LG&E and KU
Potential Legal Merger of Utilities
Internal Study

Filed Pursuant to Paragraph 7 of Order entered April 30, 2019
In Case Nos. 2018-00294 and 2018-00295

March 31, 2021

Executive Summary

On August 8, 2018, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively, the "Companies") submitted an Internal Study[1] on the Potential Legal Merger of LG&E and KU pursuant to the April 4, 2018 Order in Case No. 2017-00415.[2] For the reasons noted in the August 8, 2018 study, the Companies did not recommend proceeding with the legal merger of LG&E and KU.

The Kentucky Public Service Commission issued Orders on April 30, 2019 in the LG&E and KU rate cases that ordered the Companies to file annual updates of the potential legal merger study.[3]

In 2018, the study was performed primarily by conducting interviews with each officer and independent departmental analyses. Many of the officers included other senior members of their respective departments in the discussions. The officers identified areas for further investigation in their organizations and additional interviews and discussions were conducted based on those recommendations. Cost and savings estimates were generally developed in house by the departments affected, but some external input was obtained where necessary.

Before proceeding with the study process, the Legal Merger Study Team developed the following assumptions:

- Consider the costs and benefits of a legal merger in every area of the Companies.
- Any legal merger would need to be approved by the Commission and the Federal Energy Regulatory Commission ("FERC").[4]
- Capture impacts of a legal merger in a format that would allow them to be categorized into one of three areas:
    1. One-time costs involved in achieving the legal merger
    2. Ongoing costs above the current level that would result from the legal merger
    3. Ongoing savings that would result from the legal merger
- Any one-time costs involved in achieving the legal merger would be amortized over five years.

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[1] *In the Matter of: Joint Application of PPL Corporation, PPL Subsidiary Holdings, LLC, PPL Energy Holdings, LLC, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of an Indirect Change of Control of Louisville Gas and Electric Company and Kentucky Utilities Company,* Case No. 2017-00415, August 8, 2018 (Post Case Files)

[2] *In the Matter of: Joint Application of PPL Corporation, PPL Subsidiary Holdings, LLC, PPL Energy Holdings, LLC, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of an Indirect Change of Control of Louisville Gas and Electric Company and Kentucky Utilities Company,* Case No. 2017-00415, Order, p. 8 (April 4, 2018)

[3] *In the Matter of: Electronic Application of Kentucky Utilities for an Adjustment of its Electric Rates*, Case No. 2018-00294, Order, p. 31 (April 30, 2019); *In the Matter of: Electronic Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Rates*, Case No. 2018-00295, Order, p. 34 (April 30, 2019)

[4] Approval by the Virginia State Corporation Commission is not anticipated because the parent of LG&E and KU, LG&E and KU Energy LLC and the ultimate parent of LG&E and KU, PPL Corporation will not change the potential legal merger of LG&E and KU.

- At the time of the potential legal merger or shortly thereafter, rates for all customers in any particular rate class would be harmonized regardless of whether the customer was a legacy LG&E or KU customer.
- To avoid the cost of redeeming or tendering for existing First Mortgage Bonds ("FMB's"), the existing FMB's will remain in place.
- Existing FMB's would require property accounting records to be maintained at LG&E and KU level post- legal merger.
- New bonds issued by the consolidated entity will be issued via a Collateralized Trust Mortgage structure.
- The existing services company, LG&E and KU Services Company, would remain in place.
- The existing brands would remain in place and be used in their current service territories for the merged company.
- A Private Letter Ruling would be required from the Internal Revenue Service to address the difference between how LG&E and KU currently treat Investment Tax Credits.
- Union contracts survive in their existing format.

Similar parameters and assumptions of the 2018 Internal Study were reviewed and updates, if applicable have been included in this update.

Company background and savings realized since the May 1, 1998 merger of LG&E Energy Corp. and KU Energy Corporation can be found in the prior studies submitted.[5]

Conclusion

The Companies have completed a thorough review of the impacts of a potential legal merger of LG&E and KU as ordered by the Commission in Case Nos. 2018-00294 and 2018-00295. The ongoing review confirmed that LG&E and KU continue to operate today as an integrated company in virtually all operational areas. This integrated approach has achieved significant savings for customers in many areas including joint dispatch, consolidated procurement of capital projects, fuel and consumable goods, joint call centers, and consolidated IT systems.

