COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ATTORNEY GENERAL'S POST-HEARING BRIEF

Comes now, the Attorney General of the Commonwealth of Kentucky, Andy Beshear, by and through his Office of Rate Intervention, and provides his Post-Hearing Brief in the above-styled matter. For the reasons provided below, the Kentucky Public Service Commission ("PSC" or "Commission") should: 1) approve the proposed request to establish regulatory liabilities for the effects of recent Kentucky state tax reform, and 2) deny the proposed request to establish regulatory assets for the recovery of actual incremental amounts incurred as a result of the July 2018 Storm.

ARGUMENT

1. The Commission Should Approve the Proposed Regulatory Liabilities Resulting From Recent Kentucky State Tax Reform

Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (collectively "LG&E/KU" or "the Companies") filed a Verified Application ("Application") on September 12, 2018 requesting, *inter alia*, authority "to establish regulatory liabilities to account for the excess ADIT [accumulated deferred

income taxes] created by recent Kentucky state tax reform."[1] The Companies noted that reduction of the state corporate tax rate from 6% to 5% creates tax savings, including the change in the pace of ADIT reversal, "creating 'excess deferred taxes.'"[2] Regarding excess deferred income taxes, the reduction in the state corporate tax rate creates the need for the Companies to create regulatory liabilities, including amounts for gross-up of "$19.4 million for KU, $12.5 million for LG&E Electric, and $3.1 million for LG&E Gas."[3] The Companies further state that "consistent with prior state tax reform cases" they have chosen not to request deferral accounting for the savings resulting from the reduction in income tax expense.[4] The consequence of the Companies failing to request deferral accounting for the reduction in income tax expense is, of course, to the benefit of the Companies until new rates are set and the state income tax expense amounts *moving forward* are holistically embedded in the Companies' base rates.[5] Although the Companies errantly stated in the Application that "they request to amortize the excess ADIT," at the hearing LG&E/KU witness Mr. Robert Conroy confirmed the Companies are merely requesting approval to establish the regulatory liabilities as it deals with the tax change.[6]

The Attorney General sees no reason in the record for the Commission to deny the Companies' proposal for regulatory liabilities. Nonetheless, the Attorney General questions why the Companies chose not to request deferral accounting to reflect the reduction in income tax expense in addition to why the Companies chose to file their

[1] Application at 11.
[2] *Id*. at 4.
[3] *Id*.
[4] *Id*.
[5] The Companies have proposed new base rates in Case Nos. 2018-00294 (KU) and 2018-00295 (LG&E Gas and Electric).
[6] Application at 5; Video Testimony Evidence ("VTE") at 9:05:23.

"request" for a regulatory liability in a matter separate from their rate cases. The Companies provided no reason that the request for regulatory liabilities had to be filed separate from the rate cases, or why they had to request Commission approval at all to defer those excess ADIT. In fact, LG&E/KU witness Mr. Chris Garrett noted that the state tax reform portion of this matter merely meets the administrative directive, not that Commission approval is necessary as it is for storm damage expense.[7] The Attorney General can find no reason why the Companies' request for regulatory liabilities was filed in this particular matter, other than possibly providing some offset to the regulatory asset request for the Commission's consideration. Importantly, and as the Commission is surely aware, the regulatory assets and liabilities requested herein are distinct and unrelated, and the approval or denial of one must have no bearing on the other. Any attempt by the Companies to treat their Application as one for ultimately a "net regulatory liability," must be summarily dismissed.[8]

2. The Companies Failed to Meet Their Burden Regarding Deferral Accounting for Expenses Relating To The July 20 Storms, and Thus The Commission Must Deny Their Request

In addition to requesting deferral accounting to establish regulatory liabilities, the Companies also request Commission approval to accumulate and defer regulatory assets related to expenses incurred following storms on July 20, 2018.[9] The Companies' Application describes the July 20, 2018 storms, providing statistics and data regarding the number of customers left without power, size of hail, and wind speed.[10] Further, the Companies provided

[7] VTE at 10:38:05.
[8] *See* VTE at 9:00:15.
[9] Application at 11.
[10] *Id*. at 6.

initial estimates of their "incremental" O&M expenses resulting from the storm, at "approximately $7.1 (KU $4.7 and LG&E $2.4) million, which excludes normal operations expenses currently embedded in base rates."[11]

