over an approximately 8 year period. Total savings from all of these
2 initiatives were rolled into the base rates of KU and LG&E in Case Nos. 2008-00251
3 and 2008-00252[7] and have been reflected in the base rates of LG&E and KU since
4 that time.

5 **Q. Did integration of the Companies also create fuel savings?**

6 A. Yes, it did. Joint dispatch allows the Companies to consolidate the planning and
7 development of generating units to permit more efficient utilization of the
8 Companies' generating facilities and allow the Companies to facilitate and capture
9 fuel and capital construction savings. The Companies executed their Power Supply
10 System Agreement, which provides that the power supply resources of each utility
11 will be economically dispatched so that customers will receive the lowest energy cost
12 available. The Power Supply System Agreement is filed with and approved by the
13 Federal Energy Regulatory Commission ("FERC"). The Companies use the After-
14 the-Fact Billing ("AFB") model to determine the joint dispatch savings (fuel savings)
15 between LG&E and KU and to allocate the highest cost energy to off-system sales.
16 AFB stacks each source of energy, both generation and purchases, by cost from
17 highest to lowest for each hour in the month. The stacked energy is then matched
18 with hourly loads, and highest cost energy is assigned to off-system sales. This
19 process ensures that each Company's native load customers receive the lowest cost
20 energy available in every hour. At the time of the 1998 merger, the Companies

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[7] *In the Matter of: Application of Kentucky Utilities for an Adjustment of Electric Base Rates*, Case No. 2008-00251 and *In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Base Rates*, Case No. 2008-00252.

1 estimated the fuel savings for the first five years after the merger to be $36 million.[8]
2 Savings were and continue to be passed on to customers through the Companies' base
3 rates and fuel adjustment clauses using the AFB process.

4 **Q. Have the Companies integrated the planning and operations of the transmission**
5 **systems?**

6 A. Yes. The transmission systems of LG&E and KU are operated and planned on an
7 integrated basis pursuant to their Transmission Coordination Agreement. The
8 Transmission Coordination Agreement is filed with and approved by FERC. The
9 integration of the Companies' transmission system planning and operations allows the
10 Companies to maximize the economy, efficiency, and reliability of the transmission
11 system as a whole. The Companies jointly operate and manage their transmission
12 systems subject to a common Independent Transmission Organization known as
13 TransServ International, Inc., which performs the Independent Transmission
14 Organization functions required by FERC for both companies. TVA serves as the
15 FERC-required reliability coordinator for both companies.

16 **Q. Did the Commission consider the integrated system planning an important**
17 **benefit in determining that the 1998 merger was in the public interest?**

18 A. Yes. The Commission noted that "integrated system planning may be the single most
19 important benefit of the merger."[9] Since then, the Companies have filed joint

[8] Case No. 97-300, Testimony of Ronald L. Willhite at 15.
[9] Case No. 97-300, Order at 21 (Ky. PSC Sept. 12, 1997).

1 Integrated Resource Plans demonstrating their integration of system planning which
2 the Commission's Reports generally have found to be reasonable plans.[10]

3 **Q. Have the Companies built joint generation facilities since their 1998 merger?**

4 A. Yes. The Companies have not only jointly planned since their merger, but have also
5 executed their plans and built joint generation facilities to further integrate their
6 operations. The following generation assets of the Companies are jointly owned:

| **Generating Unit** | LG&E % | KU % |
|---|---|---|
| Brown Combustion Turbine Unit 5 | 53.00 | 47.00 |
| Brown Combustion Turbine Unit 6 | 38.00 | 62.00 |
| Brown Combustion Turbine Unit 7 | 38.00 | 62.00 |
| Brown Solar | 39.00 | 61.00 |
| Cane Run Combustion Turbine Unit 7 | 22.00 | 78.00 |
| Paddy's Run Combustion Turbine Unit 13 | 53.00 | 47.00 |
| Trimble County Steam Unit 2[11] | 14.25 | 60.75 |
| Trimble County Combustion Turbine Units 5 and 6 | 29.00 | 71.00 |
| Trimble County Combustion Turbine Units 7, 8, 9, and 10 | 37.00 | 63.00 |

7 **Q. Do the employees of LG&E, KU, and LG&E and KU Services Company reflect**
8 **the integration of the Companies' operations?**

