COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

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I. INTRODUCTION

This case stems from a formal complaint filed by Kentucky Industrial Utility Customers, Inc. ("KIUC") against Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively, the "Companies") on December 21, 2017. KIUC's complaint alleged that the Companies' rates were no longer fair, just, and reasonable due to the enactment of the Tax Cuts and Jobs Act ("TCJA").

Despite the adverse consequences on the Companies' cash flows and adverse earnings and cash flow impacts on the Companies' parent company, LG&E and KU and their parent company actively supported the passage of the TCJA, as it is beneficial to customers and the economy. With the enactment of the TCJA into law, the Companies readily agreed that the net benefits and associated impacts of the TCJA should be distributed to customers. Working quickly through the Commission's process with the KIUC and Attorney General of the Commonwealth of Kentucky ("AG"), the Companies and their customers arrived at reasonable resolution that returns the appropriate level of TCJA benefits to customers as soon as reasonably possible.

Nearly five months ago, on January 29, 2018, the KIUC, AG, and the Companies filed with the Commission their *Offer and Acceptance of Satisfaction*, which provides for a base rate credit ("TCJA Surcredit") and associated reductions in the Companies' other rate mechanisms. KIUC, as the complainant, the Companies, as the defendants, and the Attorney General who by statute represents the interests of consumers,[1] agreed that the *Offer and Acceptance of Satisfaction* was a fair, just, and reasonable resolution to this case.

[1] KRS 367.150(8).

Nearly two months after the parties entered into the *Offer and Acceptance of Satisfaction*, on March 20, 2018, without notice or a hearing, the Commission issued an order approving the *Offer and Acceptance of Satisfaction,* but with material modifications that are harmful to the Companies. The Commission modified the *Offer and Acceptance of Satisfaction* to increase the amount of the TCJA Surcredit by approximately $26.9 million by refusing to consider the recommended adjustments to update capitalization and interest rates relative to those used in the Companies' last rate cases.

On March 28, 2018, the Commission issued an order, granting the Companies' Petition for Rehearing and Request for a Hearing.[2] That same order also approved the Companies' request to implement the TCJA Surcredit effective April 1, 2018 at the levels proposed in the *Offer and Acceptance of Satisfaction*.[3] During the course of the discovery on rehearing, the Companies acknowledged that updates to the calculation of the composite tax rate and cost of debt were appropriate.[4] These two adjustments increase the TCJA Surcredit per the *Offer and Acceptance of Satisfaction* by $3.4 million to $138.9 million as shown below:

Description	KU ($)	LG&E Electric ($)	LG&E Gas ($)	Total Base Rate Credits ($)
Offer and Acceptance of Satisfaction	(70,180,255)	(48,993,021)	(16,299,321)	(135,472,597)
Updated Composite Tax Rate Impact[5]	(580,617)	(287,834)	(81,876)	(950,327)
Updated Cost of Debt Impact[6]	(885,555)	(1,225,974)	(345,570)	(2,457,099)
Offer and Acceptance of Satisfaction Updated[7]	**(71,646,427)**	**(50,506,829)**	**(16,726,767)**	**(138,880,023)**

[2] On March 30, 2018, the Commission issued an Order amending the March 28, 2018 Order "to the limited extent that the rehearing is not confined to capitalization and cost of capital, and the parties may raise any relevant issue related to TCJA."
[3] The Companies proposed to implement the TCJA Surcredit with a modification to the allocation of the gas TCJA Surcredit.
[4] Response to Commission Staff's Third Request for Information, Question No. 3.
[5] Using updated composite tax rate per Exhibit KWB-3 of Direct Testimony on Rehearing of Kent W. Blake.
[6] Using current interest rates per Exhibit KWB-4 of Direct Testimony on Rehearing of Kent W. Blake compared to *Offer and Acceptance of Satisfaction* interest rates.
[7] Sum of lines 1-3.

KU and LG&E agree the Tax Act Benefits in Article I of the *Offer and Acceptance of Satisfaction* to be distributed by the TCJA Surcredit should be increased by $3,407,426 for a total of $138,880,023.[8]

At issue are the March 20, 2018 Order's harmful, arbitrary, and unlawful modifications to the *Offer and Acceptance of Satisfaction* that rejected three essential adjustments necessary to reflect the complete impact of the TCJA on KU and LG&E and fairly balance the interests of the parties. The adjustments and their associated values are:

Description	KU ($)	LG&E Electric ($)	LG&E Gas ($)	Total Base Rate Credits ($)[9]
Tax Reform Capitalization Impact	(5,366,778)	(3,869,105)	(687,514)	(9,923,397)
Cost of Debt Impact[10]	(4,860,104)	(2,375,752)	(691,882)	(7,927,738)
Other Capitalization Impacts (Jan18-Apr19)	(5,149,674)	(2,515,555)	1,513,760	(6,151,469)

The resulting difference between the Companies' updated position of total base rate credits of $138,880,023 and the March 20, 2018 Order, revised to correct the gross-up number, is $24,002,604.[11]

The law requires the Commission to fairly balance the competing interests of the parties, including the financial interests of shareholders.[12] In discharging this fundamental duty, a

[8] During the rehearing process, the Companies agreed to Staff's revised calculation of the gross-up factor which produces a total base rate credit correction of $519,202 to the amount in the Commission's March 20, 2018 Order. *See* Staff Rehearing Exhibit 7; *see also* Direct Testimony on Rehearing of Kent W. Blake, Exhibit KWB-3; Response to KIUC Post-Hearing Data Requests, Question No. 3. This correction is included in the updated TCJA Surcredit amount of $138,880,023.

[9] Response to KIUC Post-Hearing Data Requests, Question No. 2; see also Direct Testimony on Rehearing of Kent W. Blake at 9-15.

[10] Using current interest rates per Direct Testimony on Rehearing of Kent W. Blake, Exhibit KWB-4 compared to Case Nos. 2016-00370 and 2016-00371 interest rates. The $7.9 million Cost of Debt Impact represents the difference between current market interest rates per Direct Testimony on Rehearing of Kent W. Blake, Exhibit KWB-4 and interest rates used to set the Companies' base rates in their last rate cases.

[11] Response to KIUC Post-Hearing Data Requests, Question No. 2.

[12] *Ky. Indus. Util. Customers, Inc. v. Ky. PSC,* 504 S.W.3d 695, 709 (Ky. App. 2016) (noting, "[t]he problem in this case is that the Commission failed to fairly balance the competing interests"), *citing with approval*, *Nat'l-Southwire*

number of state utility regulatory commissions have recognized the particular negative impacts of the TCJA on financial positions of utilities, and in balancing the interests, have authorized higher returns on equity, higher equity capitalization ratios, or phase-down distributions.[13] Other commissions have authorized their utilities to offset existing cost deferrals or reduce regulatory assets with TCJA benefits.[14] Finally, other commissions, having ordered a regulatory liability to be established for the impact of the TCJA, also have deferred taking direct action until the utility's next base rate case to facilitate a complete consideration of all TCJA impacts.[15] In

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Aluminum Co. v. Big Rivers Elec. Corp., 785 S.W.2d 503, 510 (Ky. 1990) ("Our role is . . . to insure that the conflicting interests of all the parties concerned with utility rates are **fairly balanced**.") (Emphasis in original).

[13] *See, e.g., In re: Georgia Power Company's 2013 Rate Case*, Docket No. 36989, Order on the Tax Cuts and Jobs Act (Ga. Pub. Serv. Comm'n April 3, 2018) (approving an agreement between Georgia Power Company and Commission Staff, whereby Georgia Power will refund $131 million in October 2018, $96 million in June 2019, and $103 million in February 2020, and until the company's next rate case, its common equity in the rate of the return will be set at the lower of actual common equity weight in capital structure or 55 percent); *In the Matter of: Alabama Power Company's Petition for Revisions to Rate RSE (Rate Stabilization and Equalization Factor)*, Docket Nos. 18117 and 18416, Order (Al. Pub. Serv. Comm'n May 7, 2018) (permitting Alabama Power Company to improve its balance sheet and credit quality by gradually increasing its equity ratio to 55% by 2025 and noting that the principal purpose of the revisions "is to enable the Company to take steps to mitigate the adverse credit quality impacts resulting from the passage of the [TCJA], while preserving rate stability for customers"); *In re: Consideration of the Stipulation and Settlement Agreement between Gulf Power Company, the Office of Public Counsel, and Florida Industrial Power Users Group, and Southern Alliance for Clean Energy regarding the Tax Cuts and Jobs Act of 2017*, Docket No. 20180039-EI, Order (Fl. Pub. Serv. Comm'n April 12, 2018) (approving an agreement regarding Gulf Power Company's tax issues and base rates and increasing Gulf Power Company's equity ratio cap from 52.3% to 53.5% to allow a tax-savings refund); *In the Matter of the Application of Tucson Electric Power Company, an Arizona corporation, for Approval of a Bill Credit Related to Federal Income Tax Rate Reduction*, Docket E-01933A-18-0064, Order (Az. Corp. Comm'n May 22, 2018) (approving Tucson Electric Power Company's proposal to refund 100 percent of 2018 tax savings, 75 percent of 2019 tax savings, and 50 percent of 2020 tax savings, with the withheld tax savings deferred as a regulatory liability, and acknowledging the utility's statement that the proposal provides adequate cash flow to maintain its credit metrics and support infrastructure developments necessary to continue to provide safe and reliable service to its customers).

[14] *In the Matter of: Alabama Power Company's Petition for Revisions to Rate RSE (Rate Stabilization and Equalization Factor)*, Docket Nos. 18117 and 18416, Order (Al. Pub. Serv. Comm'n May 7, 2018) (permitting Alabama Power Company to implement rate reductions totaling $287 million and apply up to $30 million federal excess deferred income taxes to offset costs that would otherwise have been recovered from customers"); and *In the Matter of: Accounting Treatment of the Impacts Resulting from the Passage of the 2017 Tax Reform Bill H.R. 1*, Docket No. 5-AF-101, Order (Wi. Pub. Serv. Comm'n May 24, 2018) (permitting Wisconsin Electric Power Company to use a portion of tax savings to reduce transmission escrow and Wisconsin Public Service Corporation to use a portion of tax savings to reduce certain power-plant deferrals).

[15] *In the Matter of: General Investigation Regarding the Effect of Federal Income Tax Reform on the Revenue Requirements of Kansas Public Utilities and Request to Issue an Accounting Authority Order Requiring Certain Regulated Utilities to Defer Effects of Tax Reform to a Deferred Revenue Account,* Docket No. 18-GIMX-248-GIV, Order Granting Joint Motion for Approval of Settlement Agreement Regarding Kansas Gas Service, (Ks. Corp. Comm'n May 15, 2018) (permitting Kansas Gas Service to accrue a regulatory liability representing the difference between its cost of service as approved in its last rate case and the cost of service that would have resulted had the

contrast, the March 20, 2018 Order's modifications fail to fairly balance the indisputable TCJA negative impacts. In doing so, the March 20, 2018 Order completely neglects to fairly balance the interests of the parties as the law requires.

If the Commission refuses to accept the limited adjustments to the Companies' capitalization and cost of capital proposed in the *Offer and Acceptance of Satisfaction* because the Companies are unable to address the TCJA within the context of a full base rate case, the Commission is arbitrarily depriving the Companies of the same regulatory review allowed to other utilities like Kentucky Power Company, Duke Energy Kentucky, Inc., and Atmos Energy Corporation that just happened to have base rate cases pending when the TCJA was enacted.[16]

The Commission's modifications affirmatively negate the terms of the *Offer and Acceptance of Satisfaction* that recognized the impact of the TCJA on KU's and LG&E's capital

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provision for federal income taxes been based on the rate approved in the TCJA, and reserving Kansas Gas Service's right to show in the upcoming rate case other components of its cost of service that have offset the decrease in income tax expenses such that the regulatory liability should be reduced or offset but for the other components); Docket No. 36989, Order on the Tax Cuts and Jobs Act (Ga. Pub. Serv. Comm'n April 3, 2018) (deferring unprotected excess ADIT as a regulatory liability until Georgia Power Company's next rate case); *In re: Petition for Recovery of Costs Associated with Named Tropical Systems During the 2015, 2016, and 2017 Hurricane Seasons and Replenishment of Storm Reserve Subject to Final True-Up, Tampa Electric Company*, Docket No. 20170271-EI, Order Approving Interim Storm Recovery Charge (Fl. Pub. Serv. Comm'n March 7, 2018) (permitting Tampa Electric Company to amend its previously-approved storm restoration recovery surcharge by recovering the entire estimated amount of storm costs that would have been recovered from customers over a nine month period in 2018 from the Tampa Electric Company's estimated annual tax savings over the same nine month period, subject to true-up); *In re: Application for Limited Proceeding for Recovery of Incremental Storm Restoration Costs Related to Hurricanes Irma and Nate, by Duke Energy Florida, LLC*, Docket No. 2017-0272-EI, Order Approving Interim Storm Recovery Surcharge (Fl. Pub. Serv. Comm'n Feb. 26, 2018) (permitting Duke Energy Florida, LLC to amend its previously-approved storm restoration recovery charge by recording a monthly storm reserve accrual equal to one-twelfth of the approved annual revenue requirement impact of the TCJA, taking into account accelerated depreciation of two coal units, and crediting the retail storm reserve from January 2018 through full recovery of the final approved actual storm recovery amount, subject to true-up.).

[16] *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 2017 Environmental Compliance Plant; (3) An Order Approving Its Tariffs and Riders (4) An Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities; and (5) An Order Granting All Other Required Approvals and Relief*, Case No. 2017-00179, Order (Ky. PSC Jan. 18, 2018); *In the Matter of: Application of Duke Energy Kentucky, Inc. for: 1) An Adjustment of the Electric Rates; 2) Approval of an Environmental Compliance Plan and Surcharge Mechanism; 3) Approval of New Tariffs; 4) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 5) All Other Required Approvals and Relief*, Case No. 2017-00321, Order (Ky. PSC Apr. 13, 2018); *In the Matter of: Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications*, Case No. 2017-00349, Order (Ky. PSC May 3, 2018).

requirements by denying the capitalization and interest rate adjustments, thereby increasing the TCJA Surcredit amount by almost 20 percent. The modifications in the March 20, 2018 Order eliminate recovery of the cost of capital on the additional debt issuances and equity investments necessary to pay for these incremental cash outlays caused by the TCJA and this regulatory proceeding. KU's and LG&E's returns will be lower than they otherwise would be without the TCJA and the March 20, 2018 Order, harming LG&E's and KU's financial positions and denying the Companies of the opportunity to earn their authorized rates of return.

The Commission lacks the authority to impose the modifications to the *Offer and Acceptance of Satisfaction* without the consent of the parties. If the Commission determines the provisions of the *Offer and Acceptance of Satisfaction* are unreasonable, 807 KAR 5:001, Section 20 limits the Commission to denying its approval and to ordering a hearing on KIUC's Complaint. Accordingly, the Commission should approve the updated *Offer and Acceptance of Satisfaction* without the March 20, 2018 Order's modifications, as agreed to by the Companies and KIUC.

II. STATEMENT OF THE CASE

The TCJA reduces the maximum federal corporate income tax rate from 35% to 21% effective January 1, 2018. The TCJA also includes other changes which immediately or will ultimately impact the Companies including the elimination of bonus depreciation and the corporate alternative minimum tax provision, and the repeal of other deductions, including the Section 199 domestic manufacturing deduction.

Shortly before the enactment of the TCJA, KIUC filed a formal complaint with the Commission alleging that the Companies' rates were no longer fair, just, and reasonable due to the enactment of the TCJA. The Commission then found that KIUC had "established a *prima facie* case that as of January 1, 2018, the rates of [KU and LG&E] will no longer be fair, just, or

reasonable. Rates must be set at a level to allow a utility to recover all of its reasonable expenses, including taxes, and to provide its shareholders an opportunity to earn a fair return on invested capital."[17] In an effort to expedite the prompt return of net benefits and associated impacts of the TCJA to their customers and avoid the lengthy delays inherent in a full base rate case proceeding, the Companies engaged in two informal conferences at the Commission's offices to discuss settlement with KIUC and the AG, the only intervening party. The Commission Staff supervised and provided important input in both informal conferences.

Almost five months ago, the Companies filed testimony and exhibits that included an *Offer and Acceptance of Satisfaction*. The *Offer and Acceptance of Satisfaction* was executed by the Companies, KIUC, and the AG. The Companies, KIUC, and the AG jointly recommended the Commission accept and approve the *Offer and Acceptance of Satisfaction* as the reasonable disposition of KIUC's complaint.

The *Offer and Acceptance of Satisfaction* provided for benefits to be distributed to customers through rate mechanisms. First, the Companies' various rate mechanisms, most notably their Environmental Cost Recovery Surcharges, have been adjusted to reflect the impact of the TCJA beginning in March based on a January expense month. And, the Companies agreed to pass the base rate benefits of the TCJA to customers for service rendered beginning April 1, 2018 through a new rate mechanism, the TCJA Surcredit, yielding monthly billing credits on a per kWh basis for electric customers and per Ccf for gas customers.[18] The bill

[17] *In the Matter of: Kentucky Industrial Utility Customers, Inc. vs. Kentucky Utilities Company, Louisville Gas and Electric Company, et al.*, Case No. 2017-00477, Order at 2 (Ky. PSC Dec. 27, 2017).
[18] The *Offer and Acceptance of Satisfaction* proposed that the TCJA Surcredit would not appear on customer bills until April, but would be based on the benefits of the TCJA from its inception January 1, 2018, through April 30, 2019, the day before base rates are expected to change following base rate case proceedings.

credits reflected the estimated 16-month savings returned over a 13-month billing period.[19] In total, the Companies agreed to distribute an estimated $176.9 million to customers, with approximately $135.5 million in the form of the TCJA Surcredit.[20]

The Companies calculated the TCJA Surcredit by beginning with KU's and LG&E's adjusted jurisdictional capitalization for the forecasted 13-month average capitalization from the test years ending June 30, 2018, as accepted by the Commission in their most recent rate cases. Then, the Companies adjusted jurisdictional capitalization of each utility forward for the period under review. The benefit from the amortization of excess accumulated deferred income taxes ("ADIT") also was included in the calculation of the TCJA Surcredit for this same period under review, consistently matching the time period used for reflecting the other impacts of the TCJA.[21] The Companies also updated the weighted average cost of short-term and long-term debt to reflect current market interest rates for the forecasted period.[22]

On March 20, 2018, without notice or a hearing, the Commission issued an order materially modifying the *Offer and Acceptance of Satisfaction*.

Despite the parties filing the *Offer and Acceptance of Satisfaction* nearly two months prior to the Commission issuing the Order, the Order's analysis failed to include any revenue requirement or earnings analysis or consider the total impact of the TCJA on the Companies. The Order also failed to acknowledge the increase in debt costs for the period over which these reductions in cash from operations must be financed. Instead, the Order selectively chose two

[19] The period under review is from January 1, 2018 to April 30, 2019 because it is the period during which the TCJA is in effect prior to the expected change in base rates. Direct Testimony on Rehearing of Kent W. Blake at 10.
[20] Benefits will also be distributed to customers through the Companies' rate mechanisms, such as the environmental cost recovery surcharge, demand side management mechanism, and gas line tracker. A summary of the estimated benefits of the TCJA by Company and type is included in Article I, Section 1.1 of the *Offer and Acceptance of Satisfaction*.
[21] Direct Testimony of Kent W. Blake at 10-11; *see* Brief, *infra* at pp.18-21.
[22] The specific calculations of the TCJA Surcredit for KU, LG&E Electric, and LG&E Gas are attached to the Direct Testimony of Kent W. Blake as Exhibits KWB-4, KWB-5, and KWB-6, respectively.

different time periods over which to apply two of the impacts of the TCJA, using the Companies' forecasted test period from its last base rate case to calculate the impact on the revenue requirement from only the change in the federal statutory income tax rate, while using the period from January 1, 2018 to April 30, 2019, to calculate the amortization of excess deferred income taxes resulting from the TCJA. These asymmetrical modifications to the calculation increased the amount of the TCJA Surcredit by approximately $26.9 million.

