COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

RESPONSE OF
KENTUCKY UTILITIES COMPANY
AND
LOUISVILLE GAS AND ELECTRIC COMPANY
TO
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
POST-HEARING DATA REQUESTS
DATED MAY 25, 2018

FILED: JUNE 11, 2018

VERIFICATION

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

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

Kent W Blake

Kent W. Blake

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of June 2018.

Tammy J. Elzy (SEAL)
Notary Public

My Commission Expires:

November 9, 2018

KENTUCKY UTILITIES COMPANY
AND
LOUISVILLE GAS AND ELECTRIC COMPANY

Response to Kentucky Industrial Utility Customers, Inc. Post-Hearing Data Requests
Dated May 25, 2018

Case No. 2018-00034

Question No. 1

Witness: Kent W. Blake

Q.1. At the hearing yesterday, Mr. Blake identified three primary reasons why the Commission's March 20, 2018 Order resulted in a 20% increase in the TCJA Surcredit from that agreed to in the January 29, 2018 Offer and Acceptance of Satisfaction (from $135.5 million to $162.4 million; see Appendix A to March 20, 2018 Order). Those three reasons were: 1) increase in capitalization of $84.046 million directly related to the TCJA; 2) increase in capitalization of $51.975 million for other; and 3) increases in the cost of short term debt and the variable portion of long term debt since the test year end of the last rate case. For each of these three items, please provide the effect on the TCJA Surcredits for KU, LG&E electric and LG&E gas. The intent of this question is to understand what the TCJA surcredits would be if the Companies prevail in rehearing on any or all of these three items.

A-1. The one-page attachment and supporting files provided in Excel format provide a reconciliation between the TCJA Surcredit from the *Offer and Acceptance of Satisfaction* ($135.5 million) and the $162.4 million from Appendix A of the March 20, 2018 Order.

- Line 1 represents the estimated TCJA Surcredit amounts per the *Offer and Acceptance of Satisfaction*.
- Lines 2 and 3 reflect updates the Companies have acknowledged as appropriate.
- Line 2 reflects the impact of the Uncollectible Accounts Expense and PSC fees on the composite tax rate.
- Line 3 reflects the update to market interest rates discussed in Blake Rehearing Exhibit KWB-4.
- These two adjustments increase the TCJA Surcredit by $3.4 million to $138.9 million as shown on Line 4.
- Line 9 represents corrections to the composite tax rate used in the March 20, 2018 Order as shown in Staff Rehearing Exhibit 7.
- When added to the surcredit amounts in the March 20, 2018 Order on Line 10, these corrections modify the March 20, 2018 Order to $162.9 million.

- The resulting difference between the Companies' updated position on Line 4 and the KPSC's revised Order on Line 8 is $24 million. The detail is shown on Lines 5-7 of the one-page attachment and is consistent with the three reasons noted in this data request.
- Note that the amounts on Lines 5 and 6 are slightly lower than the quantification of these items on pages 12-13 of the Direct Testimony on Rehearing of Kent W. Blake (Blake Rehearing Testimony) as the calculations on this one-page attachment incorporate the impact on these amounts of the updates noted on Lines 2 and 3.
- Note also that the calculation on Line 5 of the TCJA Capitalization Impact remains based on the surcredit amounts per the *Offer and Acceptance of Satisfaction*. Any changes to the TCJA Surcredit amounts to be returned to customers that ultimately result from this proceeding would also impact the amount on this line item.
- The $7.9 million Cost of Debt Impact on Line 7 represents the difference between current market interest rates per Blake Rehearing Exhibit KWB-4 and interest rates used to set the Companies' base rates in their last rate case. When combined with Line 3, the resulting $10.4 million represents the difference between the interest rates used in the *Offer of Acceptance and Satisfaction* and the Companies' last rate case.

