COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC JOINT APPLICATION OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY FOR AN ORDER APPROVING THE ESTABLISHMENT OF REGULATORY LIABILITIES AND REGULATORY ASSETS	))))))	**CASE NO. 2018-00304**

REPLY BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY TO ATTORNEY GENERAL'S POST-HEARING BRIEF

Dated: December 11, 2018

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INTRODUCTION

Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively "Companies") submit this brief in reply to the Attorney General's Post-Hearing Brief ("AG's Brief"). The rhetorical arguments and criticism in the AG's Brief are without merit for the reasons stated below. The Companies request the Kentucky Public Service Commission ("Commission") issue an order by December 31, 2018 authorizing the establishment of the regulatory liabilities and assets proposed in their application.

I. The Commission Should Approve the Proposed Regulatory Liabilities

The Companies request permission to record net regulatory liabilities by the end of this year to account for the excess accumulated deferred income taxes ("ADIT") created by recent Kentucky state tax reform. The Companies estimate the net regulatory liabilities including gross-ups to be approximately $19.4 million for KU, $12.5 million for LG&E Electric, and $3.1 million for LG&E Gas.[1] The amortization of this regulatory liability will be addressed in the Companies' pending rate cases where the Companies are proposing to amortize all *protected* excess ADIT using the Average Rate Assumption Method, amortize all *unprotected* excess ADIT over a 15-year amortization period, and treating all property-related excess ADIT as protected excess ADIT.[2]

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[1] Application Par. 13; Exhibit 1.

[2] *In the Matter of: Electronic Application of Kentucky Utilities Company for an Adjustment of its Electric Rates*, Case No. 2018-00294, Direct Testimony of Christopher M. Garrett, p. 35 (Ky. PSC Sept. 28, 2018); *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, Direct Testimony of Christopher M. Garrett, p. 35 (Ky. PSC Sept. 28, 2018).

The Commission has previously approved regulatory liabilities for utilities when the utility has incurred "an expense resulting from a statutory or administrative directive."[3] The Kentucky Tax Reform Act is such a statutory directive as it creates excess ADIT by the reduction in the state corporate income tax rate.

The AG expressly agrees with the Companies' request, but criticizes the Companies for requesting the Commission's approval.[4] In doing so, the AG overlooks the Commission's admonishment to KU and LG&E in its prior orders that the Commission expected the Companies to request prior approval for any regulatory assets or liabilities relating to changes in Kentucky's treatment of ADIT.[5]

The AG's Brief then questions why the Companies chose not to request deferral accounting to reflect the reduction in income tax expense also caused by the change in the Kentucky statutory income tax rate from 6% to 5%. In doing so, the AG ignores the Companies' response to Question No. 10 of the Attorney General's Initial Data Requests for Information, where the Companies noted the state tax law change also imposed additional costs on the Companies in the form of sales and use taxes on various services.

The AG also criticizes the Companies for filing a joint application requesting approval of both regulatory liabilities and assets. This criticism ignores the interest the Commission

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[3] *In the Matter of Kentucky Power Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to the Extraordinary Expenses Incurred by Kentucky Power Company in Connection with Two 2015 Major Storm Events*, Case No. 2016-00180, Order, p. 5 (Ky. PSC Nov. 3, 2016)("*Kentucky Power* Order").

[4] AG Brief, pp. 1-3 ("The Commission should approve the proposed regulatory liabilities resulting from the recent Kentucky state tax reform.").

[5] *In the Matter of Application of Louisville Gas and Electric Company for an Order Approving the Accounting Treatment Relating to Income Tax Expense for 2005 and Subsequent Years,* Case No. 2005-00180, Order, pp.4-5 (Ky. PSC June 30, 2005); *In the Matter of Application of Kentucky Utilities Company for an Order Approving the Accounting Treatment Relating to Income Tax Expense for 2005 and Subsequent Years,* Case No. 2005-00181, Order, pp. 4-5 (Ky. PSC June 30, 2005).

previously expressed to KU and LG&E concerning the need to seek administrative efficiencies in their regulatory practices before the Commission.[6]

The AG finally asserts that the Companies are requesting the Commission to "net" the regulatory liability with the regulatory asset. The request for relief at page 11 of the application plainly does not state this position.