Following the issuance of the Commission's March 20, 2018 Order, the Companies withdrew from the *Offer and Acceptance of Satisfaction* pursuant to Section 5.6 of the *Offer and Acceptance of Satisfaction*. By letter dated March 26, 2018, LG&E and KU gave notice to the parties and the Commission of their withdrawal. On that same day, consistent with their efforts to return the net benefits and associated impacts of the TCJA to customers as soon as reasonably possible, the Companies filed a Petition, requesting reconsideration of the Commission's modifications to the *Offer and Acceptance of Satisfaction* and a hearing, and the authority to implement the TCJA Surcredit at the levels proposed by the parties in the *Offer and Acceptance of Satisfaction* for service rendered on and after April 1, 2018.[23]

Following the Companies' withdrawal, on March 28, 2018, the AG also exercised his Section 5.6 right to withdraw and notified the Companies and KIUC of his withdrawal. The AG's withdrawal and defense of the Commission's treatment of capitalization represented a sudden and dramatic change in position. Only one week before the issuance of the Order of

[23] The *Offer and Acceptance of Satisfaction* provided that KU residential and non-residential customers would receive a per kWh credit of $0.00415 and $0.00323, respectively. LG&E electric residential and non-residential customers would receive a per kWh credit of $0.00444 and $0.00344, respectively. The *Offer and Acceptance of Satisfaction* also proposed a credit of $0.03384 per Ccf for LG&E gas customers. In response to Question No. 3 of the Commission Staff's First Request for Information dated February 1, 2018, LG&E provided calculations allocating the gas credit between residential and non-residential customers, respectively, for a credit of $0.05042 and $0.02087 per Ccf and indicated LG&E was willing to implement the TCJA surcredit for gas operations on this basis.

March 20, 2018, the AG supported the methodology used in the *Offer and Acceptance of Satisfaction*, advocating to the Commission:

> [I]t is appropriate for incremental capitalization effects to be taken into account when entertaining single-issue rate reductions. **It is the Attorney General's position that LG&E/KU's change in capitalization in its Satisfaction was just that; an appropriate update of capitalization to reflect the unintended consequences of the change in federal law**.[24]

The AG offered no explanation for his change in position. The AG also filed a response to the Companies' Petition, objecting to all the relief requested and demanding the modified *Offer and Acceptance of Satisfaction* be implemented as directed by the March 20, 2018 Order.

The Complainant, KIUC, on the other hand, did not exercise its right to withdraw from the *Offer and Acceptance of Satisfaction*. KIUC has continued to support the *Offer and Acceptance of Satisfaction* as a "reasonable resolution of the issues in this proceeding."[25]

On March 28, 2018, the Commission issued an Order granting the Companies' Petition for Reconsideration and Request for Hearing.[26] The Order also approved the Companies' request to implement the TCJA Surcredit effective April 1, 2018 at the levels proposed in the *Offer and Acceptance of Satisfaction*, with a modification to the allocation of the gas TCJA Surcredit.[27]

The Companies and KIUC then re-executed the *Offer and Acceptance of Satisfaction*.[28]

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[24] Attorney General's Comments on Proposed Non-Unanimous Stipulation and Settlement Agreement at 5 (Mar. 13, 2018) (filed in *Kentucky Industrial Utility Customers, Inc. v. Duke Energy Kentucky, Inc.*, Case No. 2018-00036 (Ky. PSC initiated Jan. 25, 2018)) (emphasis added).
[25] KIUC Letter in Support (filed Mar. 26, 2018).
[26] The Commission later expanded the scope of the rehearing "to the limited extent that the rehearing is not confined to capitalization and cost of capital, and the parties may raise any relevant issue related to TCJA." Order (Ky. PSC Mar. 30, 2018).
[27] Pursuant to the *Offer and Acceptance of Satisfaction* and the Commission's Order of March 28, 2018, the Companies implemented the TCJA Surcredit for service rendered on and after April 1, 2018.
[28] Direct Testimony on Rehearing of Kent W. Blake Exhibit KWB-1.

III. ARGUMENT

A. The Updated *Offer and Acceptance of Satisfaction* Represents a Fair, Just, and Reasonable Resolution of this Proceeding and should be Approved.

The updated *Offer and Acceptance of Satisfaction* provides both a fairly balanced outcome and a fair, just, and reasonable method of distributing benefits of the TCJA to customers. The Companies' updates to capitalization and interest rates presented in the updated *Offer and Acceptance of Satisfaction* are appropriate by any reasonable measure. Any modifications to those updates will deny the Companies of the opportunity to earn their authorized rate of return. The rejection of the updates is not supported by the Commission's concerns that the "[u]se of the forecasted test years as proposed in the Offer and Acceptance of Satisfaction would require the adoption of forecasted adjustments to the capitalizations of KU/LG&E that have not been subjected to the Commission's investigation and review."[29] The Commission had the authority and ample opportunity to investigate the forecasted adjustments proposed in the *Offer and Acceptance of Satisfaction*. The Commission cannot refuse to use its power to investigate the adjustments and then assert it has rejected the adjustments because the adjustments have not been investigated. The record supports the reasonableness of the capitalization and interest rates adjustments.

Additionally, Vice Chairman Cicero questioned whether the Companies had selectively made adjustments of only certain known and measurable changes.[30] Having updated total capitalization, interest rates, and the composite tax rate to cover the 16-month period (i.e., the inception of TCJA to the date when new base rates take effect), the only components of the revenue requirement rationally related to the net impact of the TCJA, but not updated from that

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[29] Order (Ky. PSC Mar. 20, 2018).
[30] Video Transcript of Evidence 12:52:15 P.M. (May 24, 2018).

used in the Companies' last base rate case, were capital structure ratios and authorized return on equity. The parties agreed that it would be appropriate to wait until the Companies' next base rate case to address those issues as they are usually the subject of expert witness testimony and substantial contention. The three adjustments at issue are known and measurable, and fully supported by the record. The updated *Offer and Acceptance of Satisfaction* fairly balances the practical and expeditious distribution of TCJA benefits to customers as quickly as possible without unduly harming the utilities and litigating the merits of KIUC's complaint.[31]

1. TCJA Impact to Capitalization Update

The Companies' capitalization update in the *Offer and Acceptance of Satisfaction* includes the direct impacts of the TCJA on capitalization. A capitalization update is necessary in order for the Companies to have the opportunity to earn their authorized rate of return. Unlike updates to capitalization proposed in other proceedings before the Commission,[32] the Companies began with a recent capitalization established in the Companies' last base rate cases and updated based on known and measurable changes.

The Companies have provided substantial evidence in this proceeding to justify the TCJA impact to capitalization update. First, the direct impacts to capitalization are those increases in KU and LG&E's capitalization due to funding the TCJA and the return of those proceeds to

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[31] Video Transcript of Evidence 12:58:12 P.M. (May 24, 2018). $176,888,715 + $3,407,426 = $180,296,141.

[32] In the KIUC complaint proceeding addressing the impact of the TCJA on Duke Energy Kentucky, Inc.'s ("Duke") gas rates (the impact of the TCJA on Duke's electric rates was considered in its pending rate case, Case No. 2017-00321), Duke adjusted the gas capitalization by using the electric rate case data to reasonably approximate the capitalization for the gas business. Notably, this is an eight-year update to capitalization as Duke's gas capitalization was last calculated in its last rate case, Case No. 2009-00202. Duke also did not update its return on equity of 10.375 percent approved in Case No. 2009-00202. *In the Matter of: Kentucky Industrial Utility Customers, Inc. v. Duke Energy Kentucky, Inc.*, Case No. 2018-00036, Settlement Agreement (Ky. PSC Mar. 2, 2018).

customers.[33] The TCJA will also result in incremental cash taxes paid by the Companies primarily as a result of the elimination of bonus tax depreciation.[34] The direct impacts to KU's and LG&E's 17-month average capitalizations are shown in the table on page 12 of Mr. Blake's Direct Testimony on Rehearing. As Mr. Blake explained at the hearing, to capture the effects of the TCJA, the Companies should be able to recover the cost of capital of the additional capital outlay necessary to finance the distribution of the TCJA benefits to customers.[35]

This capitalization update is also necessary because the estimated amount to be returned to customers under the *Offer and Acceptance of Satisfaction* represents a reduction in cash revenues received from customers without a corresponding reduction in cash expenses. Mr. Blake explained in his Direct Testimony:

> Prior to the Tax [Cuts and Jobs] Act, both KU and LG&E had a tax net operating loss carryforward and thus were not cash taxpayers. With the Tax [Cuts and Jobs] Act, both KU and LG&E are expected to be cash taxpayers for this period. The estimated amounts to be returned to customers for this period represent an additional cash outlay resulting from the Tax [Cuts and Jobs] Act that did not exist before. Put simply, the estimated $176.9 million to be returned to customers is a reduction in cash revenues received from customers without a corresponding reduction in cash expenses.

At the hearing Mr. Blake further explained that as a result of the TCJA and the associated TCJA Surcredit and rate mechanisms distributing the TCJA benefits, KU and LG&E will be paying out more cash with no resulting cash expense reductions. With less cash coming in and more cash going out, there is a direct impact on KU's and LG&E's capitalizations.[36] The direct impact on KU's and LG&E's revenue requirement increase due to capitalization changes directly

[33] Direct Testimony of Kent W. Blake at 9 and Exhibit KWB-3; Direct Testimony on Rehearing of Kent W. Blake at 11-12.
[34] Direct Testimony on Rehearing of Kent W. Blake at 11
[35] Video Transcript of Evidence 12:56:18 P.M. (May 24, 2018).
[36] Video Transcript of Evidence 9:11:50 A.M. (May 24, 2018).

attributable to the TCJA is approximately $10.0 million ($5.4 million for KU, $3.9 million for LG&E electric operations, and $0.7 million for LG&E gas operations).[37]

The modifications in the March 20, 2018 Order eliminate recovery of the cost of capital on the additional debt issuances and equity investments required to pay for these incremental cash outlays caused by the TCJA and this regulatory proceeding. As a result, this modification would lower the Companies' net income and return on equity compared to a position in which TCJA was never passed into law.

The Companies are also concerned that the failure to recognize these capitalization impacts could result in a normalization violation under the U.S. Tax Code. In particular, as discussed in detail in Section III. B. 3. of this brief, a potential normalization violation may exist where no adjustment is made to capitalization to reflect the amortization of excess ADIT.[38] The risk of such a potential normalization violation did not exist in the Commission's investigations into the effects of the 1986 Tax Reform Act because the timing of the change in the law and the periods under review were very different than the case at bar. There, unlike here, the change in the tax law was enacted September 27, 1986 with the change in the corporate tax rates occurring almost 9 months later on July 1, 1987. Based on a historic test period ended November 30, 1986, the Commission ordered change in rates reflecting the effects of the 1986 Tax Reform Act for service rendered on and after July 2, 1987. In contrast, the TCJA, enacted December 27, 2017, reduces the corporate tax rate effective January 1, 2018, impacting the last six months of the

[37] These values were calculated using KU's and LG&E's costs of capital of 8.92% and 8.86%, respectively, per the *Offer and Acceptance of Satisfaction*, and the factor of 1.33 to convert the annual revenue requirement to a sixteen-month period. Using the Commission's modified costs of capital for KU and LG&E of 8.79% and 8.75%, respectively and the same 1.33 factor to convert to a sixteen-month period, KU's and LG&E's revenue requirement increase due to capitalization changes directly attributable to the TCJA is $9.8 million ($5.3 million for KU, $3.8 million for LG&E electric operations and $0.7 million for LG&E gas operations). Please note the updated $9.9 million per the table on page 3 of this brief is slightly lower due to the updates to the cost of debt and tax gross-up factor.

[38] Response to KIUC Post-Hearing Data Request No. 1-2.

12-month test period ending June 30, 2018 with the effect of the TCJA. As a result, the 12-month test year period ending June 30, 2018 from the Companies' last rate case includes six months in 2018 when the TCJA is effective. This six month overlap did not exist when the Commission directed rate changes for the 1986 Tax Reform Act, avoiding any potential for violations of the Tax Code normalization requirements.

Additionally, another material difference between the effect of the TCJA and the Tax Reform Act of 1986 is that the Companies were *not* in a net operating loss position when the Tax Reform Act of 1986 was passed, so there were cash expense savings to offset any reduction in cash revenue.[39] In contrast, both Companies were in a net operating loss position prior to the passage of the TCJA due to years of a provision previously in the tax code known as "bonus depreciation."[40] The Companies are now incurring additional cash outlays of $176.9 million between the TCJA and adjustments made to other rate mechanisms.[41] As a result, $176.9 million being paid to customers today is a reduction in cash revenue with no reduction in cash expenses.[42]

For these reasons, the direct update to capitalization presented in the *Offer and Acceptance of Satisfaction* is reasonable and appropriate. Failure to permit the Companies to recognize the direct effects of the TCJA on capitalization would deny the Companies of the opportunity to earn their authorized rate of return.

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[39] *Id.*
[40] *Id.*
[41] *Id.* With the updated *Offer and Acceptance of Satisfaction*, the Companies will have additional cash outlay of $3.4 million or a total cash outlay of $180.3 million.
[42] *Id.* If the updated *Offer and Acceptance of Satisfaction* is approved, the $180.3 million paid to customers will be a reduction in cash revenue with no reduction in cash expenses.

2. Interest Rate Update

The *Offer and Acceptance of Satisfaction* also adjusted the cost of debt to projected interest rates for the sixteen-month period during which the TCJA impact is subject to review. Mr. Blake explained in his Direct Testimony on Rehearing that an adjustment to reflect current interest rates should be considered in calculating the TCJA Surcredit "because updated interest rate figures are rationally related to the increase in capitalization, readily available, known and measurable."[43]

Failure to update the interest rates from the stale projections used in the Commission's March 20, 2018 Order to the most recent projections would deny the Companies of the opportunity to recover their cost of debt. By any objective measure, interest rates have increased significantly since the Companies' last rate case just as federal income tax rates have decreased significantly since the Companies' last rate case. Since the most recent rate cases were filed in November 2016, the Federal Reserve has increased its targeted federal funds interest rates by 0.25% six times for a total increase of 1.50%. The current interest rates for short-term debt (2.63% for KU[44] and 2.59% for LG&E[45]) and long-term debt (4.24% for KU[46] and 4.12% for LG&E[47]) used by the Companies in the updated *Offer and Acceptance of Satisfaction* were based on then current rates being paid by the Companies and the assumption of federal fund rate increases of 25 basis points in June and December of 2018 and March of 2019. The Federal Reserve did, in fact, raise the federal funds rate by 25 basis points on June 13, 2018, and suggested two more increases were expected in 2018 and three more in 2019, suggesting the

[43] Direct Testimony on Rehearing of Kent W. Blake at 15.
[44] *Id.* at Exhibit KWB-4, page 1 of 9.
[45] *Id.* at Exhibit KWB-4, page 5-6 of 9.
[46] *Id.* at Exhibit KWB-4, page 1 of 9.
[47] *Id.* at Exhibit KWB-4, page 5-6 of 9.

current rates used by the Companies are at least reasonable and may be conservative. This clearly demonstrates that calculations in the Commission's March 20, 2018 Order which were based on short-term rates of 0.74% for KU and 0.72% for LG&E are not reasonable, and would not allow the Companies the opportunity to recover their cost of debt. Notably, the update for market interest rates made in the updated *Offer and Acceptance of Satisfaction* only affected variable rate debt and any expected financings during the sixteen-month period, with all fixed rate debt remaining at the level embedded in those debt instruments.

Additionally, a portion of the Companies' updated cost of debt impact is due to increased interest rates on incremental financing that is a direct impact of the TCJA.[48] At the hearing, Mr. Blake further noted that there is more detailed support in the record for the updated interest rates than typically in base rate cases.[49]

The TCJA Surcredit is effectively acting as an alternative rate mechanism to provide customers a timely, significant, and expeditious TCJA benefit outside of a base rate case.[50] Such rate mechanisms, which are being used to return an estimated $41.4 million of TCJA savings to customers, include provisions to update interest rates.[51]

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[48] *Id. See In the Matter of Application of Kentucky Utilities Company for an Adjustment of Base Rates*, Case No. 2009-00548, Order at 25-26 (Ky. PSC 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 27-28 (Ky. PSC July 30, 2010) ("The AG agreed that if interest rates or other capital cost rates change, such changes should be used to determine the rate of return so that LG&E will have a reasonable opportunity to earn its allowed return. The Commission finds it appropriate to recognize the cost rate for LG&E's long-term debt as of March 31, 2010 when determining its overall cost of capital. Updates to LG&E's long-term debt cost rate constitute known and measurable adjustments and using these updates, rather than the test-year-end cost rates, is more representative of the period in which the rates established in this Order will be in effect. This cost rate will be applied to the capital structure determined herein.")

[49] Video Transcript of Evidence 1:00:00 P.M. (May 24, 2018); see Direct Testimony on Rehearing of Kent W. Blake, Exhibit KWB-4.

[50] The Commission for many years has used updated interest rates when determining the cost of debt for ratemaking purposes in rate cases using a historic test period.

[51] Video Transcript of Evidence 1:01:15 P.M. (May 24, 2018); Response to KIUC Post-Hearing Data Requests, Question No. 2.

As tax rates have decreased, interest rates have increased. The Companies should not be forced to recognize the decrease of tax rates without also being able to recognize the related known and measurable increase in interest rates. Accordingly, it is both appropriate and necessary for the Companies to update market interest rates in calculating the TCJA Surcredit.

3. Other Impact to Capitalization Update

This proceeding originated with KIUC's complaint that the Companies' rates would no longer be fair, just, and reasonable following the passage of TCJA.[52] As a result, the Companies and all parties to the case negotiated the *Offer and Acceptance of Satisfaction* based on the total or net impacts to the Companies revenue requirement and current financial forecasts for the Companies for the sixteen-month period subject to review—from the time the TCJA took effect on January 1, 2018 until the TCJA would be incorporated into the Companies' base rates following its next base rate case on May 1, 2019.[53] Use of this forecast period is not only rationally related to the period subject to review, but provides the most efficient way to get cash benefits back to customers and ensure the Companies' rates remain fair, just, and reasonable until such time as the TCJA can be fully incorporated into the Companies' base rates in their next rate cases.

Consideration of other impacts on capitalization for the period of January 1, 2018 through April 30, 2019 is necessary to allow the Companies the opportunity to recover their cost of capital. As shown on page 12 of Mr. Blake's Direct Testimony on Rehearing, the $51.975 million impact to capitalization reflects the net effect of all other changes in capitalization.[54]

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[52] *In the Matter of Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company, Louisville Gas and Electric Company, et al.*, Order at 2 (Ky. PSC Dec. 27, 2017) ("Based on a review of the complaint and being otherwise sufficiently advised, the Commission finds that KIUC has established a prima facie case that as of January 1, 2018, the rates of the Defendants will no longer be fair, just and reasonable.").

[53] Direct Testimony of Kent W. Blake at 7

[54] KU $43.5 million, LG&E Electric $21.4 million, and an LG&E Gas reduction of $12.9 million.

This includes a $76.9 million capitalization increase associated with the January 2018 pension funding by the Companies.[55] That pension funding also had the effect of increasing the unprotected excess deferred income taxes and amortization thereof.[56] While both the *Offer and Acceptance of Satisfaction* and the March 20, 2018 Order, recognize the favorable effect of this amortization of excess deferred income taxes in the TCJA Surcredit, the March 20, 2018 Order fails to recognize the cost of capital associated with this pension funding which gave rise to that very benefit.

As Mr. Blake explained at the hearing, the increased pension contribution accounted for more than 100% of the increase in the Other Capitalization component shown in the table on page 12 of Mr. Blake's Direct Testimony on Rehearing.[57] All other changes actually *reduce* the capitalization absent the pension contribution. In other words, all Other Capitalization updates from the Companies' last base rate cases compared to that used in the TCJA Surcredit is a reduction of $22.9 million (increase of $9.7 million for KU and reductions for LG&E Electric of $14.2 million and LG&E Gas of $20.4 million).[58] Those LG&E reductions effectively increase the TCJA Surcredit for LG&E customers.

