

**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	:	
DEFENDANT.	:	
	:	

**BRIEF OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.**

Kentucky Industrial Utility Customers, Inc. (“KIUC”) submits this Brief in support of its recommendations to the Kentucky Public Service Commission (“Commission”). KIUC recommends that the Commission approve the January 29, 2018 Offer and Acceptance (“Settlement”) filed by Kentucky Utilities Company and Louisville Gas and Electric Company (collectively, “Companies”) as updated June 11, 2018. The update increased the Tax Cuts and Jobs Act (“TCJA”) Surcredit by \$3.4 million, from \$135.5 million to \$138.9 million.

PROCEDURAL BACKGROUND

This matter was initiated on December 21, 2017, when KIUC filed a formal Complaint alleging that in light of the TCJA, the Companies’ rates were no longer fair, just, and reasonable as required by KRS 278.030(1). Less than a month later, the Companies, KIUC and the Attorney General (“AG”) began meeting at the Commission with Staff to develop a reasonable method by which to pass the net TCJA savings back to customers as quickly as possible. Those meetings were extremely efficient and led to the Settlement filed on January 29, 2018, in which the parties unanimously recommended that the Companies begin flowing back a \$135.5 million

TCJA Surcredit to customers effective April 1, 2018. Because of the allocation agreed to by the Parties, the Residential TCJA Surcredit was larger than the Non-Residential TCJA Surcredit.

On March 20, 2018, the Commission approved the Settlement, but significantly modified the level of the TCJA Surcredit. Citing a concern about the lack of Commission scrutiny over certain incremental adjustments to capitalization used to calculate the TCJA Surcredit, the Commission instead determined that it was more appropriate to use the capitalization from the Companies' most recent base rate cases.¹ This increased the level of the TCJA Surcredit by 20%, from \$135.5 million to \$162.4 million.² Shortly thereafter, the Companies filed notice of their intent to withdraw from the Settlement and petitioned the Commission for reconsideration of the Order.

On March 28, 2018, the Commission granted the Companies' petition, allowing the Companies to implement the TCJA Surcredit at the levels proposed in the Settlement effective April 1, 2018 on an interim basis during the pendency of the rehearing.

In light of the Commission's March 28, 2018 decision, the Companies filed a letter offer to reinstate the terms of the Settlement on March 30, 2018, which KIUC accepted. The Attorney General, however, opted to withdraw from the Settlement. The case went to hearing on May 24, 2018, after which the Commission gave Staff and other parties the opportunity to serve post-hearing data responses on the Companies, which the Companies responded to on June 11, 2018.

ARGUMENT

I. The Incremental Capitalization Adjustments Recommended In The Settlement Have Now Been Subjected To Commission Investigation And Review.

The Commission's sole rationale for rejecting the use of certain incremental adjustments to the Companies' capitalization was that those adjustments "*have not been subjected to the Commission's*

¹ March 20, 2018 Order ("Order") at 7-8.

² Order, Appendix A.

investigation and review.”³ Since that decision, however, those incremental adjustments have been carefully scrutinized.

Prior to the March 20, 2018 Order, the record supporting the Settlement included the January 29, 2018 Direct Testimony and Exhibits of Kent W. Blake and 8 Staff data requests and responses by the Companies (including subparts). But the record greatly expanded on rehearing. Indeed, in the second phase of this case, the Companies filed Rehearing Testimony specifically addressing and supporting the incremental adjustments to capitalization used in the Settlement, responded to 73 additional data requests (including subparts), and appeared before the Commission in an evidentiary hearing to explain the incremental capitalization adjustments. The details of the Settlement have thus been explored in two sets of expert testimony, 81 data requests (including subparts), and through cross-examination at hearing.

Because the record on the incremental capitalization adjustments recommended in the Settlement has now been fully developed, there is substantial evidence to support the Settlement and the Commission’s previous rationale for rejecting those adjustments is no longer applicable. Therefore, having addressed the Commission’s evidentiary concerns, KIUC recommends approval of the Settlement.

II. The Incremental Capitalization Adjustments And Updated Interest Expense Recommended In The Settlement Are Reasonable And Should Be Adopted.

There are multiple different methodologies that could be used to calculate the TCJA’s impact on the Companies, and the methodology used in the Settlement is reasonable. That methodology calculated the tax expense difference between old capitalization using a higher tax rate (35%) and updated capitalization using a lower tax rate (21%). After updating for interest rate changes, the end result was a substantial and timely refund to customers with very little litigation expense or administrative burden.

Unlike the other two Kentucky investor-owned electric utilities, the Companies were not involved in base rate cases when the TCJA became effective on January 1, 2018. Consequently, in order to provide a mechanism to quickly flow back TCJA-related savings to customers outside of a base rate case, the Settlement recommended

³ Order at 7.

establishing a temporary TCJA Surcredit. That Surcredit would provide sixteen months of TCJA-related savings (from January 1, 2018 through April 30, 2019) to customers over a 13-month period. Because known and measurable changes were expected to impact the Companies' capitalization and interest expense during the sixteen-month period used to calculate the TCJA Surcredit, the Settlement allowed the Companies to reflect those changes. This had the effect of treating all four investor-owned electric utilities the same.