9 A. Yes. As of December 31, 2017, LG&E and KU Services Company ("LKS") had
10 1,574 full-time employees, while LG&E and KU had 986 and 910 full-time
11 employees, respectively. Approximately 67% of the LG&E employees are
12 represented by International Brotherhood of Electrical Workers ("IBEW") Local

[10] *In the Matter of: 2014 Joint Integrated Resource Plan of Louisville Gas and Electric Company and Kentucky Utilities Company*, Case No. 2014-00131; *In the Matter of: 2011 Joint Integrated Resource Plan of Louisville Gas and Electric Company and Kentucky Utilities Company*, Case No. 2011-00140; *In the Matter of: The 2008 Joint Integrated Resource Plan of Louisville Gas and Electric Company and Kentucky Utilities Company*, Case No. 2008-00148; *In the Matter of: The 2005 Joint Integrated Resource Plan of Louisville Gas and Electric Company and Kentucky Utilities Company*, Case No. 2005-00162; *In the Matter of: The Joint Integrated Resource Plan of Louisville Gas and Electric Company and Kentucky Utilities Company*, Case No. 2002-00367; *In the Matter of: The Joint Integrated Resource Plan of Louisville Gas and Electric Company and Kentucky Utilities Company*, Case No. 1999-00430.

[11] IMEA/IMPA owns the remaining 25% of Trimble County Steam Unit 2.

1 2100 union and approximately 13% of the KU employees are represented by either
2 IBEW Local 2100 or the United Steel, Paper and Forestry, Rubber, Manufacturing,
3 Energy, Allied Industrial and Service Workers International Union. All officers of
4 the Companies, as well as all transmission and virtually all service department
5 personnel are employees of LKS and are organized functionally, serving both KU and
6 LG&E and, where applicable, other subsidiaries of LG&E and KU Energy LLC. The
7 employees of KU and LG&E are generally those employees dedicated to facilities
8 owned by either LG&E or KU and are concentrated in the areas of generation,
9 electric distribution, gas distribution and customer service where approximately 91%,
10 84%, 98%, and 31% of the workforce from those departments are employees of either
11 KU or LG&E. For example, employees who work in gas storage at LG&E's
12 Muldraugh compressor station are LG&E employees and the Plant Manager along
13 with the staff at the Ghent generating station are KU employees. This alignment and
14 number of employees demonstrates the integration and operation of the Companies as
15 a single integrated system.

16 **Q. Would the legal merger of the Companies result in a significant reduction of**
17 **employees?**

18 A. No. Although LG&E and KU each individually employ over 900 employees, the size
19 of each workforce is that required to work at and maintain the facilities of the
20 Companies. A merger of the LG&E and KU legal entities would not change that.
21 LKS could possibly reduce a small percentage of the workforce under the Vice
22 President, State Regulation and Rates, and the Controller. The Controller group
23 includes accounting, financial and regulatory reporting, tax and payroll. Modest

1 savings might result from the elimination of separate financial, regulatory and other
2 filings, separate tariffs and fewer intercompany transactions. However, the
3 Companies do not believe such savings would be significant.

4 **Q. Can you provide additional examples of the Companies' integration?**

5 A. Yes. The Companies have taken many steps to achieve the benefits of integration.
6 Briefly, some additional examples of the Companies' integration include the
7 following:

8 - The Companies use common information technology systems. LG&E and
9 KU have used a consolidated customer information system since 2009.
10 - The insurance programs of LG&E, KU, and PPL Corporation are combined
11 when possible to reduce premium costs.
12 - LG&E and KU non-union pension plans are merged to reduce administrative
13 costs.
14 - A money pool agreement allows for the efficient use of cash between utilities.
15 - Tariff structures and terms and conditions for service are harmonized for
16 efficient implementation and administration.
17 - The Companies file consolidated SEC reports.
18 - The Companies have combined call centers.
19 - The Companies try to make combined regulatory filings whenever feasible
20 and to maximize administrative efficiencies.
21 - The Companies use substantially parallel financing documents and structures,
22 financing staff, and advisory teams, which results in significant efficiencies

1 relating to documentation, familiarity, consistency and execution while
2 achieving the benefits of scale (e.g., greater negotiation power).

3 • The Companies use consolidated governance and management policies and
4 procedures, and use forms and documents that work for both entities to
5 achieve maximum integration and efficient operations.

