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, 2023

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] The Kentucky Public Service Commission ("Commission") issued Orders on April 30, 2019 in the LG&E and KU rate cases that ordered the Companies to file annual updates to the potential legal merger study.[3] The Companies submitted internal legal merger studies to the Commission on March 31, 2020[4] and March 31, 2021[5].

In each of the three reviews conducted by the Companies it was confirmed that LG&E and KU operate as an integrated company in virtually all operational areas. LG&E and KU customers have enjoyed the benefits of this integration since the May 1, 1998 merger of LG&E Energy Corp. and KU Energy Corporation. The internal legal merger reviews identified potential savings in the accounting, tax, treasury, and regulatory areas if the Companies took the next step to merge into a single utility, but these savings were outweighed by the expected increases of ongoing costs in other areas. In addition, the legal merger would require significant one-time costs to achieve. Such a legal merger would also create winners and losers among the LG&E and KU customers because the savings are not enough to align customer rates to the lowest rates offered by each company.

Following a Commission Order issued June 30, 2021 in Case Nos. 2020-00349 and 2020-00350[6] the Companies issued a request for proposals to six independent consultants to perform a study of the potential legal merger of LG&E and KU. In October 2021, the Companies received bids from three consultants and subsequently selected PricewaterhouseCoopers Advisory Services LLC ("PwC") as the recommended consultant to perform the study. On March 31, 2022, the Companies submitted the LG&E/KU Legal Merger Assessment prepared by PwC.[7]

PwC's assessment consisted of interviews with management related to the nature of the activities performed by the Companies, the organizational construct of the Companies, and the manner in which services are planned and executed. Interviews were complemented by follow-up discussions to obtain additional clarity on the issues and topics related to the potential legal merger.

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[1] https://psc.ky.gov/pscecf/2017-00415/rick.lovekamp@lge-ku.com/08082018084656/Closed/20180808_LGE_KU_Legal_Merger_Internal_Study.pdf

[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] https://psc.ky.gov/pscecf/2018-00294/rick.lovekamp@lge-ku.com/03312020095641/Closed/2-2020_LGE_KU_Legal_Merger_Study.pdf

[5] https://psc.ky.gov/pscecf/2018-00294/rick.lovekamp@lge-ku.com/03312021094640/Closed/2-2021_LGE_KU_Legal_Merger_Study.pdf

[6] In the Matter of Electronic Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates, Case No. 2020-00349, Order, pp. 58-60 (June 30, 2021); In the Matter of Electronic Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates, Case No. 2020-00350, Order, pp. 63-64 (June 30, 2021).

[7] https://psc.ky.gov/pscecf/2018-00294/rick.lovekamp@lge-ku.com/03312022011250/Closed/2-2022_LGE_KU_Legal_Merger_Study.pdf

PwC also reviewed the internal merger studies conducted by the Companies and workpapers relevant to their assessment.

PwC's key findings from their 2022 report filed with the Commission are listed below.

- Since its merger in 1998 between LG&E and KU, the Company largely operates on an integrated basis across corporate, power production, customer and transmission and distribution operations having captured the synergies we typically find in utility combinations.
- Cost reduction opportunities resulting from the legal merger can be largely characterized as benefits from simplifying the legal entity structure from three entities to one and the resulting reduction of internal or third-party administrative costs.
- The largest estimated one-time cost incurred relates to the system modifications required to financially report in a single entity environment. Additional costs relate to regulatory approvals and rate case filings to effect the proposed merger.
- Our review found that future financing and tax considerations from the legal merger would likely not result in material financial impacts, but entail the complexities and risks from implementing potentially new financial instruments or securing IRS private letter rulings.
- Our review of similar transactions suggests that, while not common, some utilities function without services companies where multi-jurisdictional utilities or significant non-regulated operations exist. Because of the different legal structures and business portfolios of these entities, they are not directly comparable to the Company.
- Finally, our review suggests in those cases that apply, customer rate harmonization has typically been performed over a multi-year period to mitigate the impacts of customer rate changes.

