PGE at a Glance

Quick Facts

• Vertically integrated energy company encompassing generation, transmission and distribution
• 877,000 customers\(^1\)
• Serves 46 percent of Oregonians, 51 incorporated cities
• Service area covers majority of Oregon’s commercial and industrial activity

Financial Snapshot (\textit{YE 2017})

• Revenue: $2.0 billion
• Non-GAAP earnings per share: $2.29\(^2\)
• Net utility plant assets: $6.7 billion

---

1) As of 3/31/2018
2) Non-GAAP earnings per share reflect an adjustment of $0.19 for the impact of the Tax Cuts and Jobs Act. Reported GAAP earnings per share for 2017 are $2.10.
Tax Reform Impacts

Executive Summary

The Tax Cuts and Jobs Act (Tax Reform) was enacted on December 22, 2017 and is effective January 1, 2018. However, since the bill was enacted in 2017, US GAAP requires that the impacts of Tax Reform be reflected beginning with the 2017 financial statements.

Financial Statement Impacts:

2017 (Actuals)
- $17M increase to income tax expense
  - $357M increase to regulatory liability
  - $340M decrease to deferred tax liability

2018 (Actuals through March 31st)
- $15M decrease to income tax expense
- $3M tax normalization refund

Other Impacts:

Regulatory Strategy
- Defer regulatory items with financial impacts in 2017 and 2018 to a future proceeding

Elimination of the §199 Domestic Production Activities Deduction

Production Tax Credit (PTC) Carryforward Balance
- Lower PTC utilization anticipated with less tax expense to offset

Indirect Impacts to RFP
## Background

### Deferred - Tax Mechanics

<table>
<thead>
<tr>
<th>Deferred Tax Assets (DTAs)</th>
<th>Deferred Tax Liabilities (DTLs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Future tax benefit</td>
<td>Future tax expense</td>
</tr>
<tr>
<td>Book expense recognized now</td>
<td>Book expense recognized later</td>
</tr>
<tr>
<td>Tax deduction recognized later</td>
<td>Tax deduction recognized now</td>
</tr>
</tbody>
</table>

**Increases rate base**
Since shareholders have financed the cost of the expense before the tax benefit is recognized, shareholders earn a return

**Decrease rate base**
Since customers have financed the cost of the expense before the tax benefit is recognized, shareholders pay customers a return

**Example**
*Accrued Incentives –* Book expenses the incentive liability as it is accrued, while tax deducts only once the incentive is paid. This leads to higher initial book expense.

**Example**
*Depreciation –* Book depreciates fixed assets over straight line, while tax generally accelerates over a shorter time frame. This leads to higher initial tax deductions.
Background

Deferred - Regulatory Categories

DTAs/DTLs revaluation relates to the following subgroups:

Protected:
- Property-related items, the majority of deferred income taxes
- Tax Reform impact amortized in accordance with Average Rate Assumption Method (ARAM) and given back to customers over time
- Subject to normalization rules (i.e. amortization of gain/loss cannot occur more rapidly than would have occurred before tax reform)

Non-Protected:
- Not subject to normalization rules
- Included in the deferral application (one-time deferral of expected benefits submitted to the OPUC) and given back to customers over time
Regulatory Strategy

Deferral Application

A deferral application was filed with the OPUC on December 29, 2017.

- Defer regulatory items with income statement impacts in 2017 and 2018 to a future proceeding
  - Proposed a multi-year amortization period
  - Proposed limitation that only benefits in excess of the allowed regulated ROE of 9.5% will be passed back (subject to an Earning Test through the Results of Operations)

The Commission received application from OPUC Staff on December 29, 2017.

- Application requests all Tax Reform benefits to be returned to customers without mention of an earnings test

Conduct initial workshops held with OPUC staff to discuss Tax Reform.
2018 Federal Tax Reform Deferral

Summary

• On March 23rd, OPUC staff provided guidance to use a 2018 “proxy year” in calculating the 2018 tax reform deferral amounts.

