DUKE ENERGY

Mailing Address:
139 East Fourth Street
1303 Main / P.O. Box 960
Cincinnati, Ohio 45202

o: 513-287-4320
f: 513-287-4385

VIA OVERNIGHT DELIVERY

RECEIVED
JUN 10 2015
PUBLIC SERVICE
COMMISSION

June 9, 2015

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard, P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: ***Case No. 2015-*** 00187
In the Matter of the Application of Duke Energy Kentucky, Inc., for an Order Approving the Establishment of a Regulatory Asset for the Liabilities Associated with Ash Pond Asset Retirement Obligations

Dear Mr. Derouen:

Enclosed please find an original and twelve copies of the *Application of Duke Energy Kentucky, Inc., for an Order Approving the Establishment of a Regulatory Asset for the Liabilities Associated with Ash Pond Asset Retirement Obligations,* for filing in the above referenced matter.

Please date-stamp the two copies of the letter and the filing and return to me in the enclosed envelope.

Sincerely,

Rocco D'Ascenzo
Associate General Counsel
rocco.d'ascenzo@duke-energy.com

cc: Hon. Jennifer Hans

584630

RECEIVED
JUN 10 2015
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

THE APPLICATION OF DUKE ENERGY KENTUCKY, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF A REGULATORY ASSET FOR THE LIABILITIES ASSOCIATED WITH ASH POND ASSET RETIREMENT OBLIGATIONS	)	**CASE NO. 2015-** 00187

APPLICATION

Comes now Duke Energy Kentucky, Inc. (Duke Energy Kentucky or the Company), by counsel, pursuant to KRS 278.030(1), KRS 278.040(2), KRS 278.220 and other applicable law, and hereby requests that the Kentucky Public Service Commission (Commission) approve the establishment of a regulatory asset for the income statement impacts including gains, losses, accretion and depreciation expenses arising from liabilities associated with Duke Energy Kentucky's Asset Retirement Obligations (AROs) with respect to the coal ash pond located at its East Bend Generating Station (East Bend).[1] In addition, Duke Energy Kentucky further requests the creation of a regulatory asset to defer actual costs incurred to comply with newly enacted federal regulations pertaining to coal ash ponds, as well as permission to defer appropriate carrying costs associated with the regulatory assets described herein. In support of this Application, the Company states as follows:

[1] The Company also intends to reclassify the existing Cost of Removal reserves related to the ash pond closure in Account 108, Accumulated Provision, for depreciation of electric utility plant to Account 182.3, Other Regulatory Assets.

I. Applicant Information and General Filing Requirements

1. Duke Energy Kentucky is an investor-owned utility engaged in the business of furnishing natural gas and electric services to various municipalities and unincorporated areas in Boone, Bracken, Campbell, Gallatin, Grant, Kenton, and Pendleton Counties in the Commonwealth of Kentucky.

2. Pursuant to 807 KAR 5:001, Section 14(1), Duke Energy Kentucky's business address is 139 East Fourth Street, Cincinnati, Ohio 45202. Duke Energy Kentucky's local office in Kentucky is Duke Energy Envision Center, 4580 Olympic Boulevard, Erlanger, Kentucky 41018, and its electronic mail address is KYfilings@duke-energy.com.

3. Pursuant to 807 KAR 5:001, Section 14(2), Duke Energy Kentucky states that it was originally incorporated in the Commonwealth of Kentucky on March 20, 1901, and attests that it is currently in good standing in said Commonwealth.

II. Background on AROs and the Relevant Ash Ponds

4. AROs are legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal operation of such assets. Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 410-20, *Asset Retirement Obligations*, requires legal obligations associated with the retirement of long-lived assets to be recognized at fair value when incurred and capitalized as part of the related long-lived asset. ASC Topic 410-20 also clarifies the term "conditional asset retirement obligation" where an obligation exists even though the method or timing of settlement may be conditional. The liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. When the required removal activities are

performed, the entity settles the obligation for its recorded amount and potentially incurs a gain or loss.