II. The Commission Should Approve the Proposed Regulatory Assets

The July 2018 Storm's powerful conditions caused extensive, widespread damage across the KU and LG&E system, taking down 1,360 wires and damaging over 250 poles and other equipment across the Companies' distribution and transmission infrastructure.[7] Over 174,000 customers were without service immediately after the storm. Marshalling its internal resources and assembling over 2,000 contractors from several states on short notice, the Companies successfully repaired major damage and restored service to all customers within four days.[8]

The July 2018 Storm ranks among the top five most damaging storms to hit the KU and LG&E system based on the number of customers impacted and the cost of the damage. Using the top rankings of combined outages across the KU and LG&E system since 2003, only two storms have ranked higher than KU's storm damage cost from the July 2018 Storm.[9] Using the top ten combined customer outages events since 2003, the July 2018 KU storm ranks third when using only cost as a measure.[10]

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[6] *In the Matter of: Electronic 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 (April 4, 2018)
[7] KU/LG&E Responses to PSC Data Request 2-1 and 2-2.
[8] KU/LG&E Response to PSC Data Request 1-4
[9] KU/LG&E Response to PSC Data Request 2-3, p. 3 of 5
[10] KU/LG&E Response to PSC Data Request 2-3, p. 2 of 5.

The Kentucky Emergency Management recognized that the storm created an "unprecedented level of damage" and that the Companies' response to the storm was "outstanding."[11] The AG's Brief does not challenge this outstanding performance, but levels rhetorical assertions that have no merit and are made to deny the recovery of the Companies' prudent storm restoration and repair costs.

A. The July 2018 Storm meets the definition for a regulatory asset as non-recurring and extraordinary

In previous orders, the Commission has approved regulatory assets for utilities when the utility has incurred "an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning."[12] By any reasonable measure, the July 2018 Storms were both extraordinary and nonrecurring in nature and resulted in extraordinary and nonrecurring storm damage expense. The $7.2 (KU $4.8 and LG&E $2.4) million July 2018 Storm-related costs approach the Companies' combined operations and maintenance expense budgets for storm damage of approximately $9.3 (KU $3.9 and LG&E $5.4) million that are currently embedded in base rates and exceed those in the case of KU. Importantly, the July 2018 Storm damage amount alone exceeds the amount of storm damages expenses included in the forecasted test year in the pending rate cases ($6.3 million (KU $3.0 and LG&E $3.3)).[13] Thus, this single storm results in damages that exceed the total that will be included when base rates change in 2019.[14] That is not surprising as such extraordinary storms have been explicitly excluded in the calculation of a normalized storm restoration expense embedded in rates to deal

[11] KU/LG&E Response to PSC Data Request 2-3(b) and (c) attachment.
[12] *In the Matter of Kentucky Power Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to the Extraordinary Expenses Incurred by Kentucky Power Company in Connection with Two 2015 Major Storm Events*, Case No. 2016-00180 Order, p. 5 (Nov. 3, 2016).
[13] *In the Matter of: Electronic Application of Kentucky Utilities Company for an Adjustment of its Electric Rates*, Case No. 2018-00294, Application, Tab 55, Schedule B-5.2, page 4 of 6, Line 13; *In the Matter of Electronic Application of Louisville Gas and Electric Company,* Tab 55, Schedule B-5.2, page 4 of 6, Line 13.
[14] Video Transcript of Evidence ("VTE"), 9:01:54 –9:02:30 AM