The potential legal merger of the two utilities would result in savings in the accounting, tax, treasury, and regulatory areas of approximately $2 million annually, but also result in an increase of ongoing costs in other areas. In addition, the legal merger would require significant one-time costs of approximately $23 million to achieve the legal merger. Finally, the potential legal merger creates winners and losers among the customers because our analysis suggests there would be no net savings to bring all customer rates to the lowest rate offered between the Companies. In this scenario, LG&E customers would see a greater benefit of $38.6 million in overall rate reductions

[5] https://psc.ky.gov/pscecf/2017-00415/rick.lovekamp@lge-ku.com/08082018084656/Closed/20180808_LGE_KU_Legal_Merger_Internal_Study.pdf; https://psc.ky.gov/pscecf/2018-00294/rick.lovekamp@lge-ku.com/03312020095641/Closed/2-2020_LGE_KU_Legal_Merger_Study.pdf; https://psc.ky.gov/pscecf/2018-00295/rick.lovekamp@lge-ku.com/03312020100716/Closed/2-2020_LGE_KU_Legal_Merger_Study.pdf

while KU's overall rate reductions would amount to $32.4 million. In another scenario that would move all rate classes to weighted average rates between LG&E's and KU's current rates while maintaining the current overall revenue requirement, KU customers would see a net $9.8 million increase while LG&E customers would see a net $9.8 million decrease.

For these reasons, the Companies do not recommend proceeding with the legal merger of LG&E and KU.

Costs to Achieve

Merging the two utilities into a single legal entity would require certain one-time costs that would be incurred at the time of the legal merger to allow the combined entity to operate effectively following the legal merger. These include costs associated with seeking regulatory approval to merge, amending contracts, where necessary, to allow for the merged entity to be the contractual party, changing the structure for future use of FMB's, revising IT systems to reflect the elimination of one of the two legal entities, external audit costs associated with these revised systems, and other accounting costs. A summary of those costs is listed below:

Cost Area	How Costs Were Estimated	Cost
Regulatory Approval from KPSC and FERC	Estimate based on prior merger cases	$1.0 million
Rate Case Filing to Determine Appropriate Rates Following Legal Merger	Estimate based on prior rate cases	$3.2 million
Revisions to General Commercial Agreement	Internal estimates	$0.07 million
Creation of New Trust Indenture Structure	Estimate from external counsel experienced with these structures	$0.35 million
Revision of Existing IT Systems	Internal estimate based on prior system upgrades	$17.1 million
Audit Work - Transaction and Systems Review	Estimate from external auditor	$0.7 million
Investment Tax Credit – IRS Private Letter Ruling	Internal estimates	$0.15 million
Consulting on Tax Structure	Internal estimates	$0.1 million
	Total	$22.67 million

Regulatory Approvals – The Commission and FERC would each need to approve the legal merger of the utilities. The Companies have obtained regulatory approvals for at least three changes of control since 1998. The filings associated with this legal merger would be somewhat different because the utilities are merging rather than the holding companies, but the Companies expect that the overall costs associated with preparing the filing, responding to intervenor interrogatories, and conducting hearings would be similar to prior cases. The cost estimate of $1.0 million includes $0.8 million related to obtaining approvals from state regulators and $0.2 million for FERC

approvals and is based on the experience gained in prior cases. The Companies also assume that if a legal merger did occur, a rate case would be required to allocate the costs of the combined entity to its customers. The $3.2 million estimate is based on the costs of recent rate cases of the Companies. There is a risk that FERC and VSCC could possibly deny approval of higher rates as a result of a legal merger.

Revisions to Contract Templates – The Companies currently have a common contract template based on existing legal structures called the General Commercial Agreement. The procurement team has determined the contract template would need to be revised somewhat to reflect the new legal structure. The costs associated with such a revision are expected to be minimal at approximately $12,000. Existing contracts may or may not allow for the legal merger of the two utilities which could require negotiations with the existing counterparties. Costs associated with those renegotiations are estimated to be about $58,000. There is a risk that contract negotiations as a result of the legal merger could lead to increased costs.