The consideration of other impacts on capitalization is particularly necessary given the strain the TCJA is placing on the Companies' credit metrics and credit ratings. Although the updated *Offer and Acceptance of Satisfaction* does not consider the credit rating risk associated with the TCJA, credit rating agencies have observed that the TCJA will likely have a negative

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[55] Response to AG's Initial Data Requests, Question No. 1.
[56] *Id.*
[57] Video Transcript of Evidence 12:57:45 P.M. (May 24, 2018).
[58] Response to KIUC Post Hearing Data Requests, Question No. 2.

impact on utilities' cash flows, thus increasing the need for and cost of additional financings.[59] In fact, on June 18, 2018, Moody's downgraded the outlook for the US regulated utility sector from stable to negative due to (among other things) the expected impacts of the TCJA on the industry's cash flow.[60]

The update to capitalization for other impacts appropriately does not include any increase in capitalization for funding of any project that requires a Certificate of Public Convenience and Necessity ("CPCN") that has not yet been granted by the Commission.[61] As Mr. Blake explained at the hearing, the Companies' preliminary internal calculations of the effect of the TCJA included increased capitalization for the deployment of advanced metering systems ("AMS"), but this amount was removed because the Companies have not yet received a CPCN for the AMS project.[62]

The record fully supports the reasonableness of the update to capitalization for other impacts. The Companies have produced detailed spreadsheets showing the changes in Gross Utility Plant by month, a detailed list of projects where balances are changing, and the projects that are being retired.[63] As the Companies have explained in their discovery responses in their last rate cases, the calculated capital construction slippage factors (97.204 percent for KU and

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[59] *See PPL Corporation Update to Credit Analysis*, Moody's Investors Service (June 7, 2018) (a copy is included in the Appendix to the Brief); *U.S. Tax Reform: For Utilities' Credit Quality, Challenges Abound*, S&P Global Ratings (Jan. 24, 2018); *Rating Action: Moody's changes outlooks on 25 US regulated utilities primarily impacted by tax reform*, Moody's Investors Service (Jan. 19, 2018).

[60] *Moody's Investor Service Outlook: Regulated Utilities- US 2019 Outlook Shifts to Negative due Weaker Cash Flows, continued High Leverage* (June 18, 2018)("The combination of the loss of bonus depreciation and a lower tax rate as a result of the [TCJA] means the utilities and their holding companies will lose some of the cash flow contribution from deferred taxes.")(a copy is included in the Appendix to the Brief).

[61] *See* Video Transcript of Evidence 1:08:42 P.M. (May 24, 2018).

[62] Video Transcript of Evidence 1:09:10 P.M. (May 24, 2018).

[63] Response to PSC Staff Post-Hearing Request for Information, Question Nos. 1 and 2.

98.111 percent for LG&E) demonstrate their accuracy in predicting the cost of utility plant.[64] This accuracy has been achieved through use of a very robust process for forecasting capital expenditures and managing to that forecast. Given these high degrees of accuracy, the need to apply a slippage factor does not exist and the Commission should decline to do so. The Commission has never determined that the Companies' projected capitalization amounts required a slippage factor. To date, with the exception of rate proceedings involving another utility in another industry,[65] the Commission has only determined a slippage factor necessary in one other case.[66] The Commission should accept the update to capitalization for other impacts.

4. 15-Year Amortization Period

The Companies and their customers have long benefited from accelerated depreciation deductions for tax purposes where the amount of depreciation deducted on federal income tax returns is greater than the amount of depreciation recorded for book purposes. The accumulated difference reduces the capitalization of the Companies which lowers the revenue requirement for customers. This accumulated difference is reflected on the balance sheet of the Companies as deferred income taxes and, prior to the TCJA, was based on the 35% federal corporate income tax rate. With a reduction in the federal corporate income tax rate to 21%, the amount that would have ultimately been reversed in favor of the Internal Revenue Service ("IRS") is lowered. The Companies will amortize this ADIT and return such amounts to their customers using the

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[64] Case No. 2016-00370, Response to Commission Staff's First Request for Information, Question No. 13 (Ky. PSC Dec. 8, 2016); Case No. 2016-00371, Response to Commission Staff's First Request for Information, Question No. 13 (Ky. PSC Dec. 8, 2016).

[65] The Commission's treatment of KAWC appears to be based upon historic concerns regarding that utility's budgeting process. *See, e.g.*, Case No. 95-554, *Application of Kentucky-American Water Company to Increase Its Rates* (Ky. PSC Nov. 19, 1993) at 3 ("Based on the historical relationship demonstrated by the slippage factor, the Commission concluded Kentucky-American's "very best estimate(s)" of construction spending was inaccurate and showed a pervasive pattern of over budgeting for construction. To eliminate Kentucky-American's historical overestimation, the Commission reduced the forecasted recurring and specific budget projects by their respective slippage factors.").

[66] Case No. 2005-00042, *An Adjustment of the Gas Rates of Union Heat, Light and Power Company* (Ky. PSC Dec. 22, 2005).

Average Rate Assumption Method ("ARAM") for such property-related ADIT as required by the TCJA. The TCJA does not specify a method for the amortization of other non-property-related ADIT, so that matter was negotiated with the parties to this case.

In the *Offer and Acceptance of Satisfaction*, the parties agreed to amortize non-property-related excess ADIT over a 15-year period using a straight-line method. [67] In Case Nos. 2014-00371 and 2014-00372,[68] 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, because pension timing differences are the principal drivers of the Companies' unprotected excess accumulated deferred income taxes. The parties agreed to the use of this amortization period with awareness of the strain that the TCJA is placing on the credit metrics and ratings of utilities across the country.[69]

At the hearing, the AG cross-examined Mr. Blake on the Companies' inclusion of the excess ADIT for repairs in the "protected" category of excess ADIT, seeming to argue that it could have been included, along with other "property-related" items as part of the "unprotected" excess ADIT, and thus subject to a shorter amortization period. As Mr. Blake explained at the hearing, repairs, along with all other such "property-related" items the Companies included in

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[67] In response to the Commission Staff's Second Request for Information, the Companies provided a schedule of protected and unprotected excess ADIT for the test year used in the Companies' base rate cases and the test year utilized in the *Offer and Acceptance of Satisfaction*.

[68] *In the Matter of: Application of Kentucky Utilities Company for an Adjustment of its Electric Rates*, Case No. 2014-0037, Order at 5 (Ky. PSC 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. 2014-00372, Order at 5 (Ky. PSC June 30, 2015).

[69] Direct Testimony of Kent W. Blake at 11.

the "protected" excess ADIT is a net deferred tax asset;[70] thus, customers benefit by the longer amortization period. If the AG is asserting the Commission should selectively cherry pick among such items and apply differing amortization periods depending on the direction of the excess ADIT, such action would be results-oriented, unlawful, and arbitrary.

B. Continuing the March 20, 2018 Order's Modifications of the *Offer and Acceptance of Satisfaction* Would Be Arbitrary.

A Commission decision to not accept the updated *Offer and Acceptance of Satisfaction* in its entirety and to retain the modifications set forth in the Order of March 20, 2018 would be arbitrary. The modifications set forth in the Order of March 20, 2018 are not supported by substantial evidence. Their continued imposition produces an unreasonable result, constitutes unfair and discriminatory treatment of the Companies, and violates the Commission's own regulations.

1. The Evidence in the Record Does Not Support Modifications to the *Offer and Acceptance of Satisfaction.*

The Commission's modification to the *Offer and Acceptance of Satisfaction* to reject the use of the period under review for January 1, 2018 to April 30, 2019 is not supported by substantial evidence. Kentucky's highest court has stated: "Unless action taken by an administrative agency is supported by substantial evidence it is arbitrary."[71] The parties to the *Offer and Acceptance of Satisfaction* agreed to a TCJA Surcredit to reflect the impact of the known and measurable changes to the Companies' revenue requirement from the time it was enacted until such time as the TCJA effects could be incorporated into the Companies' base

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[70] *See* Response to Commission Staff's Second Request for Information, Question No. 1, Attachment A (Ky. PSC Feb. 21, 2018). In addition to repairs, protected excess ADIT includes Contributions in Aid of Construction, Capitalized Interest, Federal Net Operating Losses, CCR ARO Ponds, and Other Basis Adjustments.

[71] *American Beauty Homes Corp. v. Louisville & Jefferson Cnty. Planning & Zoning Comm'n*, 379 S.W.2d 450, 456 (Ky. 1964) (citing *Thurman v. Meridian Mut. Ins. Co.*, 345 S.W.2d 635 (Ky. 1961)).

rates. Thus, the relevant 16-month period subject to review is from January 1, 2018 to April 30, 2019.

In directing modifications to the *Offer and Acceptance of Satisfaction*, the Order of March 20, 2018 found that the use of a forecasted test-year ending April 30, 2019 for capitalization and the cost of capital was unreasonable and that the TCJA's effects should be calculated using forecasted capitalizations presented more than a year earlier in the Companies' last rate case proceeding. The only reason provided for this refusal to use the more current projections was the following:

> Use of the forecasted test years as proposed in the Offer and Acceptance of Satisfaction would require the adoption of forecasted adjustments to the capitalizations of KU/LG&E that have not been subjected to the Commission's investigation and review.[72]

The Commission offered no additional reason for its action and cited no evidence to support its use of the older forecasts.

The Commission's failure to cite supporting evidence is due to its absence from the record. Indeed, the record shows use of the capitalization for the test period ending June 30, 2018 from the last rate cases to calculate the effects of the TCJA is inappropriate because, as Mr. Blake explained, "the TCJA was not in effect for that entire rate case year and the associated impacts were not known and measureable at that time."[73] And, as Mr. Blake further observed, "since the forecasted test years in the Companies' last rate cases did not assume a change in tax law, the test year ending June 30, 2018 included the assumption that bonus depreciation would remain in place."[74] In sum, the March 20, 2018 Order ignores the actual period in which the

[72] Order of March 20, 2018 at 7.
[73] Direct Testimony on Rehearing of Kent W. Blake at 10.
[74] Direct Testimony on Rehearing of Kent W. Blake at 11.

TCJA and the TCJA Surcredit is in effect. There was no evidence to support the use of the older forecasts.

The Order of March 20, 2018 provides no explanation for the Commission's decision not to conduct its statutorily-required investigation into the actual period in which the TCJA and the TCJA Surcredit is in effect.[75] The Commission's comments in the March 20, 2018 Order clearly indicate that a review of the most current forecasts was necessary but was not performed. Kentucky courts have found that the Commission should use the most current economic information available.[76] In assessing the effects of the TCJA on other utilities, such as Duke Energy Kentucky and Atmos Energy, the Commission has conducted such review, requesting the most current information and using forecasted periods ending March 31, 2019.[77]

The record also lacks any evidence to support the rates set forth in the Order of March 20, 2018. The Commission must set rates that "enable the utility to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed."[78] The record currently contains no information that based upon current conditions, the rates set forth in the Order of March 20, 2018 will allow each of the Companies to recover its current cost of capital or earn the rate of return authorized in their last rate proceedings. To the contrary, the Companies have presented extensive evidence to demonstrate that the exact opposite will occur.

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[75] KRS 278.040 requires the Commission to enforce the provisions of KRS Chapter 278, including KRS 278.030 which permits utilities to assess fair, just and reasonable rates. KRS 278.260(1) requires the Commission upon receipt of a rate complaint to conduct such investigations as it deems necessary.

[76] *Kentucky Utilities Co. v. Public Service Commission*, 252 S.W.2d 885, 897 (Ky. 1952) ("The Public Service Commission necessarily must base its decision and actions on economic conditions existing at the time a case is before it.").

[77] *Electronic Application of Duke Energy Kentucky, Inc. For: 1) An Adjustment of the Electric Rates; 2) Approval of An Environmental Compliance Plan and Surcharge Mechanism; 3) Approval of New Tariffs; 4) Approval of Accounting Practices To Establish Regulatory Assets and Liabilities; and 5) All Other Required Approvals and Relief*, Case No. 2017-00321 (Ky. PSC Apr. 13, 2018) at 6; *Electronic Application of Atmos Energy Corporation For An Adjustment o Rates and Tariff Modifications*, Case No. 2017-00349, Order at 3 (Ky. PSC May 3, 2018).

[78] *Commonwealth ex rel Stephens v. South Central Bell Tel. Co.*, 545 S.W.2d 927, 930-931 (Ky. 1976).

2. The Commission's Order to Approve the *Offer and Acceptance of Satisfaction* with Modifications is Unreasonable.

In determining that modifications to the *Offer and Acceptance of Satisfaction* were required to reflect accurately the effects of TCJA on the Companies, the Order selectively evaluated and employed the available evidence in an inconsistent manner, relied upon stale and outdated evidence, treated the Companies in a different manner than other utilities to produce an unreasonable result, and disregarded evidence "when there is no room for difference of opinion among reasonable minds" over what the evidence shows.[79]

The Commission's analysis of the TCJA effects was flawed. In modifying the *Offer and Acceptance of Satisfaction*, the Commission selectively chose time periods for which to calculate the impacts of the TCJA but gave no consideration for regulatory lag when addressing any other adverse impacts from the TCJA or otherwise on the Companies' overall costs of capital. The Order's analysis used the forecasted test year from the Companies' last rate cases even though the TCJA was only in effect for the second half of the test period. Notably, the forecasted test years in the Companies' 2016 rate cases did not assume a change in tax law and further assumed that bonus depreciation would remain in place. The effect of the Order's selective modification is that regulatory lag is addressed for the cost-reducing components of the TCJA, but no consideration is given for regulatory lag when addressing any of the adverse impacts of the TCJA on the Companies' overall costs. This disparate and asymmetrical treatment fails to "fairly balance" both the positive and negative or the total impacts of the TCJA that the law requires.[80]

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[79] *Energy Regulatory Com. v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980).
[80] *See, e.g.*, *Ky. Indus. Util. Customers, Inc. v. Ky. PSC,* 504 S.W.3d 695 (Ky. 2016); *Nat'l-Southwire Aluminum Co. v. Big Rivers Elec. Corp*., 785 S.W.2d 503 (Ky. 1990).

Moreover, the Commission turned a blind eye to evidence in the record demonstrating that the Companies must entirely finance the TCJA Surcredits and rate mechanism reductions attributable to the TCJA given its net operating loss carryforward. Put simply, TCJA amounts to be returned to customers through the surcredits and mechanisms are a reduction in cash revenues received from customers without a corresponding reduction in cash expenses.[81] The cash reduction in revenues through the TCJA Surcredit and changes to other rate mechanisms are due to non-cash savings.[82] The TCJA will also result in incremental cash taxes paid by the Companies primarily as a result of the elimination of bonus tax depreciation.[83] Thus, the Companies will have costs associated with financing the TCJA Surcredit amount, as described in Mr. Blake's Direct Testimony on Rehearing at page 9-12, that the Commission must consider to fairly balance the interests of the parties. The Commission cannot lawfully ignore it.

The Commission's modifications also ignore the current market cost of debt for the period over which the TCJA Surcredit applies. Financing costs have increased since the Companies' last base rate cases and the modifications do not consider this impact. The Commission's failure to consider the most current cost of debt is striking as it has consistently insisted upon the use of most current information in other proceedings is contrary to its practice of considering known and measurable changes in rate proceedings, and conflicts with the requirement to supplement applications in forecasted rate proceedings with the more current financial information. As the Courts have held, "[t]he term unreasonable can be applied to an administrative agency's decision only when there is no room for difference of opinion among

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[81] Direct Testimony on Rehearing of Kent W. Blake at 11.
[82] *Id.*
[83] *Id.*

reasonable minds."[84] The evidence presented the direct impacts of the TCJA on capitalization and updated interest rates leaves no room for difference of opinion among reasonable minds. The Commission cannot lawfully reject it.

Rather than rely upon the most current information to set prospective rates, the Order relied upon stale and outdated financial information. The forecasted projections upon which the Order relies were filed with the Commission in November 2016.[85] There is no room for difference of opinion among reasonable minds, especially in light of today's dynamic and rapidly changing financial markets, that such outdated and stale information should be used when more current and reliable information was readily available.[86] Moreover, the Order's refusal to do so is contrary to precedent that the Commission should use the most current economic information available.[87]

The Order's use of such stale financial information to determine the effects of the TCJA stands in stark contrast to the Commission's treatment of utilities that are currently seeking an adjustment in their base rates. The Commission has calculated the TCJA effects on Duke Energy Kentucky and Atmos Energy using forecasted test periods ending March 31, 2019, thus establishing their rates based upon the most currently available financial information.[88] The

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[84] *Energy Regulatory Com. v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980).

[85] The Commission's Rules of Procedure prohibit any updates to the forecast projections once the Companies filed their applications. See 807 KAR 5:001, Section 16(6)(d) ("After an application based on a forecasted test period is filed, there shall be no revisions to the forecast, except for the correction of mathematical errors, unless the revisions reflect statutory or regulatory enactments that could not, with reasonable diligence, have been included in the forecast on the date it was filed. There shall be no revisions filed within thirty (30) days of a scheduled hearing on the rate application.").

[86] *Energy Regulatory Com. v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980).

[87] *Kentucky Utilities Co. v. Public Service Commission*, 252 S.W.2d 885, 897 (Ky. 1952) ("The Public Service Commission necessarily must base its decision and actions on economic conditions existing at the time a case is before it.").

[88] *Electronic Application of Duke Energy Kentucky, Inc. For: 1) An Adjustment of the Electric Rates; 2) Approval of An Environmental Compliance Plan and Surcharge Mechanism; 3) Approval of New Tariffs; 4) Approval of Accounting Practices To Establish Regulatory Assets and Liabilities; and 5) All Other Required Approvals and*

Order of March 20, 2018 offers no reason for the decidedly different approaches used to evaluate the TCJA's effects.

Use of such updates is reasonable and covers the same time period being afforded the positive TCJA impacts for customers, that being from the effective date of the TCJA until such time as it is reflected in base rates. In doing so, the updated *Offer and Acceptance of Satisfaction* reasonably presents the net benefits and associated impacts of the TCJA and matches the time period during which both the TCJA and the TCJA surcredits are in effect. Because the Order's modification to the *Offer and Acceptance of Satisfaction* do not consider these impacts and is not based on substantial evidence, continuing to impose the modifications is unreasonable.

3. The March 20, 2018 Order's Modifications to the *Offer and Acceptance of Satisfaction* Are Arbitrary and Put the Companies at Risk for a Violation of the Internal Revenue Code's Requirements

In making the modifications to *Offer and Acceptance of Satisfaction,* the March 20, 2018 Order acknowledged the risk the modifications created to the Companies for a possible violation of the Internal Revenue Code's requirements associated with the treatment of the "protected" excess ADIT. In doing so, the Commission indicated it would consider remedial actions "to ensure that Internal Revenue Service penalties, which would be detrimental to the utilities and ratepayers, are not incurred."[89] Having expressed this objective, the Commission should apply the same standard to resolve the risk created for the Companies by the March 20, 2018 Order's modification to the TCJA impact to capitalization.

Relief, Case No. 2017-00321 (Ky. PSC Apr. 13, 2018) at 6; *Electronic Application of Atmos Energy Corporation For An Adjustment o Rates and Tariff Modifications*, Case No. 2017-00349, Order at 3 (Ky. PSC May 3, 2018).

[89] Case No. 2018-00034, Order at 2, n.2 (Ky. PSC Mar. 20, 2018) ("If it is determined that application of the normalization requirements herein are inconsistent with the requirements of the Tax Cuts and Jobs Act, based on an interpretation that is different than anticipated or otherwise, the Commission would consider modifying the amortization of the 'protected' excess accumulated deferred income taxes to ensure that Internal Revenue Service penalties, which would be detrimental to the utilities and ratepayers, are not incurred.").

The TCJA provides that should a normalization violation occur the penalty is two-fold: (1) currently payable income tax is increased by the amount by which the utility reduced its excess tax reserve more rapidly than that permitted under ARAM; and (2) the utility is unable to claim accelerated depreciation for income tax purposes.[90]

The March 20, 2018 Order's failure to recognize the TCJA impact to capitalization may result in a normalization violation. Pursuant to the *Offer and Acceptance of Satisfaction* and the Commission's March 20, 2018 Order, the Companies are amortizing property-related excess ADIT and providing those benefits to customers through the TCJA Surcredit. Amortization of the Companies' excess ADIT reduces the deferred tax liability for ratemaking purposes.[91] That reduction in deferred tax liability also results in an increase in capitalization. But with the Order's modifications to the *Offer and Acceptance of Satisfaction*, the Companies are not receiving the corresponding adjustment to capitalization, creating a mismatch on the Companies' deferred tax balance.

The correct deferred tax balance is essential to achieving compliance with the Tax Code's normalization requirement. The March 20, 2018 Order creates an improper deferred tax balance for ratemaking purposes.

