DUKE ENERGY

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AUG 20 2015
PUBLIC SERVICE COMMISSION

VIA OVERNIGHT DELIVERY

August 19, 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 *Responses of Duke Energy Kentucky, Inc. to Commission Staff's Second Set of Requests for Information,* for filing in the above referenced matter.

Please date-stamp the two copies of the letter and 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

587974

VERIFICATION

STATE OF OHIO)
) **SS:**
COUNTY OF HAMILTON)

The undersigned, William Don Wathen Jr, Director of Rates & Regulatory Strategy OH/KY, being duly sworn, deposes and says that he has personal knowledge of the matters set forth in the foregoing data requests, and that the answers contained therein are true and correct to the best of his knowledge, information and belief.

Don Wathen

William Don Wathen Jr, Affiant

Subscribed and sworn to before me by William Don Wathen Jr, on this 19TH day of August, 2015.

Adele M. Frisch

NOTARY PUBLIC

ADELE M. FRISCH
Notary Public, State of Ohio
My Commission Expires 01-05-2019

My Commission Expires: 1/5/2019

VERIFICATION

RECEIVED
AUG 20 2015
PUBLIC SERVICE COMMISSION

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, being duly sworn, deposes and says that she has personal knowledge of the matters set forth in the foregoing data requests, and that the answers contained therein are true and correct to the best of her knowledge, information and belief.

Cynthia S. Lee

Cynthia S. Lee, Affiant

Subscribed and sworn to me by Cynthia S. Lee on this 13 day of August, 2015.

Kim V. Beal

NOTARY PUBLIC

My Commission expires: Oct 24, 2019

KIM V BEAL
Notary Public
Catawba County
NORTH CAROLINA

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STAFF-DR-02-001

REQUEST:

Refer to page 4, paragraph 7, of the application and to the attachment to the response to Item 1 of Commission Staff's Initial Request for Information ("Staff's First Request"). The second sentence of paragraph 7 states that the expected remaining service life of East Bend Unit 2 is 26 years.

a. Given that asset retirement costs are to be depreciated over the useful life of the related asset, explain why the schedules in the attachment show the cash flow estimates based on a period ending in 2051, or ten years beyond the end of the unit's expected remaining service life.

b. The second sentence in paragraph 7 states that the 26-year estimated remaining service life of East Bend Unit 2 is "based on currently approved depreciation rates." Explain how a change in the unit's expected remaining service life as an outcome of a future depreciation study would affect an existing Asset Retirement Obligation ("ARO").

RESPONSE:

a. The projected timing of cash flows is based on requirements outlined within EPA's Coal Combustion Residuals (CCR) Rule, rather than the expected retirement date of each plant. The CCR Requirements also include 30 years of post-closure monitoring, which extends beyond the expected remaining service life of the East Bend station.

b. A change in the expected useful service life would not change the ARO liability. As noted above, the liability and timing of cash flows is tied to closure requirements, rather than the life of the station itself. If a future depreciation study resulted in a change to the expected remaining service life at East Bend, the remaining balance of the Asset Retirement Cost (ARC or ARO Asset) would be depreciated over the new life of the station prospectively.

PERSON RESPONSIBLE: Cynthia S. Lee

REQUEST:

Refer to the attachment to the response to Item 1 of Staff's First Request, page 1 of 10.

a. In the table under the heading "Estimated Annual Cash Flows:," there are subheadings for "Basin Closure & Landfill Costs" and "Add OH & Escalation." In the first line under each of the subheadings costs are listed for "Ash Basin Closure" and "Ash Basin Closure with Escalations." Identify the type and amount of costs included in each of the line items.

b. Refer to the subheading "Contingency," and the associated cost which is estimated at 100 percent of the "Closure & Landfill Costs (including OH, escalation, & 30 Yr Maint)." Identify the authority for the Contingencies' cost and how the amount was determined.