Creation of a New First Mortgage Bond Indenture Structure –The Companies currently have two types of FMB's – those issued in the taxable market and those issued as collateral for tax-exempt bonds issued by counties in which the Companies have generation assets. The existing taxable FMB's issued by LG&E and KU have maturities ranging from 2020 to 2050. Bonds issued in the taxable market do not contain call provisions except for periods of six months or less before the maturity date. At KU, $2.05 billion of the $2.3 billion in outstanding taxable debt has a maturity date of 2040 or later. Similarly, at LG&E $1.185 billion of the $1.485 billion of taxable debt has maturity dates of 2040 and beyond. The taxable bonds of each utility are secured by a first mortgage lien on generally all fixed assets located in Kentucky of each utility. The bonds have been issued publicly to a wide range of investors and are traded in the secondary markets.

The FMB's issued as collateral for tax-exempt bonds issued by counties are subject to the same trust indenture as the taxable bonds and the lien applies to the same assets as those issued in the taxable market. The Company agrees to pay all debt service on the county's bonds via a loan agreement. Since the Company is not the issuer of the county's tax-exempt bond, it provides FMB's to the tax-exempt bond trustee as collateral for the payments due under the loan agreement. The FMB's mature on the same date and bear interest at the same rate as the bonds issued by the county. However, the principal and interest on the FMB's are not payable other than upon an event of default under the loan agreement. KU has approximately $342 million of tax-exempt bonds outstanding while LG&E has approximately $539 million outstanding. These bonds are held by a variety of investors and generally have shorter periods until they will be put back to the Company or can be called by the Company.

The Companies have considered the cost of retiring existing FMB's and starting with a new mortgage indenture for the combined entity, but bonds issued in the taxable market do not contain call provisions other than at "make whole" redemption prices (except for periods of six months or less before the maturity date at which time certain bonds could be called at par). It is possible that a tender offer could be done at a lower cost. This entails contacting each investor with an offer to buy their bonds – typically at a premium above the existing market price. As a result of the continuing decline of the 30-year treasury bond interest rate and continued tight credit spreads, the existing bonds are trading at a premium. As of the end of December 2020, the fair market value

of the KU bonds is estimated to be $3.33 billion (a premium of $692 million above face amount) while LG&E's are estimated to be $2.50 billion (a premium of $476 million above face amount). The tender offer price would have to be at a price above the market price in order to entice the bondholder to sell, but the bondholders are not required to sell unless the Companies offer the "make whole" redemption price. A rough estimate of the "make whole" premium is over $1.25 billion. The significant additional premium above the current market price eliminates the tender offer as a viable alternative.

There is no provision in the existing indentures that allows for the Companies to merge and transition the current separate liens to a new or replacement lien on the fixed assets of the merged entity for the debt that exists today under the two indentures. The successor company could not eliminate either of the existing indentures after a merger without redeeming or otherwise retiring all the bonds outstanding under that indenture. Further, each current indenture provides for that utility's bonds to be covered by the fixed assets of such utility and any after-acquired assets related to the existing assets. For example, if a sub-station currently owned by KU is expanded following the proposed legal merger, that expansion would secure the existing KU bonds but not the existing LG&E bonds. Thus, in the case of the existing bonds, the indentures require, in practice, that accounting records be maintained for legacy LG&E assets separately from the legacy KU assets, even after a merger.

Regarding future bonds after a merger, it is possible, but not common, for bonds to be issued following the legal merger under the existing separate indentures. The more common indenture structure in similar situations is to create a new Collateral Trust Mortgage Indenture to be used by the merged entity to issue new bonds following the legal merger. The Collateral Trust Mortgage Bonds would have a second lien on the assets of the successor company, and FMB's under the current indentures would be issued as collateral for the Collateral Trust Mortgage Bonds to avoid having the Collateral Trust Bonds being subordinated to the FMB's. The issuance of FMB's as collateral is comparable to the structure used today in the tax-exempt bond transactions wherein FMB's are issued as collateral to the trustee of the tax-exempt bonds issued by a county. Once all FMB's outstanding at the time of a legal merger are retired (currently KU has FMB's outstanding through 2050, and LG&E's last bond matures in 2049), the second lien on the Collateral Trust Mortgage Bonds would become a first priority lien. By using the Collateral Trust Mortgage structure, the Companies would be able to issue debt on a going forward basis that is ratably secured by the Companies' combined assets.