6 **Q. Have the Companies addressed the question of a possible legal merger of LG&E**
7 **and KU in any proceeding other than Case No. 97-300?**

8 A. Yes. In Case No. 2001-00104, the Commission Staff inquired as to whether any
9 consideration was given to consolidating LG&E and KU into one legal entity. The
10 Joint Applicants indicated that the possibility of combining the two was considered,
11 but not pursued primarily because "LG&E and KU have different rate structures that
12 are based on different cost of service models with different revenue requirements."[12]
13 These different costs of service and revenue requirements reflect the historic and
14 unique attributes of LG&E and KU and their respective service territories. Further,
15 the Joint Applicants noted that the combination would likely result in rate disparity
16 issues: LG&E customers would experience a rate decrease and KU customers would
17 experience a rate increase.[13] The same rate disparity issue exists today. This is not to
18 say that a merger of utility legal entities in Kentucky could only be achieved if the
19 two had identical pre-merger rate structures. However, merger synergy savings
20 would need to be significant enough to avoid a result where the retail rates for

[12] *In the Matter of: Joint Application for Transfer of Louisville Gas and Electric Company and Kentucky Utilities Company in Accordance With E.ON AG's Planned Acquisition of Powergen PLC*, Case No. 2001-00104, Joint Applicants Response to Third Data Request of Commission Staff Dated June 12, 2001, Item No. 25, Page 1 of 1.
[13] *Id.*

1 customers of the utility with the lower retail rates would experience a rate increase.
2 Given the synergies already achieved between LG&E and KU, it is highly unlikely
3 that this would be the case. Exhibit KWB-1 shows that, based on 2017 actual results,
4 annual savings from a merger of the KU and LG&E entities would need to total $24
5 million annually and be entirely allocated to the benefit of LG&E electric residential
6 customers in order to avoid a resulting increase in KU residential rates if the entities
7 were merged and the surviving entity had a single residential tariff. This does not
8 consider changes that would be required to align other KU and LG&E tariffs.

9 **Q. Are there considerations associated with the brands of LG&E and KU?**

10 A. Yes. LG&E and KU both have strong consumer brands in their respective service
11 territories. We believe our customers take pride in the regional nature of their utility
12 and further believe that LG&E customers wish to continue to be served by LG&E and
13 KU customers wish to continue to be served by KU. If merged, significant marketing
14 efforts and costs would be necessary and customer confusion would be likely for
15 some appreciable time.

16 **Q. Would the legal merger of LG&E and KU require the revision of the**
17 **commitments of the 2010 PPL acquisition?**

18 A. Yes. In the Application requesting approval of the PPL acquisition in Case No. 2010-
19 00204, the Joint Applicants represented, as they had in the other acquisitions, that
20 there would be no changes to the corporate structure of KU and LG&E.[14] The merger

[14] The Joint Applicants stated that LG&E and KU would "exist after the change in control as they exist now," Case No. 2010-00204, Joint Response to the Attorney General's Initial Request for Information Dated June 23, 2010, Question No. 36 (Ky. PSC July 6, 2010), and represented that the transaction would allow the Companies "to continue to jointly plan and operate their generation and transmission systems under the ownership of a

1 commitments reflect this representation that the current structure of the utilities as
2 two separate entities would continue to exist for the purposes of enforcing the merger
3 commitments. The commitments would have to be revisited and redrawn if the
4 Companies were legally merged into one entity. For instance, Commitment 34
5 requires, in part, that "KU's headquarters shall be maintained in downtown
6 Lexington, Kentucky; and E.ON US's and LG&E's headquarters shall be maintained
7 in downtown Louisville, Kentucky."[15]

8 **Q. Would the potential legal merger create debt restructuring challenges?**

9 A. Yes. The Companies currently borrow only as individual entities. None of the assets
10 of the Companies are cross collateralized—the debt of LG&E is only secured by
11 LG&E assets and the debt of KU is only secured by KU assets.

12 With respect to existing First Mortgage Bonds ("FMBs") currently
13 outstanding under the indentures of LG&E and KU, those FMBs would not have to
14 be repaid upon a merger so long as the surviving entity were to make a written
15 assumption of the obligations to pay principal and interest on the FMBs and observe
16 conditions and covenants of the indenture. The property of each entity that existed
17 immediately prior to such a merger would, subject to the exceptions already
18 applicable under such entity's indenture, continue to secure the existing FMBs. Any
19 addition or improvement to or extension of that property following the merger would
20 also secure the existing FMBs. For example, if selective catalytic reduction
21 equipment ("SCRs") are added at Mill Creek Generating Station, those new assets

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parent company that holds a long term view of their value." Case No. 2010-00204, Direct Testimony of Victor A. Staffieri at 5 (Ky. PSC May 28, 2010).

