COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.		
	)	
______________________________________	)	**CASE NO.**
	)	**2018-00034**
KENTUCKY UTILITIES COMPANY	)	
AND	)	
LOUISVILLE GAS AND ELECTRIC COMPANY	)	

RESPONSE OF
KENTUCKY UTILITIES COMPANY
AND
LOUISVILLE GAS AND ELECTRIC COMPANY
TO
COMMISSION STAFF'S THIRD REQUEST FOR INFORMATION
DATED APRIL 13, 2018

FILED: April 20, 2018

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Daniel K. Arbough**, being duly sworn, deposes and says that he is Treasurer for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Daniel K. Arbough

Daniel K. Arbough

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 20th day of April 2018.

Judy Schooler (SEAL)
Notary Public

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

VERIFICATION

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

The undersigned, **Kent W. Blake**, being duly sworn, deposes and says that he is Chief Financial Officer for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Kt W Blake

Kent W. Blake

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 20th day of April 2018.

Judy Schooler (SEAL)

Notary Public

My Commission Expires:

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

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Christopher M. Garrett**, being duly sworn, deposes and says that he is Controller for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Christopher M. Garrett

Christopher M. Garrett

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 20th day of April 2018.

Judy Schooler (SEAL)
Notary Public

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

KENTUCKY UTILITIES COMPANY
AND
LOUISVILLE GAS AND COMPANY

Response to Commission Staff's Third Request for Information
Dated April 13, 2018

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Question No. 1

Witness: Kent W. Blake

Q-1. Refer to the Direct Testimony on Rehearing of Kent W. Blake ("Blake Testimony"), page 20, lines 16-20.

a. Provide the date of the most recent load forecast to which the testimony refers.

b. Explain if the load forecast includes the effects of the price elasticity of demand associated with the lower rates resulting from the Tax Cuts and Jobs Act ("TCJA").

A-1. a. The Companies' most recent load forecast was completed in July 2017.

b. The July 2017 load forecast did not contemplate the impact of lower rates resulting from the TCJA as the TCJA was not passed until December 22, 2017.

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Question No. 2

Witness: Kent W. Blake / Daniel K. Arbough

Q-2. Refer to the Blake Testimony, Exhibit KWB-3.

a. Refer to page 1 of 5.

(1) Provide support for the proposed 17-month average capitalization component amounts.

(2) Provide support for the proposed jurisdictional adjustments.

(3) Provide support for the proposed 2.94 percent cost of short-term debt.

(4) Provide support for the proposed 4.26 percent cost of long-term debt.

b. Refer to page 3 of 5.

(1) Provide support for the proposed 17-month average capitalization component amounts.

(2) Provide support for the proposed jurisdictional adjustments.

(3) Provide support for the proposed 2.90 percent cost of short-term debt.

(4) Provide support for the proposed 4.18 percent cost of long-term debt.

c. Refer to page 4 of 5.

(1) Provide support for the proposed 17-month average capitalization component amounts for short-term debt, long-term debt, and common equity.

(2) Provide support for the proposed jurisdictional adjustments.

(3) Provide support for the proposed 2.90 percent cost of short-term debt.

(4) Provide support for the proposed 4.18 percent cost of long-term debt.

A-2.

a. (1) Pages 1-2 of the attached file, which is being provided in Excel format, show the forecasted monthly balance sheets for the 17 months from December 2017 to April 2019, and the 17 month average capitalization. Page 3 shows the categories of the changes in the capitalization over that 17 month period in a manner consistent with the table on page 12 of the Direct Testimony on Rehearing of Kent W. Blake filed on April 6, 2018.

(2) See attached provided in Excel format.