There would be legal costs with establishing this new structure. The law firm that has assisted the Companies in past FMB transactions has experience with Collateral Trust Mortgage Bonds. An estimate of the costs associated with creating the new structure was received from the law firm. The estimate is $350,000.

IT System Modifications – As noted above, integration of the IT systems for LG&E and KU has occurred since the 1998 merger. Even though common IT platforms are used for all areas, the information technology systems were designed based on the existing legal structure. Significant modifications will be required to capture the information of a consolidated entity. The IT department estimates the cost of one-time changes will be $17.1 million. The majority of the costs ($13 million) are associated with the following systems of the Companies': Oracle, PowerPlan and

Customer Care System (CCS). The estimates were developed internally based on prior system upgrades, and the Companies acknowledge that actual costs could vary significantly from this estimate. In addition to the one-time costs, there is a high degree of risk associated with modifying several systems at or near the same time. Given the complexity and enormity of the task, there is concern around being able to effectively and efficiently operate immediately following such a major IT change. The magnitude of the project would also result in delays to system upgrades to meet internal and external customer needs.

Conversion of the main accounting systems, Oracle and PowerPlan, is the single largest system cost at $12 million. In order to be able to report historical financial data on a comparable basis with the going forward results, a new company would be created within the financial systems. New setup or redesign of security and user roles would need to be developed as part of creating the new company. All the historical data would be converted into the new company and new interfaces with other systems would need to be written as Oracle is the hub for financial data. Testing the data conversion and the new interfaces would be a critical task. The $12 million estimate is broken down as follow: $0.5 million for analysis of the systems to determine the optimal solution, $2 million to design the consolidated system, $5 million to build and develop the system, $3 million for integration testing, $1 million for user acceptance testing, and $0.5 million for new hardware.

The CCS system is the primary tool used for interaction with customers, and modification is expected to cost approximately $1 million. This estimate assumes that LG&E, KU and Old Dominion Power would be maintained in the system as separate companies. To fully consolidate the companies within CCS would be cost prohibitive at approximately $50 million due to many of the same data conversion and testing issues cited above for the financial systems. It was assumed that all existing customer data would need to be maintained and tied to an existing customer account. CCS is the hub for all customer systems, is heavily integrated into the operational systems, and generates the customer account number and the location record for each account and service location. Numerous other systems use these identifiers including all the ancillary customer systems, the accounting systems, the work management systems, and the outage systems. To avoid issues in these downstream systems, and avoid negatively impacting customers, the assumption was made to maintain the separate companies in CCS.

The estimates totaling $17.1 million include only the largest systems utilized by the Companies. There are approximately 300 total applications in use at the Companies, but not all were individually evaluated as part of this estimate. However, a number of them would be addressed as part of the changes with the major systems and the remainder would not have major changes anticipated as a result of a legal merger of the utilities.

<u>One-Time Accounting and Tax Costs</u> – Several accounting issues must be resolved as part of a legal merger including a review of the accounting entries associated with the transaction. Additionally, following the consolidation and modification of the IT systems described above, the external auditors would need to complete a review of the modified systems to ensure that appropriate controls exist within the financial systems and that the systems properly capture the data input. Discussions were held with the Companies' external auditor to estimate the fee associated with this work. The firm estimated the cost would be $700,000.

As noted on pages 15-16 of Mr. Blake's testimony filed on March 13, 2018 in Case No. 2017-00415, LG&E and KU have made different elections dating back to 1972 with respect to investment tax credits. The Companies have not been able to identify a precedent where companies with differing elections have merged. The Companies' auditors were not able to find a similar situation either. The most prudent action for determining how this transaction would impact the differing elections is to pursue a private letter ruling from the Internal Revenue Service. The Companies estimate the cost of pursuing the private letter ruling is $150,000. There are a few less significant differences in tax elections that the Companies have made over the years. An estimate of $100,000 for consulting costs to resolve these differences most favorably has also been included in the one-time costs.