with more typical storm activity. Storm damages in base rates are normalized based on a historic average and do not include any storms for which regulatory asset treatment has been granted. Base rates recover typical and ongoing costs, not the costs of extraordinary events like the July 2018 Storm.[15] As noted in the hearing, no such extraordinary storms occurred in the Companies' service territories during the previous three calendar years; yet two such storms have occurred in 2018.[16] Given the unpredictable nature of such events and the obvious lack of ability to control the occurrence and timing of such, it stands to reason that it would be inappropriate to include the costs of such extraordinary events in the normalization calculation of storm damages used in the forecasted test period. Doing so would unnecessarily cause base rates to be higher than necessary and thus detrimental to customers. As noted during the hearing, the incorporation of the July 20 Storm and the November ice storm would have raised the request for normal storm damage expense in the Companies' current base rate proceeding by $5 million.[17]

At the hearing, the Commission remarked that materiality should not be a consideration for determining whether to establish a regulatory asset and correctly noted that FASB ASC 980[18] makes no mention of materiality.[19] In response, the AG's Brief now argues the Commission should ignore this well-established accounting standard and the evidence submitted in the Companies' responses to the Staff's post-hearing data requests to advance the AG's result-oriented percentage of rate base materiality standard. The Commission should reject the AG's plea to ignore long-standing accounting standards and the evidence the Commission requested at

[15] While beyond the scope of this application, the cost of the November 15, 2018 Ice Storm to LG&E of approximately $8.1 million is another example of an extraordinary event and cost not recovered by the normalized amount of storm damages in base rates.
[16] VTE 9:42:20 AM ("On record for the combined utilities, the July storm was the sixth level 4 event and the first since 2011."); 10:23:04 AM ("Question: "How many level 4 storms has the company experienced this year?"
Wolfe Answer: "Two, including the ice storm that we recently experienced.")
[17] VTE 10:19:02 AM
[18] Financial Account Standards Board Standards Codification 980-340-25-1 ("FASB ASC 980")
[19] VTE 11:40:10 AM; 11:44:00 AM

the hearing. The criteria in the *Kentucky Power* order are cumulative or in addition to the standards in FASB ASC 980. The Commission's decision in *Kentucky Power* did not pre-empt FASB ASC 980. The evidence in the Companies' responses to Staff's Post Hearing Data Requests shows that the Companies have consistently considered their internal policies on requesting regulatory asset treatment when determining whether the option to request regulatory asset authority exists, and with one limited exception (for which there was good cause) have consistently exercised their option to file for approval of regulatory asset treatment.[20] The Companies internal policies however do not, as the AG contends, "dictate the Commission's decisions."[21] The Companies believe, however, that it is entirely appropriate for the Commission to make such inquiries, as it has in this proceeding, as to what defines an "extraordinary, nonrecurring event." It was an attempt to be responsive to such inquiries that led to the Companies' discussion of such a "bright-line" standard. The Companies continue to believe that a single Level IV storm event which leads to storm damage expenses in excess of the annual amount embedded in base rates for more normal and recurring storm activity is a reasoned approach. The Companies' position, however, is not an attempt to pre-empt the Commission's authority to authorize deferral accounting as argued by the AG.

In the end, the AG finally concedes: "the Attorney General agrees that the nature of the expense must be appropriately considered in some part when determining whether the cost was "extraordinary" or "nonrecurring."[22] As a result, there can be "no room for difference of opinion

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[20] Response to Staff Post Hearing Data Request No. 3 ("Under its current methodology for determining whether to request regulatory asset treatment of storm damage, the minimum criterion is whether the storm is categorized as a Level IV storm. If a storm meets this minimum criterion, the level of expense associated with this storm relative to the amount of Storm Damage expense included in base rates is next considered. If an extraordinary storm meets both criteria, such a determination gives the Companies the option, rather than the obligation, to file for approval of regulatory asset treatment.")
[21] AG Brief, p. 6
[22] AG Brief, p. 8.

among reasonable minds" over what the evidence in this record shows: the July 2018 Storms were extraordinary and nonrecurring in nature.[23]