(3) The support for the 2.94 percent cost of short-term debt was shown on page 5 of Exhibit KWB-4 filed originally with the *Offer and Acceptance of Satisfaction* and subsequently in an Excel format in response to the Commission's first set of data requests, Question No. 1. The interest rates of 2.90 percent for 2018 and 3.15 percent for 2019 were projected using the intraday forward curve for LIBOR on December 28, 2017 plus 0.75 percent to reflect three projected increases by the Federal Reserve in 2018 and one 0.25 percent increase in early 2019.

(4) The support for the 4.26 percent cost of long-term debt was shown on page 6 of Exhibit KWB-4 filed originally with the *Offer and Acceptance of Satisfaction* and subsequently in an Excel format in response to the Commission's first set of data requests, Question No. 1. The short-term rate forecast discussed in part (3) above was used to determine the interest rate on those bonds that have a variable rate. The bonds backed by letters of credit are projected to be priced at 70% of LIBOR while the bonds in a commercial paper mode are projected to be reset at 70% of LIBOR plus a .20% credit spread. The credit spreads are consistent with historical resets.

b. (1) Pages 1-2 of the attached file, which is being provided in Excel format, show the forecasted monthly balance sheets for the 17 months from December 2017 to April 2019, and the 17 month average capitalization. Pages 3-5 show the categories of the changes in the capitalization over that 17-month period in a manner consistent with the table on page 12 of the Direct Testimony on Rehearing of Kent W. Blake filed on April 6, 2018.

(2) See attached provided in Excel format.

(3) The support for the 2.90 percent cost of short-term debt was shown on page 4 of Exhibit KWB-5 filed originally with the *Offer and Acceptance of Satisfaction* and subsequently in an Excel format in response to the Commission's first set of data requests, Question No. 1. The interest rates of 2.90 percent for 2018 and 3.15 percent for 2019 were projected using the intraday forward curve for LIBOR on

December 28, 2017 plus 0.75 percent to reflect three projected increases by the Federal Reserve in 2018 and one 0.25 percent increase in early 2019.

(4) The support for the 4.18 percent cost of long-term debt was shown on page 5 of Exhibit KWB-5 filed originally with the *Offer and Acceptance of Satisfaction* and subsequently in an Excel format in response to the Commission's first set of data requests, Question No. 1. The short-term rate forecast discussed in part (3) above was used to determine the interest rate on those bonds that have a variable rate or had an interest rate reset during the 16 month period from January 2018 through April 2019. The bonds in a commercial paper mode and the bonds in a weekly mode are projected to be reset at 70% of LIBOR plus a 0.20% credit spread. The credit spread is consistent with historical resets.

c. (1) See the response to part b.(1) above.

(2) See the attached provided in Excel format.

(3) See the response to part b.(3) above.

(4) See the response to part b.(4) above.

The attachments are being provided in separate files in Excel format.

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Question No. 3

Witness: Kent W. Blake / Daniel K. Arbough

Q-3. Refer to the Blake Testimony, Exhibit KWB-4.

a. Refer to page 2 of 9. The embedded cost of long-term debt is 4.24 percent. Also, refer to Exhibit KWB-3, page 1 of 5. Here, the cost rate of long-term debt is 4.26 percent. Explain why 4.26 percent was used as the cost of long-term debt.

b. Refer to page 3 of 9. The projected weighted cost of short-term debt is 2.628 percent. Also, refer to Exhibit KWB-3 page 1 of 5. Here, the cost rate of short-term debt is 2.94 percent. Explain why 2.94 percent was used as the cost of short-term debt.

c. Refer to page 7 of 9. The embedded cost of long-term debt is 4.12 percent. Also refer to Exhibit KWB-3 pages 3 and 4 of 5. Here, the cost rate of long-term debt is 4.18 percent. Explain why 4.18 percent was used as the cost of long-term debt.

d. Refer to page 8 of 9. The projected weighted cost of short-term debt is 2.593 percent. Also, refer to Exhibit KWH-3 pages 3 and 4 of 5. Here, the cost rate of short-term debt is 2.90 percent. Explain why 2.90 percent was used as the cost of short-term debt.