Ongoing Savings and Costs

The goal of a proposed legal merger of LG&E and KU, should it proceed, is to lower costs for customers. The review focused on reexamining opportunities within each area where savings could be realized following a legal merger of the Companies. The review also inquired about whether there were any areas where costs might increase due to the legal merger. The savings identified are summarized in the table below:

Area	**How Savings Were Estimated**	**Savings**
Accounting and Tax	Internal Estimates and Auditor Discussions	Labor - $0.76 million/year Non-labor - $0.47 million/year
Bank and Rating Agency Fees	Internal Estimates	Non-labor - $0.33 million/year
Regulatory Department	Internal Estimates	Labor - $0.12 million/year Non-labor - $0.12 million/year
Legal Fees	Internal Estimates	Non-labor - $0.12 million/year
Customer Service and Marketing	Internal Estimates	Non-labor - $0.01 million/year
Operating Services	Internal Estimates	Non-labor - $0.09 million/year
Actuarial Fees	Estimate From Actuary	Non-labor - $0.02 million/year
	Total	$2.04 million/year

Accounting and Tax Cost Reductions – Perhaps the most significant changes resulting from the legal merger of the two utilities would come in the accounting and tax areas. Currently, accounting and tax spend time preparing financial statements, tax filings and regulatory reports for the two separate legal entities. Following the potential legal merger the financial statements, tax filings, and regulatory reporting costs would be reduced through consolidation although not cut in half due to automation efforts already in place. Internal estimates indicate that labor savings of approximately $760,000 annually could be realized, and associated training costs would be reduced by $14,000 annually. This is based on estimates which include the elimination of six full time equivalent (FTE) accounting and tax staff positions. In addition, one manager's position would also be eliminated. The training cost savings are based on each of these seven positions

incurring $2,000 annually for training. External audit fees would also be less with the combination of LG&E's and KU's financial statements. Based on discussions with the auditors, the savings would be approximately $450,000 annually. One software license could also be discontinued to realize savings of $10,000 annually.

Bank and Rating Agency Fee Reductions – The Companies maintain separate credit facilities, bank accounts, and are evaluated separately by the credit rating agencies. A legal merger of the Companies would allow some of the costs associated with these arrangements to be reduced.

KU maintains a $400 million revolving line of credit and LG&E maintains a $500 million line of credit. Each Company has a commercial paper program totaling $350 million. The commercial paper programs are sized based on the desire to issue bonds that are "index eligible" which currently requires a minimum level of $300 million. Investment fund managers are typically evaluated against a benchmark index and have a strong preference to purchase bonds that are included in the index. Investors also prefer larger bonds due to the increased liquidity in the secondary markets for such larger bonds. The improved demand for these bonds typically improves the interest rate for the Company and its customers. The Companies issue commercial paper as needs arise for capital projects and working capital needs. Once the commercial paper balances approach $300 million, a bond is issued. The rating agencies require that the commercial paper balances be supported dollar-for-dollar with a revolving line of credit. The Companies also utilize the revolving lines of credit for other purposes including supporting tax-exempt bonds that can be put back to the Companies. The Companies believe that a combined entity could reduce the revolving lines of credit by $200 million as the combined company would only need a commercial paper program of $500 million rather than the $700 million in place today. This results in a reduction totaling $200,000 in commitment fees paid to banks.

The elimination of one of the commercial paper programs would also reduce associated rating agency and trustee fees by another $105,000 annually. Most bank account fees are based on the volume of transactions rather than the number of accounts. However, there would be some savings associated with eliminating bank accounts and savings associated with avoiding the agency fee paid under the revolving lines of credit. These savings total approximately $27,000 annually.

Regulatory Department Savings – The legal merger of the two utilities is expected to result in fewer regulatory filings with the Commission, although limited as many filings are already made on a combined basis. Currently, both Companies file cases related to the same or similar matters. Merging the two Companies will eliminate the duplicative filings. Since the 1998 merger of the LG&E and KU holding companies, tariff structures have been harmonized so that the rate is the only difference, and much of the work in finalizing mechanism filings has been automated.