A. STANDARD

The Commission, in Case No. 2016-00180 ("*Kentucky Power*"), recently restated the long-held standard applicable in this matter,[12] holding that approvals for regulatory assets for storm damage must be consistent with the first of four factors it ordinarily requires in order to grant utility requests for regulatory assets.[13] To receive PSC approval for deferral accounting for storm damage expense, the utility must have incurred "an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning."[14] Further, in *Kentucky Power* the Commission noted that the utility "relie[d] on Financial Accounting Standard Board Standards Codification 980-340-25-1 ('FASB Codification 980-340-25-1') as authority for the creation under prescribed circumstances of a regulatory asset."[15] FASB Codification 980-340-25-1 provides, in relevant part, that:

> Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable . . . that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment

[11] *Id*. at 8.
[12] Case No. 2016-00180, *In Re Application 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*.
[13] Order, *Kentucky Power* (Ky. PSC Nov. 3, 2016) at 5.
[14] *Id*. at 5.
[15] *Id*. at 3 (internal citations omitted).

> clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.[16]

Although the Attorney General believes the "extraordinary, nonrecurring" standard restated in *Kentucky Power* applies in this matter, FASB Codification 980-340-25-1 does not.[17] The FASB accounting section provides guidance to regulated operations regarding the proper accounting procedures *outside* of direct guidance from a regulator. This fact is evidenced by the language of FASB Codification 980-340-25-1, particularly its focus on previous regulatory decisions or actions, and the probability of treatment moving forward.[18] When a regulator requires that a utility receive explicit approval before deferring a regulatory asset, such as the Commission did in *Kentucky Power*, FASB Codification 980-340-25-1 is unnecessary. When a utility regulator takes upon the task of whether or not to allow the deferral accounting, the utility needs no guidance on this issue, nor does it need to gauge the likelihood or probability of whether the regulator will approve recovery. Thus, consideration of FASB Codification 980-340-25-1 is unnecessary in this matter. Furthermore, since the Commission must explicitly approve the deferral, the order doing so implicitly makes a finding regarding the reasonableness of the incurrence of the expenses themselves. This would effectively foreclose any argument against the recovery of the regulatory asset. Therefore, the decisions as to whether or not these costs will be deferred *and* ultimately will be recoverable are in front of the Commission now for its decision.

[16] Attorney General's Hearing Exhibit 3, page 1 of 3.
[17] The Attorney General's argument here would not necessarily apply in instances where the utility believes it has an expense that meets the threshold and the instance leading to those expenses occurs late in a fiscal year, as described in the Dec. 12, 2016 rehearing order in *Kentucky Power*. In that instance, the utility should depend on the FASB codification and Commission precedent in order to defer for future review a regulatory asset if it meets the standard.
[18] Attorney General's Hearing Exhibit 3, page 1 of 3.

Lastly, much was made at the hearing about the Companies' process of determining when to request deferral accounting for extraordinary storm damage expense. At the outset, the Companies' criteria regarding when to *request* regulatory assets should be of no consideration to the Commission in determining whether to *approve* a regulatory asset.[19] Allowing the Companies' internal controls to dictate the Commission's decisions would be self-serving and detrimental to customers.

As will be explained below, the Companies' internal decision-making on this subject is anything but objective.[20] Additionally, to seriously consider LG&E/KU's internal decision-making on this subject as a "criteria," a "policy" or "procedure" are abuses to the words as ordinarily used. The Companies' position about their decision-making process on this subject throughout this proceeding has been ethereal to say the least. When asked by the Attorney General in discovery whether "the Companies have in their possession any formal or informal guidance or policy documents on this subject," they provided none.[21] Instead, the Companies' response to the Attorney General indicated a holistic approach to requesting deferral accounting, doing so on a "case-by-case basis depending on the facts and circumstances of the expense and accounting guidance and regulatory orders."[22] Then at the hearing the Companies began to casually mention that the internal designation of a storm as a "level 4" was the bright-line rule as to when they decide to request deferral accounting or not.[23] The hearing was the first time counsel for the Attorney General had been made aware of this

[19] *See* VTE at 10:22:58, wherein LG&E/KU witness Mr. Wolfe notes the "Level 4" designation is a "Company Standard."
[20] For instance, in the Companies' response to the Staffs post-hearing data request No. 3, they noted they did not ask for deferral accounting for extraordinary storm damage expense in 2004 because, among other things, they recently had a rate case and those cases were on rehearing.
[21] LG&E/KU Response to Attorney General Data Request 1-5.
[22] *Id*.
[23] VTE at 9:08:00, 10:20:47.