KENTUCKY UTILITIES COMPANY
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BASE RATE CREDIT MECHANISM

LINE NO.	DESCRIPTION	KU	LG&E-ELECTRIC	LG&E-GAS	TOTAL BASE RATE CREDITS
		$	$	$	$
1	**COMPANY AS FILED (OFFER AND ACCEPTANCE OF SATISFACTION)**	**(70,180,255)**	**(48,993,021)**	**(16,299,321)**	**(135,472,597)**
2	UPDATED COMPOSITE TAX RATE IMPACT (1)	(580,617)	(287,834)	(81,876)	(950,327)
3	UPDATED COST OF DEBT IMPACT (2)	(885,555)	(1,225,974)	(345,570)	(2,457,099)
4	**COMPANY UPDATED (SUM OF 1 - 3)**	**(71,646,427)**	**(50,506,829)**	**(16,726,767)**	**(138,880,023)**
5	TCJA CAPITALIZATION IMPACT	(5,366,778)	(3,869,105)	(687,514)	(9,923,397)
6	OTHER CAPITALIZATION IMPACTS (JAN18-APR19)	(5,149,674)	(2,515,555)	1,513,760	(6,151,469)
7	COST OF DEBT IMPACT (3)	(4,860,104)	(2,375,752)	(691,882)	(7,927,738)
8	**KPSC PER REVISED REHEARING EXHIBITS (SUM OF 4 - 7)**	**(87,022,983)**	**(59,267,241)**	**(16,592,403)**	**(162,882,627)**
9	KPSC CORRECTIONS (4)	131,759	299,317	88,126	519,202
10	**KPSC PER MARCH 20 ORDER (SUM OF 8 - 9)**	**(86,891,224)**	**(58,967,924)**	**(16,504,277)**	**(162,363,425)**

(1) USING UPDATED COMPOSITE TAX RATE PER EXHIBIT KWB-3 OF BLAKE REHEARING TESTIMONY
(2) USING CURRENT INTEREST RATES PER REHEARING EXHIBIT KWB-4 OF BLAKE REHEARING TESTIMONY COMPARED TO OFFER AND ACCEPTANCE INTEREST RATES
(3) USING CURRENT INTEREST RATES PER REHEARING EXHIBIT KWB-4 OF BLAKE REHEARING TESTIMONY COMPARED TO CASE NOS. 2016-00370 AND 2016-00371 INTEREST RATES
(4) PER STAFF REHEARING EXHIBIT 7

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

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Question No. 2

Witness: Kent W. Blake

Q.2. Please provide the Companies' reasoning as to why the March 20, 2018 Order was incorrect as to each of these three items.

A-2. As noted in the response to Question 1, three differences remain between the revised March 20, 2018 Order and the Companies' updated position. The Companies' position with respect to these items are included in the record in this case. However, below is a summary of some of the key reasons why the Companies believe these modifications were inappropriate.

<u>Tax Reform Capitalization Impact</u>

- This modification is the most egregious because it fails to recognize the full financial effect of Tax Cuts and Jobs Act ("TCJA").
- As a result of the TCJA and this regulatory proceeding, the Companies are incurring additional cash outlays of $176.9 million between the TCJA Surcredit and the adjustments made to other rate mechanisms, most notably their Environmental Cost Recovery Mechanism, proposed in the *Offer and Acceptance of Satisfaction*. This is a different situation than the Companies experienced with the Tax Reform Act of 1986. Both Companies were in a net operating loss position prior to passage of TCJA due to years of a provision previously in the tax code known as "bonus depreciation". As a result, the $176.9 million being paid to customers today is a reduction in cash revenue with no reduction in cash expenses. 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.
- In addition, TCJA eliminated that same "bonus depreciation" provision for the Companies. As shown in Blake Rehearing Exhibit KWB-2, this change coupled with the other changes in TCJA, increase estimated cash taxes paid by $27.1 million during the sixteen-month period for which the TCJA Surcredit is being calculated.
- The combined incremental cash outlay caused directly by TCJA and this regulatory proceeding of $202.8 million increases the Companies' seventeen-month average capitalization for the TCJA Surcredit calculation period by $84 million.

- 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 relative to a situation in which TCJA was never passed into law.
- The Companies are also concerned that the failure to recognize certain of these capitalization impacts could result in a normalization violation. In particular, a potential normalization violation may exist where no adjustment is made to capitalization to reflect the amortization of excess ADIT.
- The Companies find it hard to believe that the Commission intended to financially harm the Companies in its March 20, 2018 Order regarding TCJA.

