COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ATTORNEY GENERAL'S POST-HEARING BRIEF

Comes now, the Attorney General of the Commonwealth of Kentucky, Andy Beshear, by and through his Office of Rate Intervention, and in accordance with the Commission's May 29, 2018 Procedural Order, hereby provides his Post-Hearing Brief in this Matter.

INTRODUCTION

The crux of this matter is relatively straight-forward. Following the passage of the Tax Cuts and Jobs Act ("TCJA") and the subsequent reduction of the Federal corporate income tax rate, Louisville Gas and Electric's and Kentucky Utilities' rates were no longer fair, just, and reasonable. As such, the parties to this matter, Louisville Gas and Electric ("LG&E"), Kentucky Utilities ("KU"), Kentucky Industrial Utility Customers ("KIUC") and the Attorney General of the Commonwealth of Kentucky ("Attorney General") seem to be in general agreement that with the passage of the TCJA, LG&E's and KU's (collectively, "the Companies")'s customers should see their rates reduced. The question before the Commission is, "by how much should the rates be reduced?" It is apparent from the record that the Companies and KIUC agree on what the rate reduction should be: approximately $175M, representing what they believe to be the savings (less incremental costs) for the 16-month

period from January 1, 2018 to April 30, 2019, passed back to customers over a 13-month period running from April 1, 2018 to April 30, 2019. The Attorney General was a signatory to the previous Offer and Acceptance of Satisfaction ("First Stipulation") filed with the Commission on January 29, 2018. On March 20, 2018, the Commission found that some of the adjustments made in the First Stipulation were not supported by evidence by stating that they "have not been subjected to the Commission's investigation and review."[1] The Companies subsequently withdrew from the First Stipulation and requested rehearing based on, *inter alia*, an assertion that the Commission's March 20, 2018 Order deprived them of procedural due process.[2] Regardless of the fact that the parties to the First Stipulation, and in particular the Companies, failed to adequately support the adjustments, the Commission granted rehearing "to allow the record to be more fully developed on the limited issues raised in the petition of the modification of capitalization and costs of capital."[3] Upon receipt of the Attorney General's response to the Companies' petition for rehearing and notice of his withdrawal from the First Stipulation, the Commission issued another order amending the March 28, 2018 Order granting rehearing, to allow for any party to "raise any relevant issue related to the TCJA."[4] KIUC and the Companies later reinstated the terms of the Offer and Acceptance of Satisfaction ("Second Stipulation"), which essentially is identical to the First Stipulation. Following rounds of discovery and a hearing in this matter, the parties are to submit simultaneous post-hearing briefs on or before June 29, 2018 and the case is to be submitted for decision the following day. In support of his belief that the Second Stipulation

[1] Order, Case No. 2018-00034 (Mar. 20, 2018) at 7.
[2] Petition for Reconsideration and Request for Hearing, Case No. 2018-00034 (March 26, 2018) at 6.
[3] Order, Case No. 2018-000034 (Mar. 28, 2018) at 3.
[4] Order, Case No. 2018-000034 (Mar. 30, 2018) at 2.

and Offer and Acceptance of Satisfaction is not in the customers' best interest, the Attorney General hereby provides support for his position.

ARGUMENT

Definition and Treatment of Certain "Unprotected" Excess ADIT

In calculating the surcredit amount stemming from the Second Stipulation, the Companies treated all "property-related" "unprotected" excess ADITs, such as tax repairs, as "protected."[5] "Protected" excess ADIT are those "ADITs caused by timing differences resulting exclusively from section 167 and 168 of the Internal Revenue Code."[6] By its own admission, the Companies chose to "expand the technical definition of 'protected'" in determining the amortization of excess ADIT in the Second Stipulation.[7] Per the TCJA, "protected" excess ADIT are to be amortized pursuant to a prescribed normalization method of accounting referred to as the Average Rate Assumption Method, or "ARAM."[8] According to Mr. Blake's own testimony, those lines described as "Tax versus Book (method/life) Depreciation" in the Companies' Attachment A to PSC DR 2-1 are the only amounts considered "protected" under the Tax Cuts and Jobs Act.[9] There is no set period of time over which "unprotected" excess ADIT are to be amortized, which in this matter the Second Stipulation provides for a period of 15 years.[10] Ultimately, it is within the Commission's jurisdiction to determine the amortization period for unprotected excess ADIT.[11]