[15] Case No. 2010-00204, Order, Appendix C at 9 (Ky. PSC May 28, 2010).

1 would secure the LG&E FMBs. Separate property accounting records would need to
2 be maintained with respect to each indenture until the last of the FMBs outstanding
3 under that indenture have matured. The earliest possible date that all existing FMBs
4 could be paid under their terms is April 1, 2045 for both KU and LG&E. Tender
5 offer transactions could accelerate that date, but bondholders would require a
6 premium to tender FMBs and any replacement bonds would likely be at higher rates
7 than the existing FMBs.
8 With respect to future FMB issuances, the surviving entity would have two
9 options. First, new bonds could be issued using the existing indentures secured by the
10 property of LG&E and KU immediately prior to such merger. Second, a Collateral
11 Trust Mortgage could be used to issue new bonds. The Collateral Trust Mortgage
12 structure involves creating a new indenture in the name of the successor entity. The
13 Collateral Trust Mortgage Bonds would have a second lien on the assets of the
14 successor company, and FMBs under the current indentures would be issued as
15 collateral for the Collateral Trust Mortgage Bonds. The issuance of FMBs as
16 collateral is comparable to the structure used today in our tax-exempt bond
17 transactions wherein FMBs are issued as collateral to the trustee of the tax-exempt
18 bonds issued by a county. Once all FMBs outstanding at the time of a merger were
19 retired, the second lien on the Collateral Trust Mortgage Bonds would become a first
20 priority lien. In either of these structures, property accounting records would need to
21 be maintained to support the FMBs until all have been retired.

1 **Q. How would the potential legal merger affect the Companies' financial systems?**

2 A. Despite utilizing the same financial systems, LG&E and KU would incur costs for
3 data conversion as a result of the merger. Additionally, LG&E and KU would incur
4 incremental audit fees to test internal controls around this data conversion in addition
5 to any other system changes resulting from the merger.

6 **Q. Will you please describe how the potential legal merger would affect tax**
7 **elections?**

8 A. Certainly. LG&E and KU generally have the same tax elections. If the Companies
9 were legally merged into one entity, there would be a few minor Schedule Ms that
10 would need to be aligned, but the result would be immaterial in both costs and
11 benefits.

12 However, although the Companies generally have the same tax elections, they
13 differ significantly in their election on the normalization options for Investment Tax
14 Credits ("ITC") under the Internal Revenue Code and how those credits are shared
15 with customers. Merging the Companies would create a significant risk as to the
16 Companies' ITC positions. In the 1970s LG&E and KU elected different options
17 then available under the Internal Revenue Code. Their calculations of rate base in
18 base rate cases have reflected their respective ITC elections for years. As observed
19 by an industry treatise, "[t]he failure to comply with the ITC normalization
20 requirements can be enormous."[16] To the best of our knowledge, reconciling the two
21 different ITC elections if the Companies were legally merged is an issue without
22 precedent. Because of this great uncertainty, the potential legal merger presents a risk

[16] *Taxation of Public Utilities*, Richard E. Matheny, Section 9.05[6], p. 9-43 (KPMG Peat Marwick LLP)

1 to the Companies' long-standing positions on ITC with the Internal Revenue Service,
2 including the $125 million Trimble County ITC. When the Companies received the
3 Trimble County ITC, the IRS issued eight requirements in the closing agreement.
4 One of the requirements states: "The agreement applies to Taxpayer. Any successor
5 in interest must execute a new closing agreement with the IRS."[17] If the Companies
6 are merged, they may need to execute another closing agreement with the IRS to
7 avoid the forfeiture of the entire $125 million. The Companies completed this
8 requirement after the PPL acquisition, but it still represents a cost and risk of a legal
9 merger.

10 Finally, if a new entity is created by a potential legal merger, new tax
11 elections may have to be made for the new entity. This would cause the Companies
12 to incur costs.

13 **Q. Would a legal merger eliminate the need for the LG&E and KU Service**
14 **Company?**

15 A. Not necessarily. Relevant portions of LKS expenses are still charged to non-utility
16 affiliates of the Companies. This includes certain debt and other remnants of
17 previous non-utility operations of LG&E and KU Energy LLC. It also includes
18 indirect charges from PPL which are not allowed to be charged to the Companies
19 pursuant to the Order approving the PPL acquisition in Case No. 2010-00204.[18]

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[17] Department of Treasury – Internal Revenue Service Closing Agreement (Nov. 29, 2006). The closing agreement was filed with the Commission as Exhibit 4 to KU's Application in Case No. 2007-00178.
[18] *In the Matter of: Joint Application of PPL Corporation, E.ON AG, E.ON U.S. Investments Corp., E.0N 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 of September 30, 2010, p. 8.