Under the consistency requirement of 26 U.S.C. § 168(i)(9)(B),[92] there must be consistency between the excess deferred tax benefit (amortization) and the deferred tax liability. The consistency requirement would not be satisfied if the excess deferred tax benefit was computed as of a later date than the date through which the deferred tax liability is adjusted. The March 20, 2018 Order utilizes inconsistent periods in that the deferred tax liability is calculated

[90] Tax Cuts and Jobs Act § 13001(d)(4).
[91] For ratemaking purposes, ADIT is inclusive of excess deferred taxes reclassified to a regulatory liability.
[92] "One way in which the requirements of subparagraph (A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A)."

using the IRS proration formula for the period July 1, 2017 through June 30, 2018, but the excess deferred tax benefit is calculated for the period January 1, 2018 through April 30, 2019. This mismatch creates the potential violation of the consistency requirement in the Tax Code and thus the possible normalization violation. As previously discussed, the forecasted test period includes the period in which the TCJA is enacted and accordingly capitalization adjustments must be made to reflect the reduction in the deferred tax liability associated with the change in law.

Approving the TCJA impact to capitalization adjustment will help to ensure that IRS penalties, which would be detrimental to the utilities and ratepayers, are not incurred by the Companies.

4. Affirming the Initial Order Would Suggest that the Commission Prejudged the Outcome and Failed to Act as a Neutral and Detached Fact Finder

Due process requires that the Commission act as a neutral and detached finder of fact when performing its statutory duties and that it address each case in an unbiased and open-minded manner.[93] The issuance of an order on rehearing affirming the Order of March 20, 2018 in its entirety or making only cosmetic revisions would be strong evidence that the Commission failed to review the evidence with an open mind and had prejudged this proceeding's outcome in violation of the Companies' right to due process of law.

The Commission's actions culminating with its Order of March 20, 2018, indicate a predisposition toward a predetermined result. In its Order of December 27, 2017 establishing the initial complaint proceeding, the Commission limited the scope of the proceeding to:

> [T]he savings resulting from the January 1, 2018, tax reduction, the appropriate level of deferred liabilities to be recorded on an interim basis to reflect the reduced federal corporate tax rate, and the

[93] *See*, *e.g.*, *Withrow v. Larkin*, 421 U.S. 35 (1975).

> appropriate level of reductions in utility rates to reflect the reduced federal corporate tax rate.[94]

It took this action without providing any of the defendant utilities an opportunity to respond to the KIUC complaint or to comment on the proposed limitations.

After the defendant utilities answered the complaint, it took no action to investigate the KIUC Complaint or to otherwise establish a procedural schedule for its adjudication. After establishing separate proceedings for the defendant utilities, it made only cursory attempts to investigate the effects of the TCJA on the Companies. It conducted minimal discovery that paled in comparison to that the Commission conducted in general rate case proceedings and that conducted in the Commission's review of the Tax Act of 1986. It posed few questions regarding the *Offer and Acceptance of Satisfaction*, made no attempt to examine the updated forecasts submitted in support of that agreement, gave no notice to the signatories of that agreement of any concerns regarding the agreement, and made no effort to provide an opportunity for the signatories to respond to those concerns by conducting a hearing.

In its Order of March 20, 2018, the Commission evidenced its intent to conduct very limited review of the issues presented by the TCJA by refusing to consider the Companies' most current forecasts because they "have not been subjected to the Commission's investigation and review."[95] The Commission, however, had numerous opportunities to review those forecasts, to conduct discovery on them, and to conduct a hearing to question those responsible for their preparation. It chose not to do so.

Another example of how the Commission's actions culminating with its Order of March 20, 2018, show a predisposition toward a results-oriented outcome is the Commission's approval

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[94] Case No. 2017-00477, Order at 3 (Ky. PSC Dec. 27, 2017).
[95] Order of Mar. 20, 2018 at 7.

of a $204 million TCJA Surcredit distribution knowing the record showed this cash outlay required additional capital to finance it.[96] Although the March 20, 2018 Order denied capitalization updates because it asserted there was insufficient information in the record, the record contained sufficient information for the Commission to approve the TCJA Surcredit with modifications. The TCJA Surcredit itself represents an increase to capitalization because the Company must fund the distributions to customers with additional capital. Thus, information existed in the record to support—at the very least—updates to capitalization directly associated with the TCJA Surcredit. The Commission cannot have it both ways without demonstrating a prejudged outcome.

Upon granting rehearing due the Companies' claim of serious violations of their right to due process, the Commission conducted again only minimal discovery. At the hearing in this matter, it conducted limited examination of the Companies' witnesses, focused largely on the correction of the gross-up factor.

Should the Commission merely go through the motions of conducting a hearing and then affirming the earlier Order or making cosmetic revisions to that Order, it will be clear, convincing, and overwhelming evidence that the Commission prejudged this proceeding and had no intention of conducting a thorough and comprehensive investigation as KRS Chapter 278 requires.

[96] Direct Testimony of Kent W. Blake at 9 ("Prior to the Tax Act, both KU and LG&E had a tax net operating loss carryforward and thus were not cash taxpayers. With the Tax Act, both KU and LG&E are expected to be cash taxpayers for this period. The estimated amounts to be returned to customers for this period represent an additional cash outlay resulting from the Tax Act that did not exist before. Put simply, the estimated $176.9 million to be returned to customers is a reduction in cash revenues received from customers without a corresponding reduction in cash expenses.").

5. Commission Regulations Limit the Commission's Authority to Approving the *Offer and Acceptance of Satisfaction* or Rejecting It and Ordering a Hearing on KIUC's Complaint.

In its Order of March 20, 2018 in which it modifies the terms of the *Offer and Acceptance of Satisfaction*, the Commission has acted contrary to KRS 278.310 and 807 KAR 5:001, Section 20(5). 807 KAR 5:001, Section 20 permits the Commission to approve or disapprove a utility's offer to satisfy a complaint, but does not expressly permit the Commission to modify or revise the terms of an offer and impose those modified terms upon either a complainant or a defendant utility.

The Commission initiated this proceeding pursuant to KRS 278.260, which permits the Commission upon receipt of a written complaint from a person interested in a utility's rate to investigate the reasonableness of the utility's rate. KIUC filed a complaint against four electric utilities, including the Companies. The Commission then determined that KIUC's Complaint established a prima facie case and, pursuant to 807 KAR 5:001, Section 20, directed the Companies, to "satisfy the matters complained of or file a written answer to the complaint."[97] The Companies submitted a written answer to allegations set forth in KIUC's Complaint, which included an offer of satisfaction, and offered to enter into negotiations with KIUC. These negotiations produced the *Offer and Acceptance of Satisfaction*.

807 KAR 5:001, Section 20(5) and (6) govern the Commission's review of the *Offer and Acceptance of Satisfaction*. Section 20(5) provides:

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[97] *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company, Louisville Gas and Electric Company, Kentucky Power Company, and Duke Energy Kentucky, Inc.*, Case No. 2017-00417 Order at 3 (Ky. PSC Dec. 27, 2017).

> If the defendant desires to satisfy the complaint, he or she shall submit to the commission, within the time allowed for satisfaction or answer, a statement of the relief that the defendant is willing to give. **Upon the acceptance of this offer by the complainant and with the approval of the commission, the case shall be dismissed**.[98]

Section 20(6) states:

> If the complainant is not satisfied with the relief offered, the defendant shall file an answer to the complaint within the time specified in the order or the extension as the commission, for good cause shown, shall grant.

Section 20(5) requires the Commission to review the offer. It expressly provides the Commission may approve the offer and by implication that the Commission may deny or withhold its approval, but grants the Commission no other options. Section 20(6) limits the Commission's authority to impose an offer. It confers upon a complainant the right to reject an offer without regard to the Commission's position on the offer's merits. It confers no power or authority upon the Commission to compel a complainant to accept an offer. Yet, that is exactly what the March 20, 2018 Order does: compels the complaint, KIUC, and the defendants, the Companies, to accept a materially modified version of the *Offer and Acceptance of Satisfaction*.

To the contrary, by requiring the defendant utility to answer the complaint if the complainant refuses to accept its offer, the regulation compels the Commission to move forward with further proceedings to adjudicate the complaint.

KRS 278.310 provides that "[a]ll hearings and investigations before the commission or any commissioner shall be governed by rules adopted by the commission." The Commission is

[98] (Emphasis added).

required not only to adopt rules of procedure, but to follow those rules when conducting investigations or hearing.[99]

The Commission has previously recognized that 807 KAR 5:001 only allows it to approve or withhold its approval of the accepted offer. In Case No. 91-281,[100] the Commission found a provision of the accepted offer to be unreasonable as a matter of public policy, proposed modifications to the provision, and advised the complainant and defendant utility that unless the proposed modification was accepted, "the Settlement Agreement shall be denied and the terms of the Settlement Agreement shall not be deemed binding among the parties."[101] The parties were provided the choice of accepting the proposed modifications or continuing with the proceeding. This action is consistent with Commission precedent that "absent unusual circumstances . . . a complainant is entitled to be the master of his case and should have the right to determine how it is presented to the Commission."[102] In contrast, the Commission never gave the parties a choice in this case.

By imposing modifications to the *Offer and Acceptance of Satisfaction*, the Commission acted contrary to its own regulations. 807 KAR 5:001, Section 20 only authorized the Commission to either grant or deny its approval to the *Offer and Acceptance of Satisfaction*.. At best, the Commission under its Rules of Procedure could only offer the parties the opportunity to accept the modified terms and, if the parties chose not to accept the modified terms, establish a procedural schedule to adjudicate KIUC's Complaint.

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[99] *Hagan v. Farris*, 807 S.W.2d. 488, 490 (Ky. 1991) ("An agency must be bound by the regulations it promulgates."). *See also* KRS 13A.130(1) ("An administrative body shall not by internal policy, memorandum, or other form of action . . . [m]odify a statute or administrative regulation [or] . . . [e]xpand upon or limit a statute or administrative regulation.").

[100] *Charles and Carolyn Pope v. Nicholas County Water District*, Case No. 91-281 (Ky. PSC Dec. 6, 1991).

[101] *Id.* at 4.

[102] *Americoal Corporation v. Boone County Water and Sewer District*, Case No. 90-108, Order at 2 (Ky. PSC Aug. 21, 1991).

Similarly, the Commission's regulations do not permit the Commission to expand the scope of the rehearing on its Order of March 20, 2018. 807 KAR 5:001, Section 20(5) limits the outcome of the rehearing to whether the *Offer and Acceptance of Satisfaction* should be approved. If the Commission finds that the updated *Offer and Acceptance of Satisfaction* fails to produce a fair, just, and reasonable rate and should not be approved, it cannot impose another rate at this juncture in the proceeding but must establish a procedural schedule, which includes a hearing, to adjudicate the merits of KIUC's complaint regarding the Companies' existing rates and to establish, if necessary, new rates for the Companies' services.

Notwithstanding the clear language of the 807 KAR 5:001, Section 20, the AG asserts[103] that the Commission may unilaterally modify the *Offer and Acceptance of Satisfaction*. Pointing to references in Section 5.6 of the *Offer and Acceptance of Satisfaction* to Commission modification, which permits a party to withdraw in the event the Commission enters an order modifying the terms of the *Offer and Acceptance of Satisfaction*, he argues that the Companies and the Complainant have explicitly recognized the Commission's authority to make modifications.

The AG reads too much into Section 5.6. The section contains no explicit recognition of any Commission authority to unilaterally modify an accepted offer. It merely recognizes that the Commission may attempt to impose conditions for its approval of the *Offer and Acceptance of Satisfaction*, and, if so, presumably would do so in accordance with the *Charles and Carolyn Pope v. Nicholas County Water District* decision. Under the *Offer and Acceptance of Satisfaction*, the signatories are under no obligation to accept those conditions and may withdraw from the *Offer and Acceptance of Satisfaction* within an established time period. It provides a

[103] Attorney General's Interim Response to Kentucky Utilities Company's and Louisville Gas and Electric Company's Petition for Reconsideration and Request for Hearing at 4-5.

mechanism for the signatories to voluntarily accept the Commission's conditions in accordance with the holding in *Charles and Carolyn Pope v. Nicholas County Water District, supra*. Moreover, to the extent that the Commission approved without modification Section 5.6 of the *Offer and Acceptance of Satisfaction*, the Commission has endorsed the right of the signatories to withdraw and has implicitly recognized that it cannot modify the terms of the *Offer and Acceptance of Satisfaction* over a signatory's objection.

The AG's interpretation of the *Offer and Acceptance of Satisfaction* as the signatories' recognition of the Commission's authority to unilaterally modify accepted offers is also at odds with the a longstanding legal principle that an administrative agency has only such powers that are conferred expressly by statute or by implication;[104] and that parties to an administrative proceeding cannot confer additional powers to an administrative agency. On several occasions, in compliance with this principle, the Commission has rejected the attempts of parties to its proceedings to expand the Commission's authority by agreeing that the Commission may perform some action that the Commission is not otherwise authorized by statute or regulation to perform.[105]

The Attorney General finally contends that in the absence of any statute expressly forbidding the Commission's conduct, the Commission's plenary ratemaking powers permit unilateral modification of any accepted offer. In making this argument, the Attorney General erroneously applies the Kentucky Supreme Court's decision in *Kentucky Public Service*

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[104] *Croke v. Public Serv. Comm'n*, 573 S.W.2d 927, 929 (Ky. App. 1978).

[105] *See, e.g.*, *City of Newport v. Campbell County Kentucky Water District and Kenton County Water District No. 1*, Case No. 89-014 (Ky. PSC Jan. 31, 1990); *Application of Metropolitan Sewer District For Approval to Acquire and Operate the Fairhaven Mobile Home Village Sewage Treatment Plant*, Case No. 90-169 (Ky. PSC June 22, 1990); *City of Henderson, Kentucky, City of Henderson Utility Commission, and Big Rivers Electric Corporation Application For Certificate of Public Convenience and Necessity and To File Plan For Compliance With Clean Air Act and Impose Environmental Surcharge*, Case No. 93-065 (Ky. PSC July 19, 1993); *Proposed Adjustment of the Wholesale Water Service Rates of the City of Cynthiana, Kentucky*, Case No. 99-300 (Ky. May 19, 2000).

Commission v. Commonwealth of Kentucky ex rel. Conway, 324 S.W.3d 373 (Ky. 2010) to the current proceeding.

Conway involved the use of Commission's general ratemaking powers. As it relates to the Commission's authority to unilaterally modify an accepted offer, the present proceeding involves the Commission's compliance with established procedures, not the Commission's general ratemaking powers. Unlike the Commission's general ratemaking powers, which are subject to few statutory or regulatory limitations, there are several statutory and regulatory limitations placed on the Commission's adjudication of rate complaints. KRS 278.260 and KRS 278.270 require the Commission to conduct a hearing on the complaint before the Commission may take any action affecting the rates that are the subject of the complaint. KRS 278.310 requires that complaint proceedings be governed by rules of procedure adopted by the Commission. Those rules of procedure provide a precise procedure for the Commission to address offers of satisfaction and expressly address a complainant's right to reject or accept an offer. KRS 13A.130(1) prohibits the Commission from deviating from those rules.

Furthermore, the Kentucky Supreme Court in *Conway* rejected the Attorney General's assertion of unlimited ratemaking power in the absence of specific statutory limitations. It noted the existence of limits:

> While we recognize that the PSC has discretion in fulfilling its statutory duty of insuring that rates are fair, just and reasonable, we do not hold that the PSC has unlimited power to do what it wants in regards to ratemaking.[106]

At least one other Kentucky court has also noted the existence of limits on the Commission's discretion when performing its statutory duty to regulate utility rates.[107]

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[106] *Conway* at 381, fn. 16. (Emphasis added)
[107] *See, e.g.*, *Ky. Indus. Util. Customers, Inc. v. Ky. PSC*, 504 S.W.3d 695, 706.

In summary, the Commission lacks the authority to modify the *Offer and Acceptance of Satisfaction*. If the Commission determines the provisions of the *Offer and Acceptance of Satisfaction* are unreasonable, 807 KAR 5:001, Section 20 limits the Commission to denying its approval and to ordering a hearing on KIUC's Complaint.

C. The Companies Reserve the Right to Request a Full Hearing.

If the Commission modifies the updated *Offer and Acceptance of Satisfaction*, the Companies reserve the right to reject the modification and request a full hearing on KIUC's complaint.[108]

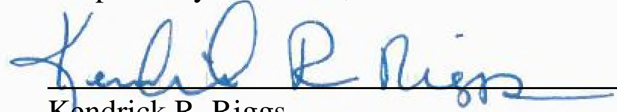
IV. CONCLUSION

The updated *Offer and Acceptance of Satisfaction* reached by the Companies and the complainant, KIUC, is a fair, just, and reasonable resolution of the issue presented in this proceeding. For the reasons stated herein and through this proceeding, the Companies ask the Commission to issue a final order approving the updated *Offer and Acceptance of Satisfaction* without modification or condition.

[108] Section 5.6 of the re-executed *Offer and Acceptance of Satisfaction* recognizes the right of the Companies to reject modifications and demand rehearing or appeal if the Commission does not accept and approve the updated *Offer and Acceptance of Satisfaction* in its entirety.

Dated: June 29, 2018

Respectfully submitted,



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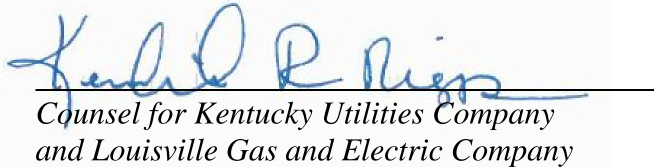
CERTIFICATE OF COMPLIANCE

This is to certify that Kentucky Utilities Company's and Louisville Gas and Electric Company's June 29, 2018 electronic filing of their 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 29, 2018; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original and six copies, in paper medium, of the Brief are being mailed by U.S. First Class Mail, postage prepaid, to the Commission on June 29, 2018.



Counsel for Kentucky Utilities Company
and Louisville Gas and Electric Company

Appendix to the Brief

MOODY'S
INVESTORS SERVICE

CREDIT OPINION
7 June 2018

Update

Rate this Research

RATINGS

PPL Corporation

Domicile	Allentown, Pennsylvania, United States
Long Term Rating	Baa2
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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PPL Corporation

Update to credit analysis

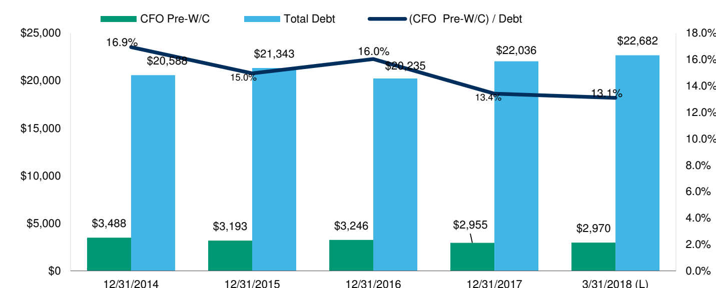
Summary

PPL Corporation's (PPL) credit strengths include the low business risk profile of its Pennsylvania and UK regulated utilities, as well as the credit supportive regulatory environments where all of its utilities operate, including Kentucky. As a fully regulated utility holding company, PPL generates approximately 70% of its earnings and cash flows from a networks or transmission and distribution (T&D) platform in the US and UK. The remaining 30% comes from vertically integrated utility operations in Kentucky, which include 8 GW of power generation that is mostly coal-fired. All of these operations provide good earnings and cash flow visibility.

We see the UK regulatory environment as one of the most transparent and credit supportive environments globally. However, there is substantial debt leverage at the parent holding company and large capital investment programs, resulting in significant negative free cash flow. Although PPL has foreign currency exchange exposure due to its operations in the UK, PPL has been actively mitigating the risk by placing hedges on foreign currency exchange rates.

We expect PPL's cash flow from operations before changes in working capital (CFO pre-WC) to debt to range from 12% to 14% over the next 2 years, slightly weaker than its 2017 actual level. The US Tax Cuts and Jobs Act had a negative impact on PPL's overall cash flow since approximately half of its cash flow is generated in the US. We estimate the impact on PPL's key cash flow to debt metric to be around a 100 basis point (bps) decrease. The impact was mitigated by a $1.7 billion equity issuance completed early May 2018.

Exhibit 1
Historical CFO Pre-WC, Total Debt and CFO Pre-WC to Debt
($MM)



Source: Moody's Financial Metrics™

Credit Strengths

» Stable earnings and cash flow generated by regulated utilities

» Constructive regulatory environments supporting rate base growth

» Consistent financial metrics

Credit Challenges

» Large capital investment programs

» Relatively high level of holding company debt

» Foreign currency exchange exposure

Rating Outlook

The stable outlook reflects PPL's relatively low business risk, as well as our expectations that it will continue to generate stable financial metrics, including a ratio of CFO pre-WC to debt in the 12%-14% range. The stable outlook also assumes that its regulated operating subsidiaries will continue to be supported by constructive regulatory environments and its large capital investments will be financed with a balanced mix of debt and equity.