<u>Cost of Debt Impact</u>

- This proceeding originated with a complaint that the Companies' rates would no longer be fair, just and reasonable following the passage of TCJA.
- As a result, the parties to the *Offer and Acceptance of Satisfaction* agreed to a TCJA Surcredit to reflect the impact of the known and measurable change in federal income tax rates to the Companies' revenue requirement from the time it was enacted until such time as the TCJA impacts could be incorporated into the Companies' base rates. Thus, the relevant 16-month period subject to review is from January 1, 2018 to April 30, 2019.
- Likewise, it is only reasonable that a known and measurable change in interest rates should also be incorporated into the calculation of the surcredit for this 16-month period.
- Certain other Kentucky utilities who happened to be in a rate case when TCJA was passed were fortunate to have the effects of TCJA calculated as of the same time period that all other revenue requirement determinants, including interest rates, were being updated.
- By any objective reasonable 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. The interest rates used in the Companies' updated surcredit calculation in the attachments to KIUC Post Hearing Data Request Q-1 are fully supported in the record. They reflect current interest rates being paid by the Companies and consensus market expectations of federal funds rate increases of 25 bps in June and December of this year and March of next year. That consensus is based largely on published comments from members of the Federal Reserve System.
- As noted on Line 7 of the one-page attachment to Question 1, use of current interest rates reduces the surcredit amount by $7.9 million, leaving a net benefit to customers via the TCJA Surcredit of $138.9 million in addition to the $41.4 million being provided through adjustments to other rate mechanisms. This $180.3 million total benefit is being provided to customers outside of a base rate case.

The TCJA Surcredit is effectively acting as an alternative rate mechanism used to provide customers a timely, significant and expeditious TCJA benefit outside of a base rate case. 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.

Other Capitalization Impacts

- This proceeding originated with a complaint that the Companies' rates would no longer be fair, just and reasonable following the passage of TCJA.
- 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 based on current financial forecasts for the Companies for the sixteen-month period subject to review --from the time TCJA took effect January 1, 2018 until TCJA would be incorporated into the Companies' base rates following its next base rate case on May 1, 2019.
- 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 remained fair, just and reasonable until such time as TCJA could be fully incorporated into the Companies' base rates in its next rate case.
- Certain other Kentucky utilities who happened to be in a rate case when TCJA was passed were fortunate to have the effects of TCJA calculated as of the same time period that all other revenue requirement determinants were being updated.
- Interestingly, the March 20, 2018 Order did use this same sixteen-month forecast period to calculate the amortization of excess deferred income taxes but deviated from that period with respect to these three modifications.
- As shown on page 12 of Blake Rehearing testimony, this Other Capitalization update resulted in a $52 million additional increase to capitalization relative to that used in the Companies' last base rate case (KU $43.5 million, LG&E Electric $21.4 million and an LG&E Gas reduction of $12.9 million).
- As noted in the Companies' response to AG1-1, the increase in Other Capitalization from the Companies' last rate case was largely driven by an increase relative to assumptions used in the Companies' last rate case for pension contributions made in January 2018. Those contributions provided an Other Capitalization increase of $76.9 million (KU $33.8 million, LG&E Electric $35.6 million and LG&E Gas $7.5 million) and increased the amortization of unprotected excess deferred income taxes in the *Offer and Acceptance of Satisfaction* and the March 20, 2018 Order.
- As a result, all Other Capitalization updates from the Companies' last base rate case to that used in the TCJA Surcredit is an increase of only $9.7 million for KU and reductions for LG&E Electric by $14.2 million and LG&E Gas by $20.4 million. Those LG&E reductions effectively increase the TCJA Surcredit for LG&E customers.

- The Companies believe providing for the cost of capital on these modest Other Capitalization increases is a reasonable outcome to this complaint case and result in rates that remain fair, just and reasonable.
- Having updated total capitalization, interest rates and 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 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. Furthermore, the Companies' attempt to maintain a relatively consistent capital structure.

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Question No. 3

Witness: Kent W. Blake

Q-3. At the hearing, Staff introduced eight exhibits regarding the correct calculation of the tax gross-up factor. Please indicate whether the Companies agree with Staff. If so, please provide the TCJA Surcredit effect for KU, LG&E electric and LG&E gas.

A-3. Yes. The Companies' updated tax gross-up factor per Blake Rehearing Exhibit KWB 3, page 2 (KU) and page 5 (LG&E) agree with that shown in the Staff exhibits. The effect of the Staff's corrected calculation on the Commission's March 20, 2018 Order is shown on Line 9 of the attachment to KIUC Post-Hearing Data Request Q-1 and Staff Rehearing Exhibit 7.