RESPONSE:

a. The Ash Basin Closure cost of $20,514,059 is comprised of amounts shaded in blue in the Ash Basin Clean Closure table above the Estimated Annual Cash Flow schedule. This includes costs such as engineering and permitting, environmental assessments, mobilization, dewatering of ponds, CCR material excavation, hauling and placement costs, storm water controls and dam breaching controls. The Ash Basin Closure with Escalations of $29,786,414 includes those same items escalated at:

1. 20% for overhead associated with excavation and disposal of ash
2. 10% for indirect costs
3. 10% for contingency

Note that only the Ash Basin Closure with Escalations of $29,786,414 is included in the Closure & Landfill Costs (including OH, Escalation, & 30 Year Maint.) row, such that there is no double-counting.

b. In establishing the CCR ARO, Duke Energy Kentucky considered the adjustments necessary to appropriately reflect how a third party would estimate the future costs as required by the Financial Accounting Standards Board (FASB) in its Accounting Standards Codification for Asset Retirement and Environmental Obligations ASC 410-20 (previously SFAS 143). Consistent with other AROs, Duke Energy Kentucky determined that it was necessary to include a percentage based cost adjustment intended to incorporate uncertainties inherent to ash basin closure and the requirements of the CCR Rule. This percentage based cost adjustment was determined after considering the following factors:

   1. The inclusion of the cost based adjustment is within accepted Duke Energy engineering practices for a Class 5 estimate and it is Duke Energy Kentucky's belief that the adjustment is necessary to appropriately reflect how a third party would estimate the cash flows.
   2. Duke Energy Kentucky is still evaluating the stability, volume and groundwater at the sites affected by the CCR Rule, and believes that as time progress and more information is known about each site, smaller percentage based cost adjustments will be necessary.

3. Uncertainty of how the EPA CCR Rule will affect available resources and the costs to perform the required closure work.
4. The risk that a state will (or will not) accept proposed closure plans under the CCR Rule in order to obtain the appropriate operating permits.
5. CCR Rule requirements regarding when closure may be triggered incorporated another uncertainty. Management believes the use of the percentage based cost adjustment to implement that impact is consistent with how a third party would implement the impact.
6. There is potential that there may be legal challenges of EPA's designation of CCR as nonhazardous. Additionally, the EPA did indicate that this designation could be reevaluated and adjusted in the future to hazardous. Finally, there could be legal challenges of Duke's conclusions regarding out of scope areas (basins) under the CCR rule. A third party taking on the ARO liability would have to increase their risk premium for this potential unknown (i.e. contingency) as well. Duke Energy Kentucky believes the use of the percentage based cost adjustment to implement that impact is consistent with how a third party would implement the impact.

PERSON RESPONSIBLE: Cynthia S. Lee

REQUEST:

Refer to the attachment to the response to Item 1 of Staff's First Request, page 10 of 10. For each of the four items that make up the "All-In Yield" percentage, explain how the item was selected and whether selection of the item is entirely within Duke Kentucky's discretion.

RESPONSE:

Duke Energy frequently receives updated indicative pricing from its banking partners, and uses these estimates as the basis for borrowing cost assumptions. The coupon of a bond includes the corresponding US Treasury benchmark ("UST") rate plus a reoffer (credit) spread. These components are based on market conditions, and are not within Duke Energy Kentucky's discretion. When issuing long-term debt, the Company incurs fees from banks to underwrite the bonds. The fee is negotiated between the Company and the underwriters. The all-in cost of borrowing (all-in yield) is equal to the UST rate plus the reoffer spread and underwriting fees.

- US Treasury Benchmark Rate: The UST rates are based on actual US treasury rates.
- Reoffer Spread: The reoffer spread represents the current estimate for the premium investors require above the risk-free UST rate. The spread is estimated

based on the Company's credit ratings, the yield of its existing securities, and recent debt issuances by comparable companies.

- Reoffer Yield/Coupon: The Reoffer/Yield Coupon is equal to the UST rate plus the reoffer spread.

U/W Fees (bps): The fee paid to banks to underwrite the debt issuance, based on a publicly marketed transaction.

PERSON RESPONSIBLE: Cynthia S. Lee

Duke Energy Kentucky
Case No. 2015-00187
Staff Second Set Data Requests
Date Received: August 10, 2015

STAFF-DR-02-004

REQUEST:

Refer to the third sentence in paragraph 8 of the application and to the response to Item 2 of Staff's First Request. The sentence states that Duke Kentucky projects ARO-related depreciation and accretion expenses of $5.9 million for 2015, while the second sentence in the response refers to deferring "income statement impacts of the depreciation and accretion." Explain whether negative income statement impacts could occur before Duke Kentucky issues year-end 2015 financial statements.

RESPONSE:

Yes, if the approval to defer the ARO depreciation and accretion is not received prior to year end 2015, negative income statement impacts would occur in Duke Energy Kentucky's financial statements, and are currently occurring as Duke Energy Kentucky does not presently have the authority to defer these expenses. If the deferral authority is approved, Duke Energy Kentucky will neutralize the income statement impact via a debit to a Regulatory Asset (Account 182.3) and a credit to Depreciation Expense for Asset Retirement Costs (Account 403.1) and Accretion Expense (Account 411.10).