5. Pursuant to KRS 278.220, the system of accounts "for electric companies shall conform as nearly as practicable to the system adopted or approved by the Federal Energy Regulatory Commission" (FERC). The FERC Uniform System of Accounts (FERC USoA)[2] states:

> (A) An *asset retirement obligation* represents a liability for the legal obligation associated with the retirement of a tangible long-lived asset that a company is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. An *asset retirement cost* represents the amount capitalized when the liability is recognized for the long-lived asset that gives rise to the legal obligation. The amount recognized for the liability and an associated asset retirement cost shall be stated at the fair value of the asset retirement obligation in the period in which the obligation is incurred.[3]

6. The FERC USoA requires that a utility initially record a liability for an ARO in Account 230 — Asset Retirement Obligations, and charge the associated asset retirement costs to the electric utility plant that gave rise to the legal obligation in Account 101 - Electric Plant in Service. The asset retirement cost is to be depreciated over the useful life of the related asset that gives rise to the obligation by recording a debit to Account 403.1 - Depreciation Expense for Asset Retirement Costs and a credit to Account 108 Accumulated Provision for Depreciation of Electric Utility Plant. In periods subsequent to the initial recording of the ARO, the utility shall recognize the period-to-period changes of the ARO that result from the passage of time due to the accretion of the liability by recording a debit to Account 411.10 - Accretion Expense, and a credit to Account 230. For any subsequent measurement changes to the initial liability for the legal obligation recorded in Account 230 for each specific ARO, the utility shall recognize said

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[2] Codified as 18 C.F.R. Part 101.
[3] *See id.*, General Instructions, subpart (25), *Accounting for asset retirement obligations.*

changes as an adjustment to the liability in Account 230 with a corresponding adjustment to the appropriate electric utility plant account. The utility shall on a timely basis monitor measurement changes of the AROs.[4] Gains or losses derived from the settlement of asset retirement obligations resulting from the difference between the amount of the liability included in account 230 and the actual amount paid to settle the obligation shall be credited to Account 411.6 - Gains from disposition of utility plant or debited to account 411.7 - Losses from disposition of utility plant.

7. The ARO liabilities at issue in this matter pertain to the existing coal ash pond[5] located at East Bend. The generating unit, Unit 2, at East Bend has an expected remaining service life of twenty-six (26) years based on currently approved depreciation rates; thus, closure of the East Bend ash pond was not expected to occur until at least 2041. However, emerging environmental regulations, such as the U.S. Environmental Protection Agency's (EPA) recently published Disposal of Coal Combustion Residuals from Electric Utilities rule (CCR Final Rule),[6] directly affect the handling of ash at coal-fired generating stations. The CCR Final Rule, which will become effective October 19, 2015, deals extensively with coal ash storage and disposal and will require the Company to take action to achieve compliance, which may include ultimate closure of the existing ash pond and conversion to dry ash handling system. Whether or not the East Bend ash pond will remain operational for the entire remaining life of the East Bend unit will depend upon the results of various tests that must occur at the pond for purposes of determining operating compliance with the CCR Final Rule. Notwithstanding the timing of such retirement, the pond will eventually have to be closed in a way that is in compliance with the

[4] *See id.* The Company generally evaluates potential changes in the AROs quarterly.

[5] As the Commission is aware, coal ash ponds are essentially temporary repositories for Coal Combustion Residuals (CCRs), or the materials that remain after combustion of coal in a power plant.

[6] *Available at* http://www2.epa.gov/sites/production/files/2014-12/documents/ccr_finalrule_prepub.pdf (last accessed May 19, 2015). The CCR Final Rule was published in the Federal Register on April 17, 2015.

CCR Final Rule's new requirements. While the CCR Final Rule effective date is October 19, 2015, the accounting for the legal obligation is recognized on April 17, 2015 (*i.e.,* the publication date of the CCR Final Rule). Therefore, as of April 30, 2015, Duke Energy Kentucky reasonably quantified its ARO liability with respect to the East Bend ash pond at approximately $116 million.[7]

8. Pursuant to the requirements of the FERC USoA, the Company records depreciation expense for the ARO-related assets and accretion expense for the ARO-related liabilities each month. These expenses began to be recognized in May 2015. The Company projects that, at the end of 2015, the ARO-related depreciation expense will be approximately $3.0 million and the accretion expense will be approximately $2.9 million. These are preliminary estimates based on the ARO recognized as of April 30, 2015, and will be subject to prospective adjustment as the underlying cost estimates and timing change based on updated compliance cost estimates.