Internal estimates suggest that labor costs could be reduced by $120,000 annually following a legal merger. Another $120,000 of annual non-labor savings is also anticipated. The non-labor savings result from reduced costs of publishing notices in the Courier Journal for one company, and from reduced consulting costs associated with separate cost of service studies.

Legal Fee Reductions – The consolidation of the two Companies would yield savings in the form of reduced fees paid to external counsel. The primary area where fees could be expected to decline

is in the regulatory area. Although many regulatory filings are done on a combined basis currently there continue to be some separate filings and some regulatory analysis must currently be done separately for the two companies. Most other areas are contracting at a single entity or using LKS, and all SEC filings are done on a consolidated basis. There would be no savings for these areas. The legal department, based on input from external counsel, provided an estimate of annual legal fee savings not expected to exceed $125,000 for the regulatory area.

Customer Service and Marketing Cost Reductions – There would be some savings in the customer service and marketing areas resulting from the proposed legal merger. The Companies currently are required to be listed in phone books to allow customers to contact them. Combining the utilities would eliminate one of the listings and result in an estimated annual savings of $11,000.

Approximately 8,900 customers receive electric service from KU and gas service from LG&E. These customers receive two invoices for the services and the Companies must process two separate payments each month. Consolidating these invoices and payments is estimated to save approximately $93,000 annually.

Actuarial Fee Savings – Actuarial costs would decline by approximately $20,000 annually if a legal merger occurred. Currently, the actuaries prepare estimates and actual costs based on historical intra-company cost allocations. A legal merger would avoid cross-charging between the utilities and reduce the actuaries' time resulting in savings. This estimate was provided by the current actuarial firm.

Some areas expect to see higher ongoing costs following a legal merger.

Area	**How Costs Were Estimated**	**Costs**
Contract Reopeners Due to Amending Existing Contracts	Internal Estimates	$0.8 million annually
Bond Indenture Costs	Estimate From Outside Counsel	$0.02 million annually

Contract Reopening Costs - Costs associated with reopening the contracts where a merger is not permitted is difficult to quantify. It is anticipated that some vendors where market prices have moved higher since finalizing the contract would hold out for a price adjustment in exchange for allowing the contract to continue with the merged entity. The procurement team has evaluated contracts where a merger could allow the counterparty to reopen the contract provisions. A sub-set of those contracts has pricing that may be below current market pricing. Procurement has estimated less than 1% of total contract value could be at risk. This equates to an annual cost increase of approximately $800,000.

Bond Indenture Costs – The use of the Collateralized Trust Mortgage structure described above is slightly more complicated than the FMB structure used currently. The Companies' outside counsel has estimated that each bond issuance will require additional legal fees of $15,000. In general, at least one bond is expected to be issued per year by the consolidated company resulting in $15,000 of incremental costs annually.

Jurisdictional Issues

As noted above, the review continued to assume approvals of a legal merger of the two utilities will be required from FERC. Although the VSCC does not need to approve a legal merger of LG&E and KU, scrutiny and resistance is expected for including any additional costs as a result of the legal merger to the Virginia cost of service. Based on prior experiences, the Companies expect all regulatory agencies to be particularly interested in ensuring no increases in rates occur as a result of the legal merger and proper cost allocation to customers under their jurisdiction continues. For example, the VSCC placed certain conditions on its approval of the 1998 merger of the holding companies of LG&E and KU in case number PUA970041. Condition No. 14 states, "[W]ithout prior approval, KU/ODP agrees not to include in Virginia retail rates any costs attributable to LG&E's regulatory assets or potential stranded costs." It is possible that rate reductions will be demanded by these regulators in exchange for approval of the legal merger. It is reasonable to expect the VSCC to possibly deny recovery by KU of any LG&E costs attributed to KU/ODP as result of the legal merger. Any savings shared with other jurisdictions will reduce the benefits obtained by Kentucky retail customers.