The process and methodology used in the Settlement complied with the law. The Kentucky Supreme Court has held that the Commission may approve isolated rate adjustments outside the context of a base rate case so long as the end result is reasonable, explaining "*because the [Kentucky] statutes generally recognize a duty to establish 'fair, just, and reasonable' rates without necessarily requiring a particular procedure to deal with isolated ratemaking issues, the Hope doctrine that '[it is] the result reached rather than the method employed which is controlling' is applicable.*"⁴

As discussed below, the disputed incremental adjustments fall into three general categories: 1) capitalization adjustments directly related to the TCJA (\$9.92 million revenue requirement effect); 2) other incremental adjustments to capitalization (\$6.15 million revenue requirement effect); and 3) adjustments to reflect the impact of market interest rate changes on the Companies' cost of debt (\$7.93 million revenue requirement effect).⁵

A. The Incremental Capitalization Adjustments Recommended In The Settlement Are Reasonable.

The first category – adjustments directly related to the TCJA – recognizes the incremental cash taxes that will be paid by the Companies as a result of the TCJA'S elimination of "*bonus depreciation*," which were not anticipated in the capitalization from the Companies' last base rate cases.⁶ Those adjustments also recognize the

⁴ Ky. PSC v. Commonwealth ex rel. Conway, 324 S.W.3d 373, 383 (2010) (citing National-Southwire, 785 S.W.2d at 510, citing Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944)).

⁵ Companies Response to KIUC Post-Hearing Data Requests (May 25, 2018) ("Responses to KIUC"), Question No. 1, Attachment 1.

⁶ Direct Testimony on Rehearing of Kent W. Blake (April 6, 2018) ("Blake Rehearing Testimony") at 11:1-4 (*Further, 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.*”).

additional cash outlays that the Companies must incur in order to provide TCJA-related refunds to customers.⁷ As Mr. Blake explained, “*the Companies must entirely finance the TCJA Surcredit and rate mechanism reductions attributable to the TCJA....the TCJA savings to be returned to customers through the TCJA Surcredit and other rate mechanisms are a reduction in cash revenues received from customers without a corresponding reduction in cash expenses given each Company’s net operating loss position.*”⁸ Hence, these incremental adjustments are simply intended to keep the Companies whole as a result of implementing the TCJA.⁹ Without this adjustment, customers would be getting more than 100% of the TCJA savings.

The second category – other adjustments to capitalization – is primarily related to an increase in pension contributions relative to the Companies’ last base rate cases.¹⁰ Retaining these adjustments would treat the Companies similarly to the other Kentucky utilities who had active base rate cases when the TCJA was implemented. While this second category is not directly related to the TCJA, these adjustments are reasonable because they provide for a fair approximation of the Companies’ capitalization during the 16-month period covered by the TCJA Surcredit.

B. The Updated Interest Expense Recommended In The Settlement Is Reasonable.

The third category – adjustments to reflect known and measurable changes in the Companies’ cost of debt since their base rates were enacted – is both reasonable and supported by the record in this proceeding.¹¹ Since the Companies’ last base rate cases were filed, the Federal Reserve has repeatedly increased its targeted federal funds interest rates.¹² Consequently, reverting to the debt rates from the Companies’ last base rate cases “*would not allow the Companies to recover their cost of debt*” over the life of the TCJA Surcredit.¹³ Mr. Blake also noted that “[*t*]he 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. Additionally, a portion of the

⁷ Responses to KIUC, Question Nos. 1 and 2.

⁸ Blake Rehearing Testimony at 15 (“*The Companies believe an adjustment to reflect current interest rates should be considered in calculating the TCJA Surcredit because updated interest figures are rationally related to the increase in capitalization, readily available, known and measurable.*”).

⁹ Responses to KIUC, Question No. 2.

¹⁰ Id.

¹¹ Id.; Blake Rehearing Testimony at 14:1-15:10.

¹² Id. at 14:6-10.

¹³ Id. at 14:13-16.

Companies' updated cost of debt impact is due to increased interest rates on incremental financing that is a direct impact of the TCJA."¹⁴ It therefore makes sense to allow the Companies to adjust its cost of debt – much of which was incurred to fund the TCJA Surcredit – to reflect interest rate increases during the sixteen-month period covered by the TCJA Surcredit.

III. The Commission Should Adopt Staff's Modified Gross-Up Factor To Calculate The TCJA Credit.

At the evidentiary hearing, Staff provided a correction to the calculation of the tax gross-up factor used to determine the TCJA Surcredit. This corrected gross-up factor results in a \$519,202 increase in the TCJA Surcredit, to the benefit of customers.¹⁵ The Companies concede that Staff has correctly calculated the tax gross-up factor.¹⁶ Consequently, the Commission should adopt Staff's corrected tax gross-up factor. The June 11, 2018 update to increase the TCJA Surcredit by \$3.4 million, from \$135.5 million to \$138.9 million incorporates this Staff correction.

CONCLUSION

Ratemaking is not an exact science. The balancing of competing interests is involved, as is judgment. In the context of a Settlement it was reasonable to allow the Companies to make adjustments for known and measurable changes. Allowing for such adjustments also served to recognize the Companies' expeditious efforts to flow TCJA-related refunds back to customers. Without compromise and cooperation, the parties might still be litigating the legal right of customers to a single-issue TCJA Surcredit instead of having the luxury of merely finalizing the exact amount of the refund.

¹⁴ Blake Rehearing Testimony at 15:4-8.

¹⁵ Responses to KIUC, Question No. 1.

¹⁶ Responses to KIUC, Question No. 3.

WHEREFORE, the Commission should approve the updated TCJA Settlement of \$138,880,023.

Respectfully submitted,



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June 28, 2018

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