bright-line "level" designation. As the hearing progressed, and when presented with their previous responses outlining their internal controls, the Companies' witnesses began to walk back that bright-line designation, retreating to their previous position that they take into account the magnitude of the costs and the regulatory and accounting standards, taking both a "qualitative and a quantitative view" on the subject.[24] In response to Staff's Post-Hearing Data Requests, the Companies finally provided the internal guidance that the Attorney General requested weeks ago, and have now married their previously alternating positions, attempting to explain that:

> 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 determination give the Companies the option, rather than the obligation, to file for approval of regulatory asset treatment.[25]

The Attorney General is glad to finally have the Companies' actual position on when they seek deferral accounting. However, beyond the fact that adoption of a utility's internal controls as a basis for the Commission to make a decision would be self-serving to the utility, an unbiased review of the Companies' position on when to seek Commission approval for deferral accounting demonstrates that it fails to be objective in any way. As such, the Commission should ignore this internal policy when considering the present Application.

[24] VTE at 11:34:14-11:35:12.
[25] LG&E/KU Response to Commission Staff's Post-Hearing Data Request, No. 3.

B. MATERIALITY

The standard the Commission must apply in this matter, whether or not the expenses incurred following the July 20, 2018 storms are "extraordinary, nonrecurring expense[s] which could not have reasonably been anticipated or included in the utility's planning,"[26] applies to both the nature and the level of expense. For the Commission to hold any sort of bright-line rule, such as approving deferral accounting for storm damage expense only on the basis of outage duration or number of customer outages, would be unreasonable and create perverse incentives for jurisdictional utilities. Furthermore, ignoring the magnitude of the costs, either regarding the financial impact to the utility in expensing them or in relation to the amount reflected in rates, creates unreasonable outcomes. Imagine if a hall of fame NFL linebacker drove to Kentucky and tackled the mailbox at KU's Morganfield call center, causing $100 in damages. Would the Commission permit deferral accounting for that $100 cost solely because of the extraordinary, nonrecurring nature of the expense? Likely not. First, damages in the ordinary course, like a broken mailbox, occur to utility property all the time. Second, if the Companies' shareholders cannot absorb the $100 cost of putting in a new mailbox, regardless of the amount recovered in rates for this type of costs, then why are they allowed a return for the risk of providing service? All the same, 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."

In 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 recovered in rates and/or budgeted for, as well as the costs' impact

[26] *See* Order, *Kentucky Power* (Ky. PSC Nov. 3, 2016) at 5.

on the Companies if they must be expensed rather than deferred. For instance, in *Kentucky Power* the Commission found that the costs at issue in that matter "are extraordinary and significant in nature based on their magnitude and the amount of storm damage expense built into its base rates."[27] The Commission went on in that matter to note that reflecting the storms' costs as expenses on the utility's "books would have a significant impact on its 2015 financial results."[28] Further, although the Commission noted the number of customer outages, it did so only in referencing that the utility's effort to restore those customers "incurred an extraordinary high level of costs."[29] When comparing the Companies' proposed storm damage costs in the instant matter, they are not extraordinary in magnitude compared to the expense level built into base rates, nor are they so when determining their impact to year-end financial results.

In reviewing the Companies' storm damage costs in this matter as compared to the amount embedded into base rates, it is without question that they exceed the amount LG&E/KU anticipated to incur.[30] Importantly though, having an expense level merely exceeding the level embedded in rates does not merit deferral accounting. As the Commission reviews this issue, it should contemplate how it perceives deviations from the amount of cost embedded in rates. For instance, in the previous calendar year, 2017, KU and LG&E were under budget for storm restoration expense by approximately $2.8M and $1.5M, respectively, and for 2016, KU was under budget by approximately $2.5M while LG&E was under budget by about $1M.[31] The Commission should study these annual costs, as well as the amount for

[27] *Id*. at 5.
[28] *Id*. at 5.
[29] *Id*. at 5.
[30] Application at 8.
[31] Attorney General's Hearing Exhibit 13, Attachment.