9. While the specific AROs will be settled and resolved at a future date, under FERC accounting standards, Duke Energy Kentucky must recognize depreciation and accretion expense now due to the publication of the CCR Final Rule. The Company believes the actual ARO settlement costs should be recoverable through appropriate rate mechanisms in the future; however, at present, the specific timeframe, cost and manner for doing so has not yet been determined. In the meantime, this recovery creates a mismatch of revenues and expenses in the Company's financial statements because accretion and depreciation expense will be recognized monthly beginning in May 2015, even though the revenue will not be recognized until some future period. These ARO-related expenses, therefore, reduce the Company's return and

[7] Duke Energy Kentucky must record the first CCR ARO for East Bend in April 2015. as the law was published in the Federal Register on April 17th. The obligation for Duke Energy Kentucky was created at that time.

understate its true financial performance in the short-term. When the actual ash pond closure costs are being recovered, the Company's revenues and expenses will be inflated and thus overstate financial performance. To avoid this outcome, Duke Energy Kentucky asks the Commission to authorize the establishment of regulatory assets of approximately $116 million and $35 million.[8] Additionally, Duke Energy Kentucky requests that it also be allowed to record as part of the regulatory assets requested herein, any prospective adjustments to the amounts for ARO-related depreciation and accretion expense associated with the ARO balances existing on December 31, 2015, as changes to the underlying cost estimates and timing will impact these amounts. Finally, Duke Energy Kentucky requests that is be permitted to defer appropriate carrying costs as part of the regulatory assets described herein. This treatment will appropriately defer recognition of these ARO expenses until recovery of the actual costs are authorized by the Commission at some point in the future. This would ultimately allow the Company to match its revenues and expenses in each relevant accounting period.

10. In addition, Duke Energy Kentucky anticipates incurring incremental expenses in 2015, and continuing into the future, that are directly attributed to compliance under the newly enacted CCR Final Rule. Specifically, Duke Energy Kentucky is currently analyzing the status of its existing ash pond at East Bend in order to determine whether the pond complies with the CCR Final Rule. This analysis requires engineering studies and analysis. Based upon current estimates, the Company will incur approximately $1.8 million in engineering, analysis, and other expenses (CCR Compliance Costs) in 2015 and additional compliance costs thereafter.

[8] The $116 million represents the value of the ARO asset and liability when they were recognized in April 2015. The ARO asset will be depreciated over the life of the East Bend ash pond, resulting in approximately $116 million of depreciation expense. The ARO liability will accrete over time, resulting in approximately $35 million of accretion expense.

III. Request to Establish a Regulatory Asset

11. A regulatory asset is created when a utility is authorized to capitalize an expenditure that, under traditional accounting rules, would be recorded as a current expense. The reclassification of an expense to a capital item allows the utility the opportunity to request recovery in future rates of the amount capitalized. The authority to establish regulatory assets arises out of the Commission's plenary authority to regulate utilities under KRS 278.040 and to "establish a system of accounts to be kept by utilities subject to its jurisdiction… and may prescribe the manner in which such accounts shall be kept."[9]

12. Duke Energy Kentucky must obtain Commission approval for accounting adjustments before establishing any expense as a new regulatory asset. Specifically, the Commission stated in Case No. 2001-00092, "[t]herefore, the Commission finds that in the future, ULH&P shall formally apply for Commission approval before accruing a cost as a deferred asset, regardless of the rate-making treatment that the Commission has afforded a similar cost in previous rate case proceedings."[10]

13. The Commission has exercised its discretion to approve regulatory assets where a utility has incurred: (1) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or administrative directive; (3) an expense in relation to an industry sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the

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[9] KRS 278.220.

[10] *In the Matter of Adjustment of Gas Rates of The Union Light, Heat and Power Company,* Final Order, Case No. 2001-00092 (Ky. P.S.C., Jan. 31, 2002).

cost.[11] In exercising discretion to allow the creation of a regulatory asset, the Commission's overarching consideration has been the context in which the regulatory asset is sought to be established and not necessarily the specific nature of the costs incurred.[12]

14. Duke Energy Kentucky asserts that its request to establish a regulatory asset for the ARO-related liabilities associated with the East Bend ash pond, as well as the aforementioned carrying costs and CCR Compliance Costs, is consistent with the second above-listed example, "an expense resulting from a statutory or administrative directive." On December 19, 2014, the EPA issued the CCR Final Rule. The CCR Final Rule was published in the Federal Register on April 17, 2015 and will become effective on October 19, 2015. Although the CCR Final Rule effective date is October 19, 2015, the accounting for the *legal* obligation to take action is recognized on April 17, 2015 (*i.e.,* the publication of the CCR Final Rule).