A-3.

a. As described on page 15 of the Direct Testimony on Rehearing of Kent W. Blake, Exhibit KWB-4 includes more current interest rate projections than those included in the *Offer and Acceptance of Satisfaction*. As noted in the response to Question Nos. 2.a.(3) and 2.b.(3), 0.75 percent was added to the forward curve as of December 27, 2017. The forward curve already included 0.50 percent of increases by the Federal Reserve. The Companies believe it would be more appropriate to use the more current market interest rates shown in Exhibit KWB-4 to calculate the TCJA Surcredit.

b. See the response to part a. above.

c. See the response to part a. above.

d. See the response to part a. above.

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Question No. 4

Witness: Kent W. Blake

Q-4. Provide KU's capitalization structure for year-end 2017.

A-4.

		000's At December 31, 2017	
Line No.	Type of Capital	Amount	Ratio
1	Long-Term Debt	$ 2,315,328	45.31%
2	Short-Term Debt	44,957	0.88%
3	Common Equity	2,749,497	53.81%
4	Total Capitalization	$ 5,109,783	100.00%

Note: Total long-term debt includes the current portion of long-term debt, $18,055k of unamortized debt expense, and $8,826k of unamortized loss on reacquired bonds.

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Question No. 5

Witness: Kent W. Blake

Q-5. Provide LG&E's capitalization structure for year-end 2017.

A-5.

Line No.	Type of Capital	000's At December 31, 2017 Amount	Ratio
1	Long-Term Debt	$ 1,690,490	41.97%
2	Short-Term Debt	198,888	4.94%
3	Common Equity	2,138,596	53.09%
4	Total Capitalization	$ 4,027,974	100.00%

Note: Total long-term debt includes the current portion of long-term debt, $13,944k of unamortized debt expense, and $15,558k of unamortized loss on reacquired bonds.

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Question No. 6

Witness: Kent W. Blake

Q-6. Provide KU's actual Return on Equity (income available to common shareholders divided by common equity) for year-end 2017.

A-6. KU's Return on Equity (income available to common shareholders divided by common equity) for year-end 2017 was 9.35%.

Kentucky Utilities Company	At December 31, 2017
Net Income available to common shareholders	$ 257,108,756
divided by Common Equity	2,749,496,925
Return on Equity	9.35%

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Question No. 7

Witness: Kent W. Blake

Q-7. Provide LG&E's actual Return on Equity for gas and electric operations for year-end 2017.

A-7. LG&E's Return on Equity (income available to common shareholders divided by common equity) for year-end 2017 was 10.10% for Electric and 9.62% for Gas.

Louisville Gas and Electric Company	At December 31, 2017
Electric	
Net Income available to common shareholders	$ 177,106,970
divided by Common Equity	1,754,290,095
Return on Equity	10.10%
Gas	
Net Income available to common shareholders	$ 36,988,797
divided by Common Equity	384,305,657
Return on Equity	9.62%

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Question No. 8

Witness: Kent W. Blake / Daniel K. Arbough

Q-8. Provide schedules reflecting both a 5-year and 15-year amortization period for KU and LG&E's unprotected excess ADIT and the impact each amortization would have on (1) KU and LG&E's revenue requirement, and (2) the surcredit to be provided to customers, as calculated using the method in both the Offer and Acceptance of Satisfaction and in the Commission's March 20, 2018 Order. Provide full explanation and support for the use of any particular amortization period.

A-8. See attached provided in Excel format. The Companies also calculated the schedules using the methods requested and in addition provided a "Per Company Revision" of the Commission's March 20, 2018 method reflecting the Gross-Up Factor using the effective tax rate provided in Exhibit KWB-3. The Companies used a 15-year amortization period for unprotected excess ADIT in the *Offer and Acceptance of Satisfaction*. See the Direct Testimony on Rehearing of Kent W. Blake at pages 17-18, where he describes the use of 15 years for amortization of actuarial gains and losses related to pensions.