• The proxy year method management is using to calculate the deferral is:
  ▪ \([(\text{Actual regulated results of operations YTD}) + (\text{Forecasted regulated results BOY})] * \text{Pre-reform tax rates}\)
  ▪ \textbf{Less:} \([(\text{Actual regulated results of operations YTD}) + (\text{Forecasted regulated results BOY})] * \text{Post-reform tax rates}\)
  ▪ = Deferral to be refunded to customers

Due to differences in the calculation of regulated results of operations and SEC results of operations, the deferral is expected to introduce earnings drag compared to the SEC budget. This difference is primarily related to items disallowed for regulatory recovery, such as incentives.
Indirect Impacts

Weakened economics to build

Base Erosion Anti-Abuse Tax (BEAT)

• Multinational corporations (e.g. many banks who finance tax equity deals) with payments between different jurisdictions will most likely face the BEAT tax and have limitations for PTC utilization

• Independent power producers who leverage tax equity structures will mostly likely see increased costs when negotiating deals

Immediate Capital Expensing and Interest Expense Deductibility Limits

• Companies may choose to 100% expense newly placed in service assets through the end of 2023

• Companies interest expense deductibility may be limited

• Regulated utilities are exempt from both provisions

• IPPs will be better able to recognize cash tax savings immediately, but may see additional costs if projects are debt-financed and their interest expense is limited
Indirect Impacts (cont’d)

Credit Ratings

Coverage Ratios

• EBIT and EBITA will go down
• EBITA to Debt lower
• Interest coverage is lower

Stressed Credit Ratings

• Incremental cash flow shortfalls causing utilities to reevaluate financing strategies
• Balance sheet changes due to the reclassification of excess deferred tax liabilities as regulatory liability and magnitude of any amounts to be refunded to customers

Earnings Volatility

Tax Shield

• Decreased tax shield for variances in revenue and expenses.
• Decreased tax shield for non-utility or disallowed utility expenses.
Overview - LG&E and KU a PPL Company

- Headquartered in Louisville, KY.
- Vertically-integrated utilities serving 2/3 of counties in Kentucky
- Small customer base in Virginia and Tennessee
- Approximately 1.3 million customers
- Operating revenue: $3 billion
- Net Income: $286 million
- Rate Base: $9.2 billion
- Electricity delivered (GwH): 31,839

**Louisville Gas & Electric**
- Serving Louisville, KY. + 16 surrounding counties
- 411,000 electric customers
- 326,000 gas customers
- 2,920 MW of regulated generation
- 669 pole miles of electric transmission
- 6,445 miles of electric distribution
- 4,706 miles of gas transmission and distribution

**Kentucky Utilities**
- Serving 77 counties in KY and 5 in VA
- 553,000 electric customers
- 5,097 MW of regulated generation
- 4,800 pole miles of electric transmission
- 16,500 miles of electric distribution

Data as of December 31, 2017. Source: 10-K
Generation data represents LKE ownership or other interest.
Regulation of LG&E and KU

Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) are separate regulated entities with different rates, and are subject to the jurisdiction of the following regulatory bodies:

• Federal
  – Federal Energy Regulatory Commission (“FERC”)
    • KU Municipals, Off-system Sales, Transmission (OATT)
• State
  – Kentucky Public Service Commission (“KPSC”)
    • KU, LG&E Electric, LG&E Gas
  – Virginia State Corporation Commission (“VSCC”)
    • KU Only
  – Tennessee Regulatory Authority (“TRA”)
    • KU Only

Methodologies for recovering expenses and earning a return on our investment vary for each jurisdiction.
## TCJA Financial Statement impacts for LG&E and KU Energy LLC – December 31, 2017

Extracted from the 2017 10-K filing:

The changes enacted by the TCJA were recorded as an adjustment to the Registrants' deferred tax provision, and have been reflected in "Income Taxes" on the Statement of Income for the year ended December 31, 2017 as follows:

<table>
<thead>
<tr>
<th></th>
<th>PPL</th>
<th>PPL Electric</th>
<th>LKE</th>
<th>LG&amp;E</th>
<th>KU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax expense (benefit)</td>
<td>$ 321</td>
<td>$ (13)</td>
<td>$ 112</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

The components of these adjustments are discussed below:

### Reduction of U.S. Federal Corporate Income Tax Rate

At the date of enactment, the Registrants’ deferred taxes were remeasured based upon the new U.S. federal corporate income tax rate of 21%. For PPL’s regulated entities, the changes in deferred taxes were, in large part, recorded as an offset to either a regulatory asset or regulatory liability and will be reflected in future rates charged to customers. The rate reduction on non-regulated deferred tax assets and liabilities were recorded as an adjustment to the Registrants' deferred tax provision, and have been reflected in "Income Taxes" on the Statement of Income for the year ended December 31, 2017 as follows:

<table>
<thead>
<tr>
<th></th>
<th>PPL</th>
<th>PPL Electric</th>
<th>LKE</th>
<th>LG&amp;E</th>
<th>KU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax expense (benefit)</td>
<td>$ 220</td>
<td>$ (13)</td>
<td>$ 112</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

For PPL’s U.S. regulated operations, reductions in accumulated deferred income tax balances due to the reduction in the U.S. federal corporate income tax rate to 21% under the provisions of the TCJA may result in amounts previously collected from utility customers for these deferred taxes to be refundable to such customers over a period of time. The TCJA includes provisions that stipulate how these excess deferred taxes are to be passed back to customers for certain accelerated tax depreciation benefits. Potential refunds of other deferred taxes will be determined by the Registrants’ regulators. The Balance Sheets at December 31, 2017 reflect the increase to the Registrants' net regulatory liabilities as a result of the TCJA as follows:

<table>
<thead>
<tr>
<th></th>
<th>PPL</th>
<th>PPL Electric</th>
<th>LKE</th>
<th>LG&amp;E</th>
<th>KU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Increase in Regulatory Liabilities</td>
<td>$ 2,185</td>
<td>$ 1,019</td>
<td>$ 1,166</td>
<td>$ 532</td>
<td>$ 634</td>
</tr>
</tbody>
</table>
Items to consider

• Accounting rules and Commission Orders from the last Tax Reform
• Planned or recent Rate Cases
• Tax effect on rate base / mechanisms and gross up factors
• Methodology for the amortization of excess deferred taxes (Protected and Unprotected)
• Deferred Tax on Net Operating Loss Carryforwards
• Rating Agency Credit Metrics – effect on FFO to Debt
• IRS Private Letter Rulings
• State Tax Reform
Timeline – when did we start and where are we now...
Tax Cut and Job Act considerations

• Kentucky TCJA considerations:
  • Recently issued rates – effective 7/1/17 (Test year 7/1/17 – 6/30/18)
  • Settlement versus Order – How do you forecast or plan your next Business Plan?
  • Impact on capitalization – perspective based on current rates which was determined using a forward looking test year
    ▪ What do you use as a starting point?
    ▪ TCJA credit to customers (residential and non-residential) - surcredit tariff x Kwh
    ▪ TCJA impact on rate mechanisms
    ▪ TCJA Impact on cash taxes paid - Impact on Cash Taxes Paid - response to PSC Question
    ▪ Other changes to capitalization not as a result of TCJA
    ▪ Here is what we filed to reflect these items: Response to KY PSC question on Capitalization Impact
Tax Cut and Job Act considerations

• Kentucky TCJA considerations continued:
  • Adjustments to cost of capital
  • Impact on Accumulated Deferred Income Taxes (ADIT)
    • Protected and Average Rate Assumption Method (ARAM)
      “...(B) AVERAGE RATE ASSUMPTION METHOD.—The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. ...”
      — Consistent with Tax Reform Act of 1986
      — Should be at a rate no faster that the regular discharge of ADIT
  • Alternative Method allowed – LG&E and KU did not use that
  • Unprotected – non property related ADIT – amortization period – our main driver is pension expense
  • Rating Agencies and Credit risk - [Before and After TCJA - Response provided to PSC]
Tax Cut and Job Act considerations

• Virginia jurisdiction
  • Base rate case filed in September 2017 utilizing a hybrid of historic and forward looking information.
  • In January 2018 Virginia State Corporation Commission (VSCC) issued order to accrue regulatory liabilities reflecting the Virginia jurisdictional revenue requirement impacts of the reduced federal corporate tax rate.
  • March 22, 2018, KU reached a settlement agreement regarding its ongoing rate case in Virginia. April 16, 2018 the hearing Commission recommended that the VSCC approve the settlement agreement.
  • May 8, 2018 final order issued. New rates, inclusive of TCJA impacts, will be effective June 1, 2018.

• FERC
  • March 2018, FERC issued a Notice of Inquiry seeking information on whether and how it should address changes relating to accumulated deferred income taxes and bonus depreciation resulting from passage of the TCJA on FERC-jurisdictional rates.
What’s next....

• May 24, 2018 Hearing
• Effect of KY State Tax Reform
Next Up

EEI and FERC Update

Presented by Mark Agnew – Sr. Director of the Financial Analysis at EEI