1 Currently, the existence and use of a service company provides certain useful
2 regulatory compliance benefits from a FERC affiliate transaction legal perspective.
3 FERC rules grant a service company a presumption of reasonableness for cost-based
4 charges for non-power goods and services provided to utility affiliates. As a practical
5 matter, this also indirectly supports the service company making cost-based charges
6 to non-utility affiliates assuming fair allocation ratios, percentages, and factors are
7 used. If service company personnel and services were to be moved in a utility, any
8 non-power goods or services provided or charged to a non-utility affiliate would have
9 to comply with FERC asymmetric pricing requirements.

10 **Q. Would a legal merger of LG&E and KU require other regulatory approvals?**

11 A. Yes. Such a legal entity merger would require the approval of the Federal Energy
12 Regulatory Commission ("FERC"), as well as the Virginia State Corporation
13 Commission, the Tennessee Public Utility Commission and potentially other
14 regulatory agencies, including but not limited to a filing under the Hart-Scott-Rodino
15 Act and the Federal Communications Commission.

16 When the holding companies of LG&E and KU merged in 1998, FERC raised
17 market power concerns, but accepted the Companies' Midwest[19] Independent System
18 Operator ("MISO") membership as mitigating any market power concerns
19 attributable to the Companies' merger.[20] Later, after the Companies withdrew from
20 the MISO, FERC again raised market power concerns.[21] FERC could raise market

[19] Now known as Midcontinent Independent System Operator, Inc.
[20] *Louisville Gas and Electric Company, LG&E Energy Marketing Inc., and Kentucky Utilities Company*, 82 FERC ¶ 61,308 (1998).
[21] *Louisville Gas and Electric Company, et al.*, 114 FERC ¶ 61,282 (2006).

1 power issues in connection with the potential legal merger of LG&E and KU. It is
2 reasonable to expect the KU wholesale municipal customers would aggressively
3 oppose the merger over rate disparity issues.

4 The Virginia State Corporation Commission has consistently required prior
5 approval of the previous changes of control or ownership of KU and can be expected
6 to require its prior approval of a legal merger of KU and LG&E. The same rate
7 disparity issue that exists for LG&E and KU customers in Kentucky also exists for
8 KU's customers in Virginia. It is reasonable based on our experience to expect the
9 Staff of the Virginia State Corporation Commission to raise this issue as a challenge
10 to the approval of the merger.[22]

11 The outcomes of the other regulatory approval processes are not certain and
12 could include unacceptable conditions.

13 **Q. Other than potential savings in the Controller and State Regulation and Rates**
14 **groups discussed earlier, have the Companies identified other potential benefits**
15 **associated with the potential legal merger of LG&E and KU?**

16 A. Yes. The Companies may have the ability to reduce the aggregate size of credit
17 facilities and associated bank fees. The current estimate of annual benefits, however,
18 would only be about $300,000 annually.

[22] *Petition of Kentucky Utilities Company d/b/a Old Dominion Power Company, KU Energy Corporation and LG&E Energy Corp. For approval of the acquisition of control of Kentucky Utilities Company by LG&E Energy Corp.,* Case No. PUA970041, 1998 Va. PUC LEXIS 296 (VSCC Jan. 20, 1998) ("Condition 14: [W]ith out prior Commission approval, KU/ODP agrees not to include in Virginia retail rates any costs attributable to LG&E's regulatory assets or potential strandable costs.").