B. The Commission should reject the AG's result-oriented materiality arguments.

As previously stated, at the hearing, the Commission observed that materiality should not be a consideration for determining whether to establish a regulatory asset.[24] The AG, in response, now conceives an argument in his brief that based on the order involving Kentucky American Water Company some 18 years ago, the Commission has always "measured materiality of the expenses as a percentage of rate base," which "yields [the] amazing results" described at page 13 of the AG's Brief.[25] First, the facts in Commission's KAW Order make the decision clearly distinguishable from the present case. There, the utility without Commission approval had recorded nearly 20 regulatory assets for a number of minor items (the largest of which was $197,362) between 1991 and 1995. This five-year period was five years prior to the forecasted test period (December 1, 2000 through November 30, 2001) at issue in the KAW case.[26] In other words, KAW recorded numerous regulatory assets five to ten years before the forecasted test period filed on April 28, 2000 to support its increase in base rates. The facts in KU's and LG&E's pending cases are not even remotely comparable. Secondly, a review of the record in each of these cases where the Companies were granted authority to book regulatory assets or liabilities and the Commission's orders based on those records demonstrates the

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[23] *Energy Regulatory Com. v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980).
[24] VTE 11:40:10 AM; 11:44:00 AM ("Materiality, in terms of whether it's .00136% or whatever the factor comes out of rate base, that shouldn't be a consideration.")
[25] *In the Matter of: Application of Kentucky-American Water Company to Increase its Rates*, Case No. 2000-120 Order (Nov. 27, 2000)("KAW Order").
[26] KAW Order, pp. 13-22.

Commission did not use a percentage of rate base methodology to determine materiality.[27] And for good reason- rate base is a balance sheet item and is not rationally related to the measurement of the materiality of income statement items. In fact, using the balance sheet metrics to measure materiality changes to the income statement is arbitrary. In contrast, measuring the level of storm damage expense compared to the amount included in base rates is a rational relationship between the event at issue and the income statement.

Indeed, the AG ultimately concedes, "[i]n determining whether the storm damage expense proposed for deferral here is reasonable, the Commission must consider the magnitude of the level of the expense, both as compared to the amount in base rates and/or budgeted for…."[28]

Again, because there is "no room for difference of opinion among reasonable minds", *supra*, on whether the July 2018 Storm damages exceed the amount in current base rates and the amount included in the proposed change in base rates, the AG then argues the Commission should consider the financial impact on the Companies if the storm damages are expensed rather

[27] The only reference to this consideration is the dissenting opinion of Vice-Chairman Gardner in Case No. 2008-00457 which makes no mention of using rate base to assess the materiality KU's Hurricane Ike-related storm costs. *See In the Matter of*: Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset, Case No. 2011-00380; *In the Matter of*: Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset, Case No. 2009-00175; *In the Matter of*: Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset, Case No. 2009-00174; *In the Matter of*: Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset, Case No. 2008-00456; *In the Matter of*: Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset, Case No. 2008-00457; *In the Matter of: An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company*, Case No. 2003-00434; *In the Matter of Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Rates, a Certificate of Public Convenience and Necessity, Approval of Ownership of Gas Service Lines and Risers, and a Gas Line Surcharge*, Case No. 2012-00222*; In the Matter of: Application of Kentucky Utilities Company for an Adjustment of Base Rates*, Case No. 2009-00548; *In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of Electric and Gas Base Rates*, Case No. 2009-00549