The PwC analysis estimated one-time incremental costs of $22.1 million largely exceed estimated annual net savings of $2.3 million. Cost reduction opportunities resulting from the legal merger can be largely characterized as benefits from simplifying the legal entity structure from three entities to one and the resulting reduction of internal or third-party administrative costs. The largest estimated one-time cost incurred relates to the system modifications required to financially report in a single entity environment. Additional costs relate to regulatory approvals and rate case filings to effect the proposed merger.

The PwC review also found that future financing and tax considerations from the legal merger would likely not result in material financial impacts but entail the complexities and risks from implementing potentially new financial instruments or securing IRS private letter rulings.

For comparative purposes, the estimated annual net savings of $2.3 million represent approximately 0.3% of Company non-fuel electric O&M, whereas PwC noted that in traditional synergistic utility mergers, savings average approximately 7% of total combined O&M.

These annual savings would permanently reduce costs while the costs we have identified are one-time. Applying an inflation factor to these savings and reflecting a two-year period to realize these savings upon completion of the technology upgrade, cumulative savings would not exceed cost incurred until year 10 as shown in the figure below.

Cumulative Annual Net Savings and Costs Comparison[8]

	Year 1	Year 2
Savings Realization Assumption	50%	100%
Annual Escalation Assumption		3%

($millions)

		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Annual Net Savings	$2.27	$ 1.14	$ 2.34	$ 2.41	$ 2.48	$ 2.55	$ 2.63	$ 2.71	$ 2.79	$ 2.88	$ 2.96
One-time Costs	$ (22.10)	$ (22.10)									
Net Savings / (Costs)		$ (20.97)	$ 2.34	$ 2.41	$ 2.48	$ 2.55	$ 2.63	$ 2.71	$ 2.79	$ 2.88	$ 2.96
Cumulative Savings / (Costs)		$ (20.97)	$ (18.63)	$ (16.22)	$ (13.74)	$ (11.18)	$ (8.55)	$ (5.84)	$ (3.05)	$ (0.17)	$ 2.79

As stated in prior reports, PPL Corporation has repositioned as a U.S.-focused energy company and commenced to implement a strategy enterprise-wide that is focused on redefining how to operate across the organization to best serve the customers. Since 2021, Audit Services, Compliance and Ethics, Supply Chain, Legal, Information Technology, Corporate Security, Human Resources, Finance, Corporate Accounting, Financial Reporting, Tax, and Risk Management have been centralized enterprise wide. Each area is focused to drive consistency and achieve efficiency improvements over time while maintaining high service levels. The new organizations will continue to identify opportunities and transform the organization over the next several years.

The reviews of the LG&E and KU legal merger considered many elements to assess the potential implications where LG&E and KU to legally merge. The main results from the four assessments showed that LG&E and KU 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 IT systems.

The costs to achieve such a legal merger continue to exceed the benefits of such a merger. Merging the two utilities into a single legal entity would require costs for obtaining regulatory approval of merger, obtaining a private letter ruling from the Internal Revenue Service, creation of new debt (first mortgage bonds) and capital structure, IT system setups and integration for new entity, and other tax items and commercial agreements.

As noted in past reviews, the costs to achieve a legal merger of LG&E and KU would have an ultimate impact on customer rates. There are different ways to determine what would be the new rates within each rate class for the new entity, but clearly the assessments did not identify cost

[8] This is a cash only view of savings and costs and does not consider revenue requirement treatment of O&M and Capital as well as carrying charges for any expenses incurred and deferred for recovery from ratepayers in the future. Alternative rate normalization approaches taken could also create a revenue shortfall that could add to the cost of the merger.

reductions required to avoid having rates increase for some customers. Rates could be equalized for each class over time until rate equalization is achieved, but this would still create winners and losers among the customers during a transition period.

Given the associated risks and costs to achieve and because the Companies are currently in a rate case stay-out and a legal merger would require a rate case filing to harmonize rates, LG&E and KU request relief from filing future updates to the potential legal merger study as required in Ordering Paragraph No. 7 of the Orders dated April 30, 2019 in Case Nos. 2018-00294 and 2018-00295.