1 **Q. Would there be any other areas that would benefit from such a legal entity**
2 **merger, such as the area of Human Resources?**
3 A. None have been identified in past discussion or in preparing this testimony. The
4 Companies concluded that union agreements and benefit plans would likely be
5 maintained in their current form following a legal entity merger. The Companies
6 currently operate under various location-specific work rule and union agreements that
7 would not be impacted by such a merger. Additionally, the Companies do not believe
8 that a combined company would lead to any changes to benefit plans. The benefit
9 plans of the Companies have been aligned for a number of years, with the only
10 exception being grandfathered pension formulas for each company.
11 **Q. Considering the challenges and potential benefits associated with a potential**
12 **legal merger of LG&E and KU, what do you conclude?**
13 A. Because the operations of the Companies are already significantly integrated, the
14 potential legal merger of the Companies would not currently generate sufficient
15 benefits to outweigh the costs and challenges associated with such a legal entity
16 merger.
17 **Q. Does this conclude your testimony?**
18 A. Yes, it does.
19

**VERIFICATION**

**COMMONWEALTH OF KENTUCKY** )
) **SS:**
**COUNTY OF JEFFERSON** )

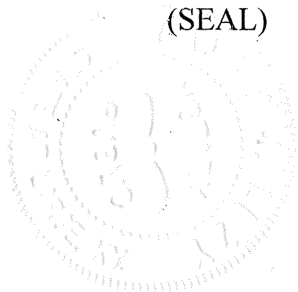
The undersigned, **Kent W. Blake**, being duly sworn, deposes and says he is the Chief Financial Officer for Kentucky Utilities Company and Louisville Gas and Electric Company, that he has personal knowledge of the matters set forth in the foregoing testimony and exhibits, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

K W Blake

**KENT W. BLAKE**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 13th day of March, 2018.

(SEAL)



Tammy J. Elzy

Notary Public

My Commission Expires:

November 9, 2018

## APPENDIX A

**Kent W. Blake**

Chief Financial Officer
Louisville Gas and Electric Company
Kentucky Utilities Company
220 West Main Street
Louisville, Kentucky 40202

**Previous Positions**

LG&E and KU Energy LLC (f/k/a E.ON U.S., LG&E Energy LLC)

| | |
|---|---|
| Vice President, Corporate Planning and Development | 2007-Feb 2012 |
| Vice President, State Regulation and Rates | 2003-2007 |
| Director, State Regulation and Rates Director, Regulatory Initiatives | |
| Director, Business Development | 2002-2003 |
| Director, Finance and Business Analysis | |

Mirant Corporation (f/k/a Southern Company Energy Marketing) 1998-2002

Senior Director, Applications Development
Director, Systems Integration
Trading Controller

LG&E Energy Corp.

Director, Corporate Accounting and Trading Controls 1997-1998

Arthur Andersen LLP 1988-1997

Manager, Audit and Business Advisory Services
Senior Auditor
Audit Staff

**Education/Certifications**

University of Kentucky, B.S. in Accounting
Certified Public Accountant, Kentucky
Leadership Louisville, 2007

**Current Professional and Community Affiliations**

American Institute of Certified Public Accountants
Kentucky State Society of Certified Public Accountants
Edison Electric Institute
Metro United Way, Board Chair Elect
Louisville Downtown Development Corporation, Board Member

## Residential Class - 12 months ending December 31, 2017

| | | | ( A ) LG&E | ( B ) KU | ( C ) Combined |
|---|---|---|---|---|---|
| (1) | No. Customer Months | | 4,315,896 | 5,152,932 | 9,468,828 |
| (2) | Energy Consumption (kWh) | | 4,004,001,092 | 5,698,194,052 | 9,702,195,144 |
| (3) | Residential Revenue | | $436,549,541 | $586,588,841 | $1,023,138,382 |
| (4) | | | | | |
| (5) | Average Rate ($/kWh) | (3) / (2) | $0.1090 | $0.1029 | $0.1055 |
| (6) | Average Monthly Usage (kWh) | (2) / (1) | 928 | 1,106 | |
| (7) | Average Monthly Bill | (5) x (6) | $101.15 | $113.84 | |
| (8) | | | | | |
| (9) | Combined Rate: | (5), col ( C ) | $0.1055 | $0.1055 | |
| (10) | Average Bill | (9) x (6) | $97.83 | $116.61 | |
| (11) | Customer Impact | (10) - (7) | ($3.32) | $2.78 | |
| (12) | | | | | |
| (13) | | | | | |
| (14) | Maintain No Increase: | | | | |
| (15) | Average Rate ($/kWh) | (5), col ( B ) | $0.1029 | $0.1029 | |
| (16) | Average Bill | (15) x (6) | $95.50 | $113.84 | |
| (17) | Total Revenue | (15) x (2) | $412,183,639 | $586,588,841 | $998,772,480 |
| (18) | Savings Required to Achieve | (16) - (3) | ($24,365,902) | $0 | ($24,365,902) |

Source: LG&E and KU Monthly Financial Reports and Revenue Volume Analysis Reports