COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF DUKE ENERGY KENTUCKY, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET RELATED TO VOLUNTARY OPPORTUNITY AND OTHER POST-RETIREMENT EXPENSES	)))))	CASE NO. 2010-00523

ORDER

On December 29, 2010, Duke Energy Kentucky, Inc. ("Duke Kentucky") filed an application seeking authority to establish a regulatory asset for the costs incurred in conjunction with two initiatives undertaken in 2010 by its ultimate parent, Duke Energy Corporation ("Duke Energy"). Those initiatives, the Voluntary Opportunity Severance Plan ("VOP") and the Midwest Office Consolidation ("MWOC") had, through October of 2010, resulted in Duke Kentucky incurring costs of $4,122,293. Based on its estimate of additional related costs to be incurred during November and December of 2010, Duke Kentucky requested authorization to defer for future rate recovery its actual and estimated 2010 costs in the amount of $4.37 million.[1]

There were no intervenors in this proceeding. Duke Kentucky responded to four information requests from Commission Staff. On May 11, 2011, in response to our May 3, 2011 Order, Duke Kentucky stated that it wished to have the case decided on the existing record without need for a hearing. The matter now stands submitted for a decision.

[1] In response to Item 1 of Staff's First Information Request, Duke Kentucky revised the amount to $4.50 million based on its actual costs for all of 2010.

DUKE KENTUCKY'S PROPOSAL

The VOP was offered to employees of: 1) Duke Kentucky; 2) other Duke Energy utilities; and 3) Duke Energy Business Services ("DEBS"), the service company affiliate, as a corporate-wide cost-savings measure. Employees electing to terminate their employment under the program were provided lump sum payments and continuing health benefits. Duke Kentucky's cost is based on the actual cost of its employees who participated in the VOP and its allocated share of the costs of the DEBS employees that participated. The window for the VOP was open from February 3 to February 24, 2010.

In early 2010, Duke Energy announced a plan to consolidate some of its Midwest (Indiana, Kentucky, and Ohio) corporate business functions. Over a period of two years, the MWOC would transfer 350 positions from Duke's Midwest offices to its Charlotte, North Carolina corporate headquarters. One of the options for employees choosing not to relocate was to participate in the VOP program. The window for the MWOC closed on March 31, 2010.

Duke Kentucky recorded the costs it incurred in conjunction with the VOP and MWOC initiatives as operating expenses in calendar year 2010. It closed its books for calendar year 2010 on January 26, 2011. Duke Kentucky's application did not request that it be allowed to reverse the accounting entries under which the VOP and MWOC costs were recorded as expenses in order to record them as a deferred asset prior to closing its 2010 books. Duke Kentucky's proposal would not affect its 2010 accounting records or its 2010 earnings. Rather, it would record a regulatory asset of $4.5 million on its books in 2011 upon receiving approval of its request, and would credit its 2011 operating expenses by an equal amount.

BACKGROUND

In past cases before the Commission, utilities have sought to establish regulatory assets in order to remove material, nonrecurring expenses from their operating, or income statements, during the year in which the related costs were incurred. Most recently, in late 2008, the Commission addressed such requests from Louisville Gas and Electric Company,[2] Kentucky Utilities Company,[3] and Duke Kentucky[4] for costs incurred as a result of Hurricane Ike, as well as in late 2009 with the request of Kentucky Power Company[5] to defer the costs it incurred from three major snow storms in its service territory. The reasoning behind these types of requests is twofold: first, a utility does not want a material, nonrecurring cost to distort its earnings for the period in which the cost is incurred; second, the utility desires to defer the cost for recovery when its rates are reset in a future general rate case.

This description could not more accurately reflect the position stated by Duke Kentucky in the 2008 case in which it sought approval to establish a regulatory asset for its Hurricane Ike-related costs. Duke Kentucky's November 8, 2008 application stated that:

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[2] Case No. 2008-00456, Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset (Ky. PSC Dec. 22, 2008).

[3] Case No. 2008-00457, Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset (Ky. PSC Dec. 22, 2008).

[4] Case No. 2008-00476, Application of Duke Energy Kentucky, Inc. for an Order Approving the Establishment of a Regulatory Asset (Ky. PSC Jan. 7, 2009).

[5] Case No. 2009-00352, 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 Three Major Event Storms in 2009 (Ky. PSC Dec. 22, 2009).