2018 including the cost considered herein, as deviations from the amount budgeted or included in rates. The PSC should imagine these deviations as a sine wave that represents the annual actual storm expense along an x-axis that itself represents the amount embedded in rates or budgeted. In 2016 and 2017 (and 2015 for KU), the actual cost for this expense type deviated a few million dollars *below* the budgeted amount.[32] The expectation is that for at least October 2018 year-to-date ("YTD"), the deviation of actual cost from the level of storm expense budgeted will be a few million dollars *higher*, or $7.885M on a combined basis.[33] From 2014 to 2017, on a combined basis, the Companies were approximately $9.5M over budget, $.5M under budget, $3.5M under budget, and $4.3M under budget each year, respectively, for storm damage expense.[34] Using just the past four full calendar years' data, the Companies' July 20, 2018 Storm Expenses are clearly neither extraordinary nor nonrecurring. Finally, regarding deviations of O&M expenses, as LG&E/KU witnesses Mr. Wolfe and Mr. Arbough both noted, coming in under budget for O&M expenses, like the Companies recently have, inures to the benefit of shareholders by bolstering earnings per share.[35]

As the Commission did in its precedential case, *Kentucky Power*, it must here consider the financial impact to the Companies if they expense the cost in considering whether to approve the proposed deferral accounting.[36] One way the Commission could consider the impact of the July 20 storm costs is to determine the YTD effect that expensing those costs would have on the Companies' earnings per share. As Mr. Arbough confirmed at the hearing

[32] *Id*.
[33] *See* LG&E/KU Response to Commission Staff's Post-Hearing Data Request No. 1.
[34] *Id.*
[35] VTE at 9:59:27, 9:30:57.
[36] Order, *Kentucky Power* (Ky. PSC Nov. 3, 2016) at 5.

in this matter, expensing those July 20 storm costs has minimal effect on the Companies, as on a combined LKE basis they would still be $7M under O&M budget, and all else equal earnings per share would still exceed expectations.[37]

Furthermore, the Attorney General appreciates the Vice Chairman's comment that it is important for the Commission to be "consistent in its approach" on the application of the standards in these type of matters.[38] In doing so, the PSC should follow the path laid out in the Kentucky-American Water matter, Case No. 2000-00120 ("*KAW*"), discussed at the hearing in this matter.[39] At the outset, the Attorney General notes that *KAW* should be considered persuasive by the Commission, if not precedential. In *KAW*, the Commission considered the reasonableness of the deferral of O&M expenses and ruled against the utility, noting that, "[n]one of these items warrant deferred treatment . . . due to their immateriality."[40] The Commission in *KAW* measured the materiality of the expenses as a percentage of rate base, which is a relevant method because a utility's rate of return is ordinarily determined using rate base, and thus gauging the cost as a percentage of rate base provides an objective measure as to the impact on earnings that expensing the cost may have.[41] Commission Staff just recently used cost as a percentage of net utility plant as a reasonable measure of materiality, albeit when considering capital costs.[42] However, expensing an item would have a far larger impact on earnings in a given year than the use of capital to invest in plant.

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[37] VTE at 10:01:52; Attorney General's Hearing Exhibit 14, page 252 of 260.
[38] VTE at 11:43:45.
[39] Case No. 2000-00120, *In Re Application of Kentucky-American Water Company to Increase its Rates.*
[40] Attorney General's Hearing Exhibit 2, at 22.
[41] *Id*. at 22-23.
[42] Kentucky Public Service Commission Staff Opinion, *In Re Nolin Rural Electric Cooperative Corporation* (Ky. PSC Nov. 29, 2018).

It must first be noted that it is highly unlikely that the expenses deferred in *KAW* were provided for at any level in base rates, as opposed to storm expense here, which merely exceed the amounts embedded in rates.[43] Having no provision in rates for a cost definitely speaks more to the nature of "extraordinary," "nonrecurring" and not reasonably anticipated in a utility's planning far more than a cost that exceeds the amount currently reflected in rates.[44] Using the methodology provided by the Commission in *KAW*, and applying it to the proposal here and the Companies' past experiences provides further support for the Commission to deny the requested deferral accounting.

Upon calculating the largest expense, reorganization costs, as a percentage of rate base, the PSC in *KAW* found it represented only .1386% of rate base and determined that to be an immaterial amount.[45] Performing the same calculation for the July 20, 2018 storm damage expense[46] as a percentage of rate base provided in the 2018 rate cases,[47] the 2011 storm expense[48] as a percentage of rate base provided in Case No. 2012-00222,[49] the 2009 winter ice storm events[50] as a percentage of rate base provided in Case Nos. 2009-00549[51] and 2009-00548,[52] the 2008 Hurricane Ike storm costs[53] as a percentage of rate base provided in Case Nos. 2009-00549[54] and 2009-00548,[55] and the 2003 ice storm as a percentage of rate base