Affiliate transactions have been a focus of all regulators in the past and remain a long-standing area of interest and concern. Under the existing structure, the majority of affiliate transactions and cost allocations involve goods and services provided by LKS to the Companies. LKS is a "Service Company" formed as required when the Companies became subject to the Public Utilities Holding Company Act of 1935 (35 Act) as a result of Powergen's acquisition of LG&E Energy Corp. in 2000. The 35 Act was repealed in 2006 and replaced with the Public Utility Holding Act of 2005 (05 Act). The 05 Act does not expressly require the use of a Service Company, but it does mandate that Services Companies use the Uniform System of Accounts and requires that most transactions between a Services Company and an affiliated utility be conducted at cost. Contracts between Services Companies and affiliated utilities also are subject to regulatory review and approval in some instances. FERC and the VSCC currently are comfortable with the allocation methodologies used by LG&E and KU, and the use of LKS provides these commissions with the transparency they desire under the existing organization structure. All regulators are likely to be reluctant to give up the Services Company structure as it is the preferred method of facilitating their regulatory oversight over affiliate transactions.

If the regulators would approve the elimination of the Services Company at some point in the future, the Companies estimate ongoing cost reductions of approximately $300,000. However, the elimination of the Service Company could result in other costs increasing – particularly within IT since most software licenses are held in the name of LKS. Prior experience suggests that software vendors often require a new license to be purchased when the users name changes through a merger or other corporate reorganization.

Impact on Customer Rates

One assumption maintained from the initial study was that following any legal merger all customers within each rate class of the merged entity would be on the same tariff schedules regardless of whether they had been a legacy LG&E or KU customer. There are two ways to achieve such an outcome. First, the schedules that currently have higher rates can be reduced to

match the lower rates of the other entity. This strategy reduces the overall revenue of the combined entity. The question becomes whether the savings associated with the legal merger are sufficient enough to offset the rate reductions which would allow the combined entity to earn a fair, just and reasonable rate of return. Given current rates, the cost reductions would need to total approximately $71 million to offset the required rate reductions to maintain the lowest rates available today. The table below summarizes the calculations:

Maintain lowest rate between Companies				
Rate Class	Savings Required to Achieve		KU (% Impact)	LG&E (% Impact)
Residential Rate RS (inclusive of VFD)	KU Lowest	$ (15,091,231)	0.00%	-3.35%
Residential Time-of-Day Service Rate RTOD	KU Lowest	$ (11,746)	0.00%	-6.55%
General Service Rate GS	LG&E Lowest	$ (23,532,723)	-9.40%	0.00%
All Electric School Rate AES **(KU Only)**	n/a	$ -	0.00%	n/a
Power Service Rates PSS and PSP	LG&E Lowest	$ (4,799,600)	-2.61%	0.00%
Time-of-Day Service Rates TODS and TODP	KU Lowest	$ (19,849,560)	0.00%	-8.21%
Retail Transmission Service Rate RTS	KU Lowest	$ (3,651,612)	0.00%	-5.60%
Fluctuating Load Service Rate FLS	n/a	$ -	0.00%	0.00%
Special Contracts **(LG&E Only)**	n/a	$ -	n/a	0.00%
Lighting Energy Rate LE	LG&E Lowest	$ (9,525)	-2.84%	0.00%
Traffic Energy Rate TE	LG&E Lowest	$ (40,457)	-14.05%	0.00%
Outdoor Sports Lighting Service Rates OSLS and OSLP	KU Lowest	$ (12,981)	0.00%	-79.28%
Electric Vehicle Charging Rate EVC	LG&E Lowest	$ (669)	-40.00%	0.00%
Lighting Service and Restricted Lighting Service Rates LS and RLS	LG&E Lowest	$ (4,032,983)	-12.08%	0.00%
	Total =	***$ (71,033,087)***		

Note: Based on Schedule M for 2020 Rate Cases Forecasted Test Year, Using Current Rates and Revenues

Clearly, the ongoing review did not identify cost reductions that are anywhere near the level required to avoid having rates increase for some customers.