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[5] Companies' responses to AG DR 1-4, Case No. 2018-00034 (Apr. 20, 2018).
[6] Companies' responses to AG DR 1-3, Case No. 2018-00034 (Apr. 20, 2018).
[7] Video Testimony Evidence ("VTE"), Case No. 2018-00034, May 24, 2018 at 9:05:40.
[8] Direct Testimony of Kent W. Blake ("Blake Direct"), Case No. 2018-00034 (Jan. 29, 2018) at 3.
[9] VTE May 24, 2018 at 9:08:05; Mr. Blake also added that certain IRS Private Letter Rulings in the record have noted that Net Operating Losses, to the extent they were driven by book/tax timing differences should be afforded the same "protected" treatment.
[10] Direct Testimony on Rehearing of Kent W. Blake ("Blake Rehearing"), Case No. 2018-00034 (Apr. 6, 2018) at 17.
[11] VTE May 24, 2018 at 9:14:00.

Nevertheless, the Companies' treatment of the "property-related"/"protected" excess ADIT is a "net benefit" to customers in the short term because on balance, the "property-related" excess ADIT that are otherwise "unprotected" are a deferred tax asset.[12] By amortizing those excess ADIT according to the ARAM, rather than the 15 years applied to other "unprotected" excess ADIT, the negative effect (to customers) of the deferred assets have a smaller impact each and every year because the lives of the underlying assets, on balance, are longer than 15 years. Ultimately, the Commission may determine that the treatment of otherwise "unprotected" "property-related" excess ADIT used by the Companies in the Second Stipulation is reasonable. It appears from the Companies' Attachment A to PSC DR 2-1 that amortizing those "property-related" excess ADIT over 15 years, as opposed to the ARAM, would serve to *reduce* the surcredit customers would receive over the 13-month period. This would not be to the customers' benefit. On this issue, the Attorney General merely requests the Commission note that although some "unprotected" excess ADITs are being amortized according to the ARAM, they are nevertheless "unprotected" and are thus under the Commission's jurisdiction as to their amortization. By all accounts, the treatment of these ADITs under the Second Stipulation are reasonable in that they provide a net benefit to customers. However, with at least ten other investor owned utilities of significant size under its jurisdiction, it is necessary for the Commission to make this distinction in this matter in order to provide consistency in application of the far-reaching TCJA.[13]

[12] VTE May 24, 2018 at 9:13:36.
[13] The Attorney General bases the statement of "at least ten investor owned utilities" on the cases stemming from the TCJA, either upon complaint or the Commission's own motion.

Amortization of "Unprotected" Excess ADIT

As previously mentioned, the Second Stipulation provides for a 15-year amortization of "unprotected" excess ADIT.[14] The Commission is provided a unique opportunity in this matter regarding the amortization of "unprotected" excess ADIT. According to the Exhibits KWB-3 through KWB-6, it is apparent that of the total $176.89 million surcredit proposed to be returned over 13 months, only approximately 1.7% of that surcredit is from the 15-year amortization of "unprotected" excess ADIT.[15] The Commission has the opportunity to approve the stipulation, in whole or in part[16], and include the 15-year amortization with little impact to customers and the Companies. Indeed, the changes to capitalization outlined at length in this matter takes into account a 15-year amortization of excess "unprotected" ADIT. Given the relative size "unprotected" excess ADIT represents in the context of the entire surcredit, a shorter amortization period would ultimately be a relatively insignificant benefit to customers. Furthermore, if the Commission chooses to approve the 15-year amortization of "unprotected" excess ADIT in the Second Stipulation, the surcredit is likely only in place until April 30, 2019.[17] The Commission will then have the option to shorten the amortization period in the subsequent rate case the Companies plan to file with an effective date of May 1, 2019.[18] For instance, if the Commission determines during the next rate case that the Companies' proposed rates are unreasonably high, the Commission can reduce the revenue

[14] Blake Rehearing at 17.
[15] See *generally* Blake Direct.
[16] The Commission has this authority pursuant to KRS 278.040 and 278.030. While KRS 278.040 mandates that the Commission "shall regulate utilities and enforce the provisions of this chapter," other parts of this chapter, namely KRS 278.030 ensures that the Commission only permits utilities to charge customers rates that are fair, just and reasonable. Nothing in KRS Chapter 278, or the regulations that the Commission operates under, can relieve the Commission from the responsibility to ensure at all times that customers taking service from utilities under its jurisdiction are only charged those rates the Commission has determined are fair, just and reasonable.
[17] Blake Direct at 9.
[18] Blake Direct at 7.