[28] AG Brief, p. 8

than deferred.[29] In support of this new theory, the AG first contends that historical deviations between budgeted and actual storm damages somehow show the July 2018 Storm damages are "clearly neither extraordinary nor nonrecurring." This assertion erroneously assumes that weather did not vary over the periods in question and that storm repair expenses do not vary in direct proportion to weather. In fact, as the testimony of Mr. Wolfe shows, just the opposite is true.[30] And the AG's focus of the historical variance of actual storm expenses compared to budget "as a sine wave" is not, again, rationally related to the comparison of the July 2018 Storm damages to the amount in base rates now or included when base rates change in 2019.[31] The AG's argument also fails to account for the fact that to the extent storm damage expense is under budget in a particular year or years, then the normalization of the storm damages in the budgeting process for a future test year reduces the ongoing storm damage expense levels to the benefit of customers. It is for this very reason that the Companies moved to a three-year average for normal storm restoration in their current base rate proceedings as that period captured all of the work done prior to that time to harden the system and reduce the impact of storm damage. His assertions about the impact of the differences between budgeted and actual amounts spent on storm damages and vegetation management in previous years on the Companies' earnings per share during the same time periods completely disregard the highly influential impact of weather on these expense levels, sales, revenues and earnings per share. While the Commission's order in Kentucky Power contains the observation that "[r]eflecting the … storm costs as expenses on Kentucky Power's … books would have a significant impact on the … results," the Commission's holding in Kentucky Power is very clear:

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[29] The AG's Brief at page 9 states: "In reviewing the Companies storm damage costs in this matter as compared to the amount embedded in base rates, it is without question that they exceed the amount LG&E/KU expect to incur."
[30] VTE 9:27:15 AM; 9:40:10 AM
[31] AG Brief, p. 10

> Having reviewed the record and being otherwise sufficiently advised, the Commission finds that Kentucky Power's total 2015 storm-related damage and service-related restoration costs at issue herein are extraordinary and significant in nature based on their magnitude and the amount of storm damage expenses built into its base rates.

The Companies' evidence more than meets this standard. The AG simply disagrees to achieve a desired result- the disallowance of prudently incurred costs to provide public safety and restore customers' service in a timely fashion under extreme conditions.

If the AG's unreasonably high threshold for materiality is imposed and regulatory asset treatment is denied, KU and LG&E will have to adjust their budgeting in the pending rate cases to account for Level IV storm events as a cost of providing service. As previously stated, this change will significantly increase the normalized expense levels for storm damages in base rates, increasing rates higher than they otherwise need to be if deferral accounting is authorized.

C. The AG's criticism of the Companies' vegetation management disregards the evidence in the record.

The AG finally contends that the Companies have "creat[ed] unnecessary risks that would otherwise be mitigated by expending the recovered amount annually."[32] The evidence in the record completely refutes this dubious claim.

At the hearing, the testimony of Mr. Wolfe demonstrated the Companies have increased their spending on tree trimming:

> We budget our tree trimming on a 5 years basis, essentially we are addressing 20% of the circuits of the system every year, and through that methodology you would assume that the system was completely trimmed over a 5 year period. Budgeting in that manner, if we look at the last 5 year period and the previous 5 year

[32] AG Brief, p. 13.

> period, we have spent $37M more in the last 5 year period compared to the previous 5 year period.[33]

Mr. Wolfe further explained the good and valid reasons why the Companies actual spending on vegetation management was less than the budgeted amount in 2016 and 2017:

> [D]ue to the period particularly in 2017, when you have mild weather, and you have less violent storms, which our storm budget was roughly half in 2017 of what it had been in the previous year [2015], when you experience that type of reduction in storm activity on your grid, you essentially have less damaged trees on your grid. And a lot of what our vegetation management crews have to do throughout a year is to address trees that have broken limbs, decayed limbs, and those create problems as they fall into or come into contact with our facilities. And when you have less activity of that nature, it requires our crews to have less activity, less requirements to go out and make corrections, what we call 'hot spot trimming'.[34]

The Companies reliability performance in recent years has been outstanding. As Mr. Wolfe made clear when he testified, "[t]he actual SAIDI and SAIFI for our customers in 2016 and 2017 was the lowest in the history of the companies, for the combined utilities. So what our customers experience as far as outages during those two years, it was the lowest reliability that they have ever experienced, and that was primarily attributable to the reduced storm activity and reduced tree vegetation interference with our grid."[35] In other words, the 2017 and 2016 SADI and SAFI results are the best reliability outcomes in the Companies' history.[36]

Mr. Wolfe also rebutted the AG's contention that the Companies tree trimming practices somehow contributed to the July 2018 Storm damage and associated expense with this testimony:

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[33] VTE, 9:19:17 AM

[34] VTE, 9:27:08 AM

[35] VTE, 9:28:10 AM

[36] VTE, 9:43:15 AM (Vice Chairman Cicero: "I don't think anyone would argue that reliability is – LG&E and KU have great history.")