PERSON RESPONSIBLE: Cynthia S. Lee

STAFF-DR-02-005

REQUEST:

Refer to paragraph 9 of the application and the response to Item 2 of Staff's First Request. Given the explanation provided in the response and the sentence that precedes the sentence referenced in the request, explain whether the referenced sentence would be more accurate if "and expenses" were removed.

RESPONSE:

Duke Energy Kentucky stated in paragraph 9 starting at the bottom of page 5 and top of page 6 of the application: "These ARO-related expenses, therefore, reduce the Company's return and understate its true financial performance in the short term. When the actual ash pond closure costs are being recovered, the Company's revenue <u>and expenses</u> will be inflated and thus overstate financial performance." Duke Energy Kentucky would accept the removal of "and expenses" from this particular sentence. Duke Energy Kentucky intended to illustrate that its financial performance would not be accurately stated if depreciation and accretion expenses were not matched up with future revenues as these costs are collected.

PERSON RESPONSIBLE: Cynthia S. Lee

STAFF-DR-02-006

REQUEST:

Refer to the last paragraph in the response to part a. of Item 4 of Staff's First Request, specifically, the last sentence that states, "The availability and method of recovery for these deferred expenses, like all costs that are included in a properly-established regulatory asset, will be determined in a future proceeding and are not issues presently before the Commission." Item 4.a. of Staff's First Request related to Duke Kentucky's request to be allowed to include carrying costs in the regulatory assets for which it seeks authorization.

a. Explain whether the referenced sentence in the response indicates Duke Kentucky's belief that the issue of including carrying costs as part of the regulatory assets for which it seeks authorization is not before the Commission at this time.

b. Explain whether the reference sentence in the response indicates Duke Kentucky's belief that it can be granted Commission approval to include carrying costs as part of the regulatory assets for which it seeks authorization and that the issue of recovery of said carrying costs can be left to be determined in a future proceeding.

RESPONSE:

a. Duke Energy Kentucky, Inc. believes that the question of whether it should be allowed to include carrying costs as part of the regulatory asset which it seeks authority to establish in this case is a question that is properly before the Commission and should be decided at this time as part of this case.

b. The standard required for a regulated utility to record a regulatory asset includes a reasonable expectation of future recovery. Commission approval for Duke Energy Kentucky to accrue carrying costs would create a presumption that those costs are recoverable. That said, it is always the case that the Commission can review the underlying costs in the regulatory asset for prudence, reasonableness, etc. But with Commission approval to accrue carrying costs, Duke Energy Kentucky would have an expectation that these costs are recoverable to the extent the cost for the underlying regulatory asset is also recoverable. Duke Energy Kentucky, Inc. believes that, if the carrying costs are included as part of the requested regulatory asset, the question of whether the carrying costs are ultimately recovered through rates will be linked to the prudency of the costs in the underlying regulatory asset as determined in a future rate proceeding.

PERSON RESPONSIBLE: William Don Wathen Jr.

STAFF-DR-02-007

REQUEST:

Refer to the response to part c. of Item 4 of Staff's First Request. Provide an illustrative example of the calculation of a weighted average cost of capital showing the use of the Federal Energy Regulatory Commission formula used to derive rates for an Allowance for Funds Used During Construction.

RESPONSE:

Please see Attachment Staff DR-02-007 for the illustrative example of the computation of Duke Energy Kentucky's weighted average cost of capital using the FERC formula for AFUDC rates.

PERSON RESPONSIBLE: Cynthia S. Lee

DEK-Electric
Computation of AFUDC Rate
For the Month of June 2015

	AMOUNT (1)	CAPITALIZATION RATIO (2)		COST RATES (3)		S/W (4)		WEIGHTED COST RATES FOR GROSS AFUDC RATE (5)	RATE TO BE USED GROSS %	RATE TO BE USED GROSS RATIO
Short-Term Debt (S)				0.579	x	0.00%	=			
Long-Term Debt (D)	321,094,711	42.32%	x	4.166	x	100.00%	=	0.01763	1.76	24.44
Preferred Stock (P)	0	0.00%	x	0.00	x	100.00%	=	0.00000		
Common Equity (C)	437,603,282	57.68%	x	9.44	x	100.00%	=	0.05445	5.44	75.56
Total Capitalization	758,697,993	100.00%								
AFUDC Rates								0.07208	7.20	100.00
CWIP (W)	30,296,398									