> Duke Energy Kentucky respectfully requests that the Commission approve this requested accounting treatment at the earliest possible date, and no later than December 31, 2008, so that the Company can reflect the necessary adjustments on its books for the year ending December 31, 2008. This is necessary to avoid inaccuracies in Duke Energy Kentucky's financial statements in 2008 and 2009. For example, if the Commission does not grant the requested deferral until 2009, Duke Energy Kentucky will have to record the expenses in 2008, artificially depressing its operating income in that year and artificially increasing it in the calendar year 2009. To avoid such an anomaly in financial records, Duke Energy Kentucky respectfully requests the Commission issue an order granting the relief requested herein no later than December 31. 2008.[6]

DISCUSSION

The point in time has passed when Duke Kentucky could have recorded a regulatory asset for its VOP and MWOC costs and adjusted its expenses and earnings for calendar year 2010. The costs of $4.5 million for the VOP and MWOC were charged to expense in 2010.[7] Generally Accepted Accounting Principles do not permit reversing the accounting entries which recorded such costs as expenses, and recording them as a regulatory asset, until the time when "it is probable of recovery"[8] of such costs. It is generally held that only when a utility's regulator authorizes the deferral of costs is the recovery of those costs considered probable. In this particular instance, the timing of Duke Kentucky's application effectively eliminated any opportunity for it to defer its VOP and MWOC-related costs on its 2010 books of account.

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[6] Case No. 2008-00476, Duke Energy Kentucky, Inc., Application at 6.

[7] Even with this additional expense recorded in 2010, Duke Kentucky earned a return on equity on its combined gas and electric operations of 9.75 percent.

[8] Duke Kentucky's April 21, 2011 response to the fourth request for information of Commission Staff, Item 1.a.

When Duke Kentucky filed its application, it had recorded actual VOP and MWOC costs, through October 2010, of $4.12 million. Through August 2010, it had recorded $4.0 million of VOP and MWOC costs.[9] Duke Kentucky states that, rather than file its application at an earlier date in order that it might record the requested regulatory asset on its books during 2010, based on the actual level of costs incurred through August, it delayed its filing because it was contemplating filing a general rate case in 2010.[10] Duke Kentucky also states that it made the filing as soon as practical after the full impacts of the VOP and MWOC were known.[11]

In the 2008 case in which it sought authorization to establish a regulatory asset for its Hurricane Ike-related costs, Duke Kentucky filed its application two months after the remnants of Hurricane Ike hit its service territory. At the time of filing, its request was based on both actual costs and estimates of additional costs to be incurred. Duke Kentucky did not wait until it knew the full monetary impact of its Hurricane Ike damage, apparently because it believed it was appropriate to submit its request early enough to allow the Commission the time required to conduct discovery and issue an expedited decision that would permit Duke Kentucky to record the proposed regulatory asset on its books in calendar year 2008.

In essence, Duke Kentucky's proposal and the timing of its application effectively give it the discretion to select the year in which it will credit its operating expenses by

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[9] Duke Kentucky's January 31, 2011 response to the first request for information of Commission Staff, Item 4.

[10] Duke Kentucky's April 21, 2011 response to the fourth request for information of Commission Staff, Item 2.a.

[11] Id., Item 2.b.

$4.5 million and increase its reported earnings by the resulting after-tax amount. While we are not unsympathetic to Duke Kentucky's situation, the Commission is not inclined to grant such a request. Given our experience with regulatory asset requests by a number of utilities, and considering the fact that Duke Kentucky had full knowledge of the VOP and MWOC initiatives in the first quarter of 2010, we conclude that it should not be given the discretion to reduce operating expenses in one year due to events occurring in the prior year which, if not to some extent within its control, were certainly events that it could easily monitor and for which the impacts could be clearly quantified.

The impact of Duke Kentucky's VOP and MWOC costs on earnings has already been reflected in its final 2010 financial statements and it cannot make adjustments to revise those financial statements. Therefore, it no longer has the ability to defer those costs. The VOP and MWOC costs Duke Kentucky incurred in 2010 for which it seeks to establish a regulatory asset were charged to expense in that year. Accordingly, it has no VOP or MWOC-related costs recorded on its books in 2011 that can be deferred as a regulatory asset.[12] As the costs which Duke Kentucky seeks to defer in 2011 were incurred in 2010, charged to expense and reflected in its 2010 earnings, we conclude that there is no sound basis, from either an accounting or regulatory perspective, to defer those costs via the creation of a regulatory asset. Given that there is no basis for establishing a regulatory asset in 2011 for costs which were booked as expenses in 2010, there is no sound basis for permitting Duke Kentucky to record a $4.5 million

[12] The Commission recognizes that Duke Kentucky indicated that, based on when the last employees retired/resigned, it expected to incur a small amount of VOP costs in the first quarter of 2011. However, it did not seek to defer any VOP or MWOC costs that were incurred subsequent to the end of calendar year 2010.

credit against its 2011 operating expenses. Accordingly, we will deny its request to establish a regulatory asset in 2011 for the costs it incurred for the VOP and MWOC programs in 2010.

SUMMARY

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that Duke Kentucky's request to establish a regulatory asset in 2011 for the costs it incurred and recorded as expenses in 2010 for the VOP and MWOC initiatives should be denied.

IT IS THEREFORE ORDERED that Duke Kentucky's request to establish a regulatory asset in 2011 for the costs it incurred and recorded as expenses in 2010 for the VOP and MWOC initiatives is hereby denied.

By the Commission

ENTERED
JUL 14 2011
KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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