Additionally, because the Company must begin analyzing the status of the East Bend ash pond, it will immediately begin incurring costs for CCR Compliance. Duke Energy Kentucky asks the Commission for permission to accumulate as a regulatory asset and defer for future recovery in appropriate accounts, the actual incremental CCR Compliance Costs incurred as a

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[11] *See In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, Final Order, Case No. 2008-00436 (Ky. P.S.C., Dec. 23, 2008); *In the Matter of the Application of Louisville Gas and Electric Company for an Order Approving the Establishment of a Regulatory Asset,* Final Order, Case No. 2008-00456 (Ky. P.S.C., Dec. 22, 2008); *In the Matter of the Application of Kentucky Utilities Company for an Order Approving the Establishment of a Regulatory Asset,* Final Order, Case No. 2008-00457 (Ky. P.S.C., Dec. 22, 2008); *In the matter of the Joint Application of Duke Energy Kentucky, Inc., Kentucky Power Company, Kentucky Utilities Company and Louisville Gas and Electric Company for an Order Approving Accounting Practices to Establish Regulatory Assets and Liabilities Related to Certain Payments Made to the Carbon Management Research Group and the Kentucky Consortium for Carbon Storage,* Final Order, Case No. 2008-00308 (Ky. P.S.C., Oct. 30, 2008); *In the Matter of the Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for an Order Approving Proposed Deferred Debits and Declaring the Amortization of the Deferred Debits to be Included in Earnings Sharing Mechanism Calculations,* Final Order, Case No. 2001-00169 (Ky. P.S.C., Dec. 3, 2001).

[12] *In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, Final Order, Case No. 2008-00436 (Ky. P.S.C., Dec. 23, 2008).

result of publication of the CCR Final Rule, including appropriate carrying costs. The measures Duke Energy Kentucky must take to determine ash pond compliance under the CCR Final Rule are reasonable and prudent and should therefore be recoverable as a necessary cost of providing service to Duke Energy Kentucky's customers. If approved, Duke Energy Kentucky will hold its deferred costs in Account No. 182.3, Other Regulatory Assets, until such time as the Commission considers the method of recovery in a future rate proceeding.

15. The provisions of the CCR Final Rule, as well as various provisions of state law, require the Company to address the permanent closure of its coal ash ponds, and the Company believes it will face significant liabilities with respect to the treatment of the ash pond at East Bend upon the unit's retirement from service or ash pond closure. In addition to the CCR Final Rule, the accounting requirements of the FERC USoA and ASC Topic 410-20 concerning ARO accounting serve as additional "statutory or administrative directive[s]" that result in the ARO-related income statement impacts at issue in this case.

16. If the Commission approves Duke Energy Kentucky's requested regulatory asset treatment, Duke Energy Kentucky expects to make the following journal entries based on estimates available as of April 30, 2015. Amounts may change as new information regarding ash pond closure costs estimates becomes available:

a. Dr. 182.3 ARO Regulatory Asset $116 million

Cr. 403.1 Depreciation Expense for ARC $116 million

Defer depreciation expense of Asset Retirement Cost (ARC) in Account 101 over the remaining life of the asset (annual amount of approximately $4.4 million).

b. Dr. 182.3 ARO Regulatory Asset $35 million

Cr. 411.10 Accretion Expense $35 million

Defer accretion expense of Asset Retirement Obligation liability until closure activities are complete (annual amount of approximately $1.3 million, which will vary annually depending on actual closure costs incurred).

c. Dr. 108 Accumulated Depreciation $0.9 million

Cr. 182.3 CCR Compliance Reg. Asset $0.9 million

Reclass estimated Cost of Removal (COR) reserve related to ash pond closure depreciation expense as of April 30, 2015. As additional COR depreciation related to ash pond closure is recorded to Account 108, the entry above will be repeated in subsequent periods for the incremental COR depreciation expense.

d. Dr. 407.3 Regulatory Debits $1.8 million

Cr. 182.3 ARO Regulatory Asset $1.8 million

Recognize incremental CCR Compliance Costs as incurred for 2015. $1.8 million represents expected closure costs incurred in 2015; additional closure costs will be incurred in subsequent years and accounted for as noted in the entry shown above.

e. Dr. 182.3 CCR Compliance Reg. Asset $0.9 million

Cr. 407.4 Regulatory Credits $0.9 million

Use of Cost of Removal reserve related to ash pond closure reclassified to Account 182.3 in entry (c) above.

f. Dr. 182.3 CCR Compliance Reg. Asset $0.9 million

Cr. 407.4 Regulatory Credits $0.9 million

Defer actual incremental CCR Compliance Costs as incurred for 2015 until recovered in rates. $0.9 million represents expected closure costs incurred in 2015 which have not previously been recorded as Cost of Removal; additional closure costs will be incurred in subsequent years and accounted for as noted in the entry shown above.