requirement to reflect a shorter amortization period for the "unprotected" excess ADIT. After the "unprotected" excess ADIT are amortized and returned to customers over the 16-month surcredit period, there should be approximately $41,874,308 million left to reduce the revenue requirement in subsequent time periods.[19] For example, given the Companies' recent 2-year schedule of rate case activity, the Commission could choose to amortize the remaining "unprotected" excess ADIT over 2 years, thus in the next rate case reflecting a revenue requirement reduction each year of approximately $20 million. Furthermore, as this amortization change would be ordered within the context of a rate case, its impact could be considered holistically and provide the Commission the chance to consider any negative implications it may have on the Companies, such as an impact on cash flow and the possibility of changes to capitalization. In addition to the opportunity to holistically consider the impact a shorter amortization period may have on the Companies and their financial metrics, the impact of a shorter period as a percentage of the Companies' revenue is relatively miniscule. For instance, the Commission need only compare the approximately $45M revenue requirement impact the "unprotected" excess ADIT balance currently represents, relative to the more than $3,000,000,000 in revenues the Companies brought in for 2017.[20] In sum, the Commission's approval of the Second Stipulation, or at least the portion relating to the 15-year amortization of "unprotected" excess ADIT, does not preclude the Commission from later shortening the amortization period in a subsequent rate case in order to benefit

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[19] This represents a revenue requirement amount using the 1.35 gross-up factor used in Exhibits KWB-4 through KWB 6 to Blake Direct.

[20] *See* Annual Revenue Report Statistics – 2017 for Investor-Owned Electric Utilities as filed by the Kentucky Public Service Commission (last visited June 28, 2018).

customers. This shortening in the context of a rate case will also prove to reduce any impact on the Companies or their financial metrics.

<u>"Other" Capitalization Changes</u>

Finally, the Commission should not afford the Companies the opportunity to recover the changes to capitalization in the Second Stipulation which the Companies categorize as "Other."[21] In fact, the Companies' own reference to these "Other" costs as distinct from those "directly attributed to the TCJA" is significant, and should provide the Commission a firm basis to deny those capitalization changes not directly attributable, or related in any sense, to the surcredit.[22] Even the changes to capitalization designated in the "Other" category that the Companies claim are "indirectly related" to the TCJA should be denied. The Companies claim that since at least some portion of the surcredit is related to pension contributions, the *current* pension contributions of $100M in January 2018 should be taken into consideration in updating the capitalization due to the enactment of the TCJA and introduction of the surcredit.[23] The Commission should deny this portion of the Companies' request. Not only are the items included in the "Other" category of changes to capitalization not directly related to the TCJA, some items are costs that the Companies expected to incur and included as test-year expenses in the most recent rate cases. As provided in the Companies' response to Commission Staff's Post-Hearing Data Request item 6, the forecasted test years in Case Nos.

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[21] Blake Rehearing at 11-12.
[22] Companies' response to AG DR 1-10, Case No. 2018-00034 (Apr. 20, 2018); Companies' Response to AG DR 1-1, Case No. 2018-00034 (Apr. 20, 2018) (Wherein the Companies go to lengths to note that "at least some of the 'Other' capitalization changes were indirectly related to the TCJA in that they added to TCJA savings being provided to customers." As later described in the response, for the Companies to detail the connection between the recent pension contributions and the impact of the TCJA as even "indirectly related" is tenuous at best).
[23] Companies' Response to AG DR 1-1, Case No. 2018-00034 (Apr. 20, 2018).

2016-00370 and 2016-00371 included "projected pension contribution[s] in January 2018." Furthermore, "Pension contributions are generally made on an annual basis," with KU making contributions every year for the past 10 years and LG&E making annual contributions in each of the last 10 years except for 2017.[24] Thus, even the amounts included in the "Other" category of capitalization changes, which the Companies tenuously described as "indirectly related," would have been incurred independently and regardless of the passage of the Tax Cuts and Jobs act. Therefore, the Commission should not provide for recovery of the "Other" capitalization changes presented in the Second Stipulation.

CONCLUSION

Wherefore, the Attorney General respectfully requests the Commission provide customers, particularly those in the residential class, the most significant rate reduction allowed in accordance with the law, while maintaining the Companies relevant credit metrics.

[24] Companies' response to Commission Staff's Post-Hearing Data Request item 6 (c), Case No. 2018-00034 (June 11, 2018).

Respectfully submitted,

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