Factors that Could Lead to an Upgrade

PPL's rating could be upgraded if its consolidated financial metrics improve, including CFO pre-WC to debt above 16% on a sustained basis. An upgrade is also possible if PPL lowers its percentage of holding company debt to below 20% of total consolidated debt on a sustained basis. A rating upgrade could also be considered if PPL's utility subsidiaries are upgraded.

Factors that Could Lead to a Downgrade

A rating downgrade could be considered if its consolidated key metrics deteriorate significantly, including if its CFO pre-WC to debt falls below 12% on a sustained basis. Also, a significant increase in parent debt could pressure the rating downward. Additional rating pressure could occur should PPL experience any unexpected negative regulatory developments, its ability to earn appropriate returns on its investments is reduced significantly, or if its utility subsidiaries are downgraded. Furthermore, negative ratings actions could occur if the company fails to properly manage its foreign exchange exposure, associated with earnings generated from its UK operations.

Key Indicators

Exhibit 2

PPL Corporation

	Dec-14	Dec-15	Dec-16	Dec-17	Mar-18 (L)
CFO pre-WC + Interest / Interest	4.9x	4.4x	4.5x	4.2x	4.1x
CFO pre-WC / Debt	16.9%	15.0%	16.0%	13.4%	13.1%
CFO pre-WC – Dividends / Debt	12.2%	10.2%	10.9%	8.5%	8.3%
Debt / Capitalization	54.6%	60.9%	58.8%	61.9%	61.7%

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics™

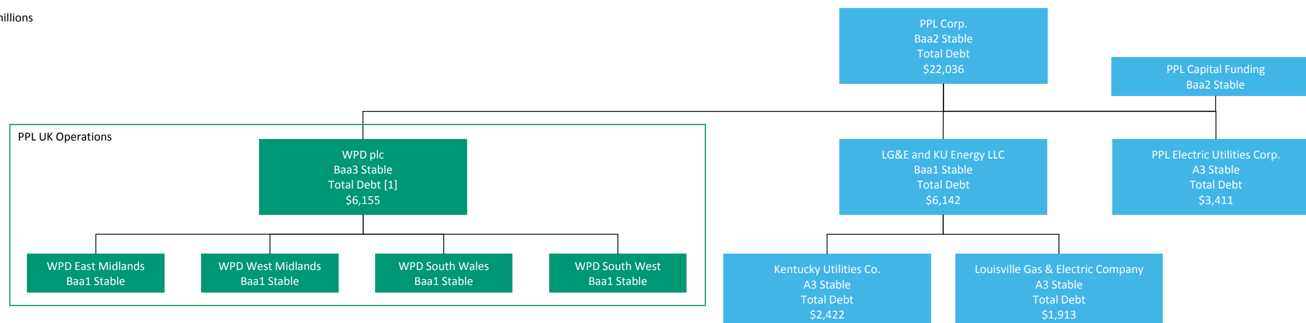
Profile

PPL Corporation is a utility holding company headquartered in Allentown, PA with three regulated jurisdictions: United Kingdom, Kentucky, and Pennsylvania. Its UK regulated operations include Western Power Distribution Plc (WPD, Baa3 stable), a pure wires-only distribution company with no retail exposure. Kentucky regulated utilities include Louisville Gas & Electric Company (LG&E, A3 stable)

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

and Kentucky Utilities Company (KU, A3 stable), which operate under a traditional integrated utility model. The two Kentucky utilities are held under an intermediate holding company, LG&E and KU Energy LLC (Baa1 stable). Its Pennsylvania operation is comprised of PPL Electric Utilities Corporation (PPLEU, A3 stable), a transmission business mostly regulated by the Federal Energy Regulatory Commission (FERC), and a distribution operation regulated by the Pennsylvania Public Utility Commission (PAPUC). PPL, through its Kentucky operating subsidiaries, controls or owns about 8,000 MW of generating capacity in the US and sells electricity and natural gas to about 10.5 million customers in the US and UK.

Exhibit 3
Organizational Structure
As of 12/31/2017



[1] As of 3/31/2017
[2] Total debt is based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics, Company

Detailed Credit Considerations

Stable and consistent earnings and cash flow generated by regulated utilities

PPL, as a regulated utility holding company, has low business risk compared to many of its peers because all of its subsidiaries are regulated utility companies. Approximately 50% of PPL's net income is produced by its UK based distribution operations, which are consolidated under the intermediate holding company Western Power Distribution Plc. The remaining 50% of cash flow is produced in the US with about 30% generated from its two Kentucky utilities, Louisville Gas & Electric Company and Kentucky Utilities Company and the remaining 20% from its utility in Pennsylvania, PPL Electric Utilities Corporation.

As a distribution network operator (DNO) in the UK, WPD's subsidiaries do not have any commodity production or procurement responsibilities, effectively eliminating all of its exposure to commodities. Although PPLEU is a wires-only utility, it maintains some commodity exposure because it has provider of last resort (POLR) obligations for the customers who do not choose an alternative power supplier within PPLEU's service territory. The risk associated with this exposure is small given the transparent purchased power cost pass-through mechanism that is in place. Additionally, PPLEU mitigates this risk by entering into full requirement supply agreements to serve its POLR customers. PPL's Kentucky utilities have the most exposure to commodities as vertically integrated utilities because they own and operate generation assets to produce power for their customers. Although LG&E and KU have direct commodity exposure, Kentucky allows the cost of fuel to be recovered through a fuel adjustment clause within four months.

Constructive US regulatory environments supporting rate base growth

We view the US regulatory environments for PPL to be credit supportive, resulting in stable and predictable earnings and cash flow generated from roughly $15 billion of rate base. The Kentucky Public Service Commission (KPSC) has approved various tracker mechanisms that provide for timely cost recovery outside of a general rate case. These tracker mechanisms include a Fuel Adjustment Clause (FAC), an Environmental Cost Recovery Surcharge (ECR), a Gas Supply Clause (GSC), a Gas Line Tracker (GLT), and a Demand-Side Management Cost (DSM) Recovery Mechanism.

The last rate case in Kentucky was settled. The KPSC issued its modified order in June 2017, which authorized a base electricity rate increase of $52 million for KU and a base electricity rate increase of $57 million and base gas rate of $7 million for LG&E based on an

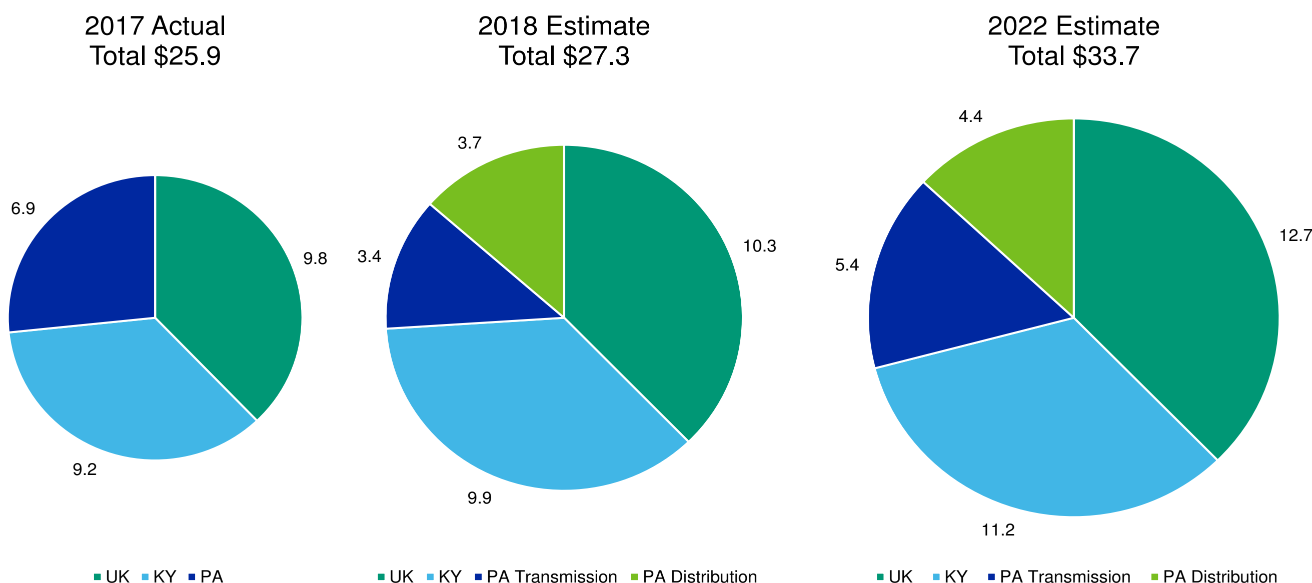
authorized return on equity (ROE) of 9.7%. The rate case resulted in a base electricity rate increase of 3.2% at KU and base electricity and gas rate increases of 5.2% and 2.1%, respectively, at LG&E. These became effective 1 July 2017. Overall, we view the settlement as credit supportive and representative of a constructive regulatory environment which continues to settle rate cases in a timely manner.

In June 2017, the KPSC also approved an authorized ROE of 9.7% for all of LG&E's and KU's existing approved ECR plans and projects, replacing the prior authorized ROE levels of 9.8% for coal projects and 10% for all other ECR approved projects, effective with bills issued in August 2017. The impact of this new authorized ROE is not expected to be significant in 2017.

In Pennsylvania, PPLEU has historically received reasonable and timely decisions in its rate cases, including the most recent distribution rate case that was settled in November 2015. In this rate case, the company was authorized to use a forward test year and reached a settlement with interveners within 6 months. PPLEU requested an 18.5% revenue increase and received about 74% of the request ($124 million versus $167.5 million) in the settlement.

Relative to other electric utilities, a high percentage of PPLEU's rate base consists of FERC regulated transmission assets. PPL expects the rate base contribution from its FERC-regulated transmission assets to be around 47% in 2017 and to increase to 55% by 2022. We consider FERC regulation to be predictable and credit supportive due to the formulaic nature of its rate case mechanisms. Based on the formula rate mechanism, PPLEU is currently authorized to earn an 11.68% ROE on its existing transmission assets, while the $650 million Susquehanna-Roseland transmission project is authorized to earn a 12.93% ROE due to incentive-based rate treatments. We note that there is an ROE complaint filed in PJM, where PPLEU is located, to reduce the FERC allowed ROE. The timing, scope and content of the final resolution are uncertain.

Exhibit 4
Projected Rate Base Growth
$ in billions



Source: Company Reports

Transparent and consistent regulatory environment in the UK

We consider the regulatory environment its WPD subsidiaries to be among the strongest and is among the most transparent globally. As the top performer among its DNO peers, the WPD utilities have benefitted from performance-based rate making mechanisms, which results in incentive bonus payments annually along with higher authorized ROE compared to its UK peers. For the regulatory year ending 30 September 2017, WPD's performance included $75 million of incentive revenues. Additionally, as the only DNO to qualify for fast-track incentives, WPD companies are allowed to retain 70% of realized cost efficiencies.

The UK electric and gas regulator Ofgem (Office of Gas and Electricity Markets) uses the RIIO (Revenue = Incentive + Innovation + Outputs) model. The reviews of RIIO determine the allowed revenues for all electricity distribution companies. The first phase of the rate review set the revenues operators are allowed to earn over the next eight years, from April 2015 to March 2023.

In early May, Ofgem decided not to hold a mid-period review in the current rate plan. The consultation period ended on 2 May 2018 and Ofgem's final review on the price control allowances is expected to be published in 2022. The second RIIO (also known as RIIO-Electric Distribution 2 or RIIO-ED2) will start in April 2023.

Exhibit 5
Western Power Distribution service area

Source: Energy Networks Association

Exhibit 6
Price control overview

			GB Electricity Distribution	
Regulator / Price Control				Ofgem / RIIO-ED1
Term of price control				2015-23
Allowed return on RAV (vanilla real)				3.56% (2018-19) 3.27% (2019-20)
Regulated Businesses	EMID	WMID	SWALES	SWEST
Regulated Asset Value (Ofgem) at March 2018	£2.35 bn	£2.35 bn	£1.06 bn	£1.56 bn

Note: Regulated Asset Value post November 2017 iteration
Source: Ofgem

Adequate financial metrics but relatively high parent debt

PPL has maintained stable financial metrics historically with its CFO pre-WC to debt in the mid-teens. However, we expect its metrics to slightly weaken to the 12%-14% range over the next 12-18 months. Metrics at these levels still position the company reasonably well relative to its low risk peers with a similar credit profile and metrics. As of the latest twelve months (LTM) period ending 31 March 2018, CFO pre-WC to debt was 14.7%. The decline in metrics is expected due to elevated capital expenditure programs as well as the negative impact from tax reform. However, prudent recovery mechanisms that are in place should result in more timely recovery of investments and help PPL to maintain its key metrics in the expected ranges. Furthermore, its recent equity issuance totaling approximately $1.7 billion also helped to mitigate the pressure on its cash flow to debt metric.

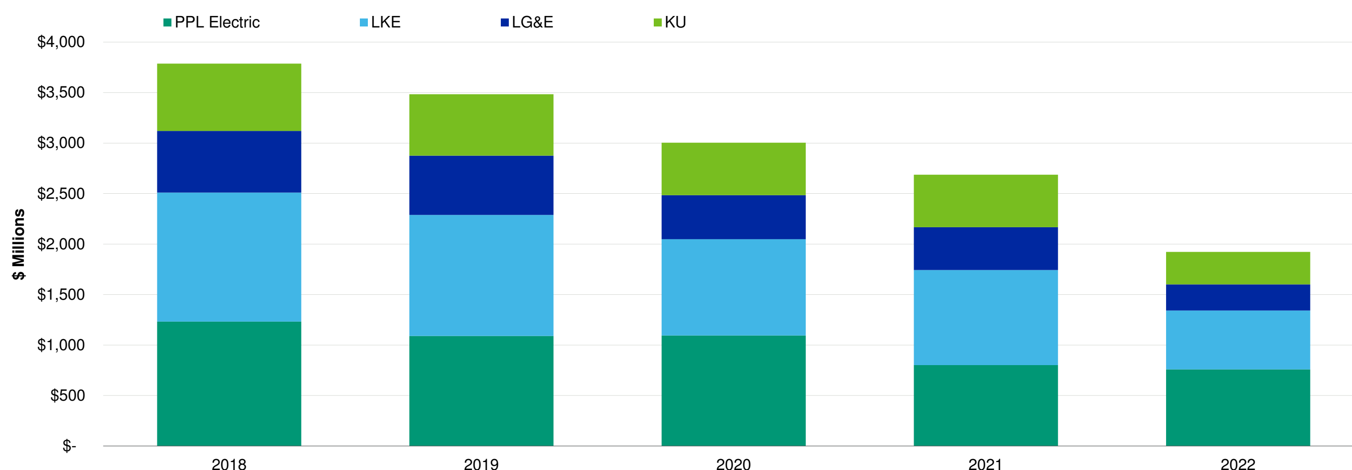
With approximately $7.4 billion of holding company debt, which includes debt at the parent holding company and intermediary holding companies in the US and UK, PPL's holding company debt accounts for approximately 35% of total consolidated debt. Holding company debt at these levels generally leads to a multiple notch differential between the parent company and its operating subsidiaries. PPL's overall credit profile, including its high parent debt level, is about two notches lower than the average credit profile of its US regulated subsidiaries.

Large but declining capital investment program

Based on their most recent earnings presentation, the company is projected to spend approximately $15.4 billion in capital expenditures between 2018 and 2022. In comparison, PPL's planned capital investment represents about 53% of the company's US and UK rate base, estimated an approximately $23.5 billion.

We expect a significant amount of the investment costs will be recovered through regulatory recovery mechanisms outside of the traditional base rate case proceedings. For instance in Kentucky, the KPSC has adopted the ECR mechanism for the recovery of certain construction work-in-progress, reducing regulatory lag. In Pennsylvania, the FERC transmission formula rate, Distribution System Improvement Charges (DSIC) mechanism and other recovery mechanisms are in place to reduce regulatory lag and provide for a more timely recovery of costs and a return on investments. All together these mechanisms allow PPL to receive timely returns between 80% and 90% of its investment.

Exhibit 7
Projected Capital Investment Plan for PPL's US Regulated Utilities



Source: Company Reports

Additional risk from and strategic attention to managing foreign currency exchange exposure

With a significant portion of earnings and cash flow generated in the UK, PPL must manage its foreign currency risk closely. As of early May 2018, PPL's foreign exchange exposure is 100% hedged for 2018 and 2019 at an average rate of $1.32 per GBP and $1.39 per GBP, respectively. For 2020, PPL has hedged 50% at average rate of $1.49 per GBP. PPL plans to maintain its three year forward hedging program, which we view as a credit positive as it mitigates volatility in earnings related to currency exchange from the otherwise stable and predictable UK operations.

Over the next three years, we expect PPL to generate about 50% of its cash flow from its UK operations while about 34% of PPL's debt is either denominated in GBP or has been swapped into GBP. As a result, we do not expect a GBP depreciation to heavily influence the CFO pre-WC to debt metric. In addition, if depreciation of the GBP against other currencies leads to higher import prices in the UK, inflation as measured by the Retail Prices Index (RPI) could increase modestly. Since WPD's revenues and regulatory assets are adjusted annually by RPI, this could lead to higher earning in GBP terms.

Liquidity Analysis

We expect PPL to maintain an adequate liquidity profile over the next 12-18 months. Although PPL does not have a short-term rating, its financing subsidiary PPL Capital Funding, Inc. (PPL Capital, Baa2 stable) has a P-2 short-term rating. The borrowings at PPL Capital are unconditionally guaranteed by PPL.

PPL's liquidity is supported by stable cash flow generated from its seven low risk utility subsidiaries. In addition to a steady stream of predictable cash flow, PPL has a significant amount of cash on hand totaling $629 million as of 31 March 2018.

At the parent level, PPL maintains a $950 million syndicated credit facility expiring in January 2023 and a $300 million syndicated credit facility expiring in November 2018. Drawings under these two revolving credit facilities are not subject to a material adverse change clause. As of 31 March 2018, there was $345 million borrowed against these facilities (letters of credit), leaving approximately $905 million of capacity available. PPL Capital Funding has a commercial paper program of $1.0 billion to provide additional short-term financing. Additionally, PPL maintains a $100 million bilateral credit facility due in March 2019.

Approximately $3.4 billion of bilateral and syndicated credit facilities are issued by various entities throughout the PPL family in the US and £1.3 billion in the UK. The expiration dates of the remaining facilities located at the operating subsidiaries are between October 2018 and January 2023. As of 31 March 2018, there was approximately $2.2 billion of availability remaining in the US and £816 million in the UK out of the $5 billion approximate total. Also, WPD has a £130 million uncommitted credit facility with £126 million available as of 31 March 2018. KU also has a separate letter of credit facility and it was fully utilized.

Over the LTM period ending 31 March 2018, PPL generated approximately $2.9 billion of cash flow from operations, spent about $3.2 billion in capital investments and paid $1.1 billion in dividends resulting in negative free cash flow of approximately $1.4 billion. Due to the high level of planned capital investments, we expect PPL to be negative free cash flow after dividends over the next 12-18 months.