> "Excess ADIT balances are largely driven by differences in book and tax accounting for pension expense. In Case Nos. 2014-00371 and 2014-00372, amortization of actuarial gains and losses in the Companies' pension expense was set at 15 years and that ratemaking treatment was carried forward in Case Nos. 2016-00370 and 2016-00371. In executing the original *Offer and Acceptance of Satisfaction*, the parties discussed and agreed to use a 15-year amortization period for non-property-related excess ADIT to be consistent with the ratemaking treatment being provided to the amortization of actuarial gains and losses in the Companies' pension expense. The parties agreed to the use of this amortization period with awareness of the stress that the TCJA is placing on the credit metrics and ratings of utilities across the country."

Attachment 2 shows that a change from 15-year amortization to 5-year amortization would further reduce already stressed credit metrics. KU's Cash Flow from Operations Pre-Working Capital/Debt would decline by 0.05% to 20.80%. LG&E's ratio would decline by 0.14% to 21.83%. The Moody's guideline for A rated utilities is 22%-30%.

The attachments are being provided in separate files in Excel format.

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Question No. 9

Witness: Kent W. Blake

Q-9. Refer to the Direct Testimony of Kent Blake, Exhibit KWB-1, Offer of Acceptance and Satisfaction.

a. Provide a revised "Overall Financial Summary" schedule for LG&E gas and electric operations, including support, calculating the revenue requirement impact of the change from the 35 percent federal income tax rate to the 21 percent federal income tax rate under the TCJA using only the capitalization and debt costs for the forecasted period January 1, 2018, through April 30, 2019.

b. Provide a revised "Overall Financial Summary" schedule for KU, including support, calculating the revenue requirement impact of the change from the 35 percent federal income tax rate to the 21 percent federal income tax rate under the TCJA using only the capitalization and debt costs for the forecasted period of January 1, 2018, through April 30, 2019.

A-9.

a. See attached provided in Excel format. The attached calculation is intended to be responsive to this data request. However, the comparison above would only be appropriate to isolate the impact of the federal income tax rate change on the Companies' revenue requirement if the average capitalization for that period and the current market interest rates were provided for in either base rates or the TCJA Surcredit.

b. See attached provided in Excel format. The attached calculation is intended to be responsive to this data request. However, the comparison above would only be appropriate to isolate the impact of the federal income tax rate change on the Companies' revenue requirement if the average capitalization for that period and the current market interest rates were provided for in either base rates or the TCJA Surcredit.

The attachments are being provided in separate files in Excel format.

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Question No. 10

Witness: Kent W. Blake / Christopher M. Garrett

Q-10. State whether KU or LG&E has received any letter or written opinion from the Internal Revenue Service since January 1, 2000, regarding the treatment of KU/LG&E's ADIT or excess ADIT and, if so, provide a copy of the letter or written opinion.

A-10. KU and LG&E have not received a letter or written opinion from the IRS regarding the treatment of ADIT or excess ADIT. The Companies do have routine correspondence with the IRS in dealings with income tax audits, payroll matters, employee benefits, tax payments/refunds, and other miscellaneous federal tax matters. The Companies are no longer subject to examinations by the IRS for years 2013 and prior. The Companies' financial statements, inclusive of its ADIT and excess ADIT balances, were last audited by its external auditor as of December 31, 2017.

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Question No. 11

Witness: Kent W. Blake / Christopher M. Garrett

Q-11. Provide any letters or written opinions prepared by the Internal Revenue Service and relied on by KU/LG&E or their agents to calculate KU/LG&E's excess ADIT or to determine how the excess ADIT may be reimbursed to ratepayers under federal tax law, regardless of whether those letters or written opinions were prepared for or at the request of KU/LG&E.