[43] Attorney General's Hearing Exhibit 2, at 14-22.
[44] *See* Order, *Kentucky Power* (Ky. PSC Nov. 3, 2016) at 5.
[45] Attorney General's Hearing Exhibit 2, at 22-23.
[46] See Application at 8.
[47] Attorney General's Hearing Exhibit 6, page 2 of 5 of Attachment; Attorney General's Hearing Exhibit 7, page 2 of 7 of Attachment.
[48] Application at 9.
[49] Attorney General's Hearing Exhibit 8, Attachment.
[50] Application at 9.
[51] Attorney General's Hearing Exhibit 9, Attachment.
[52] Attorney General's Hearing Exhibit 10, Attachment.
[53] Application at 10.
[54] Attorney General's Hearing Exhibit 9, Attachment.
[55] Attorney General's Hearing Exhibit 10, Attachment.

provided in Case No. 2003-00434,[56] and comparing the outcomes amongst these instances, yields amazing results. First, the storm costs as a percentage of rate base in the current matter do not exceed the threshold established in *KAW*.[57] Second, for those previous cases where the Commission has granted deferral accounting to the Companies, the ratio of the costs to rate base *did* exceed the threshold set in *KAW*, except in one instance, which the Attorney General will explain, *infra*. Finally, the ratios of the storm costs as a percentage of rate base for every single event cited by the Companies as precedent, except for one, exceeds the ratios in the current matter. The singular immaterial instance noted above where the Commission nevertheless granted deferral accounting was for the KU costs related to the 2009 winter storm.[58] Nevertheless, in that instance, LG&E received a $24.1M regulatory asset for incremental O&M, thus on a combined basis the request was in excess of $26M, more than three-times the combined request in this manner.[59] In fact, other than the 2003 KU-only ice storm request, the instant case seems to be the smallest deferral accounting request on a combined or singular basis in recent history.

C. VEGETATION MANAGEMENT

Vegetation management spending has a direct impact on the level of storm damage during any given event.[60] By spending less on this expense type than is recovered from customers, the Companies create unnecessary risks that would otherwise be mitigated by expending the recovered amount annually. In underspending this expense type over the past number of years, the Companies have ultimately benefitted shareholders.[61] At the same time,

[56] Attorney General's Hearing Exhibit 12, Attachment.
[57] KU- .10077% & LG&E-.06976%.
[58] See Application at 10.
[59] *Id*.
[60] VTE at 9:34:15.
[61] VTE at 9:59:27, 9:30:57; Attorney General's Hearing Exhibit 16, Attachment 1.

the Companies have invested approximately $30M in Distribution Automation ("DA"), primarily on SCADA-capable reclosers.[62] Notably, DA does not reduce storm damage, but instead reduces outages as a result of instances such as storms.[63] Conversely, robust, and when appropriate — targeted, vegetation management *does* reduce the risk of storm damage and thus storm damage expense.[64] The Companies' underspending on this item can have a direct impact on the ultimate price customers pay. If there is one O&M item the Companies should ensure they spend at the level budgeted it is vegetation management. A chronic underspend on this item will ultimately lead to higher costs for customers. Allowing the Companies to underspend the amount allocated for vegetation management, to the benefit of shareholders, while simultaneously allowing them to invest tens-of-millions of dollars on DA, upon which shareholders earn a return, creates an unreasonable and untenable situation for customers. The Commission must require the Companies to spend at the levels recovered for this expense type, and ensure they do so by identifying issues on a more granular, circuit level, and by planning specifically for those concerns.[65]

CONCLUSION

WHEREFORE, based on the foregoing, the Attorney General of the Commonwealth of Kentucky respectfully requests the Kentucky Public Service Commission approve the Companies' requests to create regulatory liabilities and deny their requests to create regulatory assets.

[62] LG&E/KU Response to Attorney General Data Request 1-7.
[63] VTE at 9:18:34.
[64] VTE at 9:18:42.
[65] VTE at 9:31:25-9:35:35.

Respectfully submitted,

ANDY BESHEAR
ATTORNEY GENERAL

KENT A. CHANDLER
REBECCA W. GOODMAN
JUSTIN M. MCNEIL
LAWRENCE W. COOK
ASSISTANT ATTORNEYS GENERAL
700 CAPITAL AVE., SUITE 20
FRANKFORT KY 40601-8204
(502) 696-5453
Kent.Chandler@ky.gov
Rebecca.Goodman@ky.gov
Justin.McNeil@ky.gov
Larry.Cook@ky.gov