S = Average short-term debt
W=Average balance in CWIP

Kentucky AFUDC Rate Inputs
For the Month of June 2015

	Kentucky
Short Term Debt	-
Short Term Debt Cost Rate	0.5790
Long Term Debt	321,094,711.00
LT Debt Excluding Unamortized Disc/Prem	-
Long Term Debt Cost Rate	4.17
Preferred Stock	-
Preferred Stock Cost Rate	-
Common Equity Unadjusted	437,603,282.00
Goodwill Adjustment	-
Common Equity Adjusted	437,603,282.00
Common Equity Cost Rate Electric	9.44
Common Equity Cost Rate Gas and Common	10.375
Common Equity Cost Rate AMRP	-
CWIP from Bus Obj Query	33,527,238.84
Fund 134	-
Interest Income on PCB Bonds	-
Adjusted CWIP for Month	33,527,238.84
Prior Month Adjusted CWIP	27,065,557.41
Average CWIP for Current and Prior Mo	30,296,398.13

Duke Energy Kentucky
Case No. 2015-00187
Staff Second Set Data Requests
Date Received: August 10, 2015

STAFF-DR-02-008

REQUEST:

Refer to the response to Item 5 of Staff's First Request where the Expected Project Schedule and Deliverables are listed. Explain if Duke Kentucky is on schedule with the August deliverables. If not, explain the reason for the delay and where Duke Kentucky is on the schedule.

RESPONSE:

The third party review of Duke Energy Kentucky's current plans and estimates has been delayed by contracting and procurement processes. The review is underway and deliverables are currently expected in the fourth quarter of 2015.

PERSON RESPONSIBLE: Cynthia S. Lee

Duke Energy Kentucky
Case No. 2015-00187
Staff Second Set Data Requests
Date Received: August 10, 2015

STAFF-DR-02-009

REQUEST:

Refer to paragraph 10 of the application and the response to Item 5 of Staff's First Request, which indicates that the ash basin closure project studies are estimated to be completed in October 2015.

a. Provide a breakdown of the $1.8 million for engineering, analysis, and other Coal Combustion Residuals compliance costs Duke Kentucky estimates it will incur in 2015.

b. Explain what the acronym "AACE" stands for.

c. With the ash basin closure project studies expected to be completed in October 2015, explain when Duke Kentucky expects it will receive notice of the actual costs of the project.

d. Explain whether receipt of a Commission ruling in this matter in the fourth quarter of 2015, after the ash basin closure project studies are complete, will permit Duke Kentucky to make the necessary accounting entries to record the requested regulatory asset for the ARO-related depreciation and accretion expenses described in paragraphs 8 and 9 of its application in a timely manner.

RESPONSE:

a. The $1.8 million CCR compliance cost estimated to be spent in 2015 was comprised primarily of the following estimated costs:

- $798k related to the landfill construction permit approval process, including a full site characterization, ground water and surface water assessments, engineering associated with landfill design and permit approval, and permit applications
- $16k (2% of the $798k landfill costs) of escalations for additional soil material that will likely be removed during excavation to ensure that all ash is removed from the ground
- $81k (10% of the $798k landfill costs + $16k escalations) for overhead associated with the Ash Basin Strategic Action Team, an internal organization created to oversee Duke Energy's coal ash management program
- $896k (100% of the total costs above) for various contingencies to account for uncertainty in the cost estimate. Please see response to Data Request STAFF-DR-02-002b for further discussion of the contingency.

b. The Association for the Advancement of Cost Engineers is an internally recognized professional standards group for cost estimate classification. Their guidelines and standards have reasonably broad acceptance within the engineering and construction professions.

c. The third party study currently underway is a third party review of Duke Energy Kentucky's initial analysis, plans and estimates. Subsequent to the first set of data requests, Duke Energy Kentucky engaged another third party (AMEC) to perform the actual analysis and engineering design required to develop the formal Closure Plan. That deliverable is expected in Q1 2016. With that analysis, Duke

Energy Kentucky will then develop a detailed Execution and Excavation Plan, prepare Requests for Proposals for the physical scope of work required, assess quotes/bids from potential suppliers, select a supplier, then work with that supplier to develop the Plan details and schedules. At that point, a more accurate cost estimate will be available. As with any other financial estimate, the final costs will not be known until closure work is completed.

d. Yes. If a ruling is received prior to the end of the year, Duke Energy Kentucky will be able to make the accounting entries to properly reflect the year-end financial statements.

PERSON RESPONSIBLE: Cynthia S. Lee