A-11. As referenced in the Direct Testimony on Rehearing of Kent W. Blake at pages 16-17, the Companies are amortizing excess ADIT balances using the Average Rate Assumption Method ("ARAM") as required for "protected" excess ADIT per the Tax Cuts and Jobs Act § 13001 that supports the position of the Companies. Below is an excerpt from that section.

(d) NORMALIZATION REQUIREMENTS.—

(1) IN GENERAL.—A normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Internal Revenue Code of 1986 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method.

(2) ALTERNATIVE METHOD FOR CERTAIN TAXPAYERS.—If, as of the first day of the taxable year that includes the date of enactment of this Act—

(A) the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and

(B) the taxpayer's books and underlying records did not contain the vintage account data necessary to apply the average rate assumption method,

the taxpayer will be treated as using a normalization method of accounting if, with respect to such jurisdiction, the taxpayer uses the alternative method for public utility property that is subject to the regulatory authority of that jurisdiction.

(3) DEFINITIONS.—For purposes of this subsection—

(A) EXCESS TAX RESERVE.—The term "excess tax reserve" means the excess of—

(i) the reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal Revenue Code of 1986) as of the day before the corporate rate reductions provided in the amendments made by this section take effect, over

(ii) the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate rate reductions provided in this Act were in effect for all prior periods.

(B) AVERAGE RATE ASSUMPTION METHOD.—The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying—

(i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by

(ii) the amount of the timing differences which reverse during such period.

(C) ALTERNATIVE METHOD.—The "alternative method" is the method in which the taxpayer—

(i) computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and

(ii) reduces the excess tax reserve ratably over the remaining regulatory life of the property.

(4) TAX INCREASED FOR NORMALIZATION VIOLATION.—If, for any taxable year ending after the date of the enactment of this Act, the taxpayer does not use a normalization method of accounting for the corporate rate reductions provided in the amendments made by this section—

(A) the taxpayer's tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting, and

(B) such taxpayer shall not be treated as using a normalization method of accounting for purposes of subsections (f)(2) and (i)(9)(C) of section 168 of the Internal Revenue Code of 1986.

Additionally, below are Private Letter Rulings supporting the treatment of net operating loss carryforward excess ADIT as "protected".

- PLR 201436037 - www.irs.gov/pub/irs-wd/201436037.pdf
- PLR 201436038 - www.irs.gov/pub/irs-wd/201436038.pdf
- PLR 201438003 - www.irs.gov/pub/irs-wd/201438003.pdf

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Question No. 12

Witness: Kent W. Blake / Christopher M. Garrett

Q-12. In calculating the rate at which protected excess ADIT may be amortized to reduce the cost of service for ratemaking purposes for the proposed settlement or in response to any request for information from Commission Staff, did KU/LG&E use the depreciation method, including the remaining useful life for each property, established by the Kentucky Public Service Commission in KU/LG&E's last rate cases? If not, please explain what depreciation method was used, explain why that method was used, and identify and provide any and all evidence that KU/LG&E contends support the use of that method, including any change in the useful life of the property.

A-12. Yes, the Companies estimated the amortization of protected excess ADIT used in the proposed settlement based on the depreciation method, including the remaining useful life for each property, established by the Kentucky Public Service Commission in KU/LG&E's last rate cases.

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Question No. 13

Witness: Kent W. Blake

Q-13. Refer to the Blake Testimony. Provide all exhibits in Excel spreadsheet format with formulas intact and unprotected, and all rows and columns fully accessible, to the extent those exhibits were created or are kept in Excel format.

A-13. See attached provided in Excel format.

The attachments are being provided in separate files in Excel format.

KENTUCKY UTILITIES COMPANY
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Question No. 14

Witness: Kent W. Blake / Daniel K. Arbough

Q-14. Provide copies of all schedules provided in the responses, supporting calculations, and documentation in Excel spreadsheet format with formulas intact and unprotected, and all rows and columns fully accessible.

A-14. Such schedules have been provided in Excel spreadsheet format as requested as part of each response.