In addition to entries (a) – (f) above, Duke Energy Kentucky may periodically incur gains and/or losses upon settlement of the legal obligation associated with the closure of the East Bend ash pond. The FERC USoA requires that such gains and/or losses be recorded to either account 411.6 - Gains from Disposition of Utility Plant or Account 411.7 - Losses from Disposition of Utility Plant.[13] Duke Energy Kentucky proposes to defer these gains and/or losses as incurred to the same 182.3 ARO Regulatory Asset account noted in entries (a), (b), and (d) above. Duke Energy Kentucky cannot predict the amount of these gains and/or losses at this time.

17. The Commission has previously approved the establishment of regulatory assets for ARO-related expenses. The Commission approved the establishment of regulatory assets for ARO-related depreciation and accretion expenses for Louisville Gas and Electric Company[14] and for Kentucky Utilities Company[15] when those utilities adopted Statement of Financial

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[13] *See id.*, General Instructions, subpart (25), *Accounting for asset retirement obligations*.

[14] *See In the Matter of Application of Louisville Gas and Electric Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003*, Order, Case No. 2003-00426, p.6 (Ky. P.S.C., Dec. 23, 2003).

[15] *See In the Matter of Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003,* Order, Case No. 2003-00427, p.6 (Ky. P.S.C., Dec. 23, 2003).

Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*.[16] The Commission also recently approved a similar request made by East Kentucky Power Cooperative, Inc., relating to AROs arising from its CCR and asbestos retirement obligations.[17]

WHEREFORE, on the basis of the foregoing, Duke Energy Kentucky respectfully requests that the Commission enter an Order:

1. Approving the establishment of a regulatory asset for the income statement impacts- including gains, losses, accretion and depreciation expenses- associated with the ARO-related liabilities arising from the East Bend ash pond, net of the historical Cost of Removal accrued through approved depreciation rates;

2. Approving the establishment of a regulatory asset to defer the actual incremental CCR Compliance Costs that the Company will begin to incur in 2015;

3. Permitting the deferral of appropriate carrying costs as part of the regulatory assets described herein; and

4. Granting Duke Energy Kentucky all other additional relief to which it may appear entitled.

This 9th day of June, 2015.

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[16] Statement of Financial Accounting Standards No. 143 is now codified as ASC Topic 410.

[17] *See In the Matter of the Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of Regulatory Assets for the Depreciation and Accretion Expenses Associated with Asset Retirement Obligations*, Case No. 2014-00432 (Ky. P.S.C., Mar. 6, 2015) (on rehearing).

VERIFICATION

State of North Carolina)
) SS:
County of Mecklenburg)

The undersigned, Cynthia S. Lee, being duly sworn, deposes and says that she is the Director of Asset Accounting and that the matters set forth in the foregoing Application are true and correct to the best of her information, knowledge and belief.

Cynthia S. Lee

Cynthia S. Lee, Affiant

Subscribed and sworn to me by Cynthia S. Lee on this 3 day of June, 2015.

Kim V. Beal

NOTARY PUBLIC

My Commission expires: October 24, 2019

KIM V BEAL
Notary Public
Catawba County
NORTH CAROLINA

Respectfully submitted,

Rocco O. D'Ascenzo
Associate General Counsel
Amy B. Spiller
Deputy General Counsel
Duke Energy Business Services, LLC
139 East Fourth Street/1303-Main
P.O. Box 960 Cincinnati, OH 45202
(513) 287-4320
Rocco.D'Ascenzo@duke-energy.com
Amy.Spiller@duke-energy.com

and

David S. Samford
M. Evan Buckley
Goss Samford, PLLC
2365 Harrodsburg Road
Suite B-325
Lexington, Kentucky 40504
(859) 368-7740
David@gosssamfordlaw.com
EBuckley@gosssamfordlaw.com

Counsel for Duke Energy Kentucky, Inc.

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing Application of Duke Energy Kentucky, Inc. has been served via overnight mail to the following party on this 9th day of June 2015.

Rocco O. D'Ascenzo

Hon. Jennifer Hans
Office of the Attorney General
Utility Intervention and Rate Division
1024 Capital Center Drive
Frankfort, Kentucky 40601