> If you just take it as a math problem, 20% of the circuits, the amount of the budget that was not achieved or that we under-ran relative to the budget that was allocated it ended up being roughly 2% of all the circuits on the system. And we know, as an example in Lexington, where most of the outages occurred during the July storm, 85,000 customers in Lexington, 67% of the circuits in Lexington were impacted. This was a result of 70-80 mph winds, not our tree trimming practices.[37]

In other words, during 2017, the Companies spent $2.7 million or 7.5% less what was budgeted, arguably affecting 1.7% of the total circuits. The July 2018 Storm affected well over 30% of the Companies' circuits and over 50% in Lexington where 85,000 customers were out of service.

The AG's dismissal of the importance of Companies' distribution automation equipment is also misplaced. While the SCADA capable reclosers do not prevent storm damage from occurring, they do prevent outages from occurring to customers.[38] In the areas where the storm occurred and DA was installed, the number of customers experiencing outages was reduced by 42.3% over the number affected if no DA in place.[39] In the wake of the July 20, 2018 Storm alone, the re-closers avoided 3,000 customer interruptions and 4.8 million customer outage minutes.[40]

There is "no room for difference of opinion among reasonable minds" over what the evidence in this record shows: the Companies distribution automation and tree trimming practices are sound and prudent.[41]

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[37] VTE, 9:28:37 AM
[38] VTE, 9:15:51 AM
[39] KU/LG&E Response to AG Request for Information 1-7(a.i.) attachment.
[40] KU/LG&E Errata Filing, p. 1 (Ky. PSC Sept. 28, 2018).
[41] *Energy Regulatory Com. v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980).

III. Conclusion

The requested regulatory liabilities arise from a change in expense "resulting from a statutory or administrative directive."[42] Prior approval is required by the Commission's orders. The record fully supports the establishment of these regulatory liabilities.

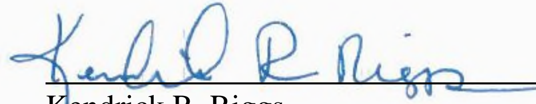
The July 2018 Storm and the associated expenses were nonrecurring and extraordinary. The Companies' budgeting processes are not designed to anticipate these extraordinary events, which is why deferral accounting is now necessary. The record fully supports the establishment of these regulatory assets.

For these reasons the Commission should issue an order by December 31, 2018 authorizing the establishment of the regulatory liabilities and assets proposed in the Companies' application.

[42] *In the Matter of Kentucky Power Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to the Extraordinary Expenses Incurred by Kentucky Power Company in Connection with Two 2015 Major Storm Events*, Case No. 2016-00180 Order, p. 5 (Nov. 3, 2016).

Dated: December 11, 2018

Respectfully submitted,



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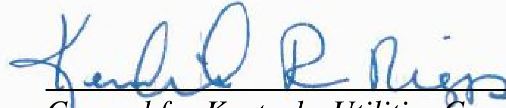
<u>**CERTIFICATE OF COMPLIANCE**</u>

In accordance with 807 KAR 5:001 Section 8(7), this is to certify that Kentucky Utilities Company's and Louisville Gas and Electric Company's December 11, 2018 electronic filing of this Reply Brief is a true and accurate copy of the documents being filed in paper medium; that the electronic filing was transmitted to the Commission on December 11, 2018; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original in paper medium of the filing will be filed with the Commission within two business days from the date of the electronic filing.



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