Rating Methodology and Scorecard Factors

Exhibit 8

Rating Factors				
PPL Corporation				
Regulated Electric and Gas Utilities Industry Grid [1][2]	Current LTM 3/31/2018		Moody's 12-18 Month Forward View As of Date Published [3]	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	Aa	Aa	Aa	Aa
b) Consistency and Predictability of Regulation	Aa	Aa	Aa	Aa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	A	A	A	A
b) Sufficiency of Rates and Returns	A	A	A	A
Factor 3 : Diversification (10%)				
a) Market Position	A	A	A	A
b) Generation and Fuel Diversity	Baa	Baa	Baa	Baa
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	4.3x	Baa	4x - 4.5x	Baa
b) CFO pre-WC / Debt (3 Year Avg)	14.2%	Baa	12% - 14%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	9.2%	Baa	7% - 10%	Ba
d) Debt / Capitalization (3 Year Avg)	60.8%	Ba	58% - 60%	Ba
Rating:				
Grid-Indicated Rating Before Notching Adjustment		A3		A3
HoldCo Structural Subordination Notching	-2	-2	-2	-2
a) Indicated Rating from Grid		Baa2		Baa2
b) Actual Rating Assigned		Baa2		Baa2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 3/31/2018(L)
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics™

Ratings

Exhibit 9

Category	Moody's Rating
PPL CORPORATION	
Outlook	Stable
Issuer Rating	Baa2
WESTERN POWER DISTRIB (WEST MIDLANDS) PLC	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured -Dom Curr	Baa1
WESTERN POWER DISTRIB (EAST MIDLANDS) PLC	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured -Dom Curr	Baa1
PPL CAPITAL FUNDING, INC.	
Outlook	Stable
Bkd Senior Unsecured	Baa2
Bkd Jr Subordinate	Baa3
Bkd Commercial Paper	P-2
WESTERN POWER DISTRIBUTION (SOUTH WEST) PLC	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured -Dom Curr	Baa1
WESTERN POWER DISTRIBUTION (SOUTH WALES) PLC	
Outlook	Stable
Senior Unsecured -Dom Curr	Baa1
PPL ELECTRIC UTILITIES CORPORATION	
Outlook	Stable
Issuer Rating	A3
Senior Secured	A1
Sr Unsec Bank Credit Facility	A3
Commercial Paper	P-2
KENTUCKY UTILITIES CO.	
Outlook	Stable
Issuer Rating	A3
Bkd LT IRB/PC	A1
Senior Secured	A1
Sr Unsec Bank Credit Facility	A3
Commercial Paper	P-2
Bkd Other Short Term	P-2
LOUISVILLE GAS & ELECTRIC COMPANY	
Outlook	Stable
Issuer Rating	A3
Bkd LT IRB/PC	A1
Senior Secured	A1
Sr Unsec Bank Credit Facility	A3
Commercial Paper	P-2
Bkd Other Short Term	P-2
WESTERN POWER DISTRIBUTION PLC	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Senior Unsecured	Baa3
LG&E AND KU ENERGY LLC	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1

Source: Moody's Investors Service

Appendix

Exhibit 10

Cash Flow and Credit Measures [1]

($MM)

CF Metrics	2013	2014	2015	2016	2017
As Adjusted					
FFO	**3,507**	**3,601**	**3,368**	**3,520**	**3,102**
+/- Other	152	(113)	(175)	(274)	(147)
CFO Pre-W/C	**3,659**	**3,488**	**3,193**	**3,246**	**2,955**
+/- ΔWC	(350)	210	(173)	(25)	(34)
CFO	**3,309**	**3,698**	**3,020**	**3,221**	**2,921**
- Div	903	982	1,019	1,045	1,084
- Capex	4,395	3,764	3,611	2,999	3,210
FCF	**(1,990)**	**(1,048)**	**(1,610)**	**(823)**	**(1,372)**
(CFO Pre-W/C) / Debt	16.0%	16.9%	15.0%	16.0%	13.4%
(CFO Pre-W/C - Dividends) / Debt	12.0%	12.2%	10.2%	10.9%	8.5%
FFO / Debt	15.3%	17.5%	15.8%	17.4%	14.1%
RCF / Debt	11.4%	12.7%	11.0%	12.2%	9.2%

[1] All figures and ratios are calculated using Moody's estimates and standard adjustments. Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.

Source: Moody's Financial Metrics™

Exhibit 11

Peer Comparison [1]

	PPL Corporation Baa2 Stable			National Grid Plc Baa1 Stable			Dominion Energy, Inc. Baa2 Negative			Duke Energy Corporation Baa1 Negative			Southern Company (The) Baa2 Negative		
(in US millions)	FYE Dec-16	FYE Dec-17	LTM Mar-18	FYE Dec-15	FYE Dec-16	LTM Sep-17	FYE Dec-16	FYE Dec-17	LTM Mar-18	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-16	FYE Dec-17	LTM Mar-18
Revenue	7,517	7,447	7,622	24,517	19,917	19,568	11,737	12,586	12,668	22,371	22,743	23,565	19,896	23,031	23,632
CFO Pre-W/C	3,246	2,955	3,341	6,768	6,718	5,572	4,010	4,702	4,769	6,833	6,655	7,444	4,548	7,081	7,361
Total Debt	20,235	22,036	22,682	39,861	40,768	35,391	36,454	38,825	38,692	41,536	49,843	54,169	48,028	51,110	52,269
(CFO Pre-W/C) / Debt	16.0%	13.4%	14.7%	15.6%	15.7%	16.7%	11.0%	12.1%	12.3%	16.5%	13.4%	13.7%	9.5%	13.9%	14.1%
(CFO Pre-W/C - Dividends) / Debt	10.9%	8.5%	9.9%	9.5%	9.9%	-2.0%	6.1%	7.0%	7.0%	11.0%	8.7%	9.2%	6.2%	9.1%	9.3%
Debt / EBITDA	4.5x	5.7x	5.8x	5.2x	6.4x	6.7x	6.4x	6.0x	6.2x	4.4x	5.1x	5.0x	6.2x	8.3x	8.3x
Debt / Book Capitalization	58.8%	61.9%	61.7%	61.0%	59.8%	54.2%	58.0%	61.1%	59.9%	44.2%	47.5%	53.0%	53.1%	59.8%	59.9%

[1] All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade.

Source: Moody's Financial Metrics™

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OUTLOOK
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Regulated utilities - US

2019 outlook shifts to negative due to weaker cash flows, continued high leverage

Our negative outlook indicates our expectations for the fundamental business conditions driving the US regulated utility industry over the next 12-18 months.

The outlook for the US regulated utility sector has changed to negative from stable, reflecting increased financial risk due to lower cash flow and holding company leverage at its highest level since 2008. These factors will reduce the ratio of funds from operations (FFO) to debt by up to 200 basis points over the next 12-18 months.

» **Cash flow will decline due to a lower contribution from deferred taxes.** The combination of the loss of bonus depreciation and a lower tax rate as a result of the Tax Cuts & Jobs Act (TCJA) means that utilities and their holding companies will lose some of the cash flow contribution from deferred taxes. Since 2010, deferred taxes have contributed around 14% of consolidated FFO, but we see this falling to around 8% through 2019. This will drive down the consolidated ratio of FFO to debt, for a peer group of 42 utility holding companies, from 17% toward 15% over the outlook period.

» **Regulatory and management responses may not improve financials until 2020.** Some state regulatory commissions have issued credit-supportive rate orders to offset reduced cash flow because of tax reform, and several holding companies are executing plans to strengthen their balance sheets. But it could take longer than 12-18 months before sector-wide financial metrics improve.

» **High leverage will persist due to growing capital spending and rising dividends.** For our peer group, consolidated debt to EBITDA of 5.1x in 2017 was at a 10-year high, and a consolidated debt to equity ratio of 1.5x was at its highest level since 2008. These leverage metrics will remain elevated given higher capital spending in 2018 and 2019, rising dividends and a continued heavy reliance on debt financing.

» **What could change our outlook** The outlook could return to stable if we expect the sector's financial profile to stabilize, even if that is at today's lower levels. A positive outlook could be considered if we expect a recovery in key cash flow metrics where consolidated cash flow starts to improve by roughly 15%-20% or the ratio of consolidated FFO to debt indicates a return to the 17%-19% range. Underpinning each of these scenarios is a supportive regulatory environment across most US jurisdictions.

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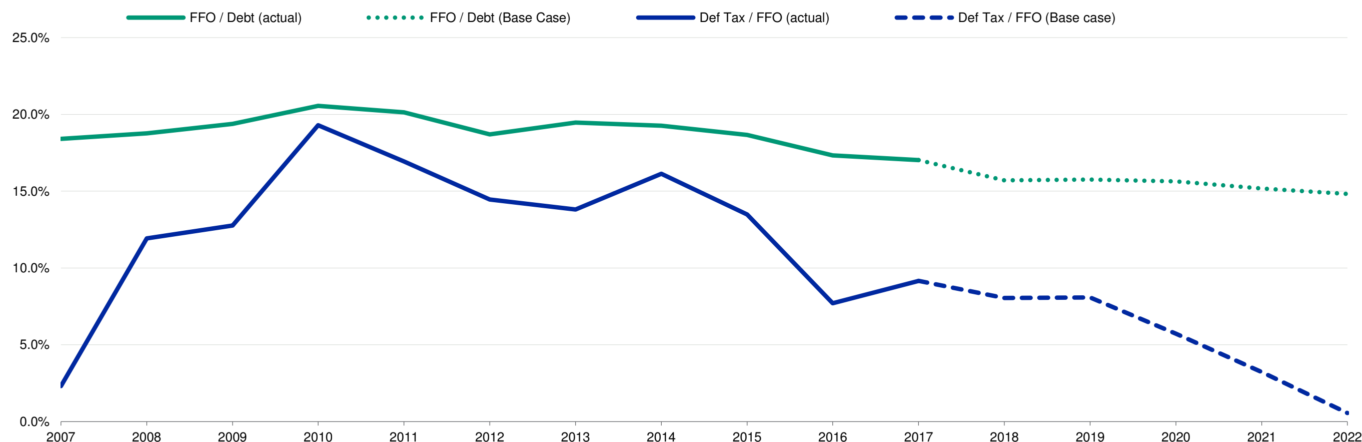
Cash flow will decline due to a lower contribution from deferred taxes

The combination of a lower tax rate and the loss of bonus depreciation as a result of the federal Tax Cuts & Jobs Act (TCJA) in December 2017 means that utilities and their holding companies will lose some of the cash flow contribution from deferred taxes on an ongoing basis, as shown in Exhibit 1.

For nearly a decade, bonus depreciation has created large timing differences between the book and tax amounts that utility holding companies report and pay as tax expense, and has resulted in a very low cash tax payment rate for the sector. Consequently, virtually all of the revenue that utilities have collected from customers to cover tax expense has been retained by the company as deferred tax liabilities, rather than paid to the Internal Revenue Service in any given year. These deferred taxes have boosted cash flow measures[1] significantly, accounting for roughly 14% of consolidated FFO, on average, since 2010.

Now, with the reduction in the corporate tax rate to 21% from 35%, utilities will collect less revenue from customers (since their federal tax expense is lower) and retain less cash via deferred taxes. As a result, the deferred-tax contribution to consolidated FFO will fall to around 8% through 2019, from an average of 14% since 2010, based on our financial forecast using a peer group of 42 regulated utility holding companies with 10 years of historical data (see Appendix A for a listing of holding company peers and Appendix D for a description of our key forecast assumptions). We also see the same trend for a peer group of 102 utility operating companies with 10 years of historical data. This decline will drive consolidated FFO to debt metrics down toward 15% from 17% and operating company FFO to debt to 20% from 24% over the next 12-18 months. See Appendix B for a list of the 102 operating companies.

Exhibit 1
Consolidated FFO to debt will decline as a result of lower deferred taxes



Key assumption: Cash tax rates of 0% in 2018 and 2019, 5% in 2020, 10% in 2021 and 15% in 2022
Source: Moody's Investors Service

Because outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of the rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

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The loss of bonus depreciation means that most companies will start paying cash tax earlier than under the previous law. Under the TCJA, utilities can claim less in depreciation expense for tax purposes and will have higher taxable income. Notwithstanding the change in law, we still expect holding companies to pay little or no cash tax in 2018 and 2019 because most have significant accumulated net operating losses driven by past claims of bonus depreciation, production tax credits from renewable generation or other tax offsets.

Lowering the tax rate also means that utilities will have over-collected for tax expenses in the past because they charged for future tax expense assuming a 35% tax rate. As utilities refund the excess collection to customers, cash flow will be reduced, with the decline likely spread over 20 years or more.

Regulatory and management responses may not improve financials until 2020

Regulatory commissions and utility management teams are taking important first steps in addressing increased financial risk, but we believe that it will take longer than 12-18 months for the majority of the sector to show any material financial improvement from such efforts.

There are two principal approaches for a utility seeking to take mitigating action against rising financial risk. The first option is to pursue financial relief from regulators, which we see most companies doing across the industry in response to tax reform. The second is "self-help," where management teams alter financial policies to improve cash flow or their balance sheet. These efforts could include cutting operating or capital costs, issuing equity, reducing debt, selling non-core assets or slowing dividend growth. Such strategies were popular during the early 2000s period known as "back to basics," when many companies shed unregulated and international assets, reduced debt and focused on strengthening core regulatory relationships.

Regulation addressing tax reform

So far, we have seen credit positive developments in some states in response to tax reform, described in the box below. Most of these measures are positive because they provide incremental cash flow that will be used to replace some of the cash lost due to tax reform.

Some regulatory commissions have allowed early tax reform relief

In Florida, the Florida Public Service Commission allowed several of the state's utilities including Florida Power & Light Company (A1 stable), Duke Energy Florida, LLC (A3 stable) and Tampa Electric Company (A3 stable) to use the bulk of customer refunds resulting from tax reform changes to offset rate increases for power restoration costs associated with the utilities' response to Hurricane Irma. Duke Energy Florida was also permitted to use a portion of the savings to accelerate the depreciation of existing coal plants.

In April, the Georgia Public Service Commission (GPSC) approved a tax reform settlement agreement allowing Georgia Power Company (A3 negative) to increase its authorized retail equity ratio, currently around 51%, to the utility's actual equity capitalization percentage or 55% (whichever is lower) until its next rate case filing, scheduled to be filed 1 July 2019.

In May, the Alabama Public Service Commission approved two supportive rate proposal requests by Alabama Power Company (A1 negative), including 1) a plan designed to improve the company's balance sheet and credit quality over time by gradually increasing its equity ratio to 55% by 2025 and 2) allowing up to $30 million of excess deferred tax liability deferrals to offset under-recovered fuel costs.

In Indiana, Northern Indiana Public Service Company (Baa1 stable) has reached a gas rate settlement that, if approved by the Indiana Utility Regulatory Commission, would defer the cash outflows associated with unprotected deferred tax liabilities until 2020.

While we expect very supportive regulatory outcomes in states such as Florida, Georgia and Alabama—three of the most credit-supportive regulatory environments in the US—other states will likely have more moderate allowances for increased rates and cash flow recovery in regard to tax reform. So far, many state commissions have provided for the 21% tax rate to be implemented into rates in 2018, but have said they will address the return of excess deferred tax liabilities to customers at a later date—under a separate proceeding or at the time of a utility's next general rate case. This adds a degree of uncertainty to the ultimate timing of any cash flow impact on the sector.

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Management efforts to address financial risk

Many companies are executing plans to strengthen their balance sheets in the face of increased financial risk, including incremental equity issuances beyond their pre-tax reform plans, selling assets or modest capex reductions. Some of these actions are defensive measures brought about by tax reform, while others are reactions to developments such as funding acquisitions, regulatory and political uncertainties, large capital programs or natural disasters. Other companies, although faced with negative credit trends, are making no material changes to financial policies.

Exhibit 2 shows a list of selected holding companies with a negative outlook or ratings under review for downgrade, as well as their planned responses to deal with heightened financial risks or other negative credit conditions.

Exhibit 2

Management teams are pursuing different avenues to relieve financial and credit risk
Holding companies with a negative outlook and under review for downgrade (RUR-D) as of 18 June 2018

Company	Rating	Outlook	Pursuing Regulatory Relief for Tax Reform	Incremental Equity Issuance	Selling Assets	Incremental Capex Reduction	% of Annual Capex Reduced	Dividend Reduction
ALLETE, Inc.	A3	Negative	Yes	No	No	No	NA	No
Consolidated Edison, Inc.	A3	Negative	Yes	No	No	No	NA	No
Edison International	A3	Negative	Yes	No	No	No	NA	No
Integrys Holding, Inc.	A3	RUR-D	Yes	No	No	No	NA	No
OGE Energy Corp.	A3	Negative	Yes	No	No	No	NA	No
WEC energy Group, Inc.	A3	RUR-D	Yes	No	No	No	NA	No
WGL Holdings, Inc.	A3	Negative	Yes	No	No	No	NA	No
Alliant Energy Corporation	Baa1	Negative	Yes	No	No	No	NA	No
CenterPoint Energy, Inc.	Baa1	Negative	Yes	Yes	No	No	NA	No
Duke Energy Corporation	Baa1	Negative	Yes	Yes	No	Yes	2%	No
PG&E Corporation	Baa1	Negative	Yes	No	No	No	NA	Yes
Sempra Energy	Baa1	Negative	Yes	Yes	Yes	No	NA	No
Dominion Energy, Inc.	Baa2	Negative	Yes	Yes	Yes	Yes	11%	No
Entergy Corporation	Baa2	Negative	Yes	Yes	No	No	NA	No
Southern Company (The)	Baa2	Negative	Yes	Yes	Yes	No	NA	No
Cleco Corporate Holdings LLC	Baa3	RUR-D	Yes	No	No	No	NA	No
Emera Inc.	Baa3	Negative	Yes	Yes	No	No	NA	No
SCANA Corporation	Ba1	RUR-D	Yes	No	No	No	NA	No

Source: Company announcements and Moody's Investors Service

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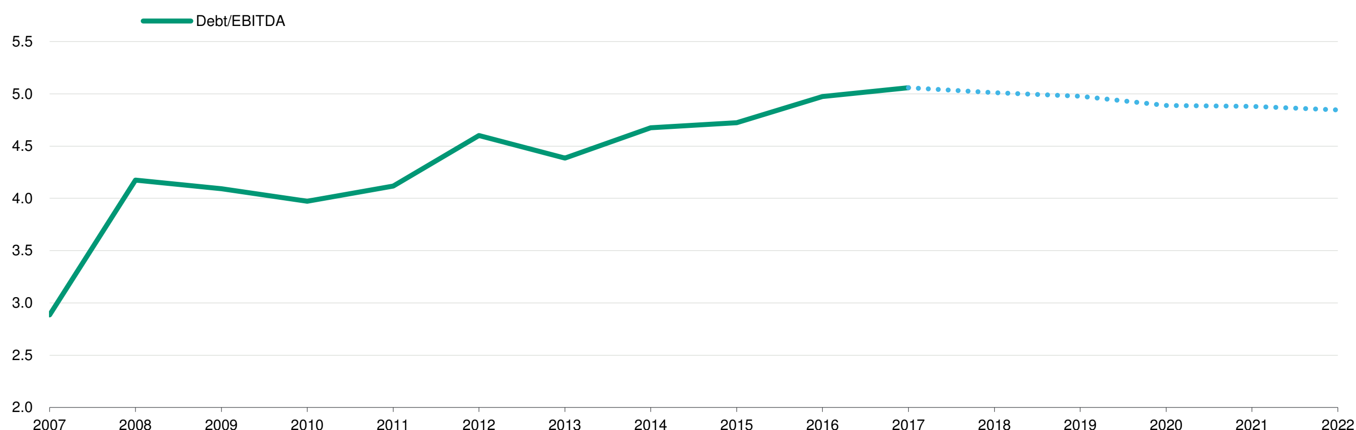
High leverage will persist because of significant capital spending and rising dividends

With roughly $600 billion of adjusted debt at year-end 2017, our peer group of 42 utility holding companies are exhibiting a 10-year high consolidated ratio of debt to EBITDA (5.1x in 2017) and the highest consolidated debt to equity ratio (1.5x in 2017) since 2008, the height of the financial crisis. As shown in Exhibit 3, these leverage ratios will remain elevated amid higher capital spending in 2018 and in 2019, rising dividends, and a continued heavy reliance on debt financing for negative free cash flow.

Exhibit 3

The ratio of debt to EBITDA for utility holding companies will likely remain at 10-year highs



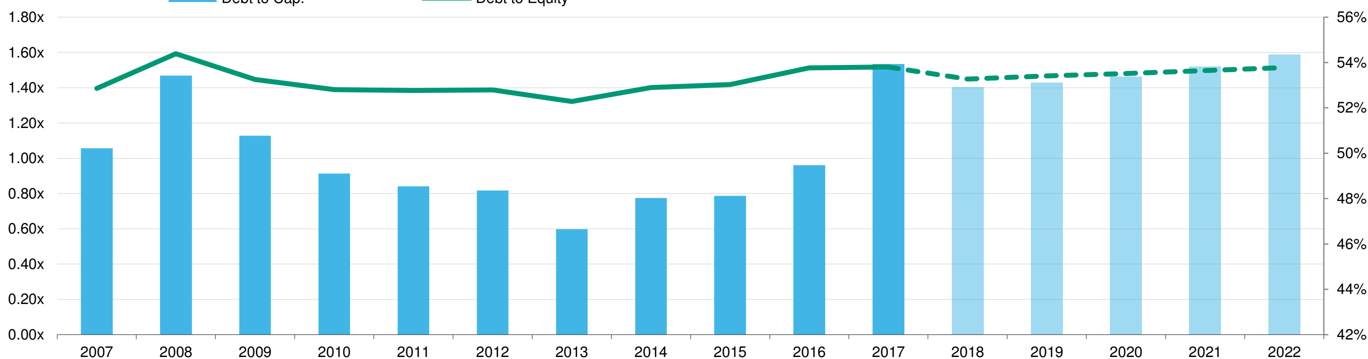
Source: Moody's Investors Service

Because of the lower tax rate, deferred tax liabilities were reduced, which negatively impacts our adjusted capitalization ratios. The deferred tax revaluation has increased the adjusted debt to capitalization ratio to 54% in 2017, from 49% in 2016, since it reduces the amount of total capitalization (debt + equity + deferred taxes) and reclassifies the excess deferred tax liabilities as a long-term regulatory liability owed to customers.