The second way to achieve harmonized rates is to have some rates increase while others decrease until the rates are consistent and yield the required revenue. Based on current approved rates, the Companies have calculated where rates would need to be to achieve this outcome and the percentage change in rates for each class of customer from current rates. For example, the average LG&E residential customer bill would see a 1.99% decrease while the average KU residential customer bill would need to increase by 1.41%. On average, an LG&E general service customer bill would see a 6.06% increase while an average KU general service customer bill would see a 3.91% decrease. The changes for all customer classes are detailed in the table below:

Maintain Total Rev Requirement for Weighted Average Rates

Rate Class	Current Avg KU Bill ($/month)	KU Rev Req Inc/(Dec)	Avg KU Customer Impact ($/month)	KU (% Impact)	Current Avg LGE Bill ($/month)	LG&E Rev Req Inc/(Dec)	Avg LG&E Customer Impact ($/month)	LG&E (% Impact)
Residential Rate RS (inclusive of VFD)	$ 120.35	$ 8,976,592	$ 1.69	1.41%	$ 99.38	$ (8,976,592)	$ (1.98)	-1.99%
Residential Time-of-Day Service Rate RTOD	$ 113.08	$ 6,113	$ 3.80	3.36%	$ 91.34	$ (6,113)	$ (3.11)	-3.41%
General Service Rate GS	$ 252.02	$ (9,797,712)	$ (9.86)	-3.91%	$ 297.27	$ 9,797,712	$ 18.00	6.06%
All Electric School Rate AES **(KU Only)**	$ 2,677.00	$ -	$ -	0.00%	$ -	$ -	$ -	0.00%
Power Service Rates PSS and PSP	$ 3,293.38	$ (2,282,713)	$ (40.96)	-1.24%	$ 4,736.40	$ 2,282,713	$ 66.69	1.41%
Time-of-Day Service Rates TODS and TODP	$ 31,656.00	$ 12,627,090	$ 1,029.79	3.25%	$ 31,661.75	$ (12,627,090)	$ (1,652.93)	-5.22%
Retail Transmission Service Rate RTS	$ 342,672.13	$ 2,088,829	$ 8,703.46	2.54%	$ 417,829.67	$ (2,088,829)	$ (13,389.93)	-3.20%
Fluctuating Load Service Rate FLS	$ 2,739,852.52	$ -	$ -	0.00%	$ -	$ -	$ -	0.00%
Special Contracts **(LG&E Only)**	$ -	$ -	$ -	0.00%	$ 153,675.58	$ -	$ -	0.00%
Lighting Energy Rate LE	$ 259.17	$ (4,200)	$ (3.24)	-1.25%	$ 133.25	$ 4,200	$ 2.17	1.63%
Traffic Energy Rate TE	$ 18.03	$ (23,197)	$ (1.45)	-8.05%	$ 27.73	$ 23,197	$ 1.93	6.97%
Outdoor Sports Lighting Service Rates OSLS and OSLP	$ 1,996.89	$ 12,537	$ 261.20	13.08%	$ 1,364.39	$ (12,537)	$ (1,044.79)	-76.58%
Electric Vehicle Charging Rate EVC	$ 0.84	$ (418)	$ (0.21)	-25.00%	$ 0.84	$ 418	$ 0.21	25.00%
Lighting Service and Restricted Lighting Service Rates LS and RLS	$ 16.05	$ (1,821,909)	$ (0.88)	-5.46%	$ 22.27	$ 1,821,909	$ 1.68	7.54%
Total =		*$ 9,781,013*				*$ (9,781,013)*		

Note: Based on Schedule M for 2020 Rate Cases Forecasted Test Year, Using Current Rates and Revenues

The above calculations are based on forecasted load at current rates presented in the 2020 rate case filings and do not include the impacts of any legal merger related costs and benefits

Recommendation

The Companies have completed a thorough review of the impacts of a potential legal merger of LG&E and KU as ordered by the Commission in Case Nos. 2018-00294 and 2018-00295. The ongoing review confirmed that the two companies operate today as an integrated company in virtually all operational areas. This integrated approach has achieved significant savings for customers in many areas including joint dispatch, consolidated procurement of capital projects, fuel and consumable goods, joint call centers, and consolidated IT systems.

The potential legal merger of the two utilities would result in some savings in the accounting, tax, treasury, and regulatory areas, but also result in an increase of ongoing costs in other areas. In addition, the legal merger would require significant one-time costs to achieve the legal merger. Perhaps most importantly, the potential legal merger creates winners and losers among the customers because the savings are not enough to bring all customer rates to the lowest rate offered by each company.

For these reasons, the Companies do not recommend proceeding with the legal merger of LG&E and KU.