As Exhibit 4 shows, leverage is expected to remain high compared with historical levels, despite a significant amount of equity being issued in 2018. In 2018 we made a simplifying assumption that $20 billion of equity would be issued, offsetting a similar amount of debt that would otherwise have been used to fund negative free cash flow. That assumption acknowledges that several companies have announced equity issuances in 2018, including Duke Energy Corporation (Baa1 negative), Dominion Energy, Inc. (Baa2 negative) and Entergy Corporation (Baa2 negative). Without this equity, the ratio of debt to capitalization would have been 55% through 2022 and debt to equity would have been 1.5x, trending to 1.6x in 2022.

Exhibit 4

Despite equity issuance in 2018, leverage metrics will remain much higher than historical levels
Debt to Cap. (%) and Debt to Equity (x)



Source: Moody's Investors Service

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Holding company leverage has been increasing in recent years due to factors such as highly levered mergers and acquisitions, investments in non-regulated activities including renewable energy portfolios and midstream ventures, and using holding company debt as a source for equity infusions into operating subsidiaries. We do not incorporate unregulated investment into our forecast scenarios, but we still see increasing debt levels because of high capital investments and rising dividends.

Capital spending is likely to increase

Utility companies continue to spend significant capital on their rate base through smart-grid investments, system resilience measures and carbon transition efforts, including renewable generation assets. This is likely to keep spending levels high for the next several years. A trend of higher capital spending could also ensue if companies see the revenue reduction from tax reform, and the consequent reduction in customer bills, as an opportunity to make additional capital investments that could be recovered in rates without increasing customer bills above their pre-tax reform levels.

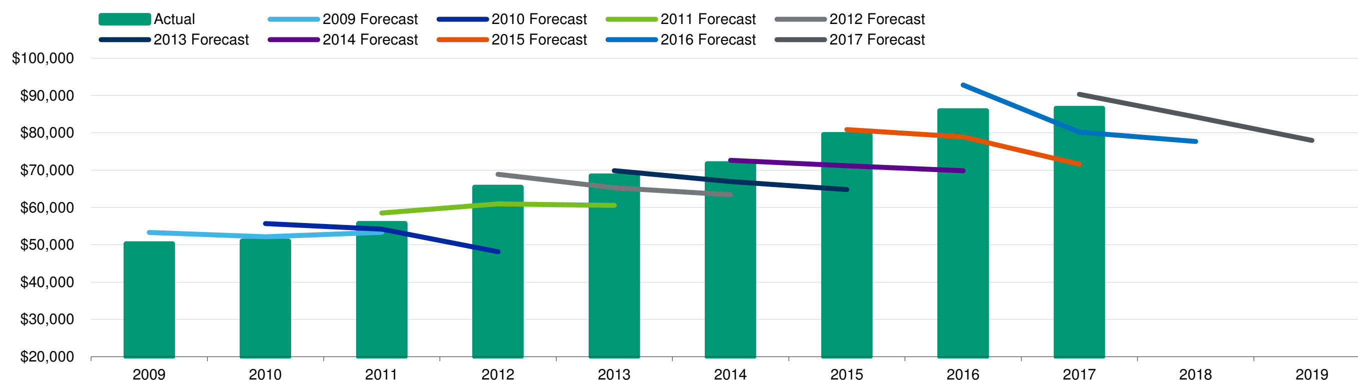
While many companies are estimating a steady decline in capital spending after 2018, our base-case projections assume that their capital spending will continue to increase, at about 5.0% each year, compared with a 2012-2017 compound annual growth rate (CAGR) of 5.7%.

As Exhibit 5 shows, while companies often project a downward trajectory in capital spending, the level of capital actually deployed frequently exceeds projections by a wide margin. In fact, for 25 holding companies that have reported 3-year capex projections since 2009 (see Appendix C for a list of companies), aggregate capital spending has always increased despite projections that usually predict a declining trend.

Exhibit 5

Utility capital spending is often projected to decline, but has actually grown annually since 2009

Annual 3-year capex projections for 25 regulated utility holding companies



Source: SPGMI

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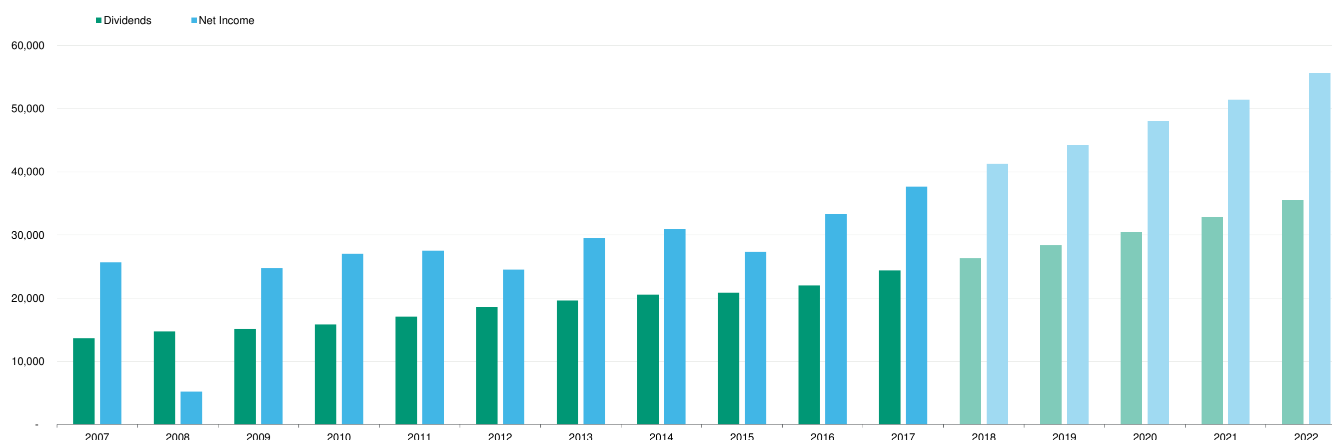
Dividends will continue to rise

As shown in Exhibit 6, we also expect that dividends will continue to increase, consistent with 2018 earnings call guidance indicating that payout policies are either unchanged or growing. In our base case forecast, we assume dividends increase at 8% year-over-year, which is the same growth rate as shown by net income.

Exhibit 6

The 10-year trend of increasing overall dividends is likely to continue through 2022

Actual dividends/net income (dark green/blue) and projected dividends/net income (light green/blue)



Source: Moody's Investors Service

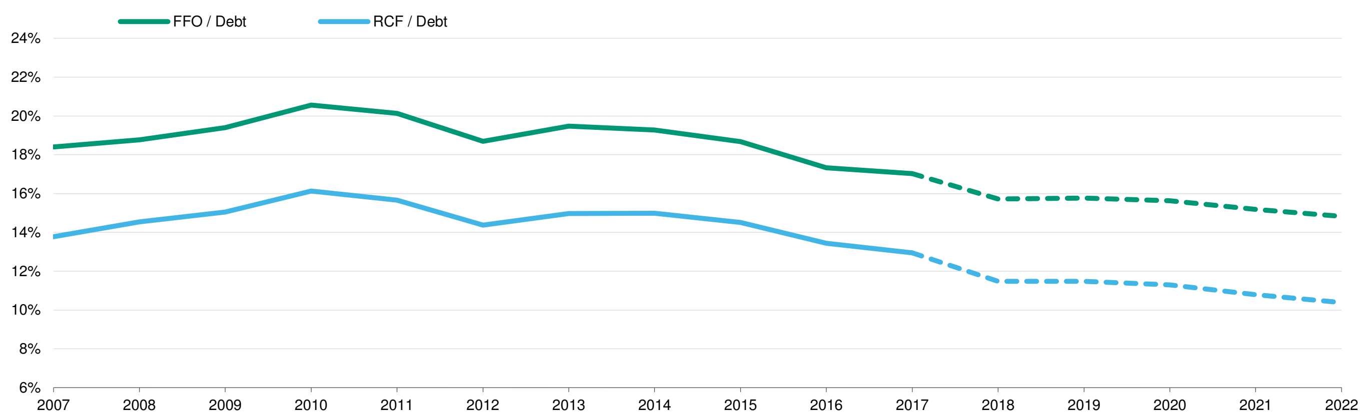
What could change our outlook

Stable outlook

The outlook could return to stable if we expect that the sector's financial profile will stabilize at today's lower levels, with consolidated FFO to debt metrics remaining steady. Exhibit 7 shows such stability could happen as early as 2019, with both FFO to debt and retained cash flow (RCF) to debt remaining between 15%-16% and 11%-12%, respectively, through year-end 2020.

Exhibit 7

A stable financial trend could emerge in 2019-2020 if cash flow growth keeps pace with debt



Key assumption: Cash tax rates of 0% in 2018 and 2019, 5% in 2020, 10% in 2021 and 15% in 2022
Source: Moody's Investors Service

We ran alternative scenarios to our base case forecast, including an upside case that assumes an improved financial performance by utilities and a downside case that assumes additional financial challenges.

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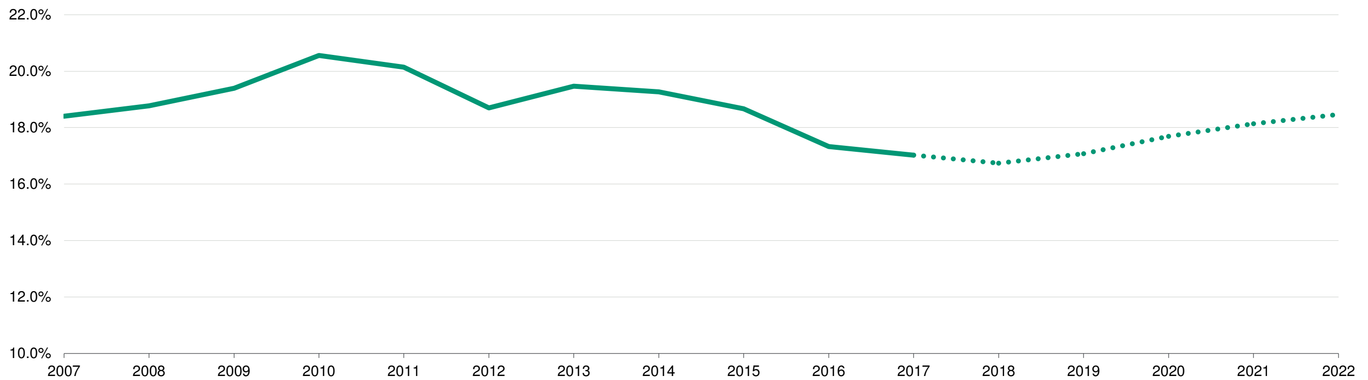
Positive outlook

A positive outlook would be possible if we expect a recovery in key cash flow metrics, such as consolidated FFO to debt returning to the 17%-19% range. This is the case in our upside projection scenario, which reflects a greater use of equity funding of negative free cash flow and very strong recovery provisions allowed by regulators. In Exhibit 8, we assumed a 5% annual decline in capital spending after 2019, simulating the downward trend in industry-reported projections.

Exhibit 8

The sector outlook could change to positive if FFO to debt rebounds as projected in our upside case
Actual historical FFO to debt (solid line) and as-projected in our upside case (dotted line)



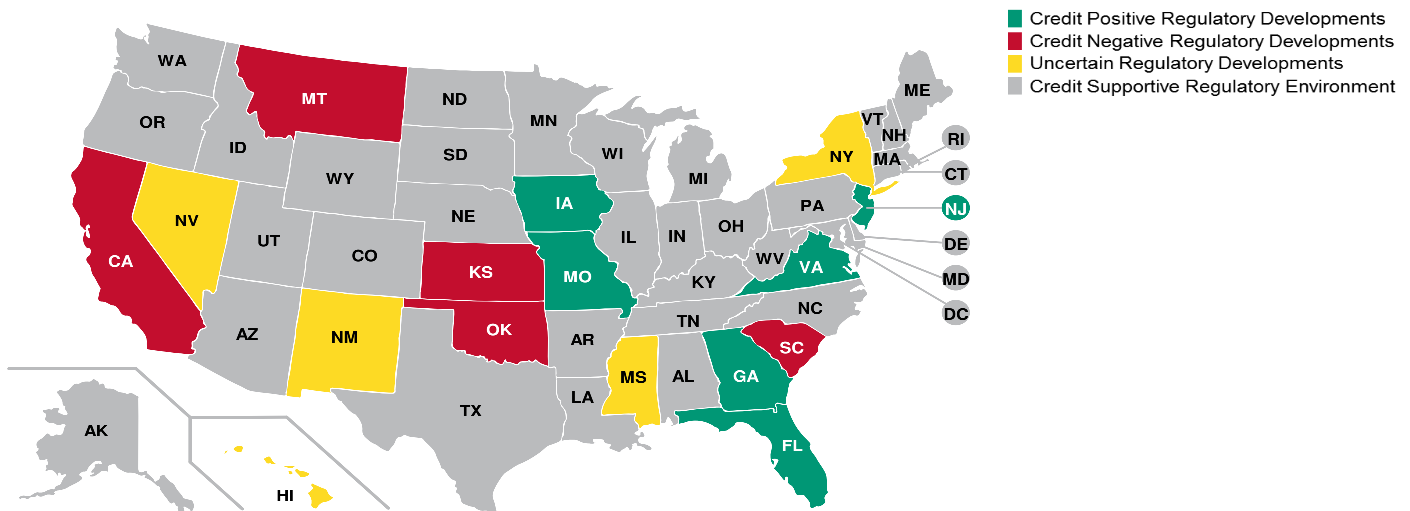
Source: Moody's Investors Service

Most state regulatory environments remain steadily supportive of credit

The underpinning of the sector outlook potentially returning to stable or changing to positive is a supportive regulatory environment. Exhibit 9 shows that, even today, most state jurisdictions remain predictably supportive of utility credit (grey), while some states have regulatory or legislative developments that could have positive (green), negative (red) or uncertain (yellow) impacts on utility credit.

Exhibit 9

Regulatory developments in most states continue to be stable and supportive of credit



Source: Moody's Investors Service

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Appendix A - Holding company peer group

Exhibits 10 and 11 list the 42 regulated utility holding companies from which financial figures were derived by aggregating the annual data from 2007-2017 and applying key assumptions (see Appendix D) to drive our forecast scenarios. These companies were selected based on having ten years of historical data.

Exhibit 10

Companies 1-22 of 42 holding companies, sorted by highest to lowest consolidated CFO / Debt
$ in millions, as of the last twelve months available

Issuer	Rating and Outlook	CFO	Total Debt	CFO / Debt	Equity	Capex	Dividends
PG&E Corporation	Baa1 Negative	$ 5,908	$ 21,352	28%	$ 19,576	$ 5,900	$ 766
ALLETE, Inc.	A3 Negative	$ 465	$ 1,747	27%	$ 2,088	$ 275	$ 111
OGE Energy Corp.	A3 Negative	$ 851	$ 3,346	25%	$ 3,800	$ 728	$ 254
Edison International	A3 Negative	$ 3,749	$ 15,920	24%	$ 12,692	$ 4,072	$ 790
Vectren Utility Holdings, Inc.	A2 Stable	$ 419	$ 1,816	23%	$ 1,766	$ 569	$ 125
Ameren Corporation	Baa1 Stable	$ 2,040	$ 9,477	22%	$ 7,230	$ 2,264	$ 441
Pinnacle West Capital Corporation	A3 Stable	$ 1,205	$ 5,661	21%	$ 5,005	$ 1,439	$ 295
WEC Energy Group, Inc.	A3 Rating(s) Under Review	$ 2,292	$ 10,809	21%	$ 10,067	$ 2,080	$ 679
Public Service Enterprise Group Incorporated	Baa1 Stable	$ 3,053	$ 14,503	21%	$ 14,006	$ 4,049	$ 879
NextEra Energy, Inc.	Baa1 Stable	$ 6,437	$ 31,715	20%	$ 33,116	$ 9,035	$ 2,040
IDACORP, Inc.	Baa1 Stable	$ 440	$ 2,178	20%	$ 2,267	$ 281	$ 113
Exelon Corporation	Baa2 Stable	$ 8,073	$ 40,215	20%	$ 30,241	$ 7,612	$ 1,274
WGL Holdings, Inc.	A3 Negative	$ 505	$ 2,683	19%	$ 1,733	$ 466	$ 105
CMS Energy Corporation	Baa1 Stable	$ 1,782	$ 9,930	18%	$ 4,535	$ 1,739	$ 382
CenterPoint Energy, Inc.	Baa1 Negative	$ 1,635	$ 9,253	18%	$ 4,857	$ 1,485	$ 466
Evergy, Inc.	Baa2 Stable	$ 879	$ 4,980	18%	$ 4,920	$ 595	$ 257
DTE Energy Company	Baa1 Stable	$ 2,414	$ 13,894	17%	$ 10,064	$ 2,266	$ 659
American Electric Power Company, Inc.	Baa1 Stable	$ 4,413	$ 25,446	17%	$ 18,391	$ 6,505	$ 1,207
Consolidated Edison, Inc.	A3 Negative	$ 3,261	$ 18,992	17%	$ 15,514	$ 3,701	$ 814
Pepco Holdings, LLC	Baa2 Stable	$ 1,068	$ 6,267	17%	$ 9,488	$ 1,367	$ 313
PNM Resources, Inc.	Baa3 Positive	$ 493	$ 3,048	16%	$ 1,689	$ 524	$ 80
Puget Energy, Inc.	Baa3 Stable	$ 974	$ 6,066	16%	$ 3,649	$ 1,087	$ 153

Source: Moody's Investors Service

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Appendix A (continued) - Holding company peer group

Exhibit 11

Companies 23-42 of 42 holding companies, sorted by highest to lowest consolidated CFO / Debt

$ in millions, as of the last twelve months available

Issuer	Rating and Outlook	CFO	Total Debt	CFO / Debt	Equity	Capex	Dividends
Hawaiian Electric Industries, Inc.	WR Stable	$ 418	$ 2,614	16%	$ 2,117	$ 546	$ 137
Berkshire Hathaway Energy Company	A3 Stable	$ 6,287	$ 42,392	15%	$ 28,667	$ 4,886	$ -
TECO Energy, Inc.	Baa2 Stable	$ 624	$ 4,276	15%	$ 2,879	$ 709	$ -
Black Hills Corporation	Baa2 Stable	$ 483	$ 3,331	15%	$ 1,871	$ 338	$ 101
Alliant Energy Corporation	Baa1 Negative	$ 873	$ 6,036	14%	$ 4,217	$ 1,520	$ 284
Entergy Corporation	Baa2 Negative	$ 2,909	$ 20,475	14%	$ 7,806	$ 3,940	$ 634
Spire Inc.	Baa2 Stable	$ 400	$ 2,872	14%	$ 2,138	$ 474	$ 102
Southern Company (The)	Baa2 Negative	$ 7,220	$ 52,269	14%	$ 26,339	$ 9,251	$ 2,505
SCANA Corporation	Ba1 Rating(s) Under Review	$ 956	$ 7,189	13%	$ 5,305	$ 1,114	$ 349
PPL Corporation	Baa2 Stable	$ 2,990	$ 22,682	13%	$ 11,409	$ 3,287	$ 1,098
Sempra Energy	Baa1 Negative	$ 3,627	$ 28,450	13%	$ 15,532	$ 3,994	$ 904
Duke Energy Corporation	Baa1 Negative	$ 6,849	$ 55,677	12%	$ 41,554	$ 8,043	$ 2,455
Eversource Energy	Baa1 Stable	$ 1,906	$ 15,542	12%	$ 11,219	$ 2,440	$ 615
Duquesne Light Holdings, Inc.	Baa3 Stable	$ 318	$ 2,596	12%	$ 1,078	$ 300	$ 103
Dominion Energy, Inc.	Baa2 Negative	$ 4,329	$ 38,692	11%	$ 18,857	$ 5,436	$ 2,050
NiSource Inc.	Baa2 Stable	$ 1,008	$ 9,429	11%	$ 4,435	$ 1,791	$ 238
FirstEnergy Corp.	Baa3 Stable	$ 2,247	$ 22,839	10%	$ 8,470	$ 3,002	$ 672
Cleco Corporate Holdings LLC	Baa3 Rating(s) Under Review	$ 287	$ 2,929	10%	$ 2,070	$ 252	$ 75
DPL Inc.	Ba2 Positive	$ 157	$ 1,692	9%	$ (536)	$ 107	$ -
IPALCO Enterprises, Inc.	Baa3 Stable	$ 253	$ 2,747	9%	$ 564	$ 179	$ 107

Source: Moody's Investors Service

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Appendix B - Operating company peer group

Exhibits 12-15 list 102 operating companies that were analyzed as part of our financial comparisons. These companies were selected based on having ten years of historical data. Our base case scenario shows the aggregate cash flow to debt ratios of these companies dropping by 400 basis points over the next 12-18 months.

Exhibit 12

Companies 1-30 of 102 operating companies, sorted by highest to lowest CFO / Debt

$ in millions, as of the last twelve months available

Issuer	Rating and Outlook	CFO	Total Debt	CFO / Debt	Capex	Dividends
Metropolitan Edison Company	A3 Stable	$ 458	$ 1,060	43%	$ 152	$ 80
Atmos Energy Corporation	A2 Stable	$ 1,095	$ 3,371	32%	$ 1,300	$ 203
Southern California Gas Company	A1 Stable	$ 1,299	$ 4,111	32%	$ 1,433	$ 1
Baltimore Gas and Electric Company	A3 Stable	$ 945	$ 3,029	31%	$ 921	$ 199
Pennsylvania Power Company	Baa1 Stable	$ 64	$ 217	30%	$ 51	$ 20
Gulf Power Company	A2 Stable	$ 420	$ 1,420	30%	$ 235	$ 175
Tampa Electric Company	A3 Stable	$ 744	$ 2,530	29%	$ 660	$ 324
Duquesne Light Company	A3 Stable	$ 387	$ 1,321	29%	$ 282	$ 90
Madison Gas and Electric Company	A1 Stable	$ 136	$ 473	29%	$ 131	$ 32
Spire Alabama Inc.	A2 Stable	$ 136	$ 476	29%	$ 121	$ 32
Wisconsin Public Service Corporation	A2 Stable	$ 414	$ 1,465	28%	$ 363	$ 120
Kentucky Utilities Co.	A3 Stable	$ 690	$ 2,460	28%	$ 496	$ 235
Pacific Gas & Electric Company	A3 Negative	$ 5,860	$ 21,051	28%	$ 5,931	$ 542
Florida Power & Light Company	A1 Stable	$ 3,764	$ 13,562	28%	$ 4,728	$ 1,050
Consumers Energy Company	(P)A2 Stable	$ 1,865	$ 6,734	28%	$ 1,702	$ 494
Indiana Gas Company, Inc.	A2 Stable	$ 159	$ 574	28%	$ 209	$ -
Tucson Electric Power Company	A3 Stable	$ 435	$ 1,596	27%	$ 401	$ 70
Southern California Edison Company	A2 Negative	$ 3,777	$ 13,937	27%	$ 3,981	$ 657
Puget Sound Energy, Inc.	Baa1 Stable	$ 1,120	$ 4,136	27%	$ 1,036	$ 262
Northern States Power Company (Minnesota)	A2 Stable	$ 1,425	$ 5,296	27%	$ 920	$ 516
New Jersey Natural Gas Company	Aa2 Negative	$ 205	$ 764	27%	$ 185	$ 68
Louisville Gas & Electric Company	A3 Stable	$ 529	$ 2,021	26%	$ 527	$ 139
PPL Electric Utilities Corporation	A3 Stable	$ 937	$ 3,583	26%	$ 1,224	$ 332
Entergy New Orleans, Inc.	Ba1 Stable	$ 139	$ 533	26%	$ 130	$ 69
Ohio Power Company	A2 Stable	$ 655	$ 2,539	26%	$ 634	$ 178
MidAmerican Energy Company	A1 Stable	$ 1,391	$ 5,529	25%	$ 1,887	$ -
San Diego Gas & Electric Company	A1 Negative	$ 1,566	$ 6,246	25%	$ 1,613	$ 275
Oklahoma Gas & Electric Company	A1 Negative	$ 783	$ 3,121	25%	$ 727	$ 105
Southwestern Public Service Company	Baa1 Negative	$ 495	$ 1,988	25%	$ 555	$ 105
Central Hudson Gas & Electric Corporation	A2 Stable	$ 156	$ 636	24%	$ 171	$ 9

Source: Moody's Investors Service

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Exhibit 13

Companies 31-60 of 102 operating companies, sorted by highest to lowest CFO / Debt

$ in millions, as of the last twelve months available

Issuer	Rating and Outlook	CFO	Total Debt	CFO / Debt	Capex	Dividends
Northern Illinois Gas Company	A2 Stable	$ 284	$ 1,205	24%	$ 601	$ 70
Questar Gas Company	A2 Negative	$ 192	$ 819	23%	$ 231	$ -
Arizona Public Service Company	A2 Stable	$ 1,229	$ 5,280	23%	$ 1,410	$ 324
Black Hills Power, Inc.	A3 Stable	$ 81	$ 351	23%	$ 75	$ -
Public Service Company of Colorado	A3 Stable	$ 1,166	$ 5,075	23%	$ 1,593	$ 336
Alabama Power Company	A1 Negative	$ 1,883	$ 8,204	23%	$ 2,192	$ 734
Duke Energy Carolinas, LLC	A1 Stable	$ 2,510	$ 10,995	23%	$ 2,575	$ 700
Sierra Pacific Power Company	Baa1 Stable	$ 272	$ 1,194	23%	$ 193	$ 43
Connecticut Natural Gas Corporation	A3 Stable	$ 55	$ 245	23%	$ 64	$ 7
Avista Corp.	Baa1 Negative	$ 447	$ 1,993	22%	$ 407	$ 94
UGI Utilities, Inc.	A2 Stable	$ 256	$ 1,144	22%	$ 328	$ 63
Piedmont Natural Gas Company, Inc.	A2 Negative	$ 500	$ 2,254	22%	$ 559	$ -
Union Electric Company	Baa1 Stable	$ 1,008	$ 4,554	22%	$ 883	$ 355
Rochester Gas & Electric Corporation	A3 Stable	$ 237	$ 1,077	22%	$ 279	$ -
Orange and Rockland Utilities, Inc.	A3 Negative	$ 224	$ 1,019	22%	$ 198	$ 45
Nevada Power Company	Baa1 Stable	$ 694	$ 3,178	22%	$ 283	$ 473
DTE Electric Company	A2 Stable	$ 1,639	$ 7,513	22%	$ 1,560	$ 439
Portland General Electric Company	A3 Stable	$ 603	$ 2,766	22%	$ 520	$ 118
Wisconsin Power and Light Company	A2 Negative	$ 456	$ 2,098	22%	$ 607	$ 129
Duke Energy Indiana, LLC.	A2 Stable	$ 926	$ 4,279	22%	$ 902	$ 300
PacifiCorp	A3 Stable	$ 1,586	$ 7,337	22%	$ 839	$ 750
PECO Energy Company	A2 Stable	$ 680	$ 3,192	21%	$ 756	$ 507
Duke Energy Kentucky, Inc.	Baa1 Stable	$ 103	$ 487	21%	$ 222	$ -
Mississippi Power Company	Ba1 Positive	$ 453	$ 2,153	21%	$ 249	$ (1)
Northern States Power Company (Wisconsin)	A2 Stable	$ 172	$ 825	21%	$ 220	$ 69
Westar Energy, Inc.	Baa1 Stable	$ 957	$ 4,602	21%	$ 778	$ 228
Otter Tail Power Company	A3 Stable	$ 125	$ 603	21%	$ 121	$ 40
Public Service Company of New Hampshire	A3 Stable	$ 287	$ 1,393	21%	$ 313	$ 155
Public Service Electric and Gas Company	A2 Stable	$ 1,829	$ 8,914	21%	$ 2,848	$ -
United Illuminating Company	Baa1 Stable	$ 234	$ 1,154	20%	$ 167	$ 125

Source: Moody's Investors Service

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Appendix B (continued) - Operating company peer group

Exhibit 14

Companies 61-90 of 102 operating companies, sorted by highest to lowest CFO / Debt

$ in millions, as of the last twelve months available

Issuer	Rating and Outlook	CFO	Total Debt	CFO / Debt	Capex	Dividends
Spire Missouri Inc.	A1 Stable	$ 267	$ 1,329	20%	$ 294	$ 14
NSTAR Electric Company	A2 Stable	$ 696	$ 3,489	20%	$ 757	$ 378
Delmarva Power & Light Company	Baa1 Stable	$ 324	$ 1,624	20%	$ 421	$ 118
Cleco Power LLC	A3 Stable	$ 305	$ 1,574	19%	$ 242	$ 128
CenterPoint Energy Houston Electric, LLC	A3 Stable	$ 985	$ 5,102	19%	$ 895	$ 180
Dayton Power & Light Company	Baa3 Positive	$ 134	$ 697	19%	$ 91	$ (96)
Virginia Electric and Power Company	A2 Stable	$ 2,562	$ 13,409	19%	$ 2,607	$ 908
Public Service Company of New Mexico	Baa2 Positive	$ 365	$ 1,937	19%	$ 324	$ 61
Washington Gas Light Company	A1 Negative	$ 279	$ 1,487	19%	$ 349	$ 87
Kansas City Power & Light Company	Baa1 Stable	$ 674	$ 3,592	19%	$ 463	$ 215
Oncor Electric Delivery Company LLC	A2 Stable	$ 1,541	$ 8,234	19%	$ 1,678	$ 151
El Paso Electric Company	Baa1 Negative	$ 284	$ 1,525	19%	$ 242	$ 54
Southern Indiana Gas & Electric Company	A2 Stable	$ 157	$ 849	19%	$ 154	$ 55
Appalachian Power Company	Baa1 Stable	$ 828	$ 4,486	18%	$ 828	$ 130
Georgia Power Company	A3 Negative	$ 2,180	$ 11,808	18%	$ 2,942	$ 1,302
Potomac Electric Power Company	Baa1 Stable	$ 502	$ 2,717	18%	$ 614	$ 128
Duke Energy Progress, LLC	A2 Stable	$ 1,489	$ 8,329	18%	$ 1,701	$ 124
Texas-New Mexico Power Company	A3 Stable	$ 93	$ 524	18%	$ 162	$ 36
Public Service Company of Oklahoma	A3 Negative	$ 286	$ 1,606	18%	$ 248	$ 65
Connecticut Light and Power Company	Baa1 Rating(s) Under Review	$ 703	$ 3,977	18%	$ 855	$ 268
Public Service Co. of North Carolina, Inc.	A3 Rating(s) Under Review	$ 131	$ 740	18%	$ 289	$ 41
Consolidated Edison Company of New York, Inc.	A2 Negative	$ 2,743	$ 15,877	17%	$ 3,190	$ 808
Hawaiian Electric Company, Inc.	Baa2 Stable	$ 340	$ 2,007	17%	$ 475	$ 94
DTE Gas Company	A2 Negative	$ 286	$ 1,692	17%	$ 434	$ 106
CenterPoint Energy Resources Corp.	Baa2 Stable	$ 492	$ 2,918	17%	$ 537	$ 579
Entergy Arkansas, Inc.	Baa1 Stable	$ 637	$ 3,780	17%	$ 798	$ 16
Northwest Natural Gas Company	A3 Negative	$ 183	$ 1,093	17%	$ 235	$ 53
Duke Energy Ohio, Inc.	Baa1 Positive	$ 418	$ 2,502	17%	$ 734	$ 25
Atlantic City Electric Company	Baa2 Positive	$ 219	$ 1,338	16%	$ 299	$ 67
Southwestern Electric Power Company	Baa2 Stable	$ 475	$ 2,923	16%	$ 472	$ 116

Source: Moody's Investors Service

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Appendix B (continued) - Operating company peer group

Exhibit 15

Companies 91-102 of 102 operating companies, sorted by highest to lowest CFO / Debt

$ in millions, as of the last twelve months available

Issuer	Rating and Outlook	CFO	Total Debt	CFO / Debt	Capex	Dividends
Idaho Power Company	A3 Stable	$ 386	$ 2,418	16%	$ 274	$ 115
Entergy Mississippi, Inc.	Baa1 Stable	$ 239	$ 1,513	16%	$ 412	$ 26
Entergy Texas, Inc.	Baa3 Stable	$ 257	$ 1,627	16%	$ 369	$ -
NorthWestern Corporation	Baa2 Stable	$ 339	$ 2,166	16%	$ 277	$ 103
Wisconsin Electric Power Company	A2 Stable	$ 861	$ 5,665	15%	$ 685	$ 241
Commonwealth Edison Company	A3 Stable	$ 1,436	$ 9,489	15%	$ 2,163	$ 434
Berkshire Gas Company	A3 Positive	$ 10	$ 68	14%	$ 17	$ -
Duke Energy Florida, LLC.	A3 Stable	$ 1,072	$ 7,577	14%	$ 1,256	$ -
South Carolina Electric & Gas Company	Baa3 Rating(s) Under Review	$ 754	$ 5,504	14%	$ 813	$ 322
Kentucky Power Company	Baa2 Negative	$ 129	$ 946	14%	$ 110	$ 26
Interstate Power and Light Company	Baa1 Negative	$ 338	$ 2,834	12%	$ 756	$ 154
South Jersey Gas Company	A2 Negative	$ 99	$ 994	10%	$ 246	$ 20

Source: Moody's Investors Service

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Appendix C - Holding company capital spending peer group

The 25 holding companies incorporated into Exhibit 5 were selected based upon having 3-year publicly disclosed capital spending projections since in every year since 2009 and being a part of our larger 42 holding company peer group. Those companies are listed in Exhibit 16 below, sorted by rating category.

Exhibit 16

Capital spending for 25 holding companies has increased, in aggregate, year-over-year since 2016
($ millions)

		Capital Expenditures		
		2016	2017	LTM Mar 18
Consolidated Edison, Inc.	A3 Negative	$ 3,898	$ 3,703	$ 3,701
Edison International	A3 Negative	$ 3,790	$ 3,879	$ 4,072
OGE Energy Corporation	A3 Negative	$ 660	$ 810	$ 728
Pinnacle West Capital Corporation	A3 Stable	$ 1,289	$ 1,424	$ 1,439
Xcel Energy, Inc.	A3 Stable	$ 3,225	$ 3,238	$ 3,363
Alliant Energy Corporation	Baa1 Negative	$ 1,182	$ 1,456	$ 1,520
Ameren Corporation	Baa1 Stable	$ 2,164	$ 2,204	$ 2,264
American Electric Power Company, Inc.	Baa1 Stable	$ 5,039	$ 5,945	$ 6,505
CenterPoint Energy, Inc.	Baa1 Negative	$ 1,423	$ 1,435	$ 1,485
CMS Energy Corporation	Baa1 Stable	$ 1,689	$ 1,682	$ 1,739
DTE Energy Company	Baa1 Stable	$ 2,082	$ 2,294	$ 2,266
PG&E Corporation	Baa1 Negative	$ 5,662	$ 5,646	$ 5,900
Duke Energy Corporation	Baa1 Negative	$ 8,089	$ 8,116	$ 8,043
Public Service Enterprise Group Inc.	Baa1 Stable	$ 4,098	$ 4,058	$ 4,049
Sempra Energy	Baa1 Negative	$ 4,153	$ 3,951	$ 3,994
Dominion Energy, Inc.	Baa2 Negative	$ 6,054	$ 5,768	$ 5,436
Entergy Corporation	Baa2 Negative	$ 4,005	$ 3,900	$ 3,940
Exelon Corporation	Baa2 Stable	$ 8,672	$ 7,741	$ 7,612
Evergy, Inc.	Baa2 Stable	$ 626	$ 591	$ 595
NiSource Inc.	Baa2 Stable	$ 1,517	$ 1,733	$ 1,791
PPL Corporation	Baa2 Stable	$ 2,999	$ 3,210	$ 3,287
Southern Company (The)	Baa2 Negative	$ 7,537	$ 8,940	$ 9,251
FirstEnergy Corporation	Baa3 Stable	$ 3,253	$ 3,117	$ 3,002
PNM Resources, Inc.	Baa3 Positive	$ 622	$ 521	$ 524
SCANA Corporation	Ba1 Rating(s) Under Review	$ 1,566	$ 1,229	$ 1,114
Group Total		**$ 85,291**	**$ 86,592**	**$ 87,620**

Source: Company 10K filings, Moody's standard adjustments

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Appendix D - 2018-2022 forecast assumptions

Key Base Case assumptions

- Projected numbers are based on the consolidated financials of a fully regulated utility holding company
- "Forward test year" (e.g., 2019 net income is derived from 2018 rate base plus 2019 capex less 2019 depreciation less 2019 deferred tax liability (DTL), adjusted for normalization of excess DTLs returned to customers)
- 50% equity layer used for rate making purposes, as opposed to the holding company capital structure that is roughly 60/40 debt/equity
- Cash tax rates: 2018- 0%, 2019- 0%, 2020- 5%, 2021- 10%, 2022- 15%
- Additional cash inflow from operations that exactly offsets the cash outflow due to normalized excess deferred tax liabilities returned to customers
- Capex - 5 year projected CAGR is 5.0% versus the 5 year historical CAGR of 5.7%
- Dividend growth is set to match Net Income growth, which is roughly 8% year-over-year
- $20 billion of equity issuance in 2018 to reflect holdco efforts to strengthen their balance sheets
- Funding percentage of negative free cash flow is 88/12 debt/equity; set to keep debt and equity CAGR equivalent at about 6%

Key differences in Upside Case assumptions

- 53% equity layer in rates
- Cash tax rates: 2018- 0%, 2019- 0%, 2020- 3%, 2021- 5%, 2022- 10%
- Regulators approve a cash inflow that is twice the size of the cash outflow due to normalized excess deferred tax liabilities returned to customers
- 2019 Capex is flat to 2018 and declines 5% year-over-year thereafter
- Funding percentage of negative free cash flow is 60/40 debt/equity (debt CAGR of 2%, equity CAGR of 7%)

Key differences in Downside Case assumptions

- 4% inflation on O&M, Taxes and Other OpEx
- Regulators approve a cash inflow that is half the size of the cash outflow due to normalized excess deferred tax liabilities returned to customers
- 7% Capex growth year-over-year
- Funding of negative free cash flow is 100% debt (debt CAGR of 7.8% vs. equity CAGR of 5.0%)

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Moody's related publications

Sector In-Depth:

» Offshore Wind is Ready for Prime Time 29 March 2018

» Tax Reform is Credit Negative for Regulated Utilities Sector, but Impact Varies by Company 24 January 2018

» Cross-Sector – US: FAQ on the Credit Impact of New Tax Law 24 January 2018

» Cross-Sector – US: Corporate Tax Cut is Credit Positive, While Effects of Other Provisions Vary by Sector 21 December 2017

» Regulated Electric & Gas Utilities – US: Insulating Utilities from Parent Contagion Risk is Increasingly a Focus of Regulators 18 September 2017

» Renewable Energy - Global: Falling Cost of Renewables Reduces Risks to Paris Agreement Compliance 6 September 2017

» Renewable Energy – Global: Renewables Sector Risks Shift as Competition Reduces Reliance on Government Subsidy 6 September 2017

Rating Methodologies:

» Regulated Electric and Gas Utilities 23 June 2017

» Unregulated Utilities and Unregulated Power Companies 17 May 2017

» Regulated Electric and Gas Networks 16 March 2017

» U.S. Electric Generation & Transmission 15 April 2013

» Natural Gas Pipelines 6 November 2012

Endnotes

1 Our cash flow analysis consists of three primary measures, including: cash flow from operations (CFO), funds from operations (FFO) and CFO before changes in working capital. For purposes of this report we reference FFO due to our forecast scenarios' focus on Net Income, Depreciation and Deferred Taxes (including regulatory liabilities